

OPEN MEETING OF THE SECURITIES AND EXCHANGE COMMISSION

Wednesday, July 15, 2009 – 10:03 a.m.

COMMISSIONERS PRESENT:

Mary L. Schapiro, Chairman  
Kathleen L. Casey  
Elisse Walter  
Luis A. Aguilar  
Troy A. Paredes

Mr. Brigagliano, Co-Acting Director, Ms. Sanow, Ms. Haines and Mr. Shillman, of the Division of Trading and Markets; Ms. Kayhan, of the Office of Economic Analysis; and Ms. Mitchell, Deputy General Counsel, and Ms. Mitnick, of the Office of General Counsel, were present.

Following discussion, the Commission approved (5-0) the issuance of a release proposing amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 and interpretive guidance intended to remind underwriters of municipal securities of their obligations under Rule 15c2-12.

(See Release 34-60332, dated July 17, 2009.)

The meeting was adjourned at 10:38 a.m.

Jill M. Peterson  
Assistant Secretary

By: Linda Cullen  
Program Information Specialist

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OFFICE OF  
THE SECRETARY

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

Open Meeting Agenda

Wednesday, July 15, 2009

Item: Municipal Securities Disclosure  
Office: Division of Trading and Markets  
Staff: Martha M. Haines, Nancy J. Sanow, David Michehl, Mary N. Simpkins,  
Rahman Harrison

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The Commission will consider whether to propose amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 and interpretive guidance intended to remind underwriters of municipal securities of their obligations under Rule 15c2-12.

For further information, please contact Rahman Harrison, at (202) 551-5664, Steven Varholik, at (202) 551-5615, or David Michehl, at (202) 551-5627, Division of Trading & Markets.

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OFFICE OF  
THE SECRETARY

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

Open Meeting Agenda

Wednesday, June 24, 2009

Item: Money Market Fund Reform

Office: Division of Investment Management

Staff: Robert E. Plaze, C. Hunter Jones, Penelope Saltzman, Diane C. Blizzard,  
Sarah ten Siethoff, Thu B. Ta, Adam Glazer, Daniele Marchesani

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The Commission will consider whether to propose amendments to rule 2a-7 and other rules under the Investment Company Act of 1940 governing the operation of money market funds.

For further information, please contact Sarah ten Siethoff [(202) 551-6729].

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OPEN MEETING OF THE SECURITIES AND EXCHANGE COMMISSION

Wednesday, June 24, 2009 – 10:04 a.m.

COMMISSIONERS PRESENT:

Mary L. Schapiro, Chairman  
Kathleen L. Casey  
Elisse Walter  
Luis A. Aguilar  
Troy A. Paredes

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Mr. Donohue, Director, Mr. Plaze, Mr. Jones, Ms. Saltzman and Ms. ten Siethoff, of the Division of Investment Management; Mr. Overdahl, Chief Economist, Mr. Dale and Mr. Johnson, of the Office Economic Analysis; and Mr. Becker, General Counsel, Ms. Mitchell, Deputy General Counsel, Mr. Singdahlsen, Associate General Counsel, and Ms. Price, of the Office of General Counsel, were present.

Following discussion, the Commission approved (5-0) the issuance of a release proposing amendments to rule 2a-7 and other rules under the Investment Company Act of 1940 governing the operation of money market funds. [Rules 2a-7, 17a-9, 30b1-5, 22e-3, 30b1-6, Form N-MFP under the Act].

(See Release IC-28807, dated June 30, 2009.)

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The meeting was adjourned at 11:48 a.m.

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Jill M. Peterson  
Assistant Secretary

By: Linda Cullen  
Program Information Specialist

**Public Reference Copy**

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

July 10, 2009

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In the Matter of

**SPECTRUM BRANDS, INC.**  
**Six Concourse Parkway, Suite 3300**  
**Atlanta, Georgia 30328**

File No. 022-28890

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**ORDER DECLARING THE APPLICATION  
FOR QUALIFICATION OF THE TRUST  
INDENTURE EFFECTIVE PURSUANT TO  
SECTION 307(c) OF THE TRUST INDENTURE  
ACT OF 1939, AS AMENDED**

Spectrum Brands, Inc. filed with the Commission an application on Form T-3 and a Form T-1 for the qualification of the indenture identified in those documents, pursuant to Section 307(a) of the Trust Indenture Act of 1939, and the rules thereunder, and has requested acceleration of the effective date of the qualification of the indenture, pursuant to Section 307(c) of the Act.

It is ORDERED that the application shall become effective and the indenture qualified at 12 noon on July 10, 2009.

Attention is directed to the provisions of Section 324 of the Trust Indenture Act of 1939, as amended, which make unlawful certain representations with respect to the effect of qualification under the Act.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

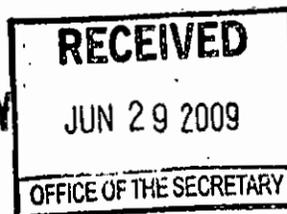
Elizabeth M. Murphy  
Secretary

**JOAN C. CONLEY**  
SENIOR VICE PRESIDENT  
AND CORPORATE SECRETARY  
9600 BLACKWELL ROAD  
ROCKVILLE, MD 20850

June 26, 2009

**Public Reference Copy**

Ms. Elizabeth Murphy  
Secretary  
US Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

**PUBLIC REFERENCE COPY**

**Re: Second Temporary Conditional Exemption for International Securities  
Exchange's Direct Edge Facility – SEC Release No. 34-60152**

Dear Ms. Murphy:

The Nasdaq Stock Market LLC (“Nasdaq”) writes to express its concerns regarding the Commission’s recent granting of a second temporary conditional exemption from Section 19 of the Exchange Act to the Direct Edge ECN facility of the International Securities Exchange (“ISE”). The granting of this second exemption to the ISE is fundamentally inconsistent with the obligations of facilities of registered national securities exchanges, materially degrades public transparency concerning the operation of Direct Edge, and results in a significant and unfair competitive advantage for that facility. As such, for the reasons set forth below, Nasdaq respectfully requests that the Commission take immediate action to modify or terminate the second exemption, and require that the ISE submit for notice and public comment, as required under Section 19, detailed rules describing the functionality and operations of its Direct Edge facility in the same manner as such rules are currently published and approved for the trading systems and facilities of all other exchanges.

As noted in the Commission’s instant approval of a second 180-day exemption period from Section 19, the ISE obtained its first 180-day Section 19 exemption for Direct Edge from the Commission in December 2008.<sup>1</sup> Having obtained a similar initial 180-day Section 19 exemption in connection with its purchase of the BRUT ECN several years ago, Nasdaq took no issue with the Commission’s original granting of an exemption believing that it drew an appropriate balance between the mandates of Section 19, and the need to give new purchasers of quoting and trading systems adequate time to fully understand and submit accurate rules describing system functionality to the Commission for public comment and, ultimately, Commission approval. That is not case with the Commission’s

<sup>1</sup> See Securities Exchange Act Release No. 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (order approving File No. SR-ISE-2008-85).

granting of a second 180-day exemption. Extension of the Section 19 exemption, resulting in a total exemption period well in excess of any previously granted by the Commission to an Exchange facility, provides Direct Edge with a material and ongoing competitive advantage by relieving Direct Edge from the operational and resource burdens that accompany full compliance with Section 19.<sup>2</sup> Equally important, the continued lack of statutorily-mandated transparency regarding how Direct Edge operates, particularly in these economic times, harms the public interest.

The sole basis for the extension of the exemption appears to be, in Nasdaq's view, an inappropriate conflation by the Commission of Direct Edge's Section 19 obligations with Direct Edge's seeking registration as a national securities exchange. The process result is that Direct Edge will not be required to obtain formal Commission approval of its existing trading system rules through the normal Section 19 procedures applicable to all other exchange facilities but, instead, through its ultimate registration as a national securities exchange – an unpredictable journey that, based on Nasdaq's prior experience, can take an unexpectedly long time to complete. The practical result is that the vast bulk of Direct Edge's system functions and related rules and procedures will remain shielded from public knowledge and scrutiny until an undetermined point in the future.

In comparison, Nasdaq notes that during the pendency of its own exchange registration process it filed and obtained Commission approval for rule sets governing the operation of both its BRUT and INET trading facilities, with the BRUT rule set being approved within the 180-day time period of its single conditional exemption, and the INET rule set being filed and approved in advance of the closing of the INET transaction. This record clearly indicates a past SEC view that the requirements of having an SEC-approved rulebook for an existing exchange facility as required under Section 19, and attempts to become a registered exchange, were separate and distinct processes with one not being considered a substitute for the other. The Commission should continue that commonsense approach and require full and ongoing compliance with Section 19 by Direct Edge while it continues separately to seek registration as a national securities exchange.

This is particularly true given the highly competitive nature of today's equity trading environment. It is simply not consistent with fair competition and equal regulation that all other exchange markets and facilities are fully subject to the delays and vagaries of the SEC rule-filing process, while Direct Edge is not. More importantly, public notice and approval of a full set of Direct Edge trading system rules will provide, in conjunction with

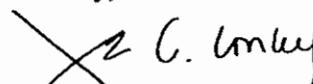
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<sup>2</sup> It should also be noted that this advantage is in no way mitigated by the limited condition of the exemption that the ISE file changes to the Direct Edge system and fees. Without a full set of system rules to put such filings into proper context, this requirement fails to provide any adequate basis upon which to provide meaningful comments in response to such filings.

the already public rulebooks of all other markets, important transparency and uniform guidance as to exactly what type of trading functionality is currently permitted or prohibited by the Commission. For example, to the extent that the Commission is currently allowing the Direct Edge exchange facility to provide certain types of trade processing, other exchange markets that may wish to offer similar functionality may be unfairly delayed or prevented from doing so because they are not aware, because of the lack of a public SEC-approved rulebook, that Direct Edge is, in fact, already providing such functionality. This asymmetrical information advantage benefits solely Direct Edge as the only exchange facility that does not currently post its system rules. While the Commission in its exemption extension order indicates it is reviewing Direct Edge's functionality as part of the exchange registration process, other exchange markets or facilities should have the opportunity to offer similar functionality, if they so desire, while that process continues. As noted in the approval order for the second exemption period, Direct Edge has filed with the Commission two Form 1s seeking exchange status for its EDGX and EDGA systems. Part of those submissions must have included detailed rule sets governing the current operation of those Direct Edge trading systems that could readily be posted on the ISE website and serve as the basis for a filing under Section 19.

Given the above, Nasdaq requests that the Commission modify or terminate ISE's current Section 19 exemption and direct that the ISE immediately post its Direct Edge facility system rules on its website and submit those rule sets to the Commission for notice and public comment as required under the Exchange Act. Further, to the extent that the Commission allows the ISE's Direct Edge facility to continue to operate, Nasdaq requests that all other exchange markets or facilities be allowed to adopt, on an immediately effective basis, any process or functionality currently being used by Direct Edge. By doing so, the Commission will fulfill its statutory obligations to ensure the fair and equal regulation of exchange markets.

Sincerely,

  
Joan C. Conley

cc: Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission  
Luis A. Aguilar, Commissioner, U.S. Securities and Exchange Commission  
Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission  
Troy A. Paredes, Commissioner, U.S. Securities and Exchange Commission

Elizabeth Murphy  
June 24, 2009  
Page 4

Elisse B. Walter, Commissioner, U.S. Securities and Exchange Commission  
James Brigagliano, Co-Acting Director, Division of Trading and Markets  
David Shillman, Associate Director, Division of Trading and Markets

**Public Reference Copy**

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

June 30, 2009

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In the Matter of

**Vector Group Ltd.  
100 S.E. Second Street, 32<sup>nd</sup> Floor  
Miami, Florida 33131**

**ORDER DECLARING THE APPLICATION  
FOR QUALIFICATION OF THE TRUST  
INDENTURE EFFECTIVE PURSUANT TO  
SECTION 307(c) OF THE TRUST INDENTURE  
ACT OF 1939, AS AMENDED**

File No. 22-28898

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Vector Group Ltd. filed with the Commission an application on Form T-3 and a Form T-1 for the qualification of the indenture identified in those documents, pursuant to Section 307(a) of the Trust Indenture Act of 1939, and the rules thereunder, and has requested acceleration of the effective date of the qualification of the indenture, pursuant to Section 307(c) of the Act.

It is ORDERED that the application shall become effective and the indenture qualified at 9:00 AM on June 30, 2009.

Attention is directed to the provisions of Section 324 of the Trust Indenture Act of 1939, as amended, which make unlawful certain representations with respect to the effect of qualification under the Act.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28770 / June 23, 2009

In the Matter of

THE MANAGERS FUNDS  
MANAGERS AMG FUNDS  
MANAGERS TRUST I  
MANAGERS TRUST II  
MANAGERS INVESTMENT GROUP LLC

800 Connecticut Avenue  
Norwalk, Connecticut 06854-2325

(812-13551)

**PUBLIC REFERENCE COPY**

ORDER UNDER SECTION 6(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING AN EXEMPTION FROM SECTIONS 18(f) AND 21(b) OF THE ACT; UNDER SECTION 12(d)(1)(J) OF THE ACT GRANTING AN EXEMPTION FROM SECTION 12(d)(1) OF THE ACT; UNDER SECTIONS 6(c) AND 17(b) OF THE ACT GRANTING AN EXEMPTION FROM SECTIONS 17(a)(1), 17(a)(2), AND 17(a)(3) OF THE ACT; AND UNDER SECTION 17(d) OF THE ACT AND RULE 17d-1 UNDER THE ACT TO PERMIT CERTAIN JOINT ARRANGEMENTS

The Managers Funds, Managers AMG Funds, Managers Trust I, Managers Trust II, and Managers Investment Group LLC filed an application on July 24, 2008, and amendments to the application on January 22, 2009, May 11, 2009, and May 27, 2009. Applicants requested an order under section 6(c) of the Investment Company Act of 1940 (the "Act") for an exemption from sections 18(f) and 21(b) of the Act, under section 12(d)(1)(J) of the Act for an exemption from section 12(d)(1) of the Act, under sections 6(c) and 17(b) of the Act for an exemption from sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Act, and under section 17(d) of the Act and rule 17d-1 under the Act to permit certain joint arrangements. The order permits certain registered open-end management investment companies to participate in a joint lending and borrowing facility.

On May 28, 2009, a notice of the filing of the application was issued (Investment Company Act Release No. 28748). The notice gave interested persons an opportunity to request a hearing and

stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that granting the requested exemption is consistent with and appropriate in the public interest, and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

It is also found that the terms of the proposed transactions, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and that the proposed transactions are consistent with the policy of each registered investment company concerned and the general purposes of the Act.

It is further found that the participation of each registered investment company in the proposed credit facility is consistent with the provisions, policies, and purposes of the Act, and not on a basis different from or less advantageous than that of other participants.

Accordingly, in the matter of The Managers Funds, *et al.*, (File No. 812-13551),

IT IS ORDERED, under section 6(c) of the Act, that the requested exemptions from sections 18(f) and 21(b) of the Act are granted, effective immediately, subject to the conditions in the application, as amended.

IT IS FURTHER ORDERED, under section 12(d)(1)(J) of the Act, that the requested exemption from section 12(d)(1) of the Act is granted, effective immediately, subject to the conditions in the application, as amended.

IT IS FURTHER ORDERED, under sections 6(c) and 17(b) of the Act, that the requested exemptions from sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Act are granted, effective immediately, subject to the conditions in the application, as amended.

IT IS FURTHER ORDERED, under section 17(d) of the Act and rule 17d-1 under the Act, that the proposed transactions are approved, effective immediately, subject to the conditions in the application, as amended.

For the Commission, by the Division of Investment Management, under delegated authority.

  
Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28801 / June 25, 2009

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In the Matter of

SEPARATE ACCOUNT VA-2NLNY OF TRANSAMERICA FINANCIAL  
LIFE INSURANCE COMPANY  
100 Manhattanville Road  
Purchase, NY 10577

(811-07370)

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ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

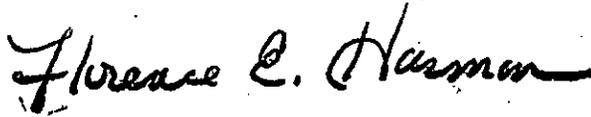
Separate Account VA-2NLNY of Transamerica Financial Life Insurance Company ("Applicant") filed an application on March 11, 2009, requesting an order under section 8(f) of the Investment Company Act of 1940 ("Act") declaring that it has ceased to be an investment company as defined by the Act.

On May 29, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 28751). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management, under delegated authority.



Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28802 / June 25, 2009

In the Matter of

SEPARATE ACCOUNT VA-2NL OF TRANSAMERICA OCCIDENTAL  
LIFE INSURANCE COMPANY  
4333 Edgewood Road NE  
Cedar Rapids, IA 52499-0001

(811-07232)

**PUBLIC REFERENCE COPY**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

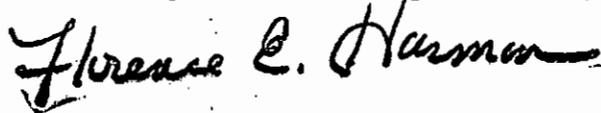
Separate Account VA-2NL of Transamerica Occidental Life Insurance Company ("Applicant") filed an application on March 11, 2009, requesting an order under section 8(f) of the Investment Company Act of 1940 ("Act") declaring that it has ceased to be an investment company as defined by the Act.

On May 29, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 28751). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management, under delegated authority.



Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28800 / June 24, 2009

In the Matter of

Genworth Life & Annuity VA Separate Account 3  
6610 West Broad Street  
Richmond, Virginia 23230

(811-21970)

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT  
COMPANY

Genworth Life & Annuity VA Separate Account 3 ("Applicant"), a unit investment trust registered under the Investment Company Act of 1940 ("1940 Act") filed an application on December 30, 2008 and an amended and restated application on February 20, 2009 and May 27, 2009, under section 8(f) of the 1940 Act, requesting an order declaring that it has ceased to be an investment company as defined by the 1940 Act.

On May 29, 2009, a notice of filing of the application was issued (Investment Company Act Release No. IC-28751). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, pursuant to section 8(f) of the 1940 Act, that the registration of Genworth Life & Annuity VA Separate Account 3 (811-21970) under the 1940 Act shall immediately cease to be in effect.

For the Commission, by the Division of Investment Management, under delegated authority.

Florence E. Harmon  
Deputy Secretary

# Public Reference Copy

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 28769; File No. 812-13633]

Embarcadero Funds, Inc., et al.; Notice of Application

June 22, 2009

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

Action: Notice of an application under section 6(c) of the Investment Company Act of 1940 ("Act" or "1940 Act") for an exemption from section 15(a) of the Act and rule 18f-2 under the Act, as well as from certain disclosure requirements.

Summary of Application: Applicants request an order that would permit them to enter into and materially amend subadvisory agreements without shareholder approval and would grant relief from certain disclosure requirements.

Applicants: Embarcadero Funds, Inc. (the "Company") and Van Wagoner Capital Management, Inc. (the "Adviser").

Filing Dates: The application was filed on February 18, 2009, and amended on June 15, 2009.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on July 17, 2009 and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

**PUBLIC REFERENCE COPY**

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants, Three Embarcadero Center, Suite 1100, San Francisco, CA 94111.

For Further Information Contact: Barbara T. Heussler, Senior Attorney, at (202) 551-6990, or Jennifer L. Sawin, Branch Chief, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a summary of the application. The complete application may be obtained via the Commission's Web site by searching for the file number or an applicant using the Company name box, at <http://www.sec.gov/search/search.htm> or by calling (202) 551-8090.

Applicants' Representations:

1. The Company, a Maryland corporation organized as a series investment company, is registered under the Act as an open-end management investment company and currently consists of five series: The All-Cap Growth Fund, Small-Cap Growth Fund, Alternative Strategies Fund, Absolute Return Fund and Market Neutral Fund (each a "Fund" and collectively, the "Funds").<sup>1</sup> Each series has separate investment objectives, policies and restrictions. The Adviser, a Delaware corporation, is an investment adviser registered under the Investment Advisers Act of 1940, as amended ("Advisers Act"). The Adviser serves as investment adviser to all five series of the Company under investment advisory agreements with

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<sup>1</sup> Applicants also request relief with respect to existing and future series of the Company and any other existing or future registered open-end management investment company or series thereof that: (i) is advised by the Adviser or any person controlling, controlled by, or under common control with the Adviser or its successors; (ii) uses the management structure described in this application; and (iii) complies with the terms and conditions of this application (together with the Funds that use Subadvisers, as defined below, the "Subadvised Funds"). For purposes of the requested order, "successor" is limited to an entity or entities that result from a reorganization into another jurisdiction or a change in the type of business organization. The only existing registered open-end management investment company that currently intends to rely on the requested order is named as an applicant. If the name of any Subadvised Fund contains the name of a Subadviser, the name of the Adviser or the name of the entity controlling, controlled by, or under common control with the Adviser that serves as the primary adviser to the Subadvised Fund will precede the name of the Subadviser.

the Company ("Advisory Agreements"). The Advisory Agreements have been approved by the shareholders of each Fund and by the board of directors of the Company ("Board"), including a majority of those directors who are not "interested persons" of the Company or the Adviser as defined in section 2(a)(19) of the Act ("Independent Directors").

2. Under the terms of the Advisory Agreements, the Adviser shall, subject to and in accordance with the investment objective and policies of a Fund and any directions which the Board may issue to the Adviser, have overall responsibility for the general management and investment of the assets and securities portfolios of the Fund. For the investment management services it provides to each Fund, the Adviser receives from that Fund the fee specified in the Advisory Agreements, payable monthly at an annual rate based the average daily net assets of the Fund. The Advisory Agreements permit the Adviser, to delegate certain asset management responsibilities to one or more subadvisers ("Subadvisers"). The Adviser has entered or intends to enter into investment subadvisory agreements ("Subadvisory Agreements") with various Subadvisers to provide investment advisory services to four of the Funds.<sup>2</sup> Each Subadviser is, and any future Subadviser will be, registered as an investment adviser under the Advisers Act. The Adviser monitors and evaluates the Subadvisers and recommends to the Board their hiring, retention or termination. Subadvisers recommended to the Board by the Adviser are selected and approved by the Board, including a majority of the Independent Directors. Subadvisers have discretionary authority to invest the assets or a portion of the assets of a particular Fund. The Adviser will compensate each Subadviser out of the fees paid to the Adviser under the Advisory Agreements.

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<sup>2</sup> The Adviser may enter into Subadvisory Agreements in the future to provide investment advisory services to the fifth fund, the Alternative Strategies Fund.

3. Applicants request an order to permit the Adviser, subject to Board approval, to select certain Subadvisers and materially amend an existing Subadvisory Agreement without obtaining shareholder approval. The requested relief will not extend to any Subadviser who is an affiliated person, as defined in section 2(a)(3) of the Act, of the Company or of the Adviser, other than by reason of serving as a Subadviser to one or more Funds ("Affiliated Subadviser").

4. Applicants also request an exemption from the various disclosure provisions described below that may require the Funds to disclose fees paid by the Adviser to each Subadviser. An exemption is requested to permit the Company to disclose for each Subadvised Fund (as both a dollar amount and as a percentage of the Subadvised Fund's net assets): (i) the aggregate fees paid to the Adviser and any Affiliated Subadviser, if any; and (ii) the aggregate fees paid to Subadvisers other than Affiliated Subadvisers (collectively, the "Aggregate Fee Disclosure"). Any Subadvised Fund that employs an Affiliated Subadviser will provide separate disclosure of any fees paid to the Affiliated Subadviser.

Applicants' Legal Analysis:

1. Section 15(a) of the Act provides, in relevant part, that it is unlawful for any person to act as an investment adviser to a registered investment company except pursuant to a written contract that has been approved by a vote of a majority of the company's outstanding voting securities. Rule 18f-2 under the Act provides that each series or class of stock in a series investment company affected by a matter must approve that matter if the Act requires shareholder approval.

2. Form N-1A is the registration statement used by open-end investment companies. Item 19(a)(3) of Form N-1A requires disclosure of the method and amount of the investment adviser's compensation.

3. Rule 20a-1 under the Act requires proxies solicited with respect to an investment company to comply with Schedule 14A under the Securities Exchange Act of 1934 ("1934 Act"). Items 22(c)(1)(ii), 22(c)(1)(iii), 22(c)(8) and 22(c)(9) of Schedule 14A, taken together, require a proxy statement for a shareholder meeting at which the advisory contract will be voted upon to include the "rate of compensation of the investment adviser," the "aggregate amount of the investment adviser's fees," a description of the "terms of the contract to be acted upon," and, if a change in the advisory fee is proposed, the existing and proposed fees and the difference between the two fees.

4. Form N-SAR is the semi-annual report filed with the Commission by registered investment companies. Item 48 of Form N-SAR requires investment companies to disclose the rate schedule for fees paid to their investment advisers, including the Subadvisers.

5. Regulation S-X sets forth the requirements for financial statements required to be included as part of investment company registration statements and shareholder reports filed with the Commission. Sections 6-07(2)(a), (b), and (c) of Regulation S-X require that investment companies include in their financial statements information about investment advisory fees.

6. Section 6(c) of the Act provides that the Commission may exempt any person, security, or transaction or any class or classes of persons, securities, or transactions from any provisions of the Act, or from any rule thereunder, if such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Applicants state that their requested relief meets this standard for the reasons discussed below.

7. Applicants assert that the shareholders rely on the Adviser's experience to select one or more Subadvisers best suited to achieve the Subadvised Fund's investment objectives.

Applicants assert that, from the perspective of the investor, the rôle of the Subadvisers is comparable to that of the individual portfolio managers employed by traditional investment company advisory firms. Applicants state that requiring shareholder approval of each Subadvisory Agreement would impose unnecessary delays and expenses on the Subadvised Funds, and may preclude the Fund from acting promptly in a manner considered advisable by the Adviser and the Board. Applicants note that each Subadvised Fund's Advisory Agreements and Subadvisory Agreements with Affiliated Subadvisers (if any) will continue to be subject to the shareholder approval requirements of section 15(a) of the Act and rule 18f-2 under the Act.

8. Applicants assert that many investment advisers use a "posted" rate schedule to set their fees. Applicants state that while investment advisers are willing to negotiate fees that are lower than those posted on the schedule, they are reluctant to do so where the fees are disclosed to other prospective and existing customers. Applicants submit that the relief requested to use Aggregate Fee Disclosure will encourage potential Subadvisers to negotiate lower subadvisory fees with the Adviser.

Applicants' Conditions:

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

1. Before a Subadvised Fund may rely on the order requested in the application, the operation of the Subadvised Fund in the manner described in the application will be approved by a majority of the Subadvised Fund's outstanding voting securities, as defined in the Act, or, in the case of a Subadvised Fund whose public shareholders purchase shares on the basis of a prospectus containing the disclosure contemplated by condition 2 below, by the sole initial shareholder before offering the Subadvised Fund's shares to the public.

2. The prospectus for each Subadvised Fund will disclose the existence, substance, and effect of any order granted pursuant to the application. Each Subadvised Fund will hold itself out to the public as employing the management structure described in the application. The prospectus will prominently disclose that the Adviser has ultimate responsibility (subject to oversight by the Board) to oversee the Subadvisers and recommend their hiring, termination, and replacement.

3. Within 90 days of the hiring of any new Subadviser, the affected Subadvised Fund's shareholders will be furnished all information about the new Subadviser that would be included in a proxy statement, except as modified to permit Aggregate Fee Disclosure. This information will include Aggregate Fee Disclosure and any change in such disclosure caused by the addition of the new Subadviser. To meet this obligation, a Subadvised Fund will provide shareholders within 90 days of the hiring of a new Subadviser with an information statement meeting the requirements of Regulation 14C, Schedule 14C, and Item 22 of Schedule 14A under the 1934 Act, except as modified by the order to permit Aggregate Fee Disclosure.

4. The Adviser will not enter into a Subadvisory Agreement with any Affiliated Subadviser without that agreement, including the compensation to be paid thereunder, being approved by the shareholders of the applicable Subadvised Fund.

5. At all times, at least a majority of the Board will be Independent Directors, and the nomination of new or additional Independent Directors will be placed within the discretion of the then-existing Independent Directors.

6. When a Subadviser change is proposed for a Subadvised Fund with an Affiliated Subadviser, the Board, including a majority of the Independent Directors, will make a separate finding, reflected in the applicable Board minutes, that such change is in the best interests of the

Subadvised Fund and its shareholders and does not involve a conflict of interest from which the Adviser or the Affiliated Subadviser derives an inappropriate advantage.

7. Independent legal counsel, as defined in rule 0-1(a)(6) under the Act, will be engaged to represent the Independent Directors. The selection of such counsel will be within the discretion of the then existing Independent Directors.

8. The Adviser will provide the Board, no less frequently than quarterly, with information about the profitability of the Adviser on a per-Subadvised Fund basis. The information will reflect the impact on profitability of the hiring or termination of any Subadviser during the applicable quarter.

9. Whenever a Subadviser is hired or terminated, the Adviser will provide the Board with information showing the expected impact on the profitability of the Adviser.

10. The Adviser will provide general management services to each Subadvised Fund, including overall supervisory responsibility for the general management and investment of the Subadvised Fund's assets and, subject to review and approval of the Board, will: (i) set each Subadvised Fund's overall investment strategies; (ii) evaluate, select and recommend Subadvisers to manage all or part of a Subadvised Fund's assets; (iii) when appropriate, allocate and reallocate a Subadvised Fund's assets among multiple Subadvisers; (iv) monitor and evaluate the performance of Subadvisers; and (v) implement procedures reasonably designed to ensure that the Subadvisers comply with each Subadvised Fund's investment objective, policies and restrictions.

11. No director or officer of the Company, or director or officer of the Adviser, will own directly or indirectly (other than through a pooled investment vehicle that is not controlled by such person) any interest in a Subadviser, except for: (i) ownership of interests in the Adviser

or any entity that controls, is controlled by, or is under common control with the Adviser; or (ii) ownership of less than 1% of the outstanding securities of any class of equity or debt of a publicly traded company that is either a Subadviser or an entity that controls, is controlled by, or is under common control with a Subadviser.

12. Each Subadvised Fund will disclose in its registration statement the Aggregate Fee Disclosure.

13. In the event the Commission adopts a rule under the 1940 Act providing substantially similar relief to that in the order requested in the application, the requested order will expire on the effective date of that rule.

For the Commission, by the Division of Investment Management, under delegated authority.

*Florence E. Harmon*

Florence E. Harmon  
Deputy Secretary

# Public Reference Copy

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION  
June 25, 2009

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In the Matter of

Silverleaf Resorts, Inc.  
1221 River Bend Drive  
Suite 120  
Dallas, TX 75247

**ORDER DECLARING THE APPLICATION  
FOR QUALIFICATION OF THE TRUST  
INDENTURE EFFECTIVE PURSUANT TO  
SECTION 307(c) OF THE TRUST INDENTURE  
ACT OF 1939, AS AMENDED**

File No. 022-28892

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Silverleaf Resorts, Inc. filed with the Commission an application on Form T-3 and a Form T-1 for the qualification of the indenture identified in those documents, pursuant to Section 307(a) of the Trust Indenture Act of 1939, and the rules thereunder, and has requested acceleration of the effective date of the qualification of the indenture, pursuant to Section 307(c) of the Act.

It is ORDERED that the application shall become effective and the indenture qualified at 10:00 a.m. on June 25, 2009.

Attention is directed to the provisions of Section 324 of the Trust Indenture Act of 1939, as amended, which make unlawful certain representations with respect to the effect of qualification under the Act.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

# Public Reference Copy

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

June 10, 2009

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In the Matter of

Community National Bancorporation  
422 Commercial Street  
Waterloo, Iowa 50704

**ORDER DECLARING THE OFFERING  
STATEMENT WITHDRAWN PURSUANT  
TO REGULATION A UNDER SECTION  
3(b) OF THE SECURITIES ACT, AS  
AMENDED**

File No. 24-10248

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Community National Bancorporation requests that its offering statement filed on May 18, 2009, referred to in the above caption, be withdrawn pursuant to Regulation A under Section 3(b) of the Securities Act of 1933.

In view of the request, it is ORDERED that the offering statement is hereby deemed withdrawn on June 10, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

June 12, 2009

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In the Matter of

CCH II, LLC  
CCH II CAPITAL CORP.  
12405 Powerscourt Drive, Suite 100  
St. Louis, Missouri 63131

File No. 022-28891

**ORDER DECLARING THE APPLICATION  
FOR QUALIFICATION OF THE TRUST  
INDENTURE EFFECTIVE PURSUANT TO  
SECTION 307(c) OF THE TRUST INDENTURE  
ACT OF 1939, AS AMENDED**

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CCH II, LLC and CCH II Capital Corp. filed with the Commission an application on Form T-3 for the qualification of the indenture identified in those documents, pursuant to Section 307(a) of the Trust Indenture Act of 1939, and the rules thereunder, and has requested acceleration of the effective date of the qualification of the indenture, pursuant to Section 307(c) of the Act.

It is ORDERED that the application shall become effective and the indenture qualified at 10:00 a.m. on Friday, June 12, 2009.

Attention is directed to the provisions of Section 324 of the Trust Indenture Act of 1939, as amended, which make unlawful certain representations with respect to the effect of qualification under the Act.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

June 11, 2009

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In the Matter of

Myriad Pharmaceuticals, Inc.  
320 Wakara Way  
Salt Lake City, Utah 84108

**ORDER DECLARING REGISTRATION  
EFFECTIVE PURSUANT TO SECTION 12(d)  
OF THE SECURITIES EXCHANGE ACT OF  
1934, AS AMENDED**

File No. 001-34275

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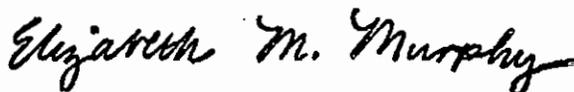
Myriad Pharmaceuticals, Inc. has filed with the Commission and the NASDAQ Stock Market LLC an application to register its common stock on the exchange, pursuant to Section 12(b) of the Securities Exchange Act of 1934.

In accordance with Section 12(d) of the Exchange Act, the authorities of the exchange have certified to the Commission that they have approved the class of securities for listing and registration.

Myriad Pharmaceuticals, Inc. requests that the registration be made effective before 30 days have expired since the Commission received the exchange's certification.

The request for acceleration appears to be appropriate in the public interest and for the protection of investors. Therefore, it is ORDERED that the registration on the NASDAQ Stock Market shall become effective immediately.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth Murphy  
Secretary

**PUBLIC REFERENCE COPY**

OPEN MEETING OF THE SECURITIES AND EXCHANGE COMMISSION

Thursday, May 14, 2009 – 10:05 a.m.

COMMISSIONERS PRESENT:

Mary L. Schapiro, Chairman  
Kathleen L. Casey  
Elisse Walter  
Luis A. Aguilar  
Troy A. Paredes

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Mr. Donohue, Director, Mr. Plaze, Ms. Bessin, Mr. Kahl and Mr. Sennett, of the Division of Investment Management; Mr. Overdahl, Chief Economist, and Mr. Johnson, of the Office Economic Analysis; Mr. Beswick, of the Office of the Chief Accountant; and Mr. Becker, General Counsel, Ms. Price and Mr. Singdahlson, of the Office of General Counsel, were present.

Following discussion, the Commission approved (5-0) the issuance of a release proposing amendments to rule 206(4)-2 under the Investment Advisers Act of 1940 (the "Act") and related forms and rules. The proposed amendments are designed to enhance the protections provided advisory clients when they entrust their funds and securities to an investment adviser. The amendments would require investment advisers having custody of client funds and securities to obtain a surprise examination by an independent public accountant, and, unless the client assets are maintained with an independent custodian, obtain a review of custodial controls from an independent public accountant. [Rules 206(4)-2 and 204-2 under the Act and Forms ADV and ADV-E].

(See Release IA-2876, dated May 20, 2009.)

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The meeting was adjourned at 10:56 a.m.

**PUBLIC REFERENCE COPY**

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Elizabeth M. Murphy  
Secretary

By: Linda Cullen  
Program Information Specialist

**Public Reference Copy**



OFFICE OF  
THE SECRETARY

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

Open Meeting Agenda

Thursday, May 14, 2009

Item 1: Custody of Funds or Securities of Clients by Investment Advisers  
Office: Division of Investment Management  
Staff: Robert E. Plaze, Sarah A. Bessin, Daniel S. Kahl, Vivien Liu

\* \* \*

Item 1: The Commission will consider custody-related matters, including whether to propose amendments to rule 206(4)-2 under the Investment Advisers Act of 1940 and related forms and rules. The proposed amendments are designed to enhance the protections provided advisory clients when they entrust their funds and securities to an investment adviser. If adopted, the amendments would require investment advisers having custody of client funds and securities to obtain a surprise examination by an independent public accountant, and, unless the client assets are maintained with an independent custodian, obtain a review of custodial controls from an independent public accountant.

For further information, please contact Vivien Liu, Senior Counsel,  
Division of Investment Management, at (202) 551-6787.

**PUBLIC REFERENCE COPY**

**Public Reference Copy**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28742/May 20, 2009

In the Matter of

ALLIANCEBERNSTEIN GLOBAL HEALTH CARE  
FUND, INC.

1345 Avenue of the Americas  
New York, NY 10105

(811-9329)

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

AllianceBernstein Global Health Care Fund, Inc. filed an application on February 24, 2009, and an amendment on March 31, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009; a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28728/May 20, 2009

**Public Reference Copy**

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In the Matter of :  
:   
:   
BBH U.S. MONEY MARKET PORTFOLIO :  
40 Water St. :  
Boston, MA 02109 :  
:   
(811-8842) :  
:

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ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

BBH U.S. Money Market Portfolio filed an application on April 15, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

March 27, 2009

**Public Reference Copy**

In the Matter of

**LTX-CREDENCE CORPORATION**  
1355 California Circle  
Milpitas, California 95035

**ORDER DECLARING THE APPLICATION  
FOR QUALIFICATION OF THE TRUST  
INDENTURE EFFECTIVE PURSUANT TO  
SECTION 307(c) OF THE TRUST INDENTURE  
ACT OF 1939, AS AMENDED**

File No. 022-28885

LTX-Credence Corporation filed with the Commission an application on Form T-3 and a Form T-1 for the qualification of the indenture identified in those documents, pursuant to Section 307(a) of the Trust Indenture Act of 1939, and the rules thereunder, and has requested acceleration of the effective date of the qualification of the indenture, pursuant to Section 307(c) of the Act.

It is ORDERED that the application shall become effective and the indenture qualified at 12 noon on March 27, 2009.

Attention is directed to the provisions of Section 324 of the Trust Indenture Act of 1939, as amended, which make unlawful certain representations with respect to the effect of qualification under the Act.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28727 / May 20, 2009

In the Matter of

WILLIAM BLAIR & COMPANY, L.L.C.  
WILBLAIRCO II, L.L.C.  
222 West Adams Street.  
Chicago, Illinois 60606

(813-00274)

ORDER UNDER SECTIONS 6(b) AND 6(e) OF THE INVESTMENT COMPANY ACT OF  
1940

William Blair & Company, L.L.C. ("Blair") and Wilblairco II, L.L.C. filed an application on June 8, 2000, and amendments to the application on March 11, 2004, May 15, 2007, January 25, 2008, May 27, 2008, and April 10, 2009, requesting an order under sections 6(b) and 6(e) of the Investment Company Act of 1940 ("Act") granting an exemption from all provisions of the Act, except section 9 and sections 36 through 53 of the Act, and the rules and regulations under those sections. With respect to sections 17 and 30 of the Act, and the rules and regulations thereunder, and rule 38a-1 under the Act, the exemption is limited as set forth in the application. The order exempts certain limited partnerships and other investment vehicles formed for the benefit of eligible employees of Blair and its affiliates from certain provisions of the Act. Each limited partnership or other investment vehicle will be an "employees' securities company" within the meaning of section 2(a)(13) of the Act.

On April 22, 2009, a notice of the filing of the application was issued (Investment Company Act Release No. 28700). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that granting the requested exemption is appropriate in the public interest and consistent with the protection of investors.

Accordingly,

IT IS ORDERED, under sections 6(b) and 6(e) of the Act, that the exemption requested by Blair and Wilblairco II, L.L.C. (File No. 813-00274), is granted, effective immediately, subject to the conditions in the application, as amended.

For the Commission, by the Division of Investment Management, under delegated authority.

A handwritten signature in cursive script that reads "Florence E. Harmon".

Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

April 24, 2009

**Public Reference Copy**

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In the Matter of

**Eternal Technologies Group, Inc.**  
Suite 2007  
Jinzhonghuan Commercial Tower  
3037 Jintian Road, Futian District  
Shenzhen, Guongdong Province  
China 518048

**ORDER DECLARING REGISTRATION  
STATEMENT ABANDONED UNDER THE  
SECURITIES ACT OF 1933, AS AMENDED**

File No.

333-109908

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**PUBLIC REFERENCE COPY**

Eternal Technologies Group, Inc. ("Eternal") filed with the Commission a registration statement to register securities under Section 6(a) of the Securities Act of 1933. The registration statement has been on file for more than nine months and has not yet become effective.

Eternal has failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

In view of the foregoing, it is ORDERED that the registration statement be declared abandoned on April 24, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth Murphy  
Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 5, 2009

**Public Reference Copy**

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In the Matter of	PracticeXpert, Inc.	:	ORDER DECLARING
	23975 Park Sorrento Drive, No. 110	:	POST-EFFECTIVE
	Calabasas, CA 91302	:	AMENDMENT TO
		:	REGISTRATION STATEMENT
		:	ABANDONED UNDER THE
		:	SECURITIES ACT OF 1933,
File No. 333-117126		:	AS AMENDED

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The above-named issuer having filed with the Commission, pursuant to Section 6(a) of the Securities Act of 1933, as amended, and the rules thereunder, a post-effective amendment to a registration statement for the registration of the securities specified on the facing sheets thereof; and

The said issuer having failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

IT IS ORDERED that the registration statement shall be declared abandoned on May 5, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 1, 2009

# Public Reference Copy

In the Matter of CarrAmerica Realty Corporation  
1850 K Street, N.W., Ste. 500  
Washington, D.C. 20006

: ORDER DECLARING  
: REGISTRATION STATEMENT  
: ABANDONED UNDER THE  
: SECURITIES ACT OF 1933,  
: AS AMENDED

File No. 333-89193

The above-named issuer having filed with the Commission, pursuant to Section 6(a) of the Securities Act of 1933, as amended, and the rules thereunder, a registration statement for the registration of the securities specified on the facing sheets thereof; and

The said issuer having failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

IT IS ORDERED that the registration statement shall be declared abandoned on May 1, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 1, 2009

**Public Reference Copy**

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In the Matter of CarrAmerica Realty Corporation  
1850 K Street, N.W., Ste. 500  
Washington, D.C. 20006

: ORDER DECLARING  
: REGISTRATION STATEMENT  
: ABANDONED UNDER THE  
: SECURITIES ACT OF 1933,  
: AS AMENDED

File No. 333-89191

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The above-named issuer having filed with the Commission, pursuant to Section 6(a) of the Securities Act of 1933, as amended, and the rules thereunder, a registration statement for the registration of the securities specified on the facing sheets thereof; and

The said issuer having failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

IT IS ORDERED that the registration statement shall be declared abandoned on May 1, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 5, 2009

**Public Reference Copy**

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In the Matter of

City Network, Inc.  
2F-1, No. 16, Jian BA Road  
Chung Ho City, Taipei County, 235  
Taiwan, ROC

**ORDER DECLARING REGISTRATION  
STATEMENT ABANDONED UNDER THE  
SECURITIES ACT OF 1933, AS AMENDED**

File No. 333-140695

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City Network, Inc. filed with the Commission a registration statement to register securities under Section 6(a) of the Securities Act of 1933. The registration statement has been on file for more than nine months and has not yet become effective.

City Network, Inc. has failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

In view of the foregoing, it is ORDERED that the registration statement be declared abandoned on May 5, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth Murphy  
Secretary

**PUBLIC REFERENCE COPY**

Public Reference Copy

Public Reference Copy

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 1, 2009

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In the Matter of

Petrol Oil and Gas, Inc.  
11020 King Street, Suite 375  
Overland Park, KS 66210

ORDER DECLARING REGISTRATION  
STATEMENT ABANDONED UNDER THE  
SECURITIES ACT OF 1933, AS AMENDED

File No.

333-130033

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**PUBLIC REFERENCE COPY**

Petrol Oil and Gas, Inc. ("Petrol") filed with the Commission a registration statement to register securities under Section 6(a) of the Securities Act of 1933. The registration statement has been on file for more than nine months and has not yet become effective.

Eternal has failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

In view of the foregoing, it is ORDERED that the registration statement be declared abandoned on May 1, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth Murphy  
Secretary

**Public Reference Copy**

IN THE STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 5, 2009

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In the Matter of

**STANDARD MOTOR PRODUCTS, INC.**  
37-18 Northern Boulevard  
Long Island City, New York 11101

File No. 022-28887

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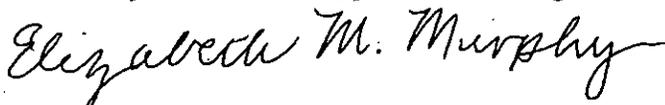
**ORDER DECLARING THE APPLICATION  
FOR QUALIFICATION OF THE TRUST  
INDENTURE EFFECTIVE PURSUANT TO  
SECTION 307(c) OF THE TRUST INDENTURE  
ACT OF 1939, AS AMENDED**

Standard Motor Products, Inc. filed with the Commission an application on Form T-3 and a Form T-1 for the qualification of the indenture identified in those documents, pursuant to Section 307(a) of the Trust Indenture Act of 1939, and the rules thereunder, and has requested acceleration of the effective date of the qualification of the indenture, pursuant to Section 307(c) of the Act.

It is ORDERED that the application shall become effective and the indenture qualified at 10:00 AM on May 5, 2009.

Attention is directed to the provisions of Section 324 of the Trust Indenture Act of 1939, as amended, which make unlawful certain representations with respect to the effect of qualification under the Act.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28730/May 20, 2009

In the Matter of

NETS TRUST  
50 South LaSalle St.  
Chicago, IL 60603

(811-22140)

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

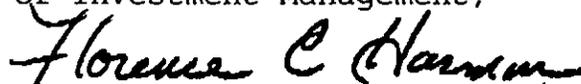
NETS Trust filed an application on April 13, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28729/May 20, 2009

**Public Reference Copy**

In the Matter of :  
: BBH PRIME INSTITUTIONAL MONEY MARKET FUND, INC. :  
40 Water St. :  
Boston, MA 02109 :  
: (811-10073) :  
:

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

BBH Prime Institutional Money Market Fund, Inc. filed an application on April 15, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28744/May 20, 2009

In the Matter of  
:  
BBH FUND, INC.  
:  
40 Water St.  
:  
Boston, MA 02109  
:  
:  
:  
(811-6139)  
:  
:

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

BBH Fund, Inc. filed an application on April 15, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management, under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28745/May 20, 2009

In the Matter of

BBH TRUST  
40 Water St.  
Boston, MA 02109

(811-3779)

**Public Reference Copy**

**PUBLIC REFERENCE COPY**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

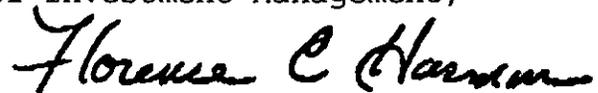
BBH Trust filed an application on April 15, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28731/May 20, 2009

In the Matter of

HEALTHSHARES<sup>TM</sup>, INC.  
420 Lexington Ave.  
Suite 2550  
New York, NY 10170

(811-21855)

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

HealthShares<sup>TM</sup>, Inc. filed an application on March 30, 2009,  
requesting an order under section 8(f) of the Act declaring that  
it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was  
issued (Investment Company Act Release No. 27813). 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.

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the information set forth in the application, that applicant has  
ceased to be an investment company. Accordingly,

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registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28732/May 20, 2009

In the Matter of :  
 :  
GOLDMAN SACHS HEDGE FUND PARTNERS :  
REGISTERED FUND, LLC :  
One New York Plaza :  
39<sup>th</sup> Floor :  
New York, NY 10004 :  
 :  
(811-21376) :  
 :

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Goldman Sachs Hedge Fund Partners Registered Fund, LLC filed an application on March 23, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.

*Florence E. Harmon*

Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28733/May 20, 2009

In the Matter of :  
:  
GOLDMAN SACHS HEDGE FUND PARTNERS :  
REGISTERED MASTER FUND, LLC :  
One New York Plaza :  
39<sup>th</sup> Floor :  
New York, NY 10004 :  
:  
(811-21721) :  
:

**PUBLIC REFERENCE COPY**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Goldman Sachs Hedge Fund Partners Registered Master Fund, LLC  
filed an application on March 23, 2009, requesting an order under  
section 8(f) of the Act declaring that it has ceased to be an  
investment company.

On April 23, 2009, a notice of filing of the application was  
issued (Investment Company Act Release No. 27813). The notice  
gave interested persons an opportunity to request a hearing and  
stated that an order disposing of the application would be issued  
unless a hearing was ordered. No request for a hearing has been  
filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of  
the information set forth in the application, that applicant has  
ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's  
registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.

*Florence E. Harmon*

Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28734/May 20, 2009

In the Matter of  
  
CAPITAL ONE FUNDS  
3435 Stelzer Rd.  
Columbus, OH 43219  
  
(811-5536)

**Public Reference Copy**

**PUBLIC REFERENCE COPY**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Capital One Funds filed an application on March 11, 2009, and an amendment on April 16, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28735/May 20, 2009

In the Matter of

DOMINI SOCIAL TRUST  
536 Broadway  
7<sup>th</sup> Floor  
New York, NY 10012

(811-5824)

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Domini Social Trust filed an application on February 13, 2009, and an amendment on April 17, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28736/May 20, 2009

In the Matter of

DREYFUS CALIFORNIA INTERMEDIATE  
MUNICIPAL BOND FUND

c/o The Dreyfus Corporation  
200 Park Ave.  
New York, NY 10166

(811-6610)

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Dreyfus California Intermediate Municipal Bond Fund filed an application on September 4, 2008, and an amendment on April 14, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued. (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28737/May 20, 2009

**PUBLIC REFERENCE COPY**

In the Matter of

AETOS CAPITAL MARKET NEUTRAL  
STRATEGIES FUND, LLC  
c/o Aetos Capital, LLC  
875 Third Ave.  
New York, NY 10022

(811-21060)

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Aetos Capital Market Neutral Strategies Fund, LLC filed an application on December 29, 2008, and an amendment on April 7, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28738/May 20, 2009

In the Matter of

NEW RIVER FUNDS  
1881 Grove Ave.  
Radford, VA 24141

(811-21384)

Public Reference Copy

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

New River Funds filed an application on December 31, 2008, and an amendment on April 6, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

PUBLIC REFERENCE COPY

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28739/May 20, 2009

In the Matter of

EVERGREEN INVESTMENT TRUST  
200 Berkeley St.  
Boston, MA 02116

(811-4154)

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Evergreen Investment Trust filed an application on October 2, 2008, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.



Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28740/May 20, 2009

\_\_\_\_\_  
In the Matter of :  
:  
MELLON INSTITUTIONAL FUNDS MASTER :  
PORTFOLIO :  
BNY Mellon Financial Center :  
One Boston Pl. :  
Boston, MA 02108 :  
:  
(811-7603) :  
\_\_\_\_\_

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

Mellon Institutional Funds Master Portfolio filed an application on December 5, 2008, and an amendment on April 1, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.

*Florence E. Harmon*

Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28741/May 20, 2009

\_\_\_\_\_  
In the Matter of :  
 :  
 :  
U.S. GLOBAL ACCOLADE FUNDS :  
7900 Callaghan Rd. :  
San Antonio, TX 78229 :  
 :  
(811-7662) :  
\_\_\_\_\_

**Public Reference Copy**

ORDER UNDER SECTION 8(f) OF THE INVESTMENT COMPANY ACT OF 1940  
DECLARING THAT APPLICANT HAS CEASED TO BE AN INVESTMENT COMPANY

U.S. Global Accolade Funds filed an application on December 4, 2008, and an amendment on April 1, 2009, requesting an order under section 8(f) of the Act declaring that it has ceased to be an investment company.

On April 23, 2009, a notice of filing of the application was issued (Investment Company Act Release No. 27813). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that applicant has ceased to be an investment company. Accordingly,

IT IS ORDERED, under section 8(f) of the Act, that applicant's registration under the Act shall forthwith cease to be in effect.

For the Commission, by the Division of Investment Management,  
under delegated authority.

*Florence E. Harmon*

Florence E. Harmon  
Deputy Secretary

**PUBLIC REFERENCE COPY**



OFFICE OF  
THE SECRETARY

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

May 27, 2009

Mr. Ira T. Kay  
Practice Director, Compensation  
Practice  
Steven Seelig, Esq.  
Executive Compensation Counsel  
Watson Wyatt Worldwide  
901 North Glebe Road  
Arlington, VA 22203

Re: Rulemaking Petition File No. 4-585

Dear Messrs. Kay and Seelig:

This letter acknowledges receipt by this office on May 27, 2009, of your rulemaking petition dated May 26, 2009 requesting the Commission to amend Item 402 of Regulation S-K to revise the current Summary Compensation Table to better depict the compensation earned for the year by named executive officers.

The petition has been assigned the above-noted file number and has been referred to the appropriate division of the Commission. This office will notify you of any pertinent action taken by the Commission.

Sincerely,

A handwritten signature in cursive script that reads "Elizabeth M. Murphy".

Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

**Public Reference Copy**

Public Reference Copy

May 26, 2009

**PUBLIC REFERENCE COPY**

4-585



Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

**Subject: Request for Rulemaking to Amend Item 402 of Regulations S-K to revise the Current Summary Compensation Table to Better Depict the Compensation Earned for the Year by Named Executive Officers**

Dear Chairperson Schapiro:

We are writing to request that the Commission reconsider the current Summary Compensation Table (SCT) disclosures for depicting the annual compensation of named executive officers on company proxies. From recent press reports (*SEC Chair Says Regulatory Agency Considering Changes to CEO Pay Disclosure Rules*, by Rachel Beck, Associated Press Business Writer, April 30, 2009), we understand the Commission is interested in revisiting the depiction of stock-based compensation on the SCT in a manner that more accurately states the actual value earned by executives for the year. The press account suggests the change being contemplated is to show the fair value of grants made for the year rather than the cost recorded on the financial statement for the year.

We applaud the Commission for seeking to improve the current rules so that shareholders will have a better understanding of the compensation earned by executives for the proxy year. However, we would urge the Commission to consider taking a different approach that would more accurately reflect the value earned by the executive for the year rather than the pay opportunity being granted for the year. We have attached a copy of an article we recently authored that outlines our suggested approach, which focuses on depicting the *pay realizable* by an executive during the year. We believe this approach accurately depicts what the executive actually earned (or lost) in stock value during the year, and would be an extremely valuable change for shareholders seeking clarity on this issue. We also have provided a link to the article as posted at our website:

<http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=21017>

Ms. Elizabeth M. Murphy  
May 26, 2009  
Page 2



We are hopeful the Commission will seriously consider adopting the approach we suggest in the article. We are available to discuss this matter with you, the Commission or the Commission Staff, at your convenience.

Best regards,

A handwritten signature in black ink that reads "Ira T. Kay".

**Ira T. Kay**  
Practice Director, Compensation Practice  
Watson Wyatt Worldwide  
875 Third Avenue | New York, NY 10011  
Phone: 212.251.5641 | Fax: 212.644.5835  
[ira.kay@watsonwyatt.com](mailto:ira.kay@watsonwyatt.com)

A handwritten signature in black ink that reads "Steven Seelig".

**Steven Seelig**  
Executive Compensation Counsel  
Watson Wyatt Worldwide  
901 N. Glebe Road | Arlington, VA, 22203  
Phone: 703.258.7623 | Fax: 703.258.7491  
[steven.seelig@watsonwyatt.com](mailto:steven.seelig@watsonwyatt.com)

**Attachments:**

1. *Improving Executive Compensation Disclosure: Why the SEC Rules Don't Fit in a Down Market*, Watson Wyatt Insider, April 2009, Volume 19, Number 4, page 15.



# Improving Executive Compensation Disclosure: Why the SEC Rules Don't Fit in a Down Market

By **Ira T. Kay** and **Steve Seelig**

Changes to the executive compensation disclosure rules made during Christopher Cox's tenure as chairman of the Securities and Exchange Commission (SEC) vastly improved disclosures, particularly in the enhanced Compensation Discussion and Analysis (CD&A) section. However, in reviewing the 2008 stock price performance for our clients, we have found the reporting rules require these companies to significantly overstate the value of executive compensation earned. The overstatement will make the inevitable criticism of executive pay practices that arises each proxy season far worse than it should be. In an effort to blunt the critics, companies might shift from shareholder-friendly equity compensation programs to less effective cash-based programs.

Proxy disclosures should not drive compensation plan design, and this article suggests changes new SEC Chairwoman Mary Shapiro could make to create more transparent and informative disclosures.

## Source of the problem

The past year has been tumultuous for shareholders and corporate executives alike. Annual bonuses are no longer paying out at target or maximum. Much of the value has been wiped out of long-term cash incentives measured at 2008 year end, most executives' stock options are underwater and time-based restricted

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**Broadly speaking, these outcomes demonstrate that the U.S. compensation model works.**

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stock is yielding far less value than anticipated. Broadly speaking, these outcomes demonstrate that the U.S. compensation model works – executives are not rewarded unless they deliver the desired financial results.

Because the SEC disclosure rules generally require companies to disclose a *fixed* value

Public Reference Copy

calculated at the start of the year (or earlier), later drops in stock value are not reflected in disclosed total compensation amounts. This misleads shareholders into believing executives are being paid far more than they are.

The discrepancy between executives' reported and received earnings arises from two SEC policies:

1. Requiring a single number to depict total annual compensation
2. Using existing accounting rules under Statement of Financial Accounting Standards (FAS) 123(R) to value stock compensation

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## The SEC should consider putting all elements of compensation on the same disclosure footing.

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With the best of intentions, the SEC wanted to give shareholders a single number so they could easily compare payments to their named executive officers (NEOs) with those to their industry peers. But disclosure experts believe the combined effect of these two policies has been to create "apples to oranges" comparisons. Simply stated, cash compensation is shown in real time based on the value *earned at year end*; stock grants are shown based on the value *estimated at the start of the year or earlier*. This discrepancy in valuation approach and timing is at odds with the notion that all compensation can be viewed as fungible.

Corporate America tolerated this approach for the 2007 and 2008 proxy seasons, while stock values continued to climb. In those years, proxy disclosures tended to understate compensation values because executives' earnings were higher than grant date values. The 2009 proxies, on the other hand, will greatly overstate the value of executives' earnings during the year.

Using a simple baseball analogy, let's say one person gives another a pair of tickets in February

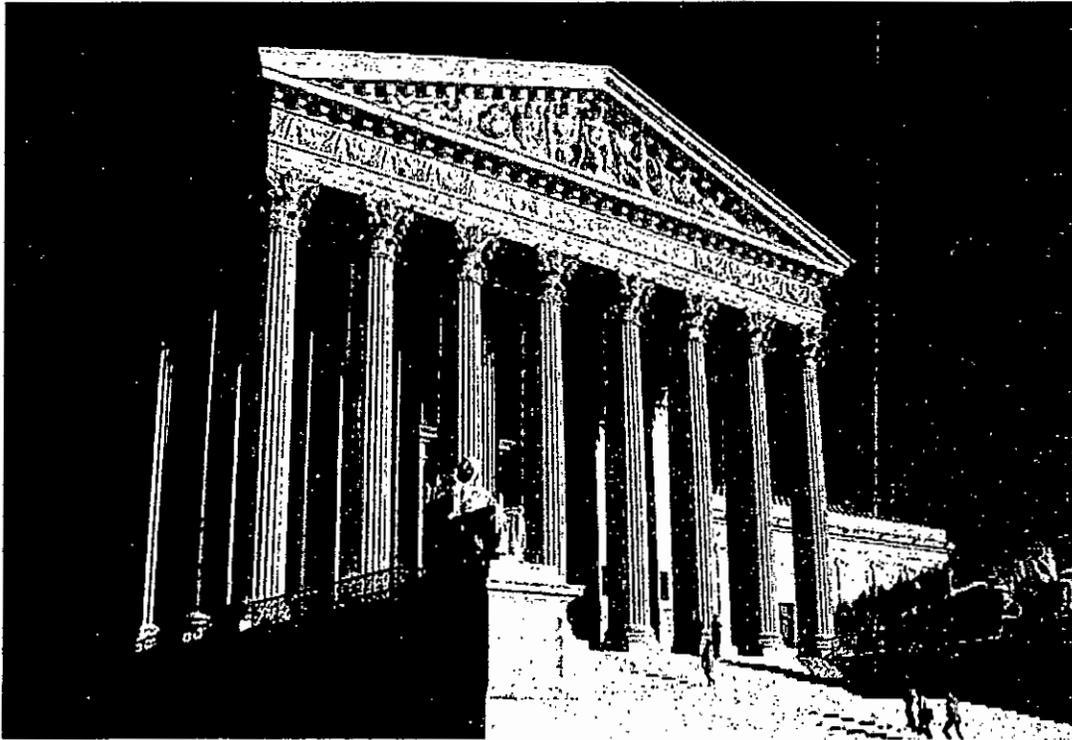
to see the Washington Nationals play a game in September. Today, the face value of two tickets is \$100. Yet when September rolls around and the fan can't make the game and needs to sell the tickets, their value might be very different. The Nationals might be mired in last place and playing another also-ran, so selling the tickets might be tough at any price. Or it could be a crucial game that will determine the division winner for that season, in which case the seller might be able to name his price. There are two ways to value the tickets: They are still worth \$100 or they are worth whatever the market will pay on game day.

The SEC's approach looks at the tickets' face value and ignores their game-day value. And in a year when most companies' stock values have tumbled, executives are holding tickets for a game between two also-rans. Given that many executives are getting little in the way of cash bonuses this year, the reaction has leaned toward revamping existing programs to put far less equity at risk. We think that direction is a bad idea for corporate America and is at odds with the way companies should "pay for performance."

### The solution

The SEC should strongly consider putting all elements of compensation on the same disclosure footing. In considering this proposal, it is important to distinguish between the concepts of *pay opportunity* and *pay realizable*. Using the baseball ticket analogy above, the face value of the tickets is the *pay opportunity*. It measures the value of the tickets at a given point in time but does not reflect their ultimate value. For a stock option grant, which provides value to the recipient only if the stock price increases, the *pay opportunity* is the FAS 123(R) value, most often calculated using the Black-Scholes method.

To make matters more confusing, the FAS 123(R) value that appears in the proxy's Summary Compensation Table (SCT) is not the value of equity *granted* for the year. Instead, this number may include unvested options granted many years earlier, because all unvested equity is



lumped together to determine the FAS 123(R) value for the year. So the SCT number does not even accurately reflect the executive's *pay opportunity* for the year. Much of the popular press recognizes this as problematic. Rather than using the total compensation number that appears in the SCT, both The Wall Street Journal and the Associated Press (whose stories disproportionately appear in local newspapers interested in what chief executive officers in their area earn) substitute the FAS 123(R) value of equity granted during the year for the FAS 123(R) equity value depicted on the company's financial statement.

These SCT numbers do not reflect the value of the executive's earnings. Returning to the baseball ticket analogy, the proper number is the market value of the tickets on game day. For stock options, that would be the in-the-money value as of year end. For restricted stock, restricted stock units and performance shares, that would be the end-of-the-year stock price. We call this number the *pay realizable*. It reflects the total value of all equity that would be available to the

executive, if monetized, plus the value of all cash compensation. Stated differently, this is the year-end value of all compensation the executive earned that year, including compensation that was not monetized via a stock option exercise.

Using this *pay realizable* concept enables companies and compensation committees to determine whether their compensation program truly pays for performance. Proxy disclosures would say how much equity value executives earned or lost during the year, and shareholders could easily determine whether pay reflects those results. More important, shareholders could compare the *pay realizable* for their executives with that at peer organizations. This would enable them to ascertain whether pay levels were linked to the company's performance when compared with the median earnings of its peers. Making this comparison is equally important during prosperous and down years. This helps facilitate the central tenet of the SEC disclosure rules: Shareholders should have enough information at their disposal to determine whether executive pay is commensurate with corporate performance.

## How would it work?

The following example illustrates how the SEC rules should measure total compensation for the year. Figure 1 shows the current SCT approach for a CEO who received both restricted stock grants and stock options during the year.

Assume all equity grants have a three-year graded vesting schedule and the company granted \$1 million in option value and \$1 million in restricted stock value for each of the past three years. Further assume the company's stock value rose from \$30 at the start of 2006 to \$40 in 2007 and to \$50 in 2008, but it had dropped to \$20 by year-end 2008.

**The *pay realizable* approach would far more accurately depict executive compensation.**

Because current rules show columns (e) and (f) based on the FAS 123(R) value for the year, the executive appears to have earned \$2 million in 2008, even though at year end, the stock awards are worth only \$522,220 and the stock options are all underwater with no in-the-money value.

Figure 2 illustrates the *pay realizable* approach, which accurately reflects the value of the

executive's earnings or losses during the year. Executives would no longer be depicted as having earned far more than they did in a down market but far less than they earned in an up market. The approach places the value of stock grants and long-term cash programs on an equal footing with salary, bonuses and long-term cash incentives earned or paid for the year. It tells shareholders exactly what their executives earned that year, which will become especially important if "say-on-pay" becomes a reality.

## How to measure pay realizable

The overarching idea of *pay realizable* is similar to that of the change in pension value in column (h) of the current SCT. That is, the value earned based on the change in value from one year to the next of unvested equity grants is the amount recorded. However, because lower equity values represent a real economic loss for executives who have not yet earned or cannot yet monetize their equity holdings, *pay realizable* could be a negative number. As mentioned earlier, allowing for a negative number clearly conveys that compensation programs pay for performance but not for failure.

The *pay realizable* approach would change only two columns in the SCT but would far more accurately depict executive compensation:

Figure 1 | Current Summary Compensation Table treatment

Name and principal position	Year	Salary (\$)	Bonus (\$)	Stock awards (\$)	Option awards (\$)	Non-equity incentive plan compensation (\$)	Change in pension value and NQDC earnings (\$)	All other compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
CEO	2008	\$1,000,000	\$200,000	\$1,000,000	\$1,000,000	\$250,000	\$250,000	\$50,000	\$3,750,000

Source: Watson Wyatt Worldwide.

↑ Compensation opportunity

Figure 2 | Proposed Summary Compensation Table treatment

Name and principal position	Year	Salary (\$)	Bonus (\$)	Stock awards realizable (\$)	Option awards realizable (\$)	Non-equity incentive plan compensation (\$)	Change in pension value and NQDC earnings (\$)	All other compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
CEO	2008	\$1,000,000	\$200,000	(\$783,330)	(\$1,222,220)	\$250,000	\$250,000	\$50,000	(\$255,550)

Source: Watson Wyatt Worldwide.

↑ Compensation realizable

1. **Stock awards realizable – column (e).**

Rather than the FAS 123(R) value, this column would show the annual change in the value of equity being expensed under FAS 123(R) of the following pay elements:

- a. *Unvested restricted stock, restricted stock units, performance shares and performance units.* To figure out the value earned or lost from unvested equity under current rules, shareholders must obtain the unvested grant information from the Grants of Plan-Based Awards and Outstanding Equity Awards at Fiscal Year End tables and then perform independent calculations. So most shareholders remain unaware of the true year-end value of equity gains or losses. Under our suggested approach, one component of the change in equity value recorded in column (e) would reflect that of equity that remained unvested during the year.
- b. *Restricted stock, restricted stock units, performance shares and performance units vested during the year.* Under current rules, the value realized is disclosed on the Option Exercises and Stock Vested table, but the change in value from the prior year is not. Shareholders can calculate the total value of pay realized from equity vested during the year, but this value will reflect earlier compensation gains or losses and does not associate earnings or losses

with the proper year. Under our suggested approach, for equity that vested that year, we would determine the change in value from the start of the year to the vesting date based only on the equity for which the company recorded an accounting expense, and record it in column (e).

In the above example, to determine the change in equity value for the year, we would consider the \$1,305,550 in unvested restricted stock at the start of the year, which declined to \$522,220 as of year end, resulting in a loss of \$783,330. Figure 3 illustrates how the calculation is done.

2. **Option awards realizable – column (f).**

This column would include the change in value from the prior year of the following pay elements:

- a. *Outstanding unvested stock options.* This would apply to the change to the in-the-money value of outstanding unvested options – the amount the executive can monetize when the options vest. As with restricted stock and restricted stock units, shareholders must find information about option grants from the Grants of Plan-Based Awards and Outstanding Equity Awards at Fiscal Year End tables and then calculate the value earned or lost from unvested equity. The change in the in-the-money value of these unvested options would be recorded in column (f) and would

Figure 3 | Determination of change in equity value

	1/1/2006	12/31/2006	1/1/2007	12/31/2007	1/1/2008	12/31/2008	Totals
Stock price	\$30	\$40	\$40	\$50	\$50	\$20	
# of shares granted	33,333		25,000		20,000		
# of shares expensed in 2008	11,111		8,333		6,667		
Start of 2008 value (\$50) for # of shares expensed	\$555,550		\$416,667		\$333,333		\$1,305,550
End of 2008 value (\$20) for # of shares expensed	\$222,220		\$166,667		\$133,333		\$522,220
2008 change in value for # of shares expensed	(\$333,330)		(\$250,000)		(\$200,000)		(\$783,330)

Source: Watson Wyatt Worldwide.



reflect equity that remained unvested during the year. Similarly, the change in the in-the-money value of options that vest during the year would be recorded from the start of the year until the vesting date.

- b. *Exercised stock options.* We would not recommend reporting the total in-the-money (intrinsic) value realized at exercise as described on the Option Exercises and Stock Vested table in column (f). While some consider this the true value of annual compensation, we believe this value reflects option grants for a number of earlier years based on volitional actions by the executives and thus would not reflect pay decisions made by the board in the most recent proxy years.

In the above example, to determine the change in equity value for the year, we would consider the \$1,222,220 in unvested stock options at the start of the year, which declined to \$0 as of year end, resulting in a loss of \$1,222,220. Figure 4 illustrates the calculation.

### What can companies do now?

We understand the Obama administration and the SEC have a lot on their plates this year, and revamping the proxy disclosure rules might not be at the top of their agenda. But executive compensation has been a lightning rod for political attacks, and attempts at regulation are likely in the near future. Companies should use their proxy and CD&A to demonstrate that their programs are paying less for lower performance, and should use a calculation of *pay realizable* to demonstrate where executives have lost significant compensation value for the year. Many of our clients have taken this approach, and their CD&As make a far more cogent argument that their compensation programs are properly calibrated in times of high and low achievement.

Stated more bluntly, companies that fail to demonstrate that their programs pay for performance may be in for more trouble down the road from pay critics and the press, especially if Congress decides to mandate "say on pay" for future proxy years. ■

Figure 4 | Determination of change in option value

	1/1/2006	12/31/2006	1/1/2007	12/31/2007	1/1/2008	12/31/2008	Totals
Stock price	\$30	\$40	\$40	\$50	\$50	\$20	
# options granted	133,333		100,000		80,000		
# options exercised in 2008	44,444		33,333		26,667		
Start of 2008 intrinsic value for # of shares exercised	\$888,887		\$333,333		\$0		\$1,222,220
End of 2008 intrinsic value for # of options exercised	\$0		\$0		\$0		\$0
2008 change in value for # of options exercised	(\$888,887)		(\$333,333)		\$0		(\$1,222,220)

Source: Watson Wyatt Worldwide.



OFFICE OF  
THE SECRETARY

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

May 27, 2009

Mr. Keith Paul Bishop  
23311 Via Dorado  
Trabuco Canyon, CA 92679-3922

Re: Rulemaking Petition File No. 4-584

Dear Mr. Bishop:

This letter acknowledges receipt by this office on May 26, 2009, of your rulemaking petition dated May 17, 2009 requesting the Commission to amend Rule 3a-5(b)(1) under the Investment Company Act of 1940 to include a reference to limited liability companies and business trusts.

The petition has been assigned the above-noted file number and has been referred to the appropriate division of the Commission. This office will notify you of any pertinent action taken by the Commission.

Sincerely,

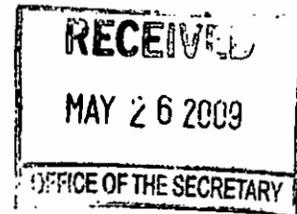
Elizabeth M. Murphy  
Secretary

**Public Reference Copy**

**PUBLIC REFERENCE COPY**

Keith Paul Bishop  
[Kbishop@post.harvard.edu](mailto:Kbishop@post.harvard.edu)

May 17, 2009



Elizabeth M. Murphy  
Secretary  
U.S. Securities & Exchange Commission  
100 F Street, NE  
Washington, DC 20549

4-584

Petition for Rulemaking with Respect to Rule 3a-5(b)(1) under the Investment Company Act of 1940

**Public Reference Copy**

Dear Ms. Murphy:

Pursuant to Rule of Practice 192(a) of the Securities and Exchange Commission ("**Commission**"), I hereby petition the Commission to amend Rule 3a-5(b)(1) (17 C.F.R. §270.3a-5(b)(1)) under the Investment Company Act of 1940 to include a reference to limited liability companies and business trusts.

Currently, Rule 3a-5 establishes an exemption for finance subsidiaries organized by domestic and foreign issuers that meet specified requirements. Rule 3a-5(b)(1) defines the term "finance subsidiary" specifically as a corporation. Notwithstanding the specific reference to corporations in the rule, the Commission's staff has granted no-action advice with respect to finance subsidiaries organized as limited liability companies (*see, e.g., Andrews & Kurth, LLP (Apr. 5, 1994)*) and business trusts (*see, e.g., Merrill Lynch & Co. (May 25, 1995)*).

While these expressions of the views of the Commission's staff are helpful, a formal amendment to the rule is needed for several reasons. First, staff views that are expressed in no-action letters are not binding on the Commission. Second, the staff from time to time changes its views and these changes may or may not be publicized. Finally, the staff has stated that it will no longer respond to inquiries in this area. (*Andrews & Kurth LLP (Apr. 5, 1994)*). For all of these reasons, it is necessary and appropriate for the Commission to establish by rule that limited liability companies and business trusts may be finance subsidiaries within the meaning of Rule 3a-5.

By way of background, I previously served as California's Commissioner of Corporations, Interim Savings & Loan Commissioner, and Deputy Secretary and General Counsel of the Business, Transportation & Housing Agency. I am a former member of the California Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions. I also previously served as Co-

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Ms. Elizabeth Murphy

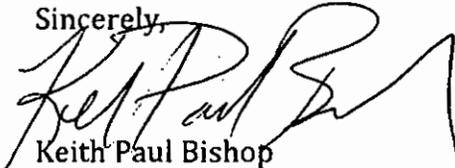
May 17, 2009

Page 2

Chairman of the Corporations Committee of the Business Law Section of the California State Bar and Chairman of the Business & Corporate Law Section of the Orange County Bar Association. I am currently an adjunct professor of law at Chapman University School of Law. Please note, however, I am writing solely in my individual capacity and not on behalf of any other person or entity.

If the Commission should have any questions regarding the foregoing, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith Paul Bishop". The signature is stylized and cursive, with a large, sweeping flourish at the end.

Keith Paul Bishop

# Public Reference Copy

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 21, 2009

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In the Matter of

**Bio-Matrix Scientific Group, Inc.**  
8885 Rehco Road  
San Diego, California 92121

**ORDER DECLARING REGISTRATION  
STATEMENT ABANDONED UNDER THE  
SECURITIES ACT OF 1933, AS AMENDED**

File No. 333-145216

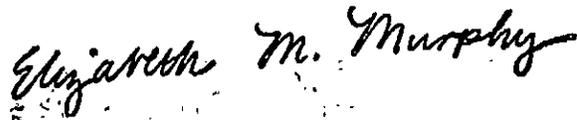
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Bio-Matrix Scientific Group, Inc. filed with the Commission a registration statement to register securities under Section 6(a) of the Securities Act of 1933. The registration statement has been on file for more than nine months and has not yet become effective.

Bio-Matrix Scientific Group, Inc. has failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

In view of the foregoing, it is ORDERED that the registration statement be declared abandoned on May 21, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth Murphy  
Secretary

**PUBLIC REFERENCE COPY**

# Public Reference Copy

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 20, 2009

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In the Matter of

**Pet Ecology Brands, Inc.**  
17250 Dallas Parkway  
Suite 125  
Dallas, TX 75248

**ORDER DECLARING REGISTRATION  
STATEMENT ABANDONED UNDER THE  
SECURITIES ACT OF 1933, AS AMENDED**

File No.

**333-148715**

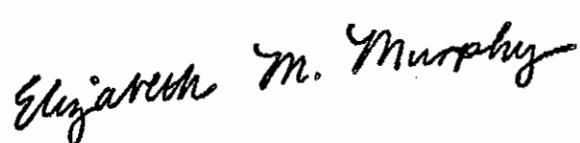
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Pet Ecology Brands, Inc. filed with the Commission a registration statement to register securities under Section 6(a) of the Securities Act of 1933. The registration statement has been on file for more than nine months and has not yet become effective.

Pet Ecology Brands, Inc. has failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

In view of the foregoing, it is ORDERED that the registration statement be declared abandoned on May 20, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth Murphy  
Secretary

**PUBLIC REFERENCE COPY**

# Public Reference Copy

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

May 20, 2009

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In the Matter of

**North American Royalty Corp.**  
4514 Cole Avenue  
Suite 600  
Dallas, Texas 75205

**PUBLIC REFERENCE COPY**

**ORDER DECLARING REGISTRATION  
STATEMENT ABANDONED UNDER THE  
SECURITIES ACT OF 1933, AS AMENDED**

File No.

**333-149266**

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North American Royalty Corp. filed with the Commission a registration statement to register securities under Section 6(a) of the Securities Act of 1933. The registration statement has been on file for more than nine months and has not yet become effective.

North American Royalty Corp. has failed to respond to notice under Rule 479 that the registration statement would be declared abandoned unless it was timely amended or withdrawn;

In view of the foregoing, it is ORDERED that the registration statement be declared abandoned on May 20, 2009.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.



Elizabeth Murphy  
Secretary



UNITED STATES  
**SECURITIES AND EXCHANGE COMMISSION**  
100 F Street, N.E.  
Washington, D.C. 20549

OFFICE OF  
THE SECRETARY

May 20, 2009

Mr. James McRitchie  
Publisher  
Corporate Governance, CorpGov.net  
9295 Yorkship Court  
Elk Grove, CA 95758

**PUBLIC REFERENCE COPY**

Re: Rulemaking Petition File No. 4-583

Dear Mr. McRitchie:

This letter acknowledges receipt by this office on May 18, 2009, of your rulemaking petition dated May 15, 2009, requesting the Commission to amend Rule 14a-4(b)(1) under the Securities Exchange Act of 1934 to prohibit conferring discretionary authority to issuers with respect to non-votes on the voter information form or proxy.

The petition has been assigned the above-noted file number and has been referred to the appropriate division of the Commission. This office will notify you of any pertinent action taken by the Commission.

Sincerely,

Elizabeth M. Murphy  
Secretary

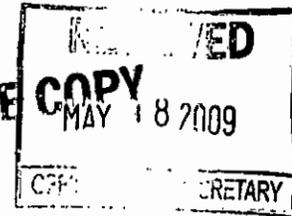
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Enhancing the Return on Capital  
Through Increased Accountability

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.; Room 10900  
Washington, D.C. 20549

PUBLIC REFERENCE COPY



4-583

May 15, 2009

Dear Ms. Murphy:

This is a petition to request that the Commission amend Rule 14a-4(b)(1) to prohibit conferring discretionary authority to issuers with respect to non-votes on the voter information form or proxy.

**Amend Rule 14a-4(b)(1) as follows:**

Means shall be provided in the voter information form and form of proxy whereby the person solicited is afforded an opportunity to specify by boxes a choice between approval or disapproval of, or abstention with respect to each separate matter referred to therein as intended to be acted upon, other than elections to office. Neither a voter information form nor A proxy may confer discretionary authority with respect to matters as to which a choice is not specified by the beneficial owner or security holder, provided that the form of proxy states in bold-face type how it is intended to vote the shares represented by the proxy in each such case. When votes are cast and fields are left blank, the beneficial owner or security holder shall be deemed to have abstained on those matters.

Furthermore, when votes are cast using an electronic platform a subsequent screen before final submission must warn the security holder in large-font bold-face red type that each field left blank will be treated as an abstention, and that no vote will be cast on their behalf regarding those matters.

**Background**

In discussions with a representative of Broadridge Financial Solutions (Broadridge), which process most proxies, it appears the current format used by their ProxyVote platform was developed many years ago before Broadridge took over this portion of their business. At that time banks and brokers typically voted discretionary proxies in lockstep with management, whereas today many vote in proportion to the votes of their clients. ProxyVote has not kept up with these changes, since the current system continues to replace all blank votes with votes as recommended by soliciting committees.

Additionally, it can be argued the format used by ProxyVote falls short of full compliance with SEC regulations with regard to notifying the voter being solicited

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as to how blank votes are counted. However, even if the regulations are strictly followed, shareowners would still be disenfranchised, since the current rules confer discretionary authority to change blank votes.

When a retail shareowner using Broadridge's [proxyvote.com](http://proxyvote.com) platform votes for or against at least one item on a proxy but fails to vote on other items, each item they fail to vote is cast in favor of the company's recommended position.

So, for example, I vote to "abstain" on ratification of the auditors but leave all other fields on the proxy blank. Then I press, "Submit." The next screen tells me I am voting to abstain on ratification of the auditors and it then shows me voting *with management* on election of directors and on every other issue. Looking closely, I see a very small asterisk next to each of these votes. Searching the page, I see this statement in very small type: "\*No vote entered. Your vote will be cast as recommended by the soliciting committee."

Even though current regulations confer discretionary authority to change blank votes, it appears open to interpretation that Broadridge's ProxyVote system may not fully comply with SEC, [Rule 14a-4\(b\)\(1\)](#). That section requires that when the security holder does not specify a choice, a proxy may confer discretionary authority "provided that the form of proxy states in **bold-face type** how it is intended to vote the shares represented by the proxy in **each such case**." (my emphasis)

Instead of highlighting each ignored item in bold as now being voted per management or the soliciting committee, ProxyVote places an asterisk in small type next to the item. Then, it uses a single note (\*No vote entered. Your vote will be cast as recommended by the soliciting committee.) in small type and, again, this single note is not in bold as appears to be required. This format appears to fall short of both the provisions and spirit of the rule. Instead of boldly highlighting the changed vote for each issue (counting directors as one issue) to call it to the voter's attention, the asterisks and small single note make it very likely that the voter will miss the changes being made.

According to a Broadridge representative:

Beneficial owners who use proxyvote.com are communicating voting instructions to their bank/broker—they are not voting a proxy. SEC Rule 14a-4(b)(1) pertains to "forms of proxy", not voting instructions. The requirement about displaying language in bold-face pertains to a "form of proxy, not a voting instruction. The voting information form (vif) doesn't comply with rules regulating the "form of proxy" because the vif is not a proxy.

Substantively, proxyvote.com discloses to users the effect of not indicating

a selection on agenda items, and then shows them how it will be submitted.

Broadridge says that shareowners using ProxyVote are communicating "voting instructions" to their bank/broker. They are not voting a proxy. Since SEC Rule 14a-4(b)(1) pertains to "forms of proxy," not the "voting instruction form," there is no violation, according to Broadridge.

However, subdivision (1) refers to the "person solicited" and the need to afford them opportunity to specify their choices. The person being solicited is the beneficial shareowner. Therefore, unless the subdivision applies both to a voting instruction and a proxy, the requirements to indicate with bold-face type how each field left blank will be voted loses meaning.

### **Enforcement**

While the Commission considers this rulemaking petition, we request the Division of Enforcement take immediate action to ensure compliance with existing Rule 14a-4(b)(1). If the Commission agrees with Broadridge's interpretation of the current law, we hope the Commission will help convince bankers, brokers and Broadridge to voluntarily modify their system so that retail shareowners are informed of changed nonvotes using red bold-face type for each instance. Shareowners would then at least be in a position to make more informed decisions. We would hope this would be an interim measure until the suggested rulemaking is promulgated and discretion is revoked.

### **Reasons for requesting Amendments**

Just as the NYSE has proposed changes to Rule 452 to better secure the rights of shareowners, we are proposing this rule amendment for much the same reason. The NYSE recognized that election of directors is not a "non-routine" matter and that discretionary authority should not be deferred to an investor's broker. The SEC appears poised to approve those changes. However, without changes similar to those we suggest, many votes will continue to be deferred to brokers/banks and ultimately to management and boards because of the discretionary authority granted through the provisions of Rule 14a-4(b)(1).

We believe that when a shareowner casts a blank vote, it should be counted as cast. The integrity of the proxy voting system demands it. Items left blank should be counted as abstentions. Those voting electronically should be warned of each skipped item. Non-votes, like more clearly indicated votes, should not be changed to reflect the voting preferences or recommendations of brokers, bankers, management, board or the soliciting committee, since these parties may have interests not fully aligned with those of shareowners. The same principle

applies to all items on the proxy, including votes for directors, company and shareowner proposals.

When we vote in civic elections, a governing body doesn't fill in our non-votes. If we have not formed an opinion, sometimes we defer to what we hope are more informed voters. That does not mean we want someone to step in and cast our vote for us. We simply trust in the intelligence of others who do have the right to vote and who exercise that right. Why should our votes in corporate elections be different in this regard?

Biased counting is having a real impact. Unfortunately, it will not end when broker voting ends. Broker voting has already been eliminated on shareowner resolutions. Yet, the impact of granting discretionary authority to vote non-votes continues to tip the voting scales. For example, Ray T. Chevedden's proposal to allow 10% shareowners to call a special meeting lost by 0.3% of the vote recently at Bank of America. Without the biased count, it may have won.

The integrity of the voting system is critical. The SEC's current rule sends the wrong message to shareowners. It says, "don't worry about voting. If you leave an item blank, we will allow that vote to be assigned to someone else," regardless of possible conflicting or nonaligned interests. The current rule does not reinforce a robust market or vigilance by shareowners. It does not send a message that voting is important. Shareowners then become *shareholders*, without responsibilities, much like gamblers with betting slips. The Commission should encourage responsible *ownership*, not gambling.

The SEC should regulate the power relationships between actors in the market, not tip the balance to one party when the other fails to act. Instead, the SEC should remind each party of the importance of their respective roles. The current Rule 14a-4(b)(1) misaligns interests by yielding disproportionate control to brokers, bankers, managers and boards, instead of educating and engaging shareowners. Please adopt the requested amendments.

Please direct questions concerning this petition to James McRitchie, who is authorized to speak for the co-filers on the substance of this petition.

Sincerely,

James McRitchie, Publisher  
Corporate Governance, CorpGov.net  
9295 Yorkship Court  
Elk Grove, CA 95758  
916.869.2402

The following have agreed to be listed as co-filers:

John Chevedden  
Rule 14a-8 proposal proponent since 1996

Glyn Holton, Executive Director  
United States Proxy Exchange

Mark Latham  
VoterMedia.org

Eric M. Jackson, Ph.D.  
Managing Member  
Ironfire Capital LLC

James P. Hawley, Ph.D.  
Professor and Co-Director  
Elfenworks Center for the Study of Fiduciary Capitalism  
Saint Mary's College of California

Andrew Williams  
Professor and Co-Director  
Elfenworks Center for the Study of Fiduciary Capitalism  
Saint Mary's College of California

Andrew Eggers, President  
ProxyDemocracy.org

Bradley Coleman  
ProxyDemocracy.org

Erez Maharshak  
ProxyDemocracy.org

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OPEN MEETING OF THE SECURITIES AND EXCHANGE COMMISSION

Wednesday, April 8, 2009 – 10:17 a.m.

COMMISSIONERS PRESENT:

Mary L. Schapiro, Chairman  
Kathleen L. Casey  
Elisse Walter  
Luis A. Aguilar  
Troy A. Paredes

---

Mr. Sirri, Director, Ms. Tao, Ms. Swindler and Mr. Williams, of the Division of Trading and Markets; Mr. Overdahl, Chief Economist, and Mr. McCormick, of the Office Economic Analysis; and Mr. Becker, General Counsel, and Ms. Mitchell, of the Office of General Counsel, were present.

Following discussion, the Commission approved (5-0) the issuance of a release proposing rules restricting short sales under certain circumstances. [Rules 200(g) and 201 of Regulation SHO under the Securities Exchange Act of 1934].

(See Release 34-59748, dated April 10, 2009.)

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(The meeting began with audio webcast only; video and audio became available on webcast at 10:27 a.m.)

The meeting was adjourned at 11:33 a.m.

---

Elizabeth M. Murphy  
Secretary

By: Linda Cullen  
Program Information Specialist

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OFFICE OF  
THE SECRETARY

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

Open Meeting Agenda

Wednesday, April 8, 2009

Item 1: Amendments to Regulation SHO  
Office: Division of Trading and Markets  
Staff: James Brigagliano, Josephine Tao, Victoria Crane, Joan Collopy,  
Christina Adams, Matthew Sparkes

\* \* \*

Item 1: The Commission will consider whether to propose rules restricting short sales under certain circumstances.

For further information, please contact Josephine Tao, Victoria Crane, Christina Adams, or Matthew Sparkes, Division of Trading and Markets, at (202) 551-5720.

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UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

April 27, 2009

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In the Matter of

Lions Gate Entertainment Corp.  
2700 Colorado Avenue, Suite 200  
Santa Monica, California 90404

**ORDER DECLARING THE APPLICATION  
FOR QUALIFICATION OF THE TRUST  
INDENTURE EFFECTIVE PURSUANT TO  
SECTION 307(c) OF THE TRUST INDENTURE  
ACT OF 1939, AS AMENDED**

File No. 22-28888

---

Lions Gate Entertainment Corp. filed with the Commission an application on Form T-3 and a Form T-1 for the qualification of the indenture identified in those documents, pursuant to Section 307(a) of the Trust Indenture Act of 1939, and the rules thereunder, and has requested acceleration of the effective date of the qualification of the indenture, pursuant to Section 307(c) of the Act.

It is ORDERED that the application shall become effective and the indenture qualified at 12:00 PM on April 27, 2009.

Attention is directed to the provisions of Section 324 of the Trust Indenture Act of 1939, as amended, which make unlawful certain representations with respect to the effect of qualification under the Act.

For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth Murphy  
Secretary

**PUBLIC REFERENCE COPY**

**Public Reference Copy**

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

April 27, 2009

---

In the Matter of

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Santa Monica, California 90404

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FOR QUALIFICATION OF THE TRUST  
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ACT OF 1939, AS AMENDED**

File No. 22-28888-01

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For the Commission, by the Division of Corporation Finance, pursuant to delegated authority.

*Elizabeth M. Murphy*

Elizabeth Murphy  
Secretary

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OFFICE OF  
THE SECRETARY

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

March 31, 2009

Keith Paul Bishop, Esq.  
23311 Via Dorado  
Trabuco Canyon, CA 92679

Re: Rulemaking Petition File No. 4-580

Dear Mr. Bishop:

This letter acknowledges receipt by this office on March 30, 2009, of your rulemaking petition dated March 22, 2009, requesting the Commission to amend the reference to Tier 1 of the Philadelphia Stock Exchange, Inc. in Rule 146(b)(1)(ii) under the Securities Act of 1933.

The petition has been assigned the above-noted file number and has been referred to the appropriate division of the Commission. This office will notify you of any pertinent action taken by the Commission.

Sincerely,

Elizabeth M. Murphy  
Secretary

Public Reference Copy

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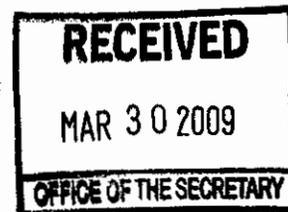
Keith Paul Bishop

(949) 290-8829  
Kbishop@post.harvard.edu

March 22, 2009

Elizabeth M. Murphy  
Secretary  
U.S. Securities & Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**PUBLIC REFERENCE COPY**



Petition for Rulemaking with Respect to Rule 146(b)

4-580

Dear Ms. Murphy

Pursuant to Securities and Exchange Commission ("Commission") Rule of Practice 192(a), I hereby petition the Commission to amend Rule 146 (17 C.F.R. §230.146) to amend the reference to Tier 1 of the Philadelphia Stock Exchange, Inc. in paragraph (b)(ii). The Commission included Tier 1 of the Philadelphia Stock Exchange, Inc. when it adopted Rule 146(b) in 1998. *See* Commission Release No. 33-7494, 34-39542. On July 24, 2008, by The NASDAQ OMX Group, Inc. acquired the Philadelphia Stock Exchange, Inc. *See* Securities Exchange Act Release Nos. 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (SR-Phlx-2008-31); and 58183 (July 17, 2008), 73 FR 42850 (July 23, 2008) (SR-NASDAQ-2008-035). Effective August 18, 2008, the name of the Philadelphia Stock Exchange, Inc. was changed to "NASDAQ OMX PHLX, Inc." *See* Commission Release No. 34-58380. Effective October 24, 2008, the NASDAQ OMX PHLX, Inc. terminated its equity trading platform. As a result of these changes, Rule 146(b) should be amended at a minimum to reflect the current name of the former Philadelphia Stock Exchange, Inc., to wit "NASDAQ OMX PHLX, Inc." Updating the name of the exchange in Rule 146 would limit confusion about the status of the NASDAQ OMX PHLX, Inc.

Before making this change, however, I urge the Commission to review the current standards of the NASDAQ OMX PHLX, Inc. with respect to the listing and trading of securities. In fact, the Commission when it adopted Rule 146(b) noted that "Congress intended for the Commission to monitor the listing requirements of the regional exchanges, consistent with its supervisory authority under the Securities Exchange Act of 1934 ("Exchange Act"), to ensure the continued integrity of these markets and the protection of investors." Commission Release No. 33-7494, 34-39542.

By way of background, I previously served as California's Commissioner of Corporations, Interim Savings & Loan Commissioner, and Deputy Secretary and General Counsel of the Business, Transportation & Housing Agency. I am a former member of the California Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions. I also previously served as Co-Chairman of the Corporations Committee of the Business Law Section of the California State Bar and

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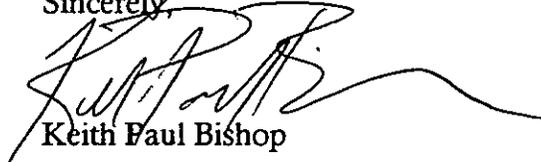
Ms. Elizabeth M. Murphy

Page 2

Chairman of the Business & Corporate Law Section of the Orange County Bar Association. Please note, however, I am writing solely in my individual capacity and not on behalf of any other person or entity.

If the Commission should have any questions regarding the foregoing, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith Paul Bishop", with a long horizontal flourish extending to the right.

Keith Paul Bishop

OPEN MEETING OF THE SECURITIES AND EXCHANGE COMMISSION

Wednesday, January 7, 2009 – 10:15 a.m.

COMMISSIONERS PRESENT:

Christopher Cox, Chairman  
Kathleen L. Casey  
Luis A. Aguilar  
Troy A. Paredes

---

The Commission heard oral argument on an appeal by Gary M. Kornman ("Kornman") from an initial decision of an administrative law judge.

The law judge found that Kornman had been convicted of providing a false statement to the Commission in violation of 18 U.S.C. § 1001. Based on his conviction and the conduct underlying it, the law judge determined that Kornman should be barred from association with a broker, dealer, or investment adviser.

The argument was concluded at 10:54 a.m., and the Commission took the matter under advisement.

---

The Commission heard oral argument on an appeal by Nature's Sunshine Products, Inc. ("Nature's Sunshine") from an initial decision of an administrative law judge.

The law judge found that Nature's Sunshine had violated Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13 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 a registered independent public accounting firm since filing its Form 10-Q for the quarter ended June 30, 2005. The law judge revoked the registration of Nature Sunshine's common stock pursuant to Section 12(j) of the Securities Exchange Act of 1934.

The argument was concluded at 11:40 a.m., and the Commission took the matter under advisement.

---

The meeting was adjourned at 11:40 a.m.

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Florence E. Harmon  
Deputy Secretary

By: Linda Cullen  
Program Information Specialist

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OFFICE OF  
THE SECRETARY

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

Open Meeting Agenda

Wednesday, January 7, 2009

Item 1: Gary M. Kornman

**PUBLIC REFERENCE COPY**

Office: Office of the General Counsel

Staff: Joan L. Loizeaux, Joan A. McCarthy, Jerome P. Sisul

Item 2: Nature's Sunshine Products, Inc.

Office: Office of the General Counsel

Staff: Joan L. Loizeaux, Joan A. McCarthy, Bari S. Podell

\* \* \*

Item 1: The Commission will hear oral argument on an appeal by Gary M. Kornman from an initial decision of an administrative law judge barring him from associating with any broker, dealer, or investment adviser. The law judge based her decision to impose associational bars on Kornman's having been criminally convicted of making a false statement to the Commission in violation of 18 U.S.C. § 1001. Issues likely to be considered include whether it is in the public interest to bar Kornman from association with any broker, dealer, or investment adviser.

Item 2: The Commission will hear oral argument on an appeal by Nature's Sunshine Products, Inc. ("Nature's Sunshine" or the "Company") from an initial decision of an administrative law judge. The law judge found that Nature's Sunshine had violated Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13 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 a registered independent public accounting firm since filing its Form 10-Q for the quarter ended June 30, 2005. Issues likely to be considered include whether it is necessary or appropriate for the protection of investors to revoke the registration of Nature's Sunshine's common stock.

For further information, please contact the Office of the Secretary at (202) 551-5400.

**Public Reference Copy**



UNITED STATES  
**SECURITIES AND EXCHANGE COMMISSION**  
100 F Street, N.E.  
Washington, D.C. 20549

OFFICE OF  
THE SECRETARY

March 3, 2009

Mr. Lawrence J. Goldstein  
Santa Monica Partners, L. P.  
1865 Palmer Avenue  
Larchmont, NY 20538

Re: Supplement to Rulemaking Petition File No. 4-483

Dear Mr. Goldstein:

This letter acknowledges receipt by this office on February 26, 2009 of your February 25, 2009 supplement to your rulemaking petition (by e-mail).

The supplement has been linked to the above-referenced file number. This office will notify you of any pertinent action taken by the Commission.

Sincerely,

A handwritten signature in cursive script that reads "Elizabeth M. Murphy".

Elizabeth M. Murphy  
Secretary

**PUBLIC REFERENCE COPY**

**Public Reference**

SANTA MONICA PARTNERS, L.P.

Founded 1982

1865 Palmer Avenue  
Larchmont, New York 10538

Tel. 914.833.0875 Fax 914.833.1068

[ljg@smplp.com](mailto:ljg@smplp.com) [www.smplp.com](http://www.smplp.com)

February 25, 2009

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.; Room 10900  
Washington, D.C. 20549

**PUBLIC REFERENCE COPY**

Dear Ms. Murphy:

I write to follow up my letter to you yesterday, February 24, 2009, in order to provide additional information, facts and perspective with respect to the issues created by the SEC definition of "shareholder" being "shareholder of record" and not "beneficial shareholder."

I am not a Johnny come lately to this issue and the problems it has caused investors. *Nineteen* years have now elapsed since I first brought this very same matter to the attention of the Commission.

I brought the matter and its negative impact to the attention of the then Chairman of the SEC, Richard Breedon, in a letter I wrote on March 28, 1990. I waited over two months without any response. A type of reaction from the SEC which we unfortunately have seen continue as the SEC norm with the previous administration – need I say anything more than "Madoff" or "Harry Markopolos?" -- and the reason we now bring this issue up once again, and with great hope for a change, given the new SEC Chairman, new commissioners and new staff.

After a while I realized I was getting bed bug treatment responses and I brought all of the above, in the spring of 1990, *nearly nineteen years ago*, to the attention of my Congresswoman Nita Lowey who then called the matter to the attention of then Chairman of the Committee on Energy and Commerce, John D. Dingell. Chairman Dingell in turn brought the matter to the attention of the SEC Chairman Richard Breedon, who in turn I presume handed the issue and all my correspondence over to E.T. That is to SEC Associate Director Ms. Mary E.T. Beech.

In May 1990 I had also started writing to Ms. Mary E. T. Beech. Today long after the still popular 1982 Spielberg hit film *E.T. the Extra-Terrestrial* "E.T. I am inclined to ask the famous question posed in that film, "E T where are you?" (Smile) since her last correspondence to me was June 15, 1990 when she wrote "*your suggestions will be given consideration by this Division and will not be forgotten as we move forward with our responsibility to ensure full and adequate disclosure pursuant to the federal securities laws.*"

Please see the attached scanned "Letters to and from SEC 1990 PDF" – there was no computer, no email and no website inexistence to post on back in 1990 -- with key correspondence of Chairman Breedon, Chairman Dingell, Mary E. T. Beech and myself.

I am a patient man but have finally concluded *after waiting nearly twenty years*, I was in fact "forgotten" and the Commission has not felt any "responsibility to ensure full and adequate disclosure" to the fullest possible extent which means recognizing that companies having *more than 300 beneficial shareholders* have been allowed to go dark because a stockholder is defined as one of record and not one which is beneficial. But hope springs eternal in me. And so I have decided to write to the Commission once again.

Along with many other investors, we have been victimized by a very troubling trend which began in the nineteen eighties, accelerated in the nineteen nineties and in the twenty-first century spurred on by the July 30, 2002 passages of Sarbanes Oxley (SOX) has progressed even further to the detriment of public shareholders. Please see our November 1, 2002 letter to Mr. Jonathan G. Katz, SEC at <http://sec.gov/rules/proposed/s74002/ljgoldstein1.txt>.

### The Problem Persists and Worsens

As I mentioned yesterday, I am hopeful that today you will take up the same issue about the definition of "shareholder" in order to remedy, indeed to protect shareholders from the damage that companies going dark cause them. Today, after well over twenty years of no change, shareholders in all too many companies have been and continue to be disenfranchised as many "darkened companies" no longer issue proxies or hold annual meetings and the owners no longer receive quarterly or even annual reports. Moreover, proxies are no longer issued nor is such basic information such as the names of the management and the board of directors and their shareholdings and compensation revealed. Shareholders are also denied all the other usual and normal information they received about the companies in the past such as media interviews, conference calls or even mere financial press releases.

We repeatedly have warned the SEC of all the damage that would result to shareholders as more and more companies "go dark" and that would and indeed has resulted merely from the use of computers and the advent of digital record keeping which was going to sweep through the investment community. Digitalization meant brokerage firms would no longer hold stock certificates and would therefore no longer hold securities in any but one main nominee name thereby reducing the number of *beneficial holders* to a far smaller number of *record holders*. The significance of this of course was as described above that the SEC defined *shareholder* as a record holder and not a beneficial holder and so by SEC definition companies could claim far fewer *shareholders* despite no change in the actual number of real owners i.e. the beneficial shareholders.

Today shareholders have found there is additional cost if they want to become shareholders of record. Brokers and DTC now make material charges if a client (beneficial owner) requests a stock certificate. Some brokers have even erroneously told me it is no longer possible to obtain stock certificates.

Let's see how it works. If a company has 500 shareholders with stock held at a handful of -- say 25 brokerage firms -- and 10 shareholders with certificates in their names, they are relieved from reporting requirements as under the regulations there are only 35 holders of record. Commencing January 1, 2009 the Depository Trust Company and its broker members have made it even more difficult for shareholders to register stock in their own names. A person buying stock and having it put into his/her name is almost an extinct practice at this point. Some firms now charge \$100 (I was just informed that Goldman Sachs has a \$200 charge) to register stock assuming they will even do it at all. Therefore, hundreds, and perhaps thousands, of public companies have escaped SEC regulation and "gone private", the so called "gone dark", even though they have many hundreds of shareholders and in fact have more than 300 beneficial shareholders -- the level below which they are permitted to de-register from the SEC -- strictly due to the disenfranchising enabling technicality of counting a "shareholder" as one which is "of record" and excluding all the "beneficial shareholders" who are the corporations owners.

My suggestion nineteen years ago was to remedy the damage real and potential with the stroke of the pen by merely substituting "beneficial" for "record" in defining "shareholder." I urged the SEC to merely make a one word change in its definition. The SEC has for decades now refused and we have since seen and suffered all the damage that has occurred in the last twenty years and is ongoing as we speak. I again urge you to do the right thing and make the appropriate change now today. Change record holders to beneficial holder or direct nominees to look all the way through brokers and others for whom they hold stocks and bonds too, to the beneficial owners.

Thank you very much for your prompt attention to this very important matter.

By all means please call me please call me to discuss further or if you have any questions. I will very much appreciate hearing from you

Warmly,



Lawrence J. Goldstein

L.J. GOLDSTEIN & COMPANY  
INCORPORATED

230 PARK AVENUE  
NEW YORK, NY 10169

212-681-0732

March 28, 1990

The Honorable Richard Breeden  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Judiciary Plaza  
Washington, D.C. 20549

Dear Sir:

I believe the time has finally arrived to recommend to the Congress a small change be made in the language of Section 12(g) of the Securities and Exchange Act of 1934.

Unless the change suggested herein is made, the number of major U. S. corporations terminating registration of their securities will accelerate.

I am enclosing a fairly complete file of correspondence on the subject of "who is a shareholder".

Under the Securities and Exchange Act of 1934, Section 12(g), a public company may terminate its registration if it certifies that the number of its shareholders has fallen below 300.

The Act defines a stockholder as a "holder of record".

With the aid of computers the entire investment community, including banks and brokers, has made a concerted effort, encouraged by the SEC itself, to reduce paperwork. One key result has been that the use of a small number of nominees to replace substantial numbers of beneficial owners as holders of record has become widespread.

The entire stock brokerage industry, for example, essentially uses a single nominee as the holder of record for all of the industry's clients who are the real, beneficial owners of securities. (The most frequently used nominee by that community is CEDE & Company, the Central Depository.)

The Honorable Richard Breeden  
March 28, 1990  
page two

Consequently, while a company could have hundreds or thousands of shareholders, they only know of one record holder, in this instance, CEDE.

Once a company certifies (on a one page form) that it has fallen below 300 record holders, that company may stop filing quarterly (10-Q) and annual (10-K) reports, and may cease soliciting proxies. In short, they may stop providing shareholders, the public and the government with important information.

I have had many experiences where companies with 500 or 600 beneficial shareholders suddenly are able to de-register by claiming they had fewer than 300 record shareholders. Even though I have been able to provide documentary evidence to both the company and the SEC that the company really had in excess of 300 beneficial holders, the company is able to say, "sorry, record holder is what counts; no information for you any more".

As the enclosed article, "Now you See the Junk, Now you Don't" on page 40 of Business Week, April 2, 1990, suggests, it now looks like a much larger ox is being gored than might be imagined. A lot of well-known companies apparently have just begun to use this "loophole" rule with regard to who is a holder. For them, a record holder means everything while beneficial owner means nothing.

I can see no reason for the government and security holders to be cut off from information, and investors to be disenfranchised simply because the use of nominees to reduce paperwork, etc., has been encouraged by the Commission and become the norm in the 1980's and 1990's.

I believe that the Securities and Exchange Act of 1934, Section 12(g), should be amended to require companies to continue to be registered with the SEC if they have 300 or more beneficial holders as opposed to record holders.

Incidentally, the rule is really a peculiar one because, as I understand it, the way it now reads, while a company may de-register if it falls below 300 holders, it isn't required to re-register until it has more than 500 holders. As a result, while "everyone" thinks that only companies with fewer than 300 holders don't have to report, there are numerous publicly traded companies with as many as 499 holders that also are not reporting companies.

The Honorable Richard Breeden  
March 28, 1990  
page three

Every company that has public shareholders and securities traded in the stock market, even if "stock market" means over-the-counter in the Pink Sheets, even if the shares are closely held and inactively traded, should have to provide 10-Q's and 10-K's and meet proxy disclosure requirements as promulgated by the SEC.

We pride ourselves in this country on having the best securities markets and the best flow of information in the world. This loophole in Section 12(g) more and more is being used to eliminate the SEC standards of full disclosure and negatively impact the high regard which the U.S. markets enjoy the world over.

I originally started to bring this issue to the attention of the Securities and Exchange Commission, New York and American Stock Exchanges, National Association of Securities Dealers and the Securities Industry Association, and others in the fall of 1988.

The spark that ignited my efforts was the decision of Gray Communications Systems, Inc. to de-register in October 1988. They claimed that they fell well under 300 holders. I provided them with documentary evidence that they had well in excess of 300 stockholders. Of course, the operative word for them was record holder while for me it was beneficial holder.

Gray Communications, incidentally, owns newspapers and television stations. I found it ironic that such an enterprise which is obviously interested in reporting information to the public, decided to cut off the information flow about itself. In this instance, it affected all shareholders negatively because not only did the information flow fall dramatically, but the market for the company's shares has virtually disappeared. None of this would have happened if the SEC Rule had been based on beneficial holders.

I suspect if this change (from "holder of record" to "beneficial owner") was made, some of the companies in the Business Week article would find that they have more than 300 security holders.

My point is that there is a much larger constituency that now should have some concern about an antiquated rule, and this includes Congress which has concerned itself with the whole junk bond phenomenon.

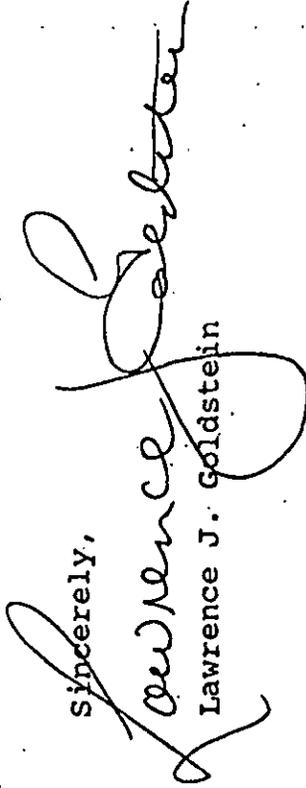
The Honorable Richard Breeden  
March 28, 1990  
page four

"Record holder" was almost synonymous with "security holder" in the 1930's when the Act was written and it needs to be changed to "beneficial owner" in the automated 1990's. There is no reason not to make this change since the spirit of the SEC Rule, if not the Rule itself, is being violated, to the detriment of the government, the public, investors and the securities markets.

I believe any problems that might be associated with requiring companies to identify all beneficial holders can be simply and easily overcome.

I hope you will give this matter serious and prompt attention. I would appreciate your letting me know what you will do.

Sincerely,



Lawrence J. Goldstein

LJG:jbn  
Encl.

JOHN D. DINGELL, MICHIGAN (CHAIRMAN)

JAMES H. SCHEUER NEW YORK  
HENRY A. WAXMAN CALIFORNIA  
PHILIP R. SHARP INDIANA  
EDWARD J. MARKEY MASSACHUSETTS  
THOMAS A. LUKEN OHIO  
BOB WAIGREN PENNSYLVANIA  
AL SWIFT WASHINGTON  
CARDISS COLLINS ILLINOIS  
MIKE SYNAR OKLAHOMA  
W. J. BILLY TAUBIN LOUISIANA  
RON WYDEN OREGON  
RALPH M. HALL TEXAS  
DENNIS E. ECKART OHIO  
BILL RICHARDSON NEW MEXICO  
JIM SLATTERY KANSAS  
GERRY SIKORSKI MINNESOTA  
JOHN BRYANT TEXAS  
JIM BATES CALIFORNIA  
RICA BOUCHER VIRGINIA  
JIM COOPER TENNESSEE  
TERRY L. BRUCE ILLINOIS  
J. ROY ROWLAND GEORGIA  
THOMAS J. MANTON NEW YORK  
EDOLPHUS TOWNS NEW YORK  
C. THOMAS McMILLEN MARYLAND

NORMAN F. ENI NEW YORK  
EDWARD R. MADIGAN ILLINOIS  
CARLOS J. MOORHEAD CALIFORNIA  
MATTHEW J. RINALDO NEW JERSEY  
WILLIAM E. DANNENBERGER CALIFORNIA  
BOB WHITAKER KANSAS  
THOMAS J. TAUBE IOWA  
DON RITTER PENNSYLVANIA  
THOMAS J. BLILEY JR. VIRGINIA  
JACK FIELDS TEXAS  
MICHAEL G. OXLEY OHIO  
HOWARD C. NIELSON UTAH  
MICHAEL BILIRAKIS FLORIDA  
DAN SCHAEFER COLORADO  
JOE BARTON TEXAS  
SONNY CALLAHAN ALABAMA  
ALEX McMILLAN NORTH CAROLINA

U.S. House of Representatives  
Committee on Energy and Commerce  
Room 2125, Rayburn House Office Building  
Washington, DC 20515

June 13, 1990

JOHN S. ORLANDO CHIEF OF STAFF  
JOHN M. CLOUGH JR. STAFF DIRECTOR

The Honorable Richard C. Breeden  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N. W.  
Washington, D. C. 20549

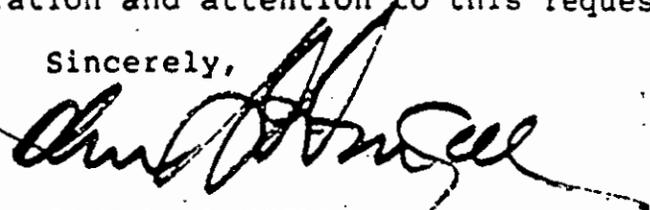
Dear Chairman Breeden:

This is with reference to the enclosed correspondence to Representative Lowey concerning the ability of highly leveraged companies to hide public disclosure of their debt by taking advantage of a loophole in the Securities Exchange Act of 1934.

Please have someone look into this inquiry and advise us of your findings by the close of business on Friday, July 27, 1990.

Thank you for your cooperation and attention to this request.

Sincerely,



JOHN D. DINGELL  
CHAIRMAN

Enclosure

cc: The Honorable Nita N. Lowey  
Subcommittee on Telecommunications and Finance

L.J. GOLDSTEIN & COMPANY

INCORPORATED

230 PARK AVENUE  
NEW YORK, NY 10169

212-661-0732

June 1, 1990

Mrs. Mary E.T. Beach  
Associate Director  
Securities and Exchange Commission  
Division of Corporation Finance  
Washington, D.C. 20549

Dear Mrs. Beach:

As you know, I have tried many times to reach you by telephone since receiving your letter of May 7th.

I know you did return one of my calls when I was out to lunch one day. I would like to speak with you.

The NASD, in administering the operation of the NASDAQ system, utilizes a "beneficial holder" standard for meeting criteria for inclusion in NASDAQ (see Part II, Section 1(5) of Schedule D of the NASD By-Laws).

Why can't the Securities and Exchange Commission move promptly to amend Section 12(g)(4) of the Securities and Exchange Act of 1934 by replacing the words "holders of record" with the words "beneficial holders", thereby modernizing the Rule and joining with the NASD which has already seen fit to do so?

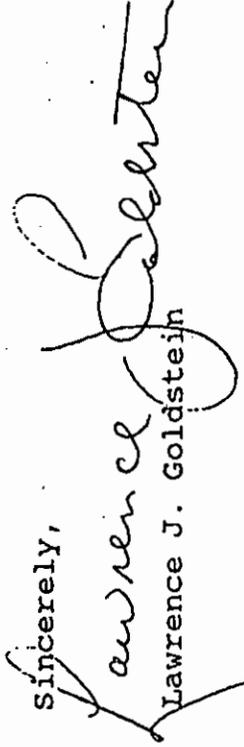
Please be assured that I appreciate your considering my suggestion. However, I think you can understand that I would like to have some sense of whether you are willing to put this on the front burner and deal with it sooner rather than later.

I would also like to point out to you that making the suggested change from "holder of record" to "beneficial holder" ties in very nicely with the Commission's approval of the OTC Bulletin Board Display Service which I understand is effective today on Levels II and III. It is paradoxical that in adopting the OTC Bulletin Board, the NASD, with the full support and approval of the Commission, has taken a step forward with regard to improving marketability for a very substantial number of stocks of companies which have ceased to be filers with the Commission. In many instances these companies were permitted to deregister because of the definition of shareholders.

Mrs. Mary E.T. Beach  
June 1, 1990  
page two

In effect, the Commission is now encouraging trading in securities for which there are no reporting requirements. Indeed there is no dissemination of information. This is a far cry from the "full disclosure" that the Commission normally requires of companies whose shares are permitted to trade in the United States.

Sincerely,

  
Lawrence J. Goldstein

LJG:jbn



DIVISION OF  
CORPORATION FINANCE

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

June 15, 1990

Mr. Lawrence J. Goldstein  
L.J. Goldstein & Company, Incorporated  
230 Park Avenue  
New York, New York 10169

Dear Mr. Goldstein:

Thank you for your letter of June 1, 1990, in which you reaffirm your desire that the Commission make certain legislative proposals to Congress regarding reporting requirements for public companies. Because we have had difficulty reaching each other by phone, I am responding by letter.

In your most recent letter, you state that you believe a paradox exists in that the Commission has recently approved a system implemented by the National Association of Securities Dealers which you assert improves the marketability of a substantial number of stocks issued by companies which have ceased to file reports with the Commission because they have been allowed to deregister pursuant to Section 12(g). As you know, the NASD's OTC Bulletin Board represents the automation of a system which has existed for many years and its implementation does not relieve issuers that list their securities through that medium of any obligation under the federal securities laws that existed previously. The same information still must be made available by market makers before a given security may be listed on the Bulletin Board, including information regarding Section 12(g) companies.

You also ask why the Commission cannot move promptly to modernize Section 12(g)(4) of the Securities Exchange Act of 1934 by replacing the words "holders of record" with the words "beneficial holders," thereby reflecting policies already implemented by the NASD in its By-Laws. As I indicated in response to your letter of March 28, 1990, your suggestions will be given consideration by this Division and will not be forgotten as we move forward with our responsibility to ensure full and adequate disclosure pursuant to the federal securities laws.

Thank you again for you communications.

Sincerely,

Mary E.T. Beach  
Associate Director

L.J. GOLDSTEIN & COMPANY  
INCORPORATED  
230 PARK AVENUE  
NEW YORK, NY 10169  

---

212-681-0732

June 25, 1990

Mrs. Mary E.T. Beach  
Associate Director  
Securities and Exchange Commission  
Division of Corporate Finance  
Washington, D.C. 20549

Dear Mrs. Beach:

Thank you for your letter of June 15, 1990 in which you responded to my letter of June 1, 1990.

I would like to clarify my point with regard to the OTC Bulletin Board.

Yes, it automates an existing system - "pink sheet trading". However, if you accept as true the assertion that marketability of a substantial number of stocks issued by companies which have ceased to file reports with the Commission has improved, (and this has been the case as there are numerous instances in which firm bids and offers have already replaced pink sheet "indications" and "workout" quotes, and spreads between bids and offers have also narrowed. It is my understanding that the volume of transactions has also picked up.) then you have the paradox which I described.

Large numbers of issuers who are not subject to Commission regulation, do not file 10-K's or 10-Q's, do not solicit proxies and provide little or no information whatever to shareholders, are now seeing an improved market for their securities.

I will be very glad to discuss specific situations with you if you are interested.

It seems to me that what we are witnessing is a Securities and Exchange Commission approved market system in which trading has been both facilitated and improved without issuers having a requirement to provide information to shareholders. While this may not have been the intent, it is nevertheless the real world effect.

Mrs. Mary E.T. Beach  
June 25, 1990  
page two

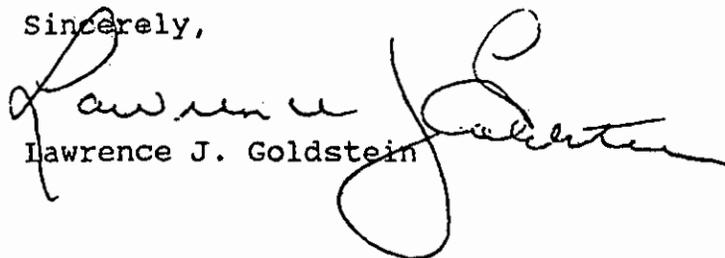
I had thought that the Commission required full disclosure from companies whose shares are permitted to trade in the United States. Was I wrong?

Also, I want you to know that I am pleased that you will see fit to give consideration to my suggestion to modernize Section 12(g)(4) of the Securities Exchange Act of 1934 by replacing the words "holders of record" with the words "beneficial holders".

I would like to know if there is anything I can do to assist you in this matter and when you will, as you say, "move forward"?

Thank you again for your prompt attention to these matters.

Sincerely,

  
Lawrence J. Goldstein

LJG:jbn  
Encl.



UNITED STATES  
**SECURITIES AND EXCHANGE COMMISSION**  
100 F Street, N.E.  
Washington, D.C. 20549

OFFICE OF  
THE SECRETARY

February 25, 2009

Mr. Lawrence J. Goldstein  
Santa Monica Partners, L. P.  
1865 Palmer Avenue  
Larchmont, NY 20538

**PUBLIC REFERENCE COPY**

Re: Rulemaking Petition File No. 4-483

Dear Mr. Goldstein:

This letter acknowledges receipt by this office on February 25, 2009 of your February 24, 2009 rulemaking petition (by e-mail). The petition asks the Commission to conduct rulemaking under Section 12(g)(5) of the Securities Exchange Act of 1934 to amend Rule 12g5-1 under the Exchange Act to include as "held of record" with respect to any particular equity security each account for a beneficial owner holding the security in "street name."

The rulemaking petition has been assigned the above-noted file number, which is the same file number given the petition filed by The Nelson Law Firm on Behalf of Nine Institutional Investors. This office will notify you of any pertinent action taken by the Commission.

Sincerely,

Elizabeth M. Murphy  
Secretary

**Public Reference Copy**

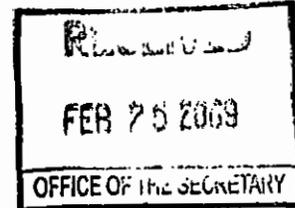
SANTA MONICA PARTNERS, L.P.  
Founded 1982

1865 Palmer Avenue  
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[ljgoldstein@bloomberg.net](mailto:ljgoldstein@bloomberg.net)

[www.smplp.com](http://www.smplp.com)



E-MAIL

February 24, 2009

4-483

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.; Room 10900  
Washington, D.C. 20549

**PUBLIC REFERENCE COPY**

Dear Ms. Murphy:

With an investment in Compass Knowledge Holdings, Inc. of nearly \$800,000 and some 540,000 shares, we own 3.4% the company's more than 16 million outstanding shares. However, we are not recognized as shareholders by the company. Moreover, we are but one of more than 200 beneficial shareholders holding over 4 1/2 million shares of the company who are *not counted* as shareholders by the company.

The reason for this is of course we and the other 200 plus *beneficial* shareholders are not *registered* shareholders. This is the case because our collective shares of stock are held by our respective stock brokerage firms each of which hold and register all of the shares in same single nominee name Cede, the nominee of the Depository Trust Company known as DTC. The latter is required to look through Cede but only to count the handful of brokerage firms holding stock as registered stockholders, but is neither required nor does it look through to the more than 200 of the brokers' separate client accounts, the beneficial holders, who actually own the millions of shares of Compass Knowledge Holdings stock.

By counting only the handful of brokerage firms as holders of record rather than the more than 200 separate client accounts owning millions of shares each of whom are beneficial holders, together with what probably are a couple of hundred beneficial stockholders holding stock certificates, who were therefore counted as holders of record, Compass Knowledge Holdings, Inc. several years ago was allowed to certify that it had fewer than 300 shareholders, according to the SEC definition of shareholder, i.e. *registered* shareholder, even though it had considerably more than 300 actual i.e. *beneficial* stockholder owners.

Accordingly, we as well as all the other more than 300 Compass Knowledge Holdings beneficial stockholders are completely in the dark as to the affairs of the company.

Compass has claimed it is a private company since it is no longer required to comply with SEC rules and regulations requiring full disclosure of what is normal and usual information to shareholders in the United States of America such as annual or quarterly reports, proxies, insider purchases and sales of stock on Form 4 or 13-D filings, or financial P R releases, or conference calls, etc and has not even held annual meetings. So we and all the other over 300 outside shareholders are completely in the dark as to what goes on in the company. Of course the Company is no more private than it was before it deregistered. It still has more than 300 shareholders, its stock trades under the symbol CKNO and has daily bids and offers and sizes displayed by sixteen market makers, it trades an average of 4,382 shares a day in the past 6 months, it traded 1.53 million shares last year and 3.66 million in 2007, it has a cusip number (20450U106); private companies have none of these things.

DTC as you also are aware makes it very difficult to obtain a stock certificate, which is the only way in which a beneficial shareholder today can get recognition as a record holder, by making it very

*Stocks Overlooked or Ignored by Otherwise Intelligent Investors®*

**Public Reference Copy**

expensive to obtain a certificate. In addition many brokers now levy high charges for a certificate and transfer agents too make charges for issuing certificates. This adds insult to injury to the record holder requirement of the SEC since for a shareholder to become a record holder is a costly and not so easy a process and clearly plays, and has played, into the hands of companies like Compass desiring to go dark and tell shareholders nothing more ever again.

The fact is we and our fellow stockholders of this Company (and as you are aware thousands of other companies that have gone dark in recent years) have been completely disenfranchised as a result of the SEC shareholder definition as holder of record rather than beneficial holder. This is neither fair nor right.

According to yesterday's The New York Times -- **S.E.C. Chief Pursues Tougher Enforcement** (<http://www.nytimes.com/2009/02/23/business/23schapiro.html?ref=todayspaper>) SEC Chairman Mary Schapiro said last week "This agency did not pursue some critical issues and problems," she said in a brief interview last week. "We need to be transparent about what we missed. We need to learn from these tragedies." No doubt she was referring to the Madoff and other scams that have recently come to light.

However, this issue of not reporting anything to shareholders by companies which went dark because of a clearly outdated use of stockholder to mean record holder rather than beneficial owner can or may even already have (hopefully not in this instance) hidden hanky panky in Compass for all we know. Problems if any exist go undetected. Confidence in the Board and management is impossible. In fact it was only recently after asking in writing numerous times for over a year "how many directors do we have, what are their names, backgrounds and affiliations, contact information, how much stock do they own, how are they compensated, what committees do they serve on etc.?" that we were finally informed the directors number four gentlemen, and we were given only their names and nothing else. Who these men are, their affiliations, experience, shareholdings, compensation, trading activities in the shares of the company and so forth remain as a military secret as all these questions go unanswered.

As with Madoff where his clients, his employees and the regulators were in a heard no evil saw no evil situation while evil was clearly being done, for all we know we shareholders of companies gone dark are in a similar situation. This is in no way an accusation or should it imply one. However, why should it even cross our minds to even think "could it be" and be left to ask ourselves or to wonder about evil doings? Don't you think particularly after all the recent news of skullduggery that a *stockholder* definition loophole which allows a company to overnight go from full disclosure to no disclosure is bad policy and in need of an immediate fix?

Chairman Schapiro indicated according to the Times article her commitment to "to moving quickly to let shareholders have more say in executive compensation and board elections." It was also mentioned that you are "studying proposals for greater disclosures of the qualifications of board members, particularly those involved in assessing risks and setting executive compensation."

Shareholders of Compass know absolutely nothing of any of these matters. Heaven only knows. We shareholders of Compass Knowledge Holdings and all the other companies having gone dark will very much appreciate and need your help in this and really ASAP.

There is absolutely zero transparency, accountability, or disclosure at Compass -- no openness of any kind whatever. Where we once had the best disinfectant, sunshine, we now have complete darkness and worse, complete silence.

This is the first time in my more than 50 years of professional investing that I have ever encountered a board and a CEO that have no interest in seeing their own stock appreciate over time. For all we know the insiders only interest is in (and maybe they are) buying up all the shares very cheaply from

the public shareholders who are as mentioned completely in the dark from one year to the next. Do these directors have this and or other conflicts of interest? How would we ever even know?

I am not the only investor who has pointed out the shenanigans made possible at companies which have been and are being today allowed to go dark as has Compass.

On July 3, 2003 a Petition for Commission Action to Require Exchange Act Registration of Over-the-Counter Equity Securities was presented to the Commission with a proposed beneficial owners rule by Stephen J. Nelson. I have included a copy below of *Request for Rulemaking under Section 12(g) (5) of the Securities Exchange Act of 1934 concerning securities held in Street Name (Petition No. 4-483)*.

That nothing has ever been done to remedy the situation such as simply taking hold of a pen and with one stroke changing the word *record* to *beneficial* when describing shareholders, or directing DTC nominee Cede look through broker names and go beyond to look through and count the beneficial shareholders that each broker holds shares for is really quite surprising if not amazing. Moreover, I find it astounding in light of the full airing given the above issue in his presentation that attorney Stephen J. Nelson who submitted the petition with a proposed beneficial owners rule has never as far as I am aware had an official response. This certainly seems odd to me. I hope it is to you and that the Commission will now move at once to correct and protect investors from a very, very bad situation.

Thank you very much for your prompt attention to this very important matter.

By all means please call me please call me to discuss further or if you have any questions. I will very much appreciate hearing from you

Warmly,



Lawrence J. Goldstein

ATTACHMENT

Petition for Commission Action to Require Exchange Act Registration of Over-the-Counter Equity Securities

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July 3, 2003

Mr. Jonathan Katz  
Secretary  
United States Securities and Exchange Commission  
450 5<sup>th</sup> Street, N.W.  
Washington, D.C. 20549

**Re: Petition for Commission Action to Require Exchange Act Registration of Over-the-Counter Equity Securities**

Dear Mr. Katz:

On behalf of David Shuldiner of Kanagawa Holdings LLC, Walter P. Carucci of Carr Securities Corporation, Paul H. O'Leary of Raffles Associates, L.P., Paul D. Sonkin of Hummingbird Management LLC, David Cohen of Athena Capital Management, David W. Wright of Henry Investment Trust, L.P., James E. Mitchell of Mitchell Partners, L.P., Jack Howard of Steel Partners, and Matt Brand of Performance Capital Group, LLC, each of whom are well-respected institutional

investors (collectively, the "Institutional Investors), The Nelson Law Firm, LLC respectfully petitions the Securities and Exchange Commission (the "Commission") to take immediate action to protect investors and prevent inequitable and unfair practices in the over-the-counter markets. In particular, the Institutional Investors request that the Commission exercise its authority under Section 12(g)(5) of the Securities Exchange Act of 1934 (the "Exchange Act") to amend Rule 12g5-1 under the Exchange Act ("Rule 12g5-1") to include as "held of record" with respect to any particular equity security each account for a beneficial owner holding the security in "street name." The proposed amendment (the "Beneficial Owner's Rule") is attached hereto as Exhibit A.

The Beneficial Owner's Rule will (i) conform a 38-year old rule to modern clearing practices, (ii) serve the public interest and further the objectives of Section 12 of the Exchange Act by requiring accurate, public reporting by issuers with many shareholders and (iii) prevent the current widespread manipulation of the capital markets by some unprincipled issuers.

### **Introduction.**

In response to complaints about fraudulent activity by companies with equities trading in the over-the-counter markets, Congress enacted legislation in 1964 to require a company having total assets in excess of \$10 million and a class of equity securities held of record by 500 or more persons to file a registration statement under the Exchange Act.<sup>1</sup> Companies whose record holders thereafter declined beneath 300 holders of record, or 500 holders of record and total assets less than \$10 million, would be permitted to deregister. As a practical matter, the legislation, which added a new Section 12(g) to the Exchange Act, for the first time required companies issuing securities that are traded over-the-counter to provide the information generally available to investors in securities listed on the New York Stock Exchange. Over-the-counter companies registered under Section 12(g) also were required for the first time to comply with the proxy rules and insider trading and reporting requirements of Sections 14 and 16 of the Exchange Act.

Section 12(g)(5) of the Exchange Act granted authority to the Commission to promulgate rules defining the meaning of the term "held of record". The Commission responded by proposing a new Rule 12g5-1 in 1964. This proposed rule was adopted in its current form in 1965.

Rule 12g5-1, as initially proposed, would have required each account held in "street name" to be counted as "held of record."<sup>2</sup> An issuer would have been entitled to rely in good faith on the representations made by the broker-dealer or bank concerning the number of accounts holding securities in street name. In response to numerous comments from brokerage industry participants who complained that Rule 12g5-1 as proposed would be too burdensome, the Commission dropped the requirement to count each account held in "street name" as "held of record". Instead, the Commission required issuers to count as "held of record" only those shareholders listed on the corporate records who had been issued a stock certificate.

For reasons that are not entirely clear, the Commission imposed a different requirement on foreign issuers. Exchange Act Rule 12g-3(a)(1) requires foreign private issuers to count each account held in street name by a broker or bank to determine whether their stock must be registered because it is held of record by more than 300 US investors.<sup>3</sup> There is no evidence to suggest that this requirement for foreign private issuers has imposed an undue burden on either issuers or the banks and brokerage firms that have been required to respond to such requests.

The contrasting treatment for US domestic issuers and foreign issuers under the rules adopted pursuant to Section 12(g)(5) of the Exchange Act produces inconsistent and perverse results. Investors in US issuers are deprived of the disclosures and protection provided under the Exchange Act to investors in foreign companies.

The 38 years since Rule 12g5-1 was adopted have witnessed monumental changes in clearing and settlement procedures. The transformation of clearing and settlement procedures have caused, among many other things, a dramatic increase in the percentage of beneficial owners holding equity securities in street name. In contrast to conditions that prevailed in 1965, it is now unusual for a beneficial owner to appear on the corporate books as a holder of record or hold a

stock certificate. As a result, Rule 12g5-1 fails to properly effectuate the Congressional intent expressed in Section 12 or the policy goals of the Exchange Act.

This petition contains four parts. In the first section, we describe recent illustrative examples of companies that have used the definition of "held of record" in Rule 12g5-1 to avoid their duties to investors under the Exchange Act. The second section points out the harsh consequences of the rule's application on the investing public. The third section demonstrates that the definition is obsolete and no longer aligns with modern clearing practices. Finally, we will show that adopting the Beneficial Owner's Rule as proposed will not impose burdensome requirements on companies or the brokerage industry. Rules adopted in response to the Shareholder's Communications Acts have led to the development of an efficient industry procedure easily accessed by companies at nominal cost to determine the correct number of beneficial owners who should be counted as record holders.

Commenting on its decision not to require inclusion of street names in determining the number of accounts "held of record", the Commission noted that it would "determine in the light of experience whether inclusion of these accounts at a future date is necessary or appropriate to prevent circumvention of the Act and to achieve the intended coverage on a uniform and acceptable basis."<sup>4</sup> We submit that recent experience provides strong and persuasive evidence that inclusion of these accounts is essential to prevent widespread circumvention of the Exchange Act and to protect the investing public.

#### **Recent Examples of Circumvention.**

In the very recent period beginning in January 2003, we have identified 24 issuers that have deregistered their securities under circumstances suggesting manipulation of the capital markets and circumvention of the Exchange Act.<sup>5</sup> The following discussion will focus on three examples that are illustrative of the current abusive practices perpetrated by issuers whose securities are traded on the over-the-counter markets.

##### *SmartDisk Corporation - Using the Capital Markets as a Personal Piggybank.*

On May 7, 2003, SmartDisk Corporation (NASDAQ: SMDK) filed a Form 15 with the Commission to deregister its common stock and suspend its reporting and disclosure obligations under the Exchange Act on the grounds that it has less than 300 "holders of record."<sup>6</sup> In a press release, SmartDisk complained about the costs associated with preparing and filing periodic reports with the Commission.<sup>7</sup> The facts suggest a more sinister motive.

On October 5, 1999, SmartDisk sold 3 million shares of its common stock to the public at a price of \$13.00 per share. Of the \$39 million raised from public investors, SmartDisk received \$36,270,000 after paying all costs of the transaction. This offering was a significant achievement for a technology company with one product, a device used to transfer digital photographs to computers only from Toshiba cameras, and that had only been in business for little more than a year.<sup>8</sup>

In its first annual report for the year ended December 31, 1999, SmartDisk disclosed that over 16 million shares of its common stock were outstanding with over 1,000 beneficial owners. The vast majority of these shares were held in street name. Accordingly, the corporate books showed only 76 "holders of record." SmartDisk's stock price had traded in a range from \$23.44 to \$55.19 per share.

In late Spring of 2000, SmartDisk sought to capitalize on its earlier capital-raising success, and the trading interest in its common stock, by launching another public offering, this time attempting to obtain \$133,568,907 from public investors.<sup>9</sup> By mid-2000, however, the public's appetite for investment in unproven technology companies had diminished, and SmartDisk was

forced to withdraw its proposed offering. SmartDisk was, however, successful in registering the stock of insiders holding SmartDisk common stock, who unloaded 1,576,768 shares to the public for a total offering price of \$8,672,224.

In September 2002, SmartDisk again sought to raise capital from public investors, this time through a rights offering for the more modest amount of \$7,500,000.<sup>10</sup> The company's stock price had now fallen to \$.16 per share. Again, market conditions forced the company to withdraw this offering.

In its fourth annual report for the year ended December 31, 2002, SmartDisk disclosed that 17,790,770 shares of its common stock were outstanding. The company estimated that its stock was now held by more than 6,000 beneficial owners, most in street name. 165 "holders of record," more than twice the number identified after the company's initial public offering, appeared on the corporation's books.

SmartDisk has over 6,000 public investors, who have entrusted to this company's management over \$36 million. Ignoring the responsibilities incumbent on such trust, SmartDisk's management spurns its duty to communicate with investors. Instead, it only cares about taking their money. When the public's investment interest was at its peak, SmartDisk was only too happy to access the public markets to finance its ideas. In these times, when capital-raising is difficult for technology companies with little or nothing in the way of earnings, SmartDisk's management would callously plunge over 6,000 public investors into the dark, depriving them of the ability to monitor the management of the \$17 million in total assets remaining from their original investment.

We submit that the Exchange Act was never intended to operate as a vehicle for fair weather disclosure by issuers. Issuers should not be entitled to treat the public capital markets as a personal piggy bank, providing public disclosures when capital-raising opportunities are abundant, but then shutting off the lights when Exchange Act registration becomes inconvenient. This practice is an abuse of trust that persists unchecked because existing Rule 12g5-1 is obsolete. The management of SmartDisk and other over-the-counter companies eagerly exploit this loophole.

*United Road Services, Inc. - Viewing Registered Equity as Acquisition Currency.*

Without fanfare or comment, United Road Services, Inc. (OTCBB: URSI) filed a deregistration statement on Form 15 on May 14, 2003.<sup>11</sup> United Road Services provides an example of an issuer who views its common stock as "acquisition currency," jettisoning its disclosure obligations to investors when the currency is devalued.

United Road Services is a national provider of motor vehicle and equipment towing, recovery and transport services, operating 79 facilities in 25 states. Its clients

include leasing and insurance companies, car dealers, law enforcement agencies, auto auction companies, and individual drivers.<sup>12</sup>

The business of United Road Services was launched through an initial public offering in May 1998, during the home stretch of the great bull market, when it sold 6.6 million shares to public investors at a price of \$13.00 per share, thereby raising \$85.8 million.<sup>13</sup> United Road Services immediately used this capital to purchase seven major towing companies. Over the next year, United Road Services acquired 49 additional companies. The Company made its last acquisition on January 16, 2002. Most of these acquisitions were paid for with stock.<sup>14</sup>

The acquisition policy of United Road Services has not proven to be particularly profitable. Consequently, the Company's stock is currently traded at around 5 cents per share. However, United Road Services still shows \$97,767,000 in total assets. There are 294 holders of record for

United Road Services' common stock. While information regarding the number of beneficial owners is not publicly available, we believe that this Company's common stock is beneficially owned by over 6,000 shareholders.

At the current trading price, the stock of United Road Services is no longer useful for acquisitions. Having exploited its value fully, this Company's management would now turn its back on its disclosure obligations to shareholders, relying on the obsolete Rule 12g5-1 definition to deregister its stock. Many of these shareholders received some of this Company's "acquisition currency," in exchange for their company's assets. It is a cruel result, and contrary to purposes of the Exchange Act, to deprive them of their last remaining good opportunity to influence the management of their hard-earned investment dollars.

*ACAP Corporation - Sharing Risks, But Not Rewards, with Public Shareholders.*

ACAP Corporation filed its deregistration statement on May 14, 2003,<sup>15</sup> at which time it had 241 holders of record. While beneficial ownership information is not publicly available, we believe that this record ownership represents over 500 public shareholders. ACAP holds \$146,799,869 in total assets.<sup>16</sup> ACAP is the story of a successful company, determined not to share its abundant wealth with the shareholders responsible for its profitability.

ACAP is a life insurance holding company, formed in 1985 to become the parent of American Capitol Insurance Company. American Capitol is a Texas life insurance company licensed in 34 states and the District of Columbia. 45% of ACAP's stock is owned by InsCap Corporation.<sup>17</sup>

Earlier this year, ACAP decided it no longer wished to share its fairly generous returns with public shareholders. Buying out minority shareholders is not illegal. The Exchange Act provides a well-developed process for self-tendering transactions that we believe results in a fair exchange for investors. The methods used by ACAP to "go private," however, strike us as the sort of behavior the Exchange Act was intended to prevent.

Rather than making an offer to buy out the minority interest through a self-tendering transaction, ACAP decided to use its corporate power to cause a reverse split, thereby reducing the number of its outstanding shares. Fractional shares that resulted from the reverse split were purchased for cash, thereby reducing the number of "holders of record."<sup>18</sup> This device worked, and the many remaining public shareholders of ACAP, rather than receiving fair consideration for their shares, are now being plunged into the darkness of holding shares in a Company without disclosure obligations under the Exchange Act.

In a statement typical of the attitude of issuers that twist Rule 12g5-1 to evade their obligations to long-term investors, the Board of Directors noted as a reason for the reverse split that ACAP had not used the Company's common stock to raise capital or make acquisitions for many years.<sup>19</sup> This view that equity is only good for capital raising or acquisition currency denies the important role that public shareholders play in guiding the use of capital investment and using Exchange Act disclosure to supervise the hand of management.

**The Harsh Results of Deregistration.**

It is certainly true that many issuers view disclosure to shareholders as a burdensome nuisance - that is why it was necessary for Congress to mandate periodic disclosure in the Exchange Act. In addition, Sarbanes-Oxley has imposed additional requirements that in some respects increase the effort involved in making adequate disclosure.

We nonetheless submit that the wholesale termination of periodic disclosure for thousands of investors frustrates the purposes of the Exchange Act and fails to provide appropriate relief where warranted. The Commission has responded to the needs of small companies and their investors with small business initiatives tailoring disclosure obligations to their special circumstances. If additional relief is warranted, this can best be accomplished through amendment to these small business initiatives.

If the Commission approves the deregistration of SmartDisk, United Road Services and ACAP, as expected, as well as the other public companies listed in Exhibit B, the disinfecting benefits of public disclosure will no longer enlighten these issuers' footsteps. Resources will no longer be dedicated to satisfy the demands of generally accepted accounting principles, leading to undisciplined business practices. Investors will no longer receive the proxy statements mandated by Section 14 of the Exchange Act that have enabled them to accurately evaluate the efforts of management and use that knowledge to make informed decisions in the election of their directors.

No longer confronting the scrutiny of informed investors, management may feel secure in its tenure, to the detriment of the thousands of public investors who can no longer rely on the federal securities laws to protect them from invidious or incompetent management behavior. Without the discipline imposed by public investors, scarce resources are unlikely to be applied by management to their most desirable uses, spreading negative consequences throughout the economy in derogation of the public interest.

Without adequate financial information to satisfy the requirements of Exchange Act Rule 15c2-11, market makers may no longer make two-sided quotes in deregistered issues. Public customers may ask market makers to find a buyer for them, but without a two-sided market, valuations amount to dubious approximations. Uncertain values make it difficult for institutional investors acting as fiduciaries to account properly for beneficial positions, resulting in liquidations at prices well below fair value.

Deprived of the good information required by the periodic reporting mandates of the Exchange Act, the public markets will trade the stock of these deregistered issuers on the basis of rumor, innuendo and uncertainty. Volatility will increase. Insiders may no longer feel inhibited by the rigors of Section 16 of the Exchange Act from taking advantage of the information they received in their positions of trust as corporate fiduciaries. Unfair informational advantages and volatile trading markets are the ingredients that enable the unscrupulous to shear shareholders of the remaining value left in their investments.

We respectfully petition the Commission for relief from this injustice inflicted on the nation's public shareholders.

### **The Definition of "Holders of Record" is Obsolete.**

#### *Holder of Record Meant Beneficial Owner When Rule 12g5-1 Was Adopted.*

A "holder of record" is established on the corporate books when a corporation issues a stock certificate to a particular person, registering the name of that person on the stock certificate and the corporate books. In 1964, when Congress enacted Section 12(g) of the Exchange Act, most equity securities were registered to their beneficial owners on the corporate books.<sup>20</sup> A relatively small percentage of equity securities were registered in the name of the broker, or in "street name," generally when stock was being held as security for margin. Over-the-counter equities in 1964 were generally not marginable.

Accordingly, when Congress enacted Section 12(g) in 1964, determining that it was in the public interest for companies with more than 300 record holders to register under the Exchange Act, 300 record holders would be reasonably equivalent to 300 beneficial owners. We contend, for reasons that will be described later, that Congress used the term "holder of record" to simplify the process for companies trying to determine whether or not they were required to register under the Exchange Act. In 1964, among other things, there was no good way to discover the number of beneficial owners represented by street names. Since the numerical difference was unlikely to be material, there was little to be gained by imposing the burden of obtaining a completely accurate count on a few relatively small issuers.

Congress nevertheless anticipated that the term "holder of record" might not achieve its intended purpose - to mandate periodic disclosure for issuers with more than 300 shareholders - over

time. Accordingly, Congress granted to the Commission authority in Section 12(g)(5) of the Exchange Act "to define by rules and regulations the [term] "held of record" as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provisions of this subsection." Exchange Act Rule 12g5-1 was promulgated in 1965 pursuant to the Commission's authority under Section 12(g) (5).

Soon after Rule 12g5-1 was adopted in 1965, a clearing and settlement crisis erupted on Wall Street. Significant changes in clearing and settlement systems were prompted by this crisis, which caused a radical increase in the percentage of stock ownership represented by street names. These changes, which have continued over the 38 years since Rule 12g5-1 was adopted, have inexorably led to a vast disparity between the number of record holders and the number of beneficial owners. The number of "holders of record" on the corporate stock records no longer reasonably approximates the number of beneficial owners. This disparity frustrates the Congressional intent expressed in Section 12(g) of the Exchange Act and provides grist to the mill for unscrupulous managers of certain over-the-counter companies. The time has come for the Commission to re-examine Rule 12g5-1 and redefine "held of record" in the public interest and for the protection of investors.

#### *Changes in the Clearing and Settlement Systems Since 1965.*

That Rule 12g5-1 is obsolete becomes readily apparent upon brief reflection on the modern history of trading, clearing and settlement practices. In 1965, NASDAQ did not exist. Neither The Depository Trust Company (DTC), nor its predecessor, the Central Certificate service, had been invented. Computers were a recent innovation, and only a few very large firms were experimenting with computerized bookkeeping using large main frame machines. Most recordkeeping on Wall Street was accomplished using paper ledgers, envelopes marked to indicate ownership, and file cabinet systems.<sup>21</sup>

In 1965, when Rule 12g5-1 was adopted, most clearing and settlement transactions involved a four-step process. To sell stock on an exchange, the beneficial owner would deliver a stock certificate together with stock powers to a broker. The broker would then deliver (generally by a runner) the stock certificate to the broker used by the purchaser. The purchasing broker would deliver the certificate to the purchaser who, in turn, would submit the certificate, along with attached stock powers, to the transfer agent for registration. This process involved multiple re-registrations on the books of transfer agents (who maintain the lists of corporate "holders of record") and was cumbersome and costly.

In 1968, this system for clearing and settling securities transactions disintegrated into chaos. Volumes on the New York and American Stock Exchanges exploded, and responding to an increased interest in over-the-counter issues, the NASD began development of NASDAQ. Stock transfer departments were overwhelmed by the increased volumes and began to fall behind. Delays at one firm held up the work at other firms who were waiting to receive stock certificates. Errors were generated causing more work; certificates were lost or stolen. By December 1968, unsettled trades had accumulated to \$4 billion and "the trade settlement system had virtually broken down."<sup>22</sup> This "paperwork crisis," which lasted until 1971, was described in the resulting Congressional hearings as "the most prolonged and severe crisis in the securities industry in 40 years."<sup>23</sup>

The main culprit of the "paperwork crisis" was generally agreed to be the "stock certificate." An influential report by Lybrand, Ross & Montgomery, for example, concluded that the "stock certificate [was] a chief catalyst of the paper crisis that in 1968 brought Wall Street to the edge of chaos."<sup>24</sup> When the elimination of stock certificates proved to be politically unfeasible,<sup>25</sup> the securities industry, with the strong encouragement of the Commission and Congress, began searching for ways to immobilize the stock certificate.

The immobilization of stock certificates has largely been accomplished through the use of street names and the creation of securities depositories. In 1968, the New York Clearing Corporation, a subsidiary of the New York Stock Exchange, established the Central Certificate Service, which was ultimately succeeded by The Depository Trust Company (DTC), using a system that has continued

to date. Under this system, investors are strongly encouraged to leave their certificates in an account maintained by a broker-dealer.<sup>26</sup> In turn, broker-dealers maintain accounts at DTC, indicating the total number of shares held for their customers' accounts. To execute a delivery, the selling firm instructs DTC to debit its account for the amount of the sale and credit the buying broker's account.<sup>27</sup> Title to the shares is transferred by computer entries, eliminating the necessity of physical transfer of the certificate from customer to broker, broker to broker, and broker to customer.

The use of securities depositories has not entirely eliminated the use of paper certificates. Instead, a paper certificate representing equity ownership on the corporate books remains in place as a "global certificate" with DTC's nominee, CEDE & Co., as the "holder of record", representing all of the shares held in accounts of the brokerage firm members of DTC. These global certificates gather dust in a vault in the Wall Street area. In turn, the accounts of the brokerage firm members of DTC represent ownership by the many beneficial owners of those securities who are clients of the brokerage firms. Stock certificates are immobilized because the "global certificate" never moves from the vault.

#### *Holder of Record Now Means Street Name.*

The immobilization of stock certificates has eliminated the prior function of stock certificates to identify beneficial owners as "holders of record." In contrast to conditions in 1965, beneficial owners are no longer represented in the vast majority of cases as "holders of record".<sup>28</sup> Instead, beneficial owners are represented almost entirely on the corporate books by "CEDE & Co.," the nominee for banks and brokerage firms with accounts at DTC, and other nominee names serving similar function under other clearing systems.

There have been several attempts to create systems that would cause beneficial owners to be registered electronically as holders of record on corporate books. Most recently, the Commission in 1995 studied and approved a pilot project that would list beneficial owners electronically on corporate records through a transfer agent operated book-entry registration system.<sup>29</sup> If this pilot, known as "DRS," had been successful, this petition would not have been necessary. As of this time, however, no good alternative has been found to replace the convention of using "CEDE & Co." and other street names to represent the beneficial ownership of the vast majority of equity investment. Instead, the Commission's efforts to shorten

settlement cycles from T+5 to T+3 resulted in an intense investor education effort led by the Securities Industry Association to increase the percentage of investors holding their securities in street name. Further efforts to reduce settlement cycles can be expected to virtually eliminate individual possession of stock certificates.

It is submitted that at this time very few investors hold stock certificates registered in their names. Instead, their stock is held in street name by their brokerage firms. Moreover, there has been a significant increase in investor interest in over-the-counter securities in recent years. These investors assume that the protections of Section 12(g) of the Exchange Act are available to them if the stock they own is widely held. A stock beneficially owned by

thousands of investors can never be considered a closely-held investment. Existing Rule 12g5-1 simply no longer conforms to common understanding and therefore presents a trap for all but the most sophisticated and legally prescient investors.

#### **Determining the Number of Beneficial Owners is Not Burdensome.**

As noted earlier, the Commission in 1965 dropped the requirement to count each account held in "street name" as "held of record" under Rule 12g5-1 in response to numerous comments from industry participants who complained that this requirement would be too burdensome. This complaint was dubious even in 1965. Foreign issuers have been required to include accounts held in street name as "holders of record" for many years without apparent difficulty.<sup>30</sup> But, to the

extent that determining the number of beneficial owners was ever a burden, modernization of the proxy rules in the 1980s has resulted in a streamlined, inexpensive process to count beneficial owners holding securities in street name.

This process resulted from the enactment of a series of Shareholders Communications Acts beginning in 1985. The Acts reflected Congressional concern that, while the development of securities depositories solved the "paperwork crisis," the use of street names to immobilize paper certificates erected a barrier to communication between companies and their shareholders.<sup>31</sup> The Shareholders Communications Acts led to the adoption of rules for the solicitation of proxies under Section 14 of the Exchange Act. Accordingly, Rule 14b-1(b)(1)(i) requires each broker-dealer to respond within seven days after it has received an inquiry from a company that wishes to solicit proxies from the beneficial owners of its securities by indicating the approximate number of its customers who are beneficial owners of the company's securities. Rule 14b-2(b)(1)(A) requires a similar response from banks holding their customer's securities in street name.

The securities industry responded by developing a streamlined process for issuers to obtain information about the number of beneficial owners holding their equities.<sup>32</sup> To solicit proxies or for any other reason, any issuer can submit a request to ADP Proxy Services and for a nominal cost immediately receive a current count of the number of its beneficial owners. We believe that issuers can use the same medium to determine whether their equities are held by more than 300 beneficial owners prompting an obligation to register and make periodic reports under the Exchange Act.

#### **The Proposed Beneficial Owner's Rule.**

The proposed Beneficial Owner's Rule would require issuers to use the process developed under the proxy rules to determine the number of securities "held of record" under Rule 12g5-1.

Under the proposed Beneficial Owner's Rule, Rule 12g5-1 under the Exchange Act would be amended to provide that each beneficial owner of a security held in street name is to be counted for determining the number of securities "held of record" for the purpose of determining whether an issuer is subject to the provisions of Section 12(g) and 15(d) of the Exchange Act. An issuer would be required to inquire of each record holder of its equity securities that is a broker-dealer or bank whether other persons are the beneficial owners of such securities, and if so, the number of such beneficial owners. The issuer would also be required to inquire if such record holder holds the issuer's securities on behalf of any respondent bank, and if so, the name and address of each such respondent bank. Conforming amendments would also be made to Rules 14b-1(b)(1)(i) and 14b-2(b)(1)(A) to require broker-dealers and banks to respond to inquiries from issuers made in accordance with Rule 12g5-1. As a practical matter, the requirements of the proposed Beneficial Owner's Rule can be easily accomplished through inquiry to ADP Proxy Services using the well-developed procedure under the proxy rules.

#### **Conclusion.**

We respectfully submit that the light of experience calls out for a re-examination of Rule 12g5-1. The Rule is obsolete and no longer achieves its intended purpose. The inconsistent protections provided to investors in foreign issuers over domestic issuers can no longer be justified as a matter of policy. Over-the-counter companies in record numbers are using an arcane definition to circumvent the Exchange Act and deprive the investing public of the benefits of full and accurate disclosure promised by the federal securities laws.

The Commission has authority under Section 12(g)(5) of the Exchange Act to define by rules and regulations the term "held of record" as it deems necessary or appropriate in the public interest and for the protection of investors and to prevent circumvention of Section 12(g) of the Exchange

Act. We urge the Commission to adopt the proposed Beneficial Owner's Rule or, alternatively, another rule that would better serve the public interest and effectuate Congressional intent.

Please call me if you have any questions.

Respectfully submitted,

/s/ STEPHEN J. NELSON

Stephen J. Nelson

cc: Chairman William H. Donaldson  
Commissioner Paul S. Atkins  
Commissioner Roel C. Campos  
Commissioner Cynthia A. Glassman  
Commissioner Harvey J. Goldschmid  
Mr. Allan L. Beller, Director of the Division of Corporation Finance  
Mr. Martin Dunn, Deputy Director of the Division of Corporation Finance  
Ms. Annette Nazareth, Director of the Division of Market Regulation

### **Proposed Beneficial Owner's Rule**

Section 12g5-1 under the Securities Exchange Act of 1934 (the "Exchange Act") is hereby amended as follows:

A new paragraph (b)(3) is added to read as follows:

"For purposes of this paragraph (b)(3), the terms "entity that exercises fiduciary powers", "record holder" and "respondent bank" shall have the meanings assigned to such terms in rule 14a-1 under the Exchange Act. Each beneficial owner of securities for which a broker, dealer, bank, association or other entity that exercises fiduciary powers in nominee name or otherwise is the record holder shall be included as "held of record" by such beneficial owner. An issuer shall inquire of each such record holder: (A) whether other persons are the beneficial owners of such securities and if so, the number of such beneficial owners and (B) whether it holds the issuer's securities on behalf of any respondent bank and, if so, the name and address of each such respondent bank."

Paragraph (b)(3) is renumbered (b)(4).

Rule 14b-1(b)(1) is amended to insert the words "Rule 12g5-1(b)(3)," after the word "with" and before the words "Rule 14a-13(a)".

Rule 14b-2(b)(1)(i) is amended to insert the words "Rule 12g5-1(b)(3)," after the word "with" and before the words "Rule 14a-13(a)".

### **Companies Deregistering to Circumvent the Exchange Act In 2003**

1. SEMX Corp, 1 Labriola Court, Armonk, NY 10504 (telephone: (914) 698-5353). Holders of Record: 89. Estimated Beneficial Owners: 1,800. Total Assets: \$30,418,000.
2. Chester Bancorp Inc., 1112 State St., Chester IL 62233 (telephone: (618) 826-5038). Holders of Record: 250. Estimated Beneficial Owners: 5,250. Total Assets: \$113,800,000.
3. First Reserve Inc., 1360 South Dixie Highway, Coral Gables FL 33146 (telephone: (305) 667-8871). Holders of Record: 174. Estimated Beneficial Owners: 3,600. Total Assets: \$12,044,409.

4. United Road Services, Inc., 17 Computer Drive West, Albany NY 12205 (telephone: (518) 446-0140). Holders of Record: 294. Estimated Beneficial Owners: 6,100. Total Assets: \$97,767,000.
5. ACAP Corp., 10555 Richmond Ave, 2nd Fl, Houston, TX 77042 (telephone: (713) 974-2242). Holders of Record: 241. Estimated Beneficial Owners: 400. Total Assets: \$146,799,869.
6. Oncure Technologies Corp., Ignacio Valley Road, Suite 300, Walnut Creek, CA 94596 (telephone: (925) 279-2273). Holders of Record: 285. Estimated Beneficial Owners: 6,000. Total Assets: \$32,854,737.
7. SmartDisk Corp., 12780 Westlinks Drive, Fort Myers, FL 33913-8019 (telephone: (239) 425-4000). Holders of Record: 278. Estimated Beneficial owners: 6,000. Total Assets: \$17,172,000.
8. Koala Corp., 7881 S Wheeling Court, Englewood, CO 80112 (telephone: (303) 539-8300). Holders of Record: 114. Estimated Beneficial Owners: 2,300. Total Assets: \$47,076,475.
9. First Federal of Olathe Bancorp, Inc., 100 East Park Street, Olathe, Kansas 66061 (telephone: (913) 782-0026). Holders of Record: 148. Estimated Beneficial Owners: 3,100. Total Assets: \$49,729,000.
10. First Independence Corp., Myrtle & 6th Streets, Independence, KS 67301 (telephone: (316) 331-1660). Holders of Record: 223. Estimated Beneficial Owners: 4,683. Total Assets: \$156,050,000.
11. Lam SW Inc., Unit 25- 32, 2nd Floor, Block B, Focal Ind. C, Man Lok Street, Hunghom, Hong Kong K3 12345 (telephone: (011-852-2766). Holders of Record: 140. Estimated Beneficial Owners: 2,900. Total Assets: \$21,707,000.
12. Webhire Inc., 91 Hartwell Avenue, Lexington, MA 02421 (telephone: (781) 869-5000), Holders of Record: 155. Estimated Beneficial Owners: 3,200. Total Assets: \$12,300,000.
13. Excal Enterprises, Inc., 100 North Tampa Street, Suite 3575, Tampa, FL 33602 (telephone: (813) 224-0228). Holders of Record: 292. Estimated Beneficial Owners: 500. Total Assets: \$16,254,179.
14. Ubics, Inc., 333 Technology Drive, Suite 210, Canonsburg, PA 15317 (telephone: (724) 746-6001. Holders of Record: 69. Estimated Beneficial Owners: 700. Total Assets: \$12,600,000.
15. Guardian International, Inc., 3880 N. 28<sup>th</sup> Terrace, Hollywood, FL 33020 (telephone: (954) 926-5200). Holders of Record: 157. Estimated Beneficial Owners: 3,200. Total Assets: \$33,900,000.
16. Kimmins Corp., 1501 Second Avenue, East, Tampa, FL 33605 (telephone: (813) 248-3878). Holders of Record: 297. Estimated Beneficial Owners: 1,500. Total Assets: \$77,300,000.
17. Madison Bancshares Group, Ltd., 767 Sentry Parkway West, Blue Bell, PA 19422 (telephone: (215) 641-1111). Holders of Record: 294. Estimated Beneficial Owners: 3,000. Total Assets: \$195,300,000.
18. Isomet Corporation, 5263 Port Royal Road, Springfield, VA 22151 (telephone: (703) 321-8301). Holders of Record: 235. Estimated Beneficial Owners: 2,300. Total Assets: \$9,008,000.
19. Harbourton Financial Corporation, 8180 Greensboro Drive, McLean, VA 22102 (telephone: (703) 883-9757). Holders of Record: 95. Estimated Beneficial Owners: 500. Total Assets: \$31,900,000.
20. Lexington B & L Financial Corp., 205 S. 13<sup>th</sup> Street, Lexington MO 64067 (telephone: (660) 259-2247). Holders of Record: 281. Estimated Beneficial Owners 3,000. Total Assets: \$135,900,000.
21. Zachary Bancshares, Inc., 4743 Main Street, Zachary, LA 70791 (telephone: (225) 654-2701). Holders of Record: 266. Estimated Beneficial Owners: 1,000. Total Assets: \$96,700,000.
22. Barrett Business Services, Inc., 4724 SW Macadam Avenue, Portland OR 97239 (telephone: (503) 221-0988). Holders of Record: 162. Estimated Beneficial Owners: 500. Total Assets: \$45,400,000.
23. US Data Corporation, 2435 N. Central Expressway, Richardson, TX 75080 (telephone: (972) 680-9700). Holders of Record: 296. Estimated Beneficial Owners: 2,100. Total Assets: \$8,184,000.
24. Neff Corp, 3750 NW 87<sup>th</sup> Ave, Suite 400, Miami, FL 33178 (telephone: (305) 513-3350). Holders of Record: 97. Estimated Beneficial Owners: 1,000. Total Assets: \$269,757,000.

- <sup>1</sup> The Act, as adopted by Congress, required Companies with 500 shareholders and total assets greater than \$1 million to register under the Exchange Act. Amendments adopted as Exchange Act Rule 12g-1 pursuant to the Commission's authority under Section 12(g)(5) of the Exchange Act have raised the "total assets" threshold to \$10 million. These amendments were intended to effectuate Congressional purposes by taking account of inflation.
- <sup>2</sup> SEC Release No. 34-7426 (1964). The proposed rule contained a paragraph (b)(3) which provided as follows: "To the extent indicated below, securities registered in the name of a broker, dealer or bank or nominee for any of them, which at the time are being held by the broker or dealer in customers' accounts or by the bank in custody or investment advisory accounts, shall be included as held of record by the number of separate accounts for which the securities are held. Each registered owner known by the issuer, or a person maintaining its record of security holders, to be a broker, dealer or bank or nominee for any of them shall be requested to furnish the issuer the number of such separate accounts. A recipient of such a request will be expected to comply only to the extent the information can be readily supplied, and the issuer may rely in good faith on such information as is received in response to the request."
- <sup>3</sup> Exchange Act Rule 12g3-2(a)(1) provides as follows: "Securities of any class issued by any foreign issuer shall be exempt from Section 12(g) of the Act if the class has fewer than 300 holders resident in the United States. This exemption shall continue until the next fiscal year end at which the issuer has a class of equity securities held by 300 or more persons resident in the United States. For the purpose of determining whether a security is exempt pursuant to this paragraph, securities held of record by persons resident in the United States shall be determined as provided in Rule 12g5-1 except that securities held of record by a broker, dealer or bank or nominee for any of them in the United States for the accounts of customers resident in the United States shall be counted as held in the United States by the number of separate accounts for which the securities are held. The issuer may rely in good faith on information as to the number of such separate accounts supplied by all owners of the class of its securities which are brokers, dealers or banks in the United States or a nominee for any of them."
- <sup>4</sup> SEC Release No. 34-7492 (1965).
- <sup>5</sup> Exhibit B provides pertinent information regarding these issuers.
- <sup>6</sup> SEC File No. 000-27257 (2003).
- <sup>7</sup> SmartDisk cited the following reasons for its decision to deregister: (i) the market value that the public markets are applying to the Company, (ii) the costs, both direct and indirect, associated with the preparation and filing of the Company's periodic reports with the SEC, (iii) the expected substantial increase in costs associated with being a public company in light of new regulations promulgated as a result of the Sarbanes-Oxley Act of 2002, (iv) the fact that the Company's stock is very thinly traded, (v) the nature and extent of the trading in the Company's common stock, and (vi) the lack of analyst coverage and minimal liquidity for the Company's common stock.
- <sup>8</sup> SEC File No. 333-82793 (1999). SmartDisk, a company located in Naples, Florida, was incorporated in Delaware on March 5, 1997 as "Fintos, Inc." and changed its name to "SmartDisk Corporation" on September 26, 1997. Significant operations related to its then current products were commenced in January 1998, and SmartDisk received its first significant capital contributions in May 1998.
- <sup>9</sup> Registration Statement on Form S-1. SEC File No. 333-35300 (2000).
- <sup>10</sup> Registration Statement on Form S-1. SEC File No. 333-67022 (2002).
- <sup>11</sup> SEC File No. 000-24019 (May 14, 2003).
- <sup>12</sup> Annual Report on Form 10K for the period ended December 31, 2002. SEC File No. 000-24019 (April 15, 2003).
- <sup>13</sup> Registration Statement on Form S-1. SEC Registration Statement No. 333-4692 (1998).
- <sup>14</sup> *Infra*, note 11.
- <sup>15</sup> ACAP Corporation, Securities Registration Termination on Form 15-12G, dated May 14, 2003, SEC File No. 000-14451 (2003).
- <sup>16</sup> ACAP Corporation, Annual Report on Form 10-KSB for the period ended December 31, 2002, SEC File No. 000-14451 (2003).
- <sup>17</sup> See Note 15, *infra*.
- <sup>18</sup> ACAP Corporation, Information Statement on Schedule 13E-3, dated May 14, 2003, SEC File No. 005-49858.
- <sup>19</sup> See Note 18, *infra*.

- <sup>20</sup> In 1982, long after the creation of securities depositories and book-entry settlement, the ratio of book-entry deliveries to certificate withdrawals was 2.3:1. In 1992, the ratio had increased six times to 12.9:1. See U.S. Securities and Exchange Commission, 1993 Annual Report (1994) at 125. If we assume that the ratio of beneficial owners to street names is roughly equivalent to the ratio of book-entry deliveries to certificate withdrawals, then a company in 1992 with 25 holders of record would have 300 beneficial owners. This ratio has undoubtedly increased since 1992. By comparison, based on the same assumptions, a company with 300 holders of record in 1982 would have 690 beneficial owners. Significant changes in clearing practices that occurred in the early 70's caused a "dramatic" increase in the number of accounts holding in street names. So, it is a fair assumption that in 1965 the number of holders of record for most over-the-counter issues would be roughly equivalent to the number of beneficial owners.
- <sup>21</sup> For an interesting discussion of clearing and settlement practices in the 1960's see Hazen and Markham, 23 Broker-Dealer Operations Under Securities and Commodities Law, "Broker-Dealers - The Regulatory Era; The 60's - The Go-Go Years" § 2.14 (2002).
- <sup>22</sup> James Burk, Values in the Marketplace: The American Stock Market Under Federal Securities Law 106 (1988), as quoted in Hazen and Markham, *infra* n. 21.
- <sup>23</sup> Securities Processing Act, Hearings Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce on H.R. 14567, H.R. 14826 and S.3876, 92d Cong. 2d Sess. 2 (1972), as quoted in Hazen and Markham, *infra* n. 21.
- <sup>24</sup> Lybrand, Ross Bros. & Montgomery, Paper Crisis in the Securities Industry: Causes and Cures, Is the Stock Certificate Necessary? 1 (1969) (Preliminary Draft), Reprinted in, Studies of the Securities Industry, Hearings Before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, 92d Cong. 1st Sess. Ser. No. 92-37C, pt. 4, 2159 (1971), as quoted in Hazen and Markham, 23 Broker-Dealer Operations Under Securities and Commodities Law, "Clearing and Settlement. Clearing Agencies Evolve." § 3.3 (2002).
- <sup>25</sup> UCC Article 8, adopted by every State, for the most part mandates the use of paper certificates because perfection is accomplished in negotiable instruments through physical possession.
- <sup>26</sup> Brokerage firms penalize investors who wish to take physical possession of a stock certificate by charging a fee, usually \$50 for each transfer. In addition, investors are warned that sales will take longer to accomplish because the broker must take physical possession of the certificate, and physical possession of a stock certificate is dangerous, as the certificate can be stolen or forged. As a result, stock certificates have become a curiosity - many younger investors have only seen them in museums.
- <sup>27</sup> The textual description is a bit of an oversimplification for the sake of clarity. Since the early 1990s, there have been further advances in clearing and settlement procedures with the implementation of continuous net settlement. In general, the selling firm no longer settles directly with the purchaser, but instead with the National Securities Clearing Corporation (NSCC), an affiliate of DTC, which acts as a central clearing counterparty. In turn, the purchasing firm settles with NSCC. This avoids any settlement delays caused by the failure of a single firm to deliver.
- <sup>28</sup> As noted by the Circuit Court of Appeals: "Modernization of this task has led to storage of most stock certificates in a depository affiliated with the clearing agency. Thus, 'delivery' amounts to a bookkeeping entry that removes the security from one account and places it in another." *Bradford Nat. Clearing Corp. v. Securities and Exchange Commission*, 590 F.2d 1085 (D.C. Cir. 1978).
- <sup>29</sup> See Transfer Agents Operating Direct Registration System, Concept Release, SEC Release No. 34-35038 (1995).
- <sup>30</sup> See Note 3, *infra*, and the associated textual discussion.
- <sup>31</sup> As noted in the Commission's seminal study of this issue in 1975, "[street names place] one or more layers between issuers and the beneficial owners of their stock which may make issuer-shareholder communications more difficult and expensive. The street or nominee names reflected on the issuers' books as owners of record are not the beneficial owners, that is the persons entitled to receive dividends, vote on matters presented to stockholders, dispose of the stock or otherwise exercise the prerogatives of ownership. If the record owner is not the beneficial owner, the issuer cannot contact the beneficial owner directly, nor can the beneficial owner directly exercise the prerogatives or receive the benefits of ownership. Both must act through one or more intermediaries -- the brokerage firm or financial agent, and perhaps the depository." Street Name Study, SEC Release No. 34-11707 (1975).
- <sup>32</sup> See Bloomenthal, Going Public and the Public Corporation, "Proxy Solicitations and Contests," § 11.07 (2001).

<http://www.sec.gov/rules/petitions/petn4-483.htm>

**PUBLIC REFERENCE COPY**

September 22, 2008

**HAND DELIVERED**

Elizabeth G. Osterman  
Associate Director  
Division of Investment Management  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0506

10-28465,

812-13576

Re: Application of The Reserve Fund (Docket No. 812-13576)

Dear Ms. Osterman:

I am writing regarding The Reserve Fund and its series, the Primary Fund and the U.S. Government Fund (the "Funds"). Earlier today, the Commission issued an Order permitting the Reserve Fund to suspend all rights of redemption in the Funds indefinitely.

I am writing on behalf of a shareholder in the Primary Fund to object to the granting of the Order, which was issued without consideration of the express requirements of the Investment Company Act of 1940 (the "1940 Act").

Section 22(e)(3) of the 1940 Act authorizes the Commission to issue an order permitting an investment company to delay redemptions when necessary "for the protection of security holders of the company." In this instance, a delay in redemptions does not serve to protect the Funds' shareholders. These Funds are designed and marketed as short-term cash management vehicles. As a result, many shareholders need to be able to redeem their shares to fund their ongoing operations. The Funds have already delayed redemption requests made on September 15 and 16, 2008 for seven days. Permitting the Funds to delay redemptions further puts shareholders at great risk of being unable to conduct their day-to-day business.

Moreover, while the Funds' shareholders have an interest in maximizing the Funds' proceeds from the sale of portfolio securities, the nature of the Funds' portfolios (consisting of commercial paper and government securities) should allow for liquidation over a matter of days, not weeks.

In addition, Section 40(a) of the 1940 Act requires that the Commission issue orders only after "appropriate notice and opportunity for hearing." The Commission issued the Order in this matter without notice of any kind.

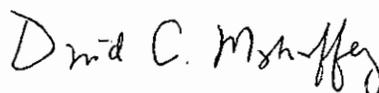
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Public Reference Copy

The Commission should rescind the Order immediately. Should the Commission later determine to grant an Order to the Funds after notice, the Commission must consider the interests of shareholders in fashioning relief. In particular, the Commission should limit the duration of the order to as short a period as possible--no more than seven additional days beyond the seven days permitted by Section 22. In addition, the Commission should require the Funds to offer to pay redemptions in part as the Funds receive proceeds from the sale of portfolio securities. This will reduce the hardship imposed on shareholders who require immediate access to cash.

Please feel free to contact me if you have any questions.

Very truly yours,

A handwritten signature in dark ink, reading "David C. Mahaffey". The signature is written in a cursive style with a large, looped "D" and "M".

David C. Mahaffey

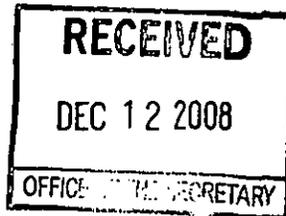
DCM/

cc: The Honorable Christopher Cox  
The Honorable Luis A. Aguilar  
The Honorable Kathleen L. Casey  
The Honorable Troy A. Paredes  
The Honorable Elisse B. Walters  
Mr. Andrew Donohue

December 6, 2008

Florence E. Harmon Acting Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

1C - 28466,  
812 - 13585



RE: Securities and Exchange Commission Release No. IC-28466; 812-13585 Reserve  
Municipal Money-Market Trust, et al.; Notice of Application and Temporary Order

Dear Ms. Harmon:

## PUBLIC REFERENCE COPY

The Securities and Exchange Commission issued a temporary order (the "Order") permitting "The Reserve" to temporarily suspend all rights of redemption on 28 of the money market funds managed by the Reserve. The order, effective as of October 8, 2008, states regarding suspension of redemption rights "with respect to each Fund until that Fund has liquidated, or until the Commission rescinds the order granted herein".

This order in effect ties up billions of dollars of investors assets. I am, through my TD Ameritrade brokerage account, invested in the Reserve's Interstate Tax Exempt Fund. I have had a redemption order in place for over two months which to date is still not executed. Of the 28 funds the Reserve has closed, only 5 have been liquidated and the assets returned to the investors. The Order as written does not define the meaning of "temporarily suspend". I would like to at least know there is light at the end of the tunnel or that we are in fact in a tunnel and not a bottomless pit from which we will never emerge.

Further the "Order" states that "each Fund continuously will provide timely and appropriate information, including initial and ongoing disclosure about the plan and its implementation, to its shareholders, via Web site or otherwise."

While the Reserve does maintain a web site the information provided is only "after the fact". We are told when a fund has been liquidated but there is no information regarding how the plan is being implemented regarding individual funds or any estimate as to when redemption orders will be filled. Calls to the Reserve provide no help as the people that are assigned to answer the phones only know what is already on the web site and nothing more.

I understand that the reason for the suspension of redemption is so that the Reserve will not be forced to liquidate assets at "fire sale prices" resulting in the loss of investor value. Please consider with all of the funds closed we the investors are losing value because the funds are not earning any interest or growth potential. Please help!

Sincerely  
James Phillips

A handwritten signature in black ink, appearing to read "James Phillips".

Contact Information:

Address:  
427 Deep Wood Cove  
Fort Wayne, IN 46845

Phone:  
(260) 637-3630

Email:  
Voyager38@Verizon.net

Public Reference Copy

IC - 28466;

Ms. Florence E. Harmon  
Acting Secretary  
U.S. Securities and Exchange Commission  
100 F St., NE  
Washington, DC 200549-1090  
Page 1 of 2

812 - 13585

Mr. Eric Scharff  
3717 Nobel Drive, Unit 1408  
San Diego, CA, 92122  
Cell: 858-334-9662  
Fax: 310-606-2116  
escharff@earthlink.net

**RE: SEC violations damaging RYPQX shareholders, need immediate assistance**

Dear Secretary Harmon,

I am writing to bring to your attention the following **urgent complaints regarding The Reserve's handling of its RYPQX fund** and request your kind and swift assistance:

1. The Reserve has not complied with the terms of the SEC's temporary order permitting suspend redemptions of RYPQX issued on 10/8/08. As a result, it is further damaging its shareholders to a very great extent. See further discussion below.
2. The Reserve has over 46% of RYPQX assets held in Cash, yet has made no distributions of it, despite having done so with other funds (Reserve Primary and Reserve Government funds) when similar amounts of cash or even less became available. Many shareholders, myself included, are in great need of our funds for daily living expenses, and critical life needs. We are being damaged immensely and in some cases irreparably as time goes on.
3. The Reserve has and continues to allow redemptions from the RYPQX fund which it declared "frozen". In so doing, it is damaging the existing shareholders and further jeopardizing their prospects for recovering their funds. Further, it is allowing such redemptions to a privileged subset of the shareholders and not to all of them. It has allowed such redemptions via ACH, check writing, and debit card transactions.

Please find on page 2. more details on these violations.

**As these violations damage the entire class of RYPQX shareholders, I kindly ask that the SEC act expeditiously to:**

- (A) Verify that the above complaints are true
- (B) Order The Reserve to stop all forms of disbursement from RYPQX and reinstate all funds that it erroneously disbursed to the extent possible.
- (C) Revoke your temporary order allowing The Reserve to suspend redemptions of RYPQX and thereby compel them to begin immediate, equitable disbursements as the SEC has done with the Reserve's other funds. Their first disbursement should return all available cash to shareholders.

Please confirm receipt of this correspondence and kindly advise on your ability to address these matters.

With great concern and appreciation,

Sincerely,

*Eric Scharff*

**More detail on The Reserve's violation of SEC's Notice of Application and Temporary Order to Suspend distributions of RYPQX, SEC Release No. IC-28466; 812-13585**

The SEC issued a temporary order permitting The Reserve Yield Plus Fund to suspend redemptions as of October 8, 2008 until the Fund has been liquidated or until the Commission rescinds that temporary order.

The order was based on various representations by the The Reserve, including.

\* "promptly will create plans for the orderly liquidation of each Fund's assets and for the appropriate payments to each Fund's shareholders, including those whose redemption orders have been received but not yet paid ." (p. 6),

\* "each fund will make and keep appropriate records surrounding these events..." (p. 6), and

\* "each Fund continuously will provide timely and appropriate information, including initial and ongoing disclosure about the plan and its implementation, to its shareholders, via Web site or otherwise." (p.6)

To the detriment of shareholders – many of whom have all of their assets invested in Yield Plus -- there is little evidence whatsoever to indicate that either of these activities are underway.

The Reserve has issued only *one* statement on Yield Plus since the order ([http://www.ther.com/pdfs/Press%20Release%20YidPlus%202008\\_1118.pdf](http://www.ther.com/pdfs/Press%20Release%20YidPlus%202008_1118.pdf)).

This statement indicates that nearly half of the fund's assets are in cash, yet after more than a month there is still no plan for redemption of shareholders' funds.

The lack of a liquidation plan and lack of information from The Reserve indicate a clear violation of terms under which the order was issued.

In addition to the lack of liquidation plan, there has been no correspondence from The Reserve regarding the safety of our captive funds, whether or not they are earning any interest, whether or not The Reserve will attempt to charge management fees to shareholders during the liquidation of the fund, or any timeline, however vague, for expected resolution of virtually all related issues.

As a result, we urge the Commission to take action to force The Reserve to return these funds to shareholders, either by (1) rescinding the order or (2) amending the order so as to force The Reserve to immediately return funds to shareholders and publicly disclose records surrounding these events.



OFFICE OF  
THE SECRETARY

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

February 18, 2009

Philip McBride Johnson, Esq.  
Skadden, Arps, Slate, Meagher & Flom LLP  
1440 New York Avenue, NW  
Washington, DC 20005-2111

Re: Rulemaking Petition File No: 4-578

Dear Mr. Johnson:

This letter acknowledges receipt by this office on February 17, 2009, of your rulemaking petition dated February 15, 2009, requesting the Commission to adopt a new rule identical to Rule 3a12-8 under the Securities Exchange Act of 1934 exempting from Commission registration under Section 3(a)(12) of the Act any futures contract on the sovereign debt of a foreign government so that it may lawfully be offered to U.S. persons pursuant to Section 2(a)(1)(C)(iv) of the Commodity Exchange Act.

The petition has been assigned the above-noted file number and has been referred to the appropriate division of the Commission. This office will notify you of any pertinent action taken by the Commission.

Sincerely,

Elizabeth M. Murphy  
Secretary

Public Reference Copy

**PUBLIC REFERENCE COPY**

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

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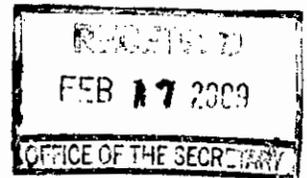
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February 15, 2009

4-578

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington D.C. 20549-6628



RE: Petition for Rulemaking

Dear Ms. Murphy:

Pursuant to the Commission's Rule of Practice 192,<sup>1</sup> petition is hereby made to adopt a new rule identical to Commission Rule 3a12-8 ("Rule")<sup>2</sup> under the Securities Exchange Act of 1934 (the "Act")<sup>3</sup> in light of the fact that the Commission has failed to employ that Rule, despite one or more requests to do so, since enactment of the Commodity Futures Modernization Act of 2000 (the "CFMA") (P. L. 106-554, 114 Stat. 2763 (2000))<sup>4</sup> on the ground that the CFMA no longer allows the Rule to be used for the purpose of exempting from Commission registration under section 3(a)(12) of the Act any futures contract on the sovereign debt of a foreign government so that it may lawfully be offered to United States persons pursuant to section 2(a)(1)(C)(iv) of the Commodity Exchange Act.<sup>5</sup> In the

<sup>1</sup> 17 C.F.R. § 201.192.

<sup>2</sup> *Id.* at. § 240.3a12-8.

<sup>3</sup> 15 U.S.C. § 78a *et seq.*

<sup>4</sup> 7 U.S.C. §§ 1 *et seq.*

<sup>5</sup> *Id.* at §2(a)(1)(C)(iv).

RECEIVED FEB 17 2009

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alternative, request is hereby made to reactivate the Rule and to pass upon all pending requests thereunder.

**Historical background.** As part of the Commodity Futures Trading Commission ("CFTC") reauthorization legislation in 1982,<sup>6</sup> an arrangement made earlier between the CFTC and the SEC with respect to the jurisdictional treatment of certain futures contracts related to securities (the "Shad-Johnson Accord") was enacted into law. As a result, futures contracts on broad-based stock indexes and on securities exempted by the Commission under section 3(a)(12) of the Act<sup>7</sup> were assigned to the jurisdiction of the CFTC. The CFMA has not altered that assignment, as discussed below.

Section 3(a)(12) of the Act, however, does not expressly address the exemption of sovereign debt of foreign governments. However, the Commission adopted the Rule which extends the exemptions to certain qualified foreign government securities upon application. Until adoption of the CFMA, the sovereign debt of twenty-one (21) nations was admitted to this exemption, allowing futures contracts on those securities to be acquired and sold by United States persons if certain terms and conditions were met.

As noted above, that relief has been withheld by the Commission ever since enactment of the CFMA despite one or more requests for inclusion in the Rule's coverage.

**Analysis.** The CFMA created a system of co-regulation between the Commission and the CFTC with respect to a statutorily defined "security future." Conforming amendments were made as a result to the enabling statutes of both the Commission and the CFTC. In both the Act and the Commodity Exchange Act, that definition explicitly states that a futures contract on "an exempted security under section 3(a)(12) of the Securities Exchange Act of 1934" is *not* a security future.<sup>8</sup> Accordingly, it is clear that the Congress sought by its creation of a limited system of co-regulation *not* to affect the pre-existing program under the Rule for futures on foreign government securities.

Moreover, the same definition is used in the Act and the Commodity Exchange Act when discussing possible adoption by the agencies of joint regulations

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<sup>6</sup> Futures Trading Act of 1982, P.L. 97-444, 96 Stat. 2294 (1983).

<sup>7</sup> 15 U.S.C. § 78c(a)(12).

<sup>8</sup> 15 U.S.C. § 78c(a)(55) and 7 U.S.C. § 1a(31).

Ms. Elizabeth M. Murphy  
February 15, 2009  
Page 3

"to permit the offer and sale of a security futures product traded on or subject to the rules of a foreign board of trade to United States persons."<sup>9</sup> While no such regulations have yet been adopted, securities that can be exempted under section 3(a)(12) of the Act are explicitly excluded from the definition of "security future" so that any joint rulemaking on this subject simply would not apply and thus this rulemaking provision cannot be seen as having revoked or superseded the prior exemptive regime.

If necessary, request is hereby made to adopt a *new* Rule identical to the old Rule so that the exemptive program for sovereign foreign securities can resume or, more practicably, to re-activate the original Rule so that pending requests may be processed.

Sincerely,



Philip McBride Johnson

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<sup>9</sup> 15 U.S.C. § 78f(k)(1) and 7 U.S.C. § 2(a)(1)(E)(i).

# Public Reference Copy

PICKARD AND DJINIS LLP

ATTORNEYS AT LAW

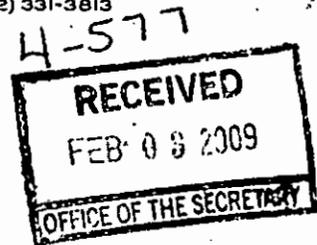
1990 M STREET, N. W.

WASHINGTON, D. C. 20036

TELEPHONE  
(202) 223-4418

TELECOPIER  
(202) 331-3813

February 3, 2009



Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-6628

**Re: Petition for Rulemaking**

Dear Ms. Murphy:

On behalf of Federated Investors, Inc. ("Federated" or "Petitioner"),<sup>1</sup> we hereby petition the Securities and Exchange Commission ("Commission"), pursuant to Commission Rule of Practice 192(a), to amend Rule 15c3-3 under the Securities Exchange Act of 1934 ("Exchange Act"), to treat U.S. government money market mutual fund shares, where the underlying portfolio assets of the fund consist of securities issued or guaranteed by the U.S. government or its agencies or instrumentalities, as "qualified securities" to meet a broker-dealer's deposit requirements under the Special Reserve Bank Account for the Exclusive Benefit of Customers ("Special Reserve Account").<sup>2</sup>

This proposed amendment, we believe, will improve broker-dealers' operational flexibility in meeting their obligation under Rule 15c3-3 and will allow broker-dealers to obtain more competitive yields on such assets while, at the same time, not compromise the Rule 15c3-3's Congressional purpose of safeguarding customers' deposits or credit balances. Further, this proposed amendment would inure to the benefit of qualifying money market funds and provide the Commission with an opportunity to clearly express its confidence in money market mutual funds. We appreciate that Rule 15c3-3 is central to the system of protecting customers' funds held by broker-dealers. We would not

<sup>1</sup> Federated is a mutual fund sponsor with total assets under management of approximately \$420 billion, of which \$350 billion constitute money market funds.

<sup>2</sup> On March 19, 2007, the Commission proposed certain amendments to the financial responsibility rules for broker-dealers. In that release, the Commission proposed to expand the definition of "qualified securities" to include certain money market funds that invest in securities meeting the definition of "qualified securities." The Commission has not yet acted on this rule proposal. Federated believes that the March 2007 proposal expanding the definition of "qualified securities" is unnecessarily limiting. This petition for rule making does not recommend the adoption of the March 2007 amendment as proposed. Federated requests that this petition receive separate and independent review pursuant to Commission Rule of Practice 192(a).

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petition for this rule making if we did not believe that the modest change we urge was inconsistent with investor protection.

Specifically, we propose amending Rule 15c3-3(a)(6) to define "qualified securities" as "a security issued by the United States, a security in respect to which the principal and interest are guaranteed by the United States, *or a redeemable security of an investment company registered under the Investment Company Act of 1940 and described in 17 C.F.R. § 270.2a-7, unaffiliated with the broker dealer and which limits its investments to securities issued or guaranteed by the United States Government or its agencies or instrumentalities (including repurchase transactions).*" (proposed amendment in italics and referred to herein as "U.S. government money market fund").

## I. Overview.

The Commission adopted Rule 15c3-3 in 1972 in response to a Congressional directive to strengthen the financial responsibility requirements for broker-dealers that carry customer assets.<sup>3</sup> With respect to customer funds, Rule 15c3-3 requires broker-dealers to account for all customer funds held by the broker-dealer. The intent of the rule is to require a broker-dealer to hold customer assets in a manner that enables their prompt return in the event of insolvency. The required amount of customer funds to be segregated is calculated pursuant to a formula set forth in Exhibit A to Rule 15c3-3. If, under the formula, customer credit items exceed customer debit items, the broker-dealer must maintain cash or "qualified securities" in that net amount in a "Special Reserve Bank Account for the Exclusive Benefit of Customers."

Rule 15c3-3 is the result of compromise between customer protection and broker-dealer flexibility. Rule 15c3-3 limits a broker-dealer's ability to put customer cash and securities at risk by using them to finance its own activities, such as proprietary trading. However, the rule allows brokers to, among other things, deploy customer funds into margin loans to other customers, which does not confer the same level of safety for those funds as would occur were all the customer funds required to be "locked up" in the reserve account in the form of U.S. Treasury securities or cash. Those who crafted Rule 15c3-3 to protect customer funds were not seeking absolute safety of customer funds, but rather sought a degree of protection that recognized the needs of both the broker-dealer and its customers without significantly impairing the safety of customers' funds.

In funding the reserve account, Rule 15c3-3(e) provides that a broker-dealer may deposit only "cash and/or qualified securities in an amount not less than the amount computed in accordance with the formula set forth in §240.15c3-3a." Rule 15c3-3(a)(6) defines the term *qualified security* as meaning "a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States."

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<sup>3</sup> In 1971, Congress amended Section 15(c)(3) of the Exchange Act to clothe the Commission with the authority to adopt rules providing for safeguards respecting the financial responsibility of brokers concerning the use of customers' deposits or credit balances. See Release No. 9388 (Nov. 8, 1971).

The strict limitations on the types of assets that can be used to fund a broker-dealer's customer reserve account are designed to further the purpose of Rule 15c3-3, namely, that customer assets be segregated and held in a manner that makes them readily available to be returned to the customers.

Petitioner submits that the inclusion of "U.S. government money market fund" shares, a security that was not available at the time the Commission drafted and adopted Rule 15c3-3, as a "qualified security" would provide greater operational flexibility to broker-dealers in meeting their Rule 15c3-3 customer protection requirements without compromising customer protection.

**II. U.S. government money market funds would provide greater operational flexibility and efficiency to broker-dealers in meeting their Rule 15c3-3 customer protection requirements.**

Under current law, a broker-dealer may only meet its deposit requirement by depositing cash or a qualified security into the special reserve account. Accordingly, a broker-dealer must assemble a portfolio of U.S. Treasury securities or deposit cash into the account or a combination thereof.

In order to deposit U.S. Treasury securities into its special reserve account, a broker-dealer must assemble a portfolio of U.S. Treasury securities by constantly buying and selling them to ensure that it has sufficient funds in the reserve account. Such active management of a U.S. Treasury portfolio can become complex and may cause a broker-dealer to incur a loss, as most transactions in government securities take place only in large denominations. For example, a representative of a major broker dealer has provided that the broker-dealer was required to undertake to engage in sixty-two separate transactions in order to assemble a portfolio of Treasury bills to meet its deposit requirements under Rule 15c3-3. Further, such active management requires significant broker-dealer resources.

By using a U.S. government money market fund, the broker-dealer avoids the operational risk of purchasing and selling U.S. Treasury securities and can reduce the confusion, complexity and opportunity for error that can result. Broker-dealers would have much greater efficiency in their ability to maintain the appropriate level of deposit in the reserve account, and would be able to purchase and sell U.S. government money market funds in precise dollar amounts. Further, broker-dealers will also be able to reduce the human and other costs associated with managing a reserve account with U.S. Treasuries. In sum, the use of U.S. government money market funds will facilitate a broker-dealer's ability to meet its cash management and liquidity in a highly cost-efficient manner.

Alternatively, a broker-dealer may deposit cash into the account, putting the funds at risk of the balance sheet of the bank where the cash deposit exceeds the FDIC level of

insurability. Banks are not required to hold the cash separately from the banks' other assets. Therefore, funds in the reserve account become subject to the same risks as any other bank deposit. This is particularly true in the instance of large cash deposits being made in reserve accounts that are held at a limited number of major banks. With aggregate reserve deposits being made by broker-dealers under Rule 15c3-3 reaching an estimated \$150- \$180 billion, a substantial portion of reserve deposits are backed by the balance sheets of these banks rather than FDIC insured. Of additional concern, is the concentration of reserve deposits in a few large banks. The failure of such a bank could effectively eliminate most customer funds properly on deposit under Rule 15c3-3.

This petition to amend Rule 15c3-3 proposes an alternative measure for meeting regulatory obligations which offers comparative protections with additional benefits. This petition asks that the Commission recognize that investments in U.S. government money market funds, with all the protections of the 1940 Act for registered investment companies; the strict requirements of Rule 2a-7 under the 1940 Act; and the stability of portfolio assets limited to investments in securities issued or guaranteed by the United States government or its agencies or instrumentalities (including repurchase transactions), would allow broker-dealers greater flexibility in meeting their Rule 15c3-3 reserve account requirements without denigrating customer protection.

**III. The use of U.S. government money market funds would be consistent with Rule 15c3-3's purpose of protecting customers' funds in a manner that makes them readily available to be returned to the customers.**

**A. U.S. government money market funds would be limited to funds that satisfy the relevant requirements of Rule 2a-7 of the Investment Company Act of 1940.**

The Commission's regulatory program for money market funds under Rule 2a-7 of the Investment Company Act of 1940, as amended, has been an unqualified success.<sup>4</sup> The Commission adopted Rule 2a-7 in 1983 and has revised and strengthened the rule periodically.<sup>5</sup> An investment company may not call itself a "money market mutual fund" unless it satisfies the relevant requirements of Rule 2a-7. This rule has a number of requirements designed to ensure that the money market fund has high quality assets and can redeem shares with a net asset value of \$1.00 per share. The basic requirements for a money market mutual fund include:

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<sup>4</sup> Release No. IC-13380 (July 11, 1983), 48 Fed. Reg. 32555 (July 18, 1983) ("Rule 2a-7 Adopting Release). As noted above, money market funds (including those that limit their investments to securities issued or guaranteed by the United States Government or its agencies or instrumentalities) were not available at the time the Commission drafted and adopted Rule 15c3-3.

<sup>5</sup> Release No. IC-21837 (Mar. 21, 1996), 61 Fed. Reg. 13956 (Mar. 28, 1996).

- **Portfolio Maturity** – In general, Rule 2a-7 requires that money market mutual funds hold portfolio securities with relatively short maturities. Rule 2a-7(c)(2) provides that a money market fund must not acquire any instrument with a remaining maturity of greater than 397 calendar days and may not maintain a dollar-weighted average portfolio maturity of more than 90 days.
- **Portfolio Quality** – Rule 2a-7 requires money market mutual funds to invest in high quality portfolio securities. Rule 2a-7(c)(3) generally requires that a money market fund must have at least 95% of its portfolio investments qualifying for the top rating (“first tier”) and the remainder may be in the second highest rating category (“second tier”).
- **Portfolio Diversification** – Rule 2a-7(c)(4) provides that a money market fund “shall not have invested more than five percent of its total assets in securities issued” by the same entity, except for Government Securities.<sup>6</sup>
- **Portfolio Liquidity** – A money market mutual fund must limit its investment in illiquid assets to not more than 10% of its net assets.<sup>7</sup>

These requirements have provided a strong investor protection foundation for money market funds.<sup>8</sup>

**B. U.S. government money market funds would be limited to investments in United States Government and United States Government Agency Securities.**

We have sought to further increase the level of safety with our proposed formulation of the “U.S. government money market fund” to limit the funds’ *investments*

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<sup>6</sup> Rule 2a-7(a)(14) defines “government security” as defined in Section 2(a)(16) of the 1940 Act. That provision states that “government security” means any security issued or guaranteed as to principal or interest by the United States, or by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit for any of the foregoing.”

<sup>7</sup> The “board of directors of a money market fund ... may have a fiduciary obligation to limit further the acquisition of illiquid portfolio securities.” Rule 2a-7 Adopting Release, at 32561. An illiquid asset is any asset which may not be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the mutual fund has valued the investment. See Investment Company Act, Release No. 14983 (Mar. 12, 1986).

<sup>8</sup> In addition, we note that federal agencies have taken action to ensure that liquidity and safety of money market funds. The Department of Treasury and the Federal Reserve actions include, among others, the Temporary Guarantee Program for Money Market Funds; the Money Market Investor Funding Facility; the Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility; and the Commercial Paper Funding Facility.

*to securities issued or guaranteed by the United States Government or its agencies or instrumentalities (including repurchase transactions).*

A security issued or guaranteed by the United States Government, as well as a security issued by a United States Government agency or instrumentality, is exceptionally safe. There is no credit that is safer than a security issued or guaranteed by the United States Government. In addition, the markets have always assumed that a security issued by a United States Government agency or instrumentality<sup>9</sup> would have an implicit U.S. Government guarantee. Although that assumption has not been tested, based on recent events, we now know that the U.S. Government will back Fannie and Freddie securities.

On July 15, 2008, President Bush stated in a press conference,

In this case, there is a feeling that the government will stand behind mortgages through these two entities. And therefore, we felt a special need to step up and say that we are going to provide, if needed, temporary assistance through either debt or capital. ... [In response to a question:] You know, there is an implicit guarantee.<sup>10</sup>

On July 13, 2008, the Board of Governors of the Federal Reserve System announced:

The Board of Governors of the Federal Reserve System announced Sunday that it has granted the Federal Reserve Bank of New York the authority to lend to Fannie Mae and Freddie Mac should such lending provide necessary. Any lending would be at the primary credit rate and collateralized by U.S. government and federal agency securities. This authorization is intended to supplement the Treasury's existing lending authority and to help ensure the ability of Fannie Mae and Freddie Mac to promote the availability of home mortgage credit during a period of stress in financial markets.<sup>11</sup>

Freddie Mac was able to sell \$3 billion in securities after the Federal Reserves' announcements.<sup>12</sup>

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<sup>9</sup> Agencies and instrumentalities include, among others, Government Sponsored Enterprises ("GSEs") such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac").

<sup>10</sup> Press Conference of the Honorable George W. Bush, July 15, 2008.

<sup>11</sup> <http://www.federalreserve.gov/newsevents/press/other/20080713a.html>.

<sup>12</sup> On July 15, 2008, THE WALL STREET JOURNAL reported:

Ms. Elizabeth M. Murphy

February 3, 2009

Page 7 of 10

Further, Congress passed legislation that President Bush signed, that statutorily authorizes the U.S. Treasury to purchase any obligations and other securities issued by the GSEs.<sup>13</sup> In addition, on September 7, 2008, the Secretary of the Treasury and the Director of the Federal Housing Finance Agency ("FHFA") announced that they were taking additional steps to bolster the financial integrity of the GSEs.<sup>14</sup>

Based on the above, it is not conceivable that the U.S. Government would let these GSEs fail, with enormous ripple effects on both the housing markets and on the institutions holding their debt. Whatever question lingered about whether the federal government would back the GSEs has been answered by President Bush, Chairman Bernanke, Secretary Paulson, and Congress.<sup>15</sup>

Finally, there are in excess of fifty U.S. government money market funds, none of which have ever broken the buck.<sup>16</sup> Accordingly, we believe that there should be no question that such investments are safe.

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Freddie Mac passed a crucial test of investor confidence Monday when there was strong demand for short-term debt it was selling, .... A closely watched auction of \$3 billion in Freddie's short-term debt drew more bids than usual. The company was able to sell its three- and six-month notes at lower-than-expected yields, which in turn helped keep its borrowing costs low.

"Freddie Mac Auction Eases Concerns," July 15, 2008, page A15, available at [http://online.wsj.com/article/SB121603898437750725.html?mod=googlenews\\_wsj](http://online.wsj.com/article/SB121603898437750725.html?mod=googlenews_wsj)

<sup>13</sup> H.R. 3221, P.L. No. 110-289, Sections 1117-1118.

<sup>14</sup> See Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers, available at <http://www.treasury.gov/press/releases/hp1129.htm>, and authorities cited therein. See also "Government Support Underlying Obligations held by Federated Government Obligations Funds" (Dec. 17, 2008), attached hereto as Exhibit A which further describes the nature of the United States Government's support underlying certain debt obligations issued or guaranteed by agencies or instrumentalities of the United States Government.

<sup>15</sup> We also petition that the Commission permit such portfolios to include repurchase transactions with respect to such securities. We do not believe that the addition of repurchase transactions would be a significant departure from current practice. Under current law, broker-dealers may use borrowed Treasury securities for deposit into their special reserve accounts. See SEC Staff to NASD, Nov. 1993 (available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/industry/p037772.pdf>)

<sup>16</sup> By comparison, between 1994 and 2008, the FDIC reports that 80 institutions failed, incurring losses of over \$2 trillion, and that dollar amount does not include recent failures such as IndyMac, First National Bank of Nevada, and First Heritage Bank NA. See FDIC website calculation of closings and assistance transactions between 1994 and 2008, available at <http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30>.

**IV. U.S. government money market funds may be used by FCMs to meet CFTC segregation requirements analogous to Rule 15c3-3.**

This petition request would also modernize Rule 15c3-3(a)(6) and place it on an equal footing with other regulatory changes.

Other regulators allow the use of money market funds for similar purposes. For example, the Commodity Futures Trading Commission allows futures commission merchants ("FCMs") to use Rule 2a-7 funds to satisfy its segregation requirements.<sup>17</sup> Section 4(d)(2) of the Commodity Exchange Act ("CEA") established the hallmark principle of segregation of customer funds and the trust-like nature of the broker's duties in respect of such funds. Because of the absence of an analogue to the Securities Investor Protection Corporation ("SIPC"), the CFTC segregation requirements are of critical importance under the CEA's regulatory scheme, and are arguably more important than segregation requirements under securities laws. Accordingly, we believe it is all the more telling that the CFTC has permitted the use of Rule 2a-7 funds for this purpose and has had good experience with this rule.<sup>18</sup>

There does not appear to be any customer protection justification that allows FCMs to use money market funds for segregation purposes, but denies broker-dealers the authority to use money market funds in an analogous function, especially when the SEC itself regulates money market funds.

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<sup>17</sup> See Investment of customer funds, CFTC Rule 1.25 (17 CFR§ 1.25)

(a) Permitted investments.

(1) Subject to the terms and conditions set forth in this section, a futures commission merchant ("FCM") of a derivatives clearing organization may invest customer money in the following instruments:

....  
(viii) Interests in money market mutual funds.

(2)

(i) In addition, a future commission merchant or derivatives clearing organization may buy and sell the permitted investments lists in paragraphs (a)(1)(i) through (viii) of this section pursuant to agreements for resale or repurchase of the instruments....

<sup>18</sup> In 2000 the CFTC allowed FCMs to invest customer funds in money market funds based upon, in part, its conclusion that "an expanded list of permitted investments could enhance the yield available to FCMs, clearing organizations and their customers without compromising the safety of customer funds." 65 Fed. Reg. 39008, 39014 (June 22, 2000) (rule proposal); 65 Fed. Reg. 77993 (Dec. 13, 2000) (rule adoption). The rule initially limited FCMs to using money market funds that received the highest rating from a nationally recognized statistical rating agency, if rated at all. After several years of favorable experience, the CFTC amended its rule and allowed FCMs to use any money market fund. See 68 Fed. Reg. 38654 (June 30, 2003); 70 Fed. Reg. 28190, 28194-95 (May 17, 2005)(noting that SEC Rule 2a-7 establishes important risk-limiting standards governing the portfolio quality, diversification, and maturity of money market funds.) To our knowledge, the CFTC has not publicly identified any problems that have resulted as a consequence of this further change.

**V. U.S. government money market funds have broad support in the broker-dealer community.**

We petition for this change in Rule 15c3-3 in response to broad support for the broker-dealer community.<sup>19</sup> Federated simply is trying to respond to the needs of its customer base. Indeed, the petition for change would not solely benefit Federated. This petition for rule making proposes an approach that other funds could meet and Federated fully expects that other fund complexes will compete with Federated for broker-dealers' assets.

**VI. Approving U.S. government money market funds for the Rule 15c3-3 deposit requirements would constitute a strong signal of support and confidence by the Commission in the mutual fund industry.**

We note that the proposed change would also support the ongoing efforts of the Department of Treasury and the Federal Reserve in their respective programs to instill and maintain confidence in the financial community, particularly the mutual fund industry. The Department of Treasury has noted that money market funds play an important role as an investment vehicle for many Americans and that maintaining confidence in the money market fund industry is critical to protecting the integrity and stability of the global financial system. The limited modification we seek, if implemented by the Commission, would likewise send a strong signal of public confidence in this segment of the financial community and would be consistent as well as supportive of the efforts of the Department of Treasury and the Federal Reserve.

**VII. Conclusion.**

Petitioner seeks this change to Rule 15c3-3 because it wishes to respond to the needs of its customers. Broker-dealers have a strong desire to avoid the operational risks of managing portfolios of U.S. Treasury securities and to limit the balance sheet risk of bank deposits. Money market funds, specifically money market funds that are limited to investments in securities issued or guaranteed by the United States Government or its agencies or instrumentalities (including repurchase transactions), are safe. FCMs enjoy the same conveniences for purposes analogous to the Rule 15c3-3 special reserve account requirement. We believe that it is long overdue for the SEC to allow broker-dealers and investors to enjoy this same advantage.

We thank you for your consideration of this request for rule making.

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<sup>19</sup> Many of the comment letters or memoranda of meetings in the public file concerning the March 2007 proposal broadly support this change to Rule 15c3-3.

Ms. Elizabeth M. Murphy

February 3, 2009

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Please do not hesitate to contact Lee A. Pickard or Peter E. McLeod of Pickard and Djinis, LLP at (202) 223-4418 with any questions or requests for further information with respect to the matters set forth in this letter. We look forward to your response.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Lee A. Pickard". The signature is fluid and cursive, with the first name "Lee" being particularly prominent.

Lee A. Pickard

cc: The Honorable Mary L. Shapiro  
The Honorable Kathleen L. Casey  
The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
The Honorable Troy A. Paredes  
Mr. Erik R. Sirri, Director, Division of Trading and Markets  
Mr. Daniel M. Gallagher, Deputy Director, Division of Trading and Markets  
Mr. Michael A. Macchiaroli, Associate Director, Division of Trading and Markets  
Mr. Thomas K. McGowan, Assistant Director, Division of Trading and Markets

GOVERNMENT SUPPORT  
UNDERLYING OBLIGATIONS  
held by  
FEDERATED GOVERNMENT  
OBLIGATIONS FUND

**Federated**

WORLD-CLASS INVESTMENT MANAGER

EXHIBIT

A

tabbles

December 17, 2008

To: Eugene F. Maloney

From: Melanie L. Fein

**GOVERNMENT SUPPORT  
UNDERLYING OBLIGATIONS**  
held by  
**FEDERATED GOVERNMENT  
OBLIGATIONS FUND**

You asked me to describe the nature of the government support underlying certain debt obligations issued or guaranteed by agencies of the U.S. government and which are held in the portfolio of the Government Obligations Fund for which an affiliate of Federated Investors, Inc. is the investment adviser (hereinafter "GOF").

Specifically, you asked me to address the government support underlying debt obligations issued or guaranteed by the following government agencies:

- > Federal National Mortgage Association ("Fannie Mae")
- > Federal Home Loan Mortgage Corporation ("Freddie Mac")
- > Federal Home Loan Bank System
- > Farm Credit System
- > Department of Housing and Urban Development

In general, the debt obligations issued or guaranteed by each of these agencies are supported by a comprehensive system of federal supervision and regulation that supports the safety and soundness of the agencies and their ability to repay their obligations. In addition, specific statutory provisions explicitly or implicitly guarantee or otherwise enhance the creditworthiness of their obligations, as follows:

- > **Fannie Mae and Freddie Mac** debt obligations are supported by a binding contractual commitment by the U.S. Treasury to fund obligations of the agencies up to \$100 billion each and temporary statutory authority for the Treasury to purchase an unlimited amount of their securities until December 31, 2009.
- > **Federal Home Loan Bank** debt obligations are supported by similar statutory authority for the Treasury to purchase up to \$4 billion of their obligations and additional temporary authority for the Treasury to purchase an unlimited amount of their obligations until December 31, 2009.
- > **Farm Credit System** debt obligations are supported by a system of mutual liability and an insurance fund dedicated to ensuring the timely payment of interest and principal on insured obligations issued by the Farm Credit Banks.
- > Debt obligations guaranteed by the **Department of Housing and Urban Development** pursuant to the Housing and Community Development Act of 1974 are explicitly backed by the full faith and credit of the United States.

These provisions are discussed in greater detail below.

You also asked me to address the bankruptcy risk characteristics of repurchase agreements that GOF enters into with banks and broker-dealers using securities issued or guaranteed by the U.S. Treasury or government agencies as collateral.

2 | As discussed below and in the attached memorandum, the Bankruptcy Code includes several provisions that protect parties to repurchase agreements in the event of a counterparty's bankruptcy.

# GOVERNMENT AGENCY DEBT SECURITIES

## A. Fannie Mae and Freddie Mac Notes

The Federal National Mortgage Association ("FNMA"), commonly known as "Fannie Mae," and the Federal Home Loan Mortgage Corporation ("FHLMC"), commonly known as "Freddie Mac," (collectively, the "GSEs") are government-sponsored entities created by the federal government to provide financial support for the housing markets in the United States.<sup>2</sup>

Prior to enactment of the Housing and Economic Recovery Act of 2008 ("Recovery Act"),<sup>3</sup> the debt obligations of the GSEs generally were thought to be backed by an implicit guarantee of the U.S. government inherent in their status as government-sponsored entities. After the GSEs appeared likely to default on their debt obligations in the summer of 2008, Congress enacted the Recovery Act in order to, among other things, make the implicit government guarantee of the GSEs more explicit.

The Act authorized the Treasury to purchase unlimited amounts of GSE debt obligations and other securities and placed the GSEs under the oversight of a new independent agency—the Federal Housing Finance Agency ("FHFA").<sup>4</sup> The FHFA was authorized, under certain circumstances, to take the GSEs into conservatorship.<sup>5</sup>

### GSE Rescue Plan

On September 7, 2008, the Treasury Department, FHFA and the GSEs implemented a rescue plan pursuant to which the Treasury now is effectively guaranteeing the GSEs' obligations up to at least \$100 billion each, through a binding contractual arrangement.

Under the rescue plan, FHFA appointed itself conservator of the GSEs, with the consent of each.<sup>6</sup> Pursuant to this conservatorship, FHFA has assumed all legal authority of the shareholders, directors, and officers of the GSEs.<sup>7</sup> The conservatorships have no fixed termination date.

3

<sup>1</sup> GOF is an open-end investment company registered with the Securities and Exchange Commission (the "SEC") under the Investment Company Act of 1940 that holds itself out as a money market mutual fund in compliance with the requirements of that Act and regulations issued by the SEC thereunder. According to Federated's web site, GOF has been assigned the highest possible ratings from Standard & Poor's, Moody's and Fitch.

<sup>2</sup> 12 U.S.C. §§ 1454, 1716(a).

<sup>3</sup> Pub. L. 110-289, 12 Stat. 2654 (enacted July 30, 2008).

<sup>4</sup> Recovery Act, § 1117(a) (adding 12 U.S.C. § 1719(g)) & (b) (adding 12 U.S.C. § 1455(h)), and § 1101.

<sup>5</sup> *Id.*, § 1145.

<sup>6</sup> Federal Housing Finance Agency, "Statement of FHFA Director James B. Lockhart" (September 7, 2008), at 6, available at [http://treasury.gov/press/releases/reports/fhfa\\_statement\\_090708hp1128.pdf](http://treasury.gov/press/releases/reports/fhfa_statement_090708hp1128.pdf).

<sup>7</sup> Recovery Act, § 1145(a) (amending 12 U.S.C. § 4617(b)(2)).

Concurrently with the conservatorships, the GSEs entered into identical Senior Preferred Stock Purchase Agreements (“Agreements”) with the Treasury Department to provide capital and liquidity support, pursuant to Treasury’s authority under the Recovery Act.<sup>8</sup> Under the Agreements, the Treasury received certain senior preferred stock with an initial liquidation preference of \$1 billion in each GSE, as well as warrants to purchase 79.9 percent of the common stock of each GSE on a fully-diluted basis at a nominal price.<sup>9</sup>

### Treasury Backing for GSE Obligations

In exchange for the equity received through the Agreements, the Treasury became contractually bound to make available to each GSE up to \$100 billion. The funds must be provided at the request of the FHFA, on a quarterly basis (or sooner if the GSE would otherwise be forced into receivership), in an amount sufficient to cover the difference between the GSE’s assets and liabilities.<sup>10</sup>

Treasury’s obligation to provide this funding to each GSE continues until the earlier of (i) liquidation of the GSE (with any difference between assets and liabilities paid off),<sup>11</sup> (ii) full payment of all of the GSE’s liabilities, or (iii) when the \$100 billion limit has been reached.<sup>12</sup> Treasury’s obligation is expressly not contingent upon the GSEs’ financial condition or receivership.<sup>13</sup> For each infusion of funds, the liquidation preference of Treasury’s senior preferred stock increases by the same amount.<sup>14</sup> Amendments to the Agreements are prohibited to the extent that they would decrease the amount of Treasury’s commitment or add conditions if a GSE reasonably believes that such an amendment would have an adverse material effect on debtholders.<sup>15</sup>

Thus, although the Agreements specifically state that they do not give rise to a “guarantee” of any obligation,<sup>16</sup> the Treasury in effect has assumed responsibility for each GSE’s obligations up to \$100 billion.

### Authority for the Agreements

The Recovery Act expressly authorized the Treasury to purchase GSE securities “on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine” as necessary to stabilize the financial and mortgage-finance markets and protect taxpayers.<sup>17</sup> Because the Agreements involve the purchase of GSE securities subject to terms and conditions agreed to by the Treasury, they appear to fall within the

<sup>8</sup> Amended and Restated Senior Preferred Stock Purchase Agreement (September 26, 2008), available at <http://www.ustreas.gov/press/releases/reports/seniorpreferredstockpurchaseagreementfrea.pdf> (Freddie Mac) and <http://www.ustreas.gov/press/releases/reports/seniorpreferredstockpurchaseagreementfma1.pdf> (Fannie Mae).

<sup>9</sup> Agreement, ¶ 3.1 The Agreements imposed additional duties upon the parties, as well. For example, the GSEs were each prohibited from increasing their aggregate indebtedness by more than ten percent, ¶ 5.5, and from entering any merger, acquisition, or reorganization without Treasury’s advance permission, ¶ 5.4, and were required to limit their mortgage asset holdings to \$850 billion by December 31, 2009, and to decrease such holdings by ten percent each year thereafter, down to a floor of \$250 billion, ¶ 5.7. The GSEs also assumed certain reporting requirements under ¶ 5.9. This memorandum focuses on the Treasury’s obligation to fund the GSEs and is not intended to give an exhaustive description of the Agreements.

<sup>10</sup> Agreement, ¶¶ 2.1, 2.2, 2.3.

<sup>11</sup> FHFA stated at the inception of the Agreements that FHFA has no present intention of liquidating the GSEs. FHA Fact Sheet, “Questions and Answers on Conservatorship” (September 7, 2008), at 3, available at [http://treasury.gov/press/releases/reports/fhfa\\_consrv\\_faq\\_090708hp1128.pdf](http://treasury.gov/press/releases/reports/fhfa_consrv_faq_090708hp1128.pdf).

<sup>12</sup> Agreement, ¶ 2.5.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*, ¶¶ 2.1 & 3.3.

<sup>15</sup> *Id.*, ¶ 6.3.

<sup>16</sup> *Id.*, ¶ 6.6.

<sup>17</sup> Recovery Act, § 1117(a), adding 12 U.S.C. § 1719(g)(1) & 1117(b), adding 12 U.S.C. § 1455(f)(1).

Treasury's statutory authority.<sup>18</sup> Moreover, the Treasury itself has acknowledged that each of the Agreements "is a binding legal obligation between two parties."<sup>19</sup> Furthermore, an executive department is generally considered to have authority to contract in the course of carrying out an authorized program.<sup>20</sup>

The authority of the GSEs to enter the Agreements is clear. The Recovery Act allows the FHFA Director to assume conservatorship over the GSEs in the event, among others, that the GSEs consent.<sup>21</sup> Once conservatorship has been assumed, the FHFA may exercise all rights of the GSE,<sup>22</sup> which includes the right to enter contracts.<sup>23</sup>

## B. Federal Home Loan Bank System Notes

Notes issued by the Federal Home Loan Bank System are supported by the Treasury Department's authority to purchase securities of the Federal Home Loan Banks and by the federal regulatory system governing the Federal Home Loan Banks, as described below.

The twelve Federal Home Loan Banks were created by Congress in 1932 to improve the supply of funds to local lenders that in turn finance loans for home mortgages. The Federal Loan Bank Act authorizes the Banks to issue notes and other debt obligations to finance their activities.<sup>24</sup> Obligations of the Banks are lawful investments and may be accepted as security, for all fiduciary, trust, and public funds invested or deposited under the authority or control of the United States or any officer or officers thereof.<sup>25</sup>

In addition to notes issued by the individual Banks, the FHFA may issue consolidated Federal Home Loan Bank debentures on which the Banks are jointly liable.<sup>26</sup> Any such debentures outstanding may not exceed five times the total paid-in capital of all the Federal Home Loan Banks at the time of issuance and may not exceed the notes or obligations of member institutions held and secured by all the Federal Home Loan Banks. If no debentures are outstanding, or in order to refund all outstanding consolidated debentures issued, the FHFA may issue consolidated Federal Home Loan Bank bonds which shall be the joint and several obligations of all the Banks.<sup>27</sup>

All obligations of Federal Home Loan Banks are required by statute to state that "such obligations are not obligations of the United States and are not guaranteed by the United States."<sup>28</sup> Nevertheless, such obligations are thought to carry an implicit guarantee of the government similar to that of the GSEs.

Although that authority expires on December 31, 2009, Recovery Act, § 1117(a) (adding 12 U.S.C. § 1719(g)(4)) & (b), adding 12 U.S.C. § 1455(l)(4), the purchase has already been completed, and no further purchases are required to complete Treasury's commitment of funds. The Recovery Act places no temporal limitation on the duration of such purchase agreements, only on Treasury's authority to enter them. The Recovery Act explicitly excludes from any temporal limitation the Treasury's authority to exercise any rights received in connection with such purchases. *Id.*, § 1117(a), adding 12 U.S.C. § 1719(g)(2)(A) and (b), adding 12 U.S.C. § 1455(l)(2)(A). The Treasury Department has stated that all GSE securities, regardless of when issued, are protected by the Agreements. Department of the Treasury, "Frequently Asked Questions: Treasury Senior Preferred Stock Purchase Agreement," HP-1131 (September 11, 2008) (hereinafter "HP-1131 FAQ"), available at <http://www.ustreas.gov/press/releases/hp1131.htm>.

HP-1131 FAQ.

*United States v. Winstar*, 518 U.S. 839, 890 n.36 (1996).

Recovery Act, § 1145(a), amending 12 U.S.C. § 4617(a)(3)(1).

*Id.*, amending 12 U.S.C. § 4617(b)(2).

12 U.S.C. §§ 1452(c)(4), 1723a(a).

12 U.S.C. § 1431(a).

12 U.S.C. § 1435.

12 U.S.C. § 1431(b).

12 U.S.C. § 1431(c).

*Id.*

Specifically, the Secretary of the Treasury is authorized to purchase any obligations issued by the Federal Home Loan Banks provided that the aggregate principal amount of such obligations held by the Treasury does not exceed \$4 billion.<sup>29</sup> The Housing and Economic Recovery Act of 2008 temporarily increased this amount to “such amounts as the Secretary may determine” in his discretion until December 31, 2009.<sup>30</sup> As with the GSEs, in exercising this temporary authority, the Treasury Secretary must determine that such action is necessary to provide stability to the financial markets, prevent disruptions in the availability of mortgage finance, and protect the taxpayer.

The Recovery Act placed the Federal Home Loan Banks, along with the GSEs, under the supervision and regulation of the FHFA,<sup>31</sup> which is endowed with the same conservatorship powers as with the GSEs. Thus, the FHFA and Treasury could implement an arrangement with the Banks similar to the one implemented as to the GSEs. As of this date, they have not exercised such authority, but could elect to do so upon a determination by the Secretary that it was necessary to provide stability to the financial markets, prevent disruptions in the availability of mortgage finance, and protect the taxpayer.<sup>32</sup>

The Federal Home Loan Banks also are subject to the extensive prudential supervision and regulation by the FHFA similar to that accorded to the GSEs, which provides a further measure of government support for the Federal Home Loan Bank System and its obligations.

### C. Farm Credit System Notes

Notes issued by the Farm Credit Banks are supported by the federal regulatory framework applicable to the Farm Credit System and by the Farm Credit Insurance Fund which Congress established to insure the timely payment of interest and principal on insured obligations issued by the Farm Credit Banks.

The Farm Credit System was created by Congress in 1916 to provide financing to the agriculture sector. The System currently operates pursuant to the Farm Credit Act of 1971, as amended<sup>33</sup> and consists of the Farm Credit Banks, federal land bank associations, production credit associations, banks for cooperatives, and “such other institutions as may be made a part of the System,” all of which are subject to regulation by the Farm Credit Administration (the “FCA”).<sup>34</sup>

<sup>29</sup> 12 U.S.C. § 1431(f). As a condition to such purchases, the Treasury Secretary must certify to Congress that “alternative means cannot be effectively employed to permit members of the Federal Home Loan Bank System to continue to supply reasonable amounts of funds to the mortgage market, and the ability to supply such funds is substantially impaired because of monetary stringency and a high level of interest rates.”

<sup>30</sup> Recovery Act, § 1117(c), adding 12 U.S.C. § 1431(f). Although not authorized to make new purchases above \$4 billion after December 31, 2009, the Secretary may continue to hold and sell amounts above that threshold beyond that date.

<sup>31</sup> Previously, the Banks were regulated by the Federal Housing Finance Board—also an independent agency—pursuant to the Federal Home Loan Bank Act, 12 U.S.C. § 1421 *et seq.*

<sup>32</sup> Recovery Act, § 1117(c), adding 12 U.S.C. § 1431 (f)(1).

<sup>33</sup> 12 U.S.C. § 2001 *et seq.*

<sup>34</sup> 12 U.S.C. § 2002. The FCA is governed by a three-person board whose members are appointed by the President with the advice and consent of the Senate. The FCA’s board members also serve as the board of directors of the Farm Credit System Insurance Corporation.

The FCA is an independent agency of the U.S. government created by Congress to charter the Farm Credit Banks. The statute specifically designates the Banks as "Federally chartered instrumentalities of the United States."<sup>35</sup> The FCA has broad powers to supervise and regulate the Farm Credit Banks, similar to the powers of the federal banking regulators with respect to commercial banks and the FHFA with respect to the GSEs and Federal Home Loan Banks.

The Farm Credit Banks mutually support each other's obligations. Each Farm Credit Bank is fully liable for any notes, bonds, debentures, or other obligations that it issues and for interest payments on long-term notes, bonds, debentures, or other obligations issued by other Farm Credit Banks.<sup>36</sup> Each Bank also is primarily liable for the portion of any issue of consolidated or system-wide obligations made on its behalf and is jointly and severally liable for additional sums as required by the Farm Credit Administration in order to make payments of interest or principal which any primarily liable Bank cannot make.<sup>37</sup>

The Farm Credit Act specifically provides, with respect to debt obligations of the Farm Credit Banks, that "the United States shall not be liable or assume any liability directly or indirectly thereon."<sup>38</sup>

Nevertheless, Congress created a federal agency and insurance fund whose primary purpose is to insure the notes and other obligations of the Farm Credit Banks.<sup>39</sup> The Farm Credit System Insurance Corporation is required to expend amounts in the Farm Credit System Insurance Fund ("Fund") to the extent necessary to insure the timely payment of interest and principal on insured obligations.<sup>40</sup>

The FCA may not call on any Farm Credit institution to satisfy the liability of the institution on any joint, consolidated, or system-wide obligation participated in by the institution or with respect to which the institution is primarily, or jointly and severally, liable, before the Insurance Fund is exhausted.<sup>41</sup> In the event the assets of the Fund were to be exhausted, joint and several liability of all Banks would be triggered, in which case the financial resources of the other Banks would be used to repay the defaulting Bank's portion of the debt issuance.

The Farm Credit System Insurance Fund is funded by annual insurance premiums paid by the Farm Credit Banks. Premium rates are calculated using a statutorily defined formula based on System loan volume with different rates for accrual loans, nonaccrual loans, and loans guaranteed by Federal or State governments. Congress has directed the Farm Credit System Insurance Corporation to build the Fund to a "secure base amount."<sup>42</sup>

<sup>35</sup> 12 U.S.C. § 2011.

<sup>36</sup> 12 U.S.C. § 2155(a).

<sup>37</sup> *Id.*

<sup>38</sup> 12 U.S.C. § 2155(c).

<sup>39</sup> 12 U.S.C. 2277a-1.

<sup>40</sup> 12 U.S.C. § 2277a-9(c)(1).

<sup>41</sup> 12 U.S.C. § 2155(d).

<sup>42</sup> The secure base amount is defined as two percent of the aggregate of outstanding insured obligations of all insured Banks, adjusted downward by a certain percentage of the System's government guaranteed loans. The Farm Credit System Reform Act of 1996 provided the Corporation's board the authority, in its sole discretion, to reduce insurance premiums from the statutory rates before the Fund reaches the secure base amount.

The Farm Credit Act specifically provides that debt obligations of the Farm Credit Banks are permissible fiduciary investments for trustees:

- > The bonds, debentures, and other similar obligations issued under the authority of this Act shall be lawful investments for all fiduciary and trust funds and may be accepted as security for all public deposits.<sup>43</sup>

## D. Housing and Urban Development Guaranteed Notes

The Government Obligations Fund also holds notes (or obligations that are backed by a trust or pool composed of such notes) that are issued by various "eligible public entities" and which are guaranteed by the U.S. Department of Housing and Urban Development pursuant to section 108 of the Housing and Community Development Act of 1974.<sup>44</sup>

Section 108 of the Act authorizes the Secretary of Housing and Urban Development to guarantee notes or other obligations issued by eligible public entities (or their public-agency designees), for the purposes of financing specified housing rehabilitation and economic development projects.<sup>45</sup> An "eligible public entity" generally is defined as "any unit of general local government."<sup>46</sup>

To receive the guarantee, an issuer must, among other things: enter into a contract for repayment of the guaranteed notes or other obligations; pledge any grant for which the issuer may become eligible under the Act; and furnish such other security as the Secretary may deem appropriate in making the guarantees (including increments in local tax receipts generated by the activities assisted or dispositions proceeds from the sale of land or rehabilitated property).<sup>47</sup>

The Act specifically provides that "the full faith and credit of the United States is pledged to the payment of all guarantees made under this section [108]" and that "any such guarantee made by the Secretary shall be conclusive evidence of the eligibility of the obligations for such guarantee with respect to principal and interest, and the validity of any such guarantee so made shall be incontestable in the hands of a holder of the guaranteed obligations."<sup>48</sup>

Section 108 also authorizes the Secretary to guarantee the timely payment of principal and interest on trust certificates or other obligations that may be offered by the Secretary (or by another offeror approved by the Secretary) that are based on and backed by a trust or pool composed of notes or other obligations guaranteed or eligible for guarantee by the Secretary under section 108.<sup>49</sup> The guarantee of such trust certificates or other obligations is backed by the full faith and credit of the United States to the same extent as the guarantee of the underlying notes.<sup>50</sup>

<sup>43</sup> 12 U.S.C. § 2157. I am not aware as to whether this particular provision has been interpreted by the courts in any given circumstances and have not researched the extent to which this provision would preempt any state trust law to the contrary. The provision most likely pertains only to fiduciaries and trustees holding government funds.

<sup>44</sup> 42 U.S.C. § 5308(a).

<sup>45</sup> A guarantee under this authority may be used to assist a grantee in obtaining financing "only if the grantee has made efforts to obtain such financing without the use of such guarantee and cannot complete such financing consistent with the timely execution of the program plans without such guarantee."

<sup>46</sup> 42 U.S.C. § 5308(o).

<sup>47</sup> 42 U.S.C. § 5308(d).

<sup>48</sup> 42 U.S.C. § 5308(f).

<sup>49</sup> 42 U.S.C. § 5308(i).

<sup>50</sup> *Id.*

## BANKRUPTCY RISK AND REPURCHASE AGREEMENTS

GOF enters into U.S. government securities repurchase agreements with a number of different banks and broker-dealers. These counterparties generally are large and reputable institutions. Nevertheless, you have asked me to address the risks that may arise in the event that a counterparty declares bankruptcy.

The Bankruptcy Code includes provisions that protect counterparties in repurchase transactions in the event of bankruptcy and generally allow a party to liquidate, terminate, accelerate, exercise security rights, and offset obligations under a repurchase agreement notwithstanding a bankruptcy. In particular, the Bankruptcy Code provides an exception from the automatic stay provisions for parties to repurchase agreements.

Attached hereto is a memorandum prepared by Bryan Cave LLP discussing the Bankruptcy Code provisions in greater detail. The memorandum concludes that, in a typical Treasury repurchase transaction involving a bankrupt counterparty, a creditor generally should be able to liquidate the collateral and to apply it to the debtor's obligations.<sup>51</sup>

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*In preparing this memorandum, I have relied solely on your representations as to the types of obligations in the GOF portfolio. I have not reviewed the terms or conditions of any specific notes or obligations.*

*This memorandum has addressed certain bankruptcy risk characteristics of repurchase agreements on U.S. Treasury securities, but is not intended to provide a comprehensive analysis of the risks of repurchase agreements.*

*This memorandum should not be interpreted as providing investment advice regarding the Federated Government Obligations Fund, any government agency debt securities or other obligations, or any repurchase agreement transactions.*

<sup>51</sup> I would note that I am not expert in the Bankruptcy Code and defer to the memorandum prepared by Bryan Cave LLP.

## Memorandum

Date: September 19, 2008

To: Eugene F. Maloney, Executive Vice President,  
Federated Investors Management Company, Inc.,  
Vice President and Corporate Counsel of Federated Investors, Inc.  
and member of the Executive Committee

From: Brian C. Walsh

Re: Treatment of Repurchase Agreements in Bankruptcy

Bryan Cave LLP  
One Metropolitan Square  
211 North Broadway  
Suite 3600  
St. Louis, MO 63102-2750  
Tel (314) 259-2000  
Fax (314) 259-2020  
www.bryancave.com

As you requested, I have summarized below four of the key provisions of the Bankruptcy Code governing repurchase agreements. In general, these provisions permit a party to a repurchase agreement to liquidate, terminate, accelerate, exercise security rights, and offset obligations under the agreement despite a bankruptcy filing by the counterparty and despite otherwise applicable bankruptcy rules that would prevent similar actions if a different type of contract were involved. They also protect most ordinary pre-bankruptcy transactions under repurchase agreements from reexamination in bankruptcy.

I understand that your customers have raised questions about repurchase agreements involving Treasury securities. The fact that Treasury securities are involved is significant for two reasons. First, the Bankruptcy Code sections discussed below concern procedural matters and do not address the economic risk that the securities involved in a repurchase agreement may decline in value and thus be insufficient to cover the related obligation. This is, of course, less of a concern with Treasury securities than with other types of securities. Second, a repurchase agreement involving United States government securities fits within the statutory definition of "repurchase agreement" in Section 101(47) of the Bankruptcy Code, provided that the term of the agreement is one year or less.

**Ipsa-facto actions.** The Bankruptcy Code generally precludes creditors from terminating or modifying contracts based on default provisions triggered by a bankruptcy filing, insolvency, or similar matters, which bankruptcy practitioners generally refer to as "ipso-facto" clauses. Section 559 of the Bankruptcy Code overrides these general principles in the case of repurchase agreements, authorizing a repo participant to liquidate, terminate, or accelerate a repurchase agreement based on an ipso-facto event if it has a "contractual right" to do so. The section also clarifies that no court or administrative agency may stay, avoid, or otherwise limit

the repo participant's right to liquidate, terminate, or accelerate unless the debtor is a stockbroker or a securities clearing agency and the order is authorized by the Securities Investor Protection Act or the federal securities laws. The term "repo participant" refers to a party with an outstanding repurchase agreement with the debtor at any time prior to the bankruptcy filing. "Contractual right" is defined broadly to include not only rights specified in the repurchase agreement itself but also rights derived from the common law and a variety of other sources.

**The automatic stay.** Section 362(b)(7) of the Bankruptcy Code provides an exception to the automatic stay for "the exercise by a repo participant ... of any contractual right (as defined in section 559) under any security agreement or arrangement or other credit enhancement forming a part of or related to any repurchase agreement, or of any contractual right ... to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements." The automatic stay ordinarily prevents creditors from pursuing collection actions against debtors, disposing of collateral, or setting off mutual debts without leave of the bankruptcy court, which can be difficult and time-consuming to obtain. As a result, the exception to the automatic stay for repurchase agreements is significant.

**Setoff.** Section 553 of the Bankruptcy Code generally preserves the right of a creditor to offset debts owed to a debtor against the creditor's claims against the debtor. However, Section 553 limits rights of setoff in some circumstances where the creditor obtains a claim against the debtor by transfer, or the creditor incurs its debt to the debtor, within 90 days prior to the bankruptcy filing. Section 553 also permits a debtor to recover amounts offset by a creditor within 90 days prior to bankruptcy if certain other facts are present. All of these restrictions expressly exclude rights of setoff and actual setoffs described in Section 362(b)(7) and 559, discussed above. Accordingly, setoffs under repurchase agreements are essentially unaffected by the Bankruptcy Code.

**Avoidance actions.** The Bankruptcy Code ordinarily permits a debtor or a trustee to attack pre-bankruptcy transactions as preferential or fraudulent transfers. Section 546(f) imposes a significant limitation on these rights: a pre-bankruptcy transfer made by, to, or for the benefit of a repo participant in connection with a repurchase agreement is avoidable only if the debtor made the transfer with actual intent to hinder, delay, or defraud creditors.

As a consequence of these provisions, in a typical Treasury repurchase transaction involving a bankrupt counterparty, the creditor should be able to liquidate the collateral and to apply it to the debtor's obligations. It is highly unlikely that the Bankruptcy Code or a bankruptcy court would prevent the creditor from taking such action. Of course, different facts might lead me to a different conclusion.

Please let me know if you have any questions about the issues discussed above.

cc: Stuart J. Kaswell

## MELANIE L. FEIN, ESQ.

*Author and Banking Law Specialist*

Melanie L. Fein provides legal services to financial institutions and other clients on a wide range of banking and securities law matters, focusing on regulatory issues at the forefront of developments in the financial services industry. She has extensive experience with matters affecting domestic and foreign banks, financial holding companies, securities firms, mutual funds, trust companies, and other financial service institutions. Much of Ms. Fein's work involves new products and services at the intersection of banking and the securities laws.

Ms. Fein has been a partner in the law firms of Goodwin Procter LLP (2003–2007) and Arnold & Porter (1986–1999). She also served as an attorney and senior counsel to the Board of Governors of the Federal Reserve System (1979–1986) and before that was on the legislative staff of Congressman John F. Seiberling of Ohio.

Ms. Fein is past chairman of the Executive Council of the Federal Bar Association's Banking Law Committee and has participated in leadership roles on committees of the American Bar Association. She has served on advisory boards for the Practising Law Institute, Consumer Bankers Association, Banking Policy Report and Stanford Journal of Law, Business & Finance, among other organizations. She is listed in the Guide to the World's Leading Banking Lawyers and An International Who's Who of Banking Lawyers, and has been awarded the highest peer rating by Martindale Hubbell.

Ms. Fein is the author of leading treatises on banking law, including *Federal Bank Holding Company Law*, *Securities Activities of Banks*, *Mutual Fund Activities of Banks* and *Law of Electronic Banking*. Her most recent work is a two-volume treatise entitled *Banking and Financial Services: A Regulatory Guide to the Convergence of Banking, Securities and Insurance in the United States*. Ms. Fein authored a major study for the Bank Administration Institute entitled *Regulating Convergence: Towards a Uniform Framework for Banking, Insurance and Investments* and has published numerous articles on banking law, including "Functional Regulation: A Concept for Glass-Steagall Reform?" in the Stanford Journal of Law, Business & Finance.

Ms. Fein has taught courses on Banking and Financial Services Law at Yale Law School where she served on the adjunct faculty from 1992–2002. Ms. Fein also has taught courses at Boston University School of Law and Catholic University's Columbus School of Law.

Ms. Fein is a member of the U.S. Supreme Court Bar and is licensed to practice in Virginia and the District of Columbia. Ms. Fein received her J.D. at Catholic University, Columbus School of Law in 1979 and her B.A. from Earlham College in 1971.

*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60391 / July 28, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-11892

In the Matter of

New York Stock Exchange LLC (f/k/a  
New York Stock Exchange, Inc.)

Respondent.

**ORDER AMENDING ORDER  
INSTITUTING PUBLIC ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO SECTIONS  
19(h)(1) AND 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934, MAKING  
FINDINGS, ORDERING COMPLIANCE  
WITH UNDERTAKINGS, AND IMPOSING  
A CENSURE AND A CEASE-AND-DESIST  
ORDER**

I.

On April 12, 2005, the Securities and Exchange Commission ("Commission") issued an Order Instituting Public Administrative Proceedings Pursuant to Sections 19(h)(1) And 21C Of The Securities Exchange Act Of 1934, Making Findings, Ordering Compliance With Undertakings, And Imposing A Censure And A Cease-And-Desist Order against Respondent New York Stock Exchange LLC (f/k/a "New York Stock Exchange, Inc.") (collectively "NYSE") relating to the NYSE's failure to properly detect, investigate and discipline widespread unlawful proprietary trading by specialists on the floor of the NYSE ("Order"). See Securities Exchange Act Release No. 51524. Pursuant to the Undertakings at Paragraph IV.C.3 of the Order, the NYSE was required to implement an 18 month pilot program to establish an on-floor video and audio surveillance program to track floor trading activity at the NYSE trading posts ("Pilot Program").

The Undertaking, at Paragraph IV.C.3(c), further required that within 360 days of implementation of the Pilot Program, the NYSE's internal audit group, Regulatory Quality Review ("RQR"), submit a report to the Director of the Commission's Office of Compliance Inspections and Examinations ("OCIE") and the Director of the Commission's Division of Market Regulation ("Market Regulation") (collectively, "Commission Officials") setting forth RQR's independent evaluation of the Pilot Program and RQR's recommendation as to whether to expand, modify, or eliminate the Pilot Program. The Undertakings further provide at Paragraph IV.C.3(c) that within 120 days of receipt of RQR's report on the Pilot Program, the Commission Officials shall submit to the Commission, for Commission

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approval, their own recommendation as to whether the Commission should modify or eliminate the Pilot Program, or expand the program to the entire floor of the NYSE.

The Commission Officials have conducted their own independent evaluation of the Pilot Program and submitted their own recommendation to the Commission.

The Commission has determined that the Pilot Program has played a helpful role in supplementing the NYSE's routine surveillance, examination, and enforcement programs. While the nature of the NYSE trading has changed significantly in recent years, floor-based trading remains an important component of the NYSE's current market structure.

The Commission recognizes, however, that allowing the NYSE greater flexibility in its usage of the on-floor surveillance hardware installed pursuant to the Pilot Program and the resulting data would allow it to devote additional resources to regulatory issues that arise. As such, the Commission has determined to amend the Order and to no longer require the NYSE to operate the Pilot Program so that the NYSE may be afforded greater flexibility in determining the appropriate regulatory usage of its audio-visual surveillance technology and data to maximize the potential benefit to the NYSE's surveillance, examination, and enforcement process.

## II.

Accordingly, it is hereby ORDERED that the Order be amended so that the NYSE's requirement to operate the Pilot Program, as implemented pursuant to Paragraph IV.C.3 thereof, be eliminated. With the exception of Paragraph IV.C.3, all other findings, remedial sanctions, and undertakings in the Order remain in full effect.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

(64 Documents)

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60219 / July 1, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3004 / July 1, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13533

In the Matter of

ROBERT D. GRAHAM, ESQ.,

Respondent.

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

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Robert D. Graham ("Graham") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)].<sup>1</sup>

II.

The Commission finds that:

1. Graham was a senior vice president and assistant general counsel at General Re Corporation ("Gen Re"), which he joined in 1986. Graham has been a member of the Delaware Bar since 1973, but his license has been suspended since April 18, 2008, pending the results of the criminal action against him. Graham also has been a member of the Connecticut Bar since 1988, but his license has been on administrative suspension since May 22, 2007 for failure to pay that State's client security fund fee.

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

2. On May 7, 2009, a judgment of conviction was entered against Graham in *United States v. Robert D. Graham, et al*, No. 06 CR 137 (CFD), in the United States District Court for the District of Connecticut, finding him guilty of sixteen felony counts, including 1 count of conspiracy to violate the Federal securities laws and to commit mail fraud, 7 counts of securities fraud, 5 counts of making false statements to the Commission, and 3 counts of mail fraud. The indictment charged Graham with engaging in a fraudulent scheme to help American International Group, Inc. ("AIG") structure a sham reinsurance transaction in order to make it appear as if AIG had increased its loss reserves by \$250 million in the fourth quarter of 2000 and by an additional \$250 million in the first quarter of 2001.

3. The court sentenced Graham to 12 months and 1 day imprisonment followed by 24 months of supervised release and ordered him to pay a fine of \$100,000.

### III.

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

Accordingly, it is ORDERED, that Robert D. Graham, Esq. is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Casey and  
Commissioner Paredes  
Disapproved*

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60215; File No. SR-NYSE-2006-92)

July 1, 2009

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company

I. Introduction

On October 24, 2006, the New York Stock Exchange LLC ("Exchange" or "NYSE") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend NYSE Rule 452 and corresponding Section 402.08 of the Listed Company Manual ("Manual") to eliminate broker discretionary voting for the election of directors. On May 23, 2007, the Exchange filed Amendment No. 1 to the proposed rule change to exempt companies registered under the Investment Company Act of 1940 ("1940 Act") from the ban on broker discretionary voting for the election of directors. On June 28, 2007, the Exchange filed Amendment No. 2 to the proposed rule change, to codify two previously published interpretations<sup>3</sup> that do not permit broker discretionary voting for material amendments to investment advisory contracts with an investment company. On February 26, 2009, the Exchange filed and withdrew Amendment No. 3 to the proposed rule change for

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release Nos. 30697 (May 13, 1992), 57 FR 21434 (May 20, 1992) (SR-NYSE-92-05) (approval order) and 52569 (October 6, 2005), 70 FR 60118 (October 14, 2005) (SR-NYSE-2005-61) (notice of filing and immediate effectiveness).

technical reasons. On February 26, 2009, the Exchange filed Amendment No. 4 to the proposed rule change. Amendment No. 4 superseded and replaced the proposal in its entirety. The Commission published the proposed rule change, as modified by Amendment No. 4, for comment in the Federal Register on March 6, 2009.<sup>4</sup> The Commission received 153 comments from 137 commenters on the proposal.<sup>5</sup> This order approves the proposed rule change, as modified by Amendment No. 4.

## II. Description of the Proposal and Background

### A. Description of the Proposal

The Exchange proposes amending NYSE Rule 452 and Section 402.08 of the Manual (together, "NYSE Rule 452") to eliminate broker discretionary voting for all elections of directors at shareholder meetings held on or after January 1, 2010,<sup>6</sup> whether contested or not, except for companies registered under the 1940 Act. Currently, NYSE Rule 452 permits brokers to vote without voting instructions from the beneficial owner on uncontested elections of directors.<sup>7</sup> Specifically, the NYSE proposal would add to the list of enumerated items for which

<sup>4</sup> See Securities Exchange Act Release No. 59464 (February 26, 2009), 74 FR 9864 (March 6, 2009) ("Notice").

<sup>5</sup> See Comment letters in the Commission's Public Reference Room or on the Commission's Web site at [www.sec.gov](http://www.sec.gov). For a complete list of comment letters and the short cites to letters used here, see Appendix A, attached hereto.

<sup>6</sup> The proposed change to NYSE Rule 452 would not apply to a meeting that was originally scheduled to be held prior to January 1, 2010, but was properly adjourned to a date on or after the effective date.

<sup>7</sup> As discussed in more detail below, under current NYSE Rule 452 a broker can vote without instruction from the beneficial owner provided "the person in the member organization giving or authorizing the giving of the proxy has no knowledge of any contest as to the action to be taken at the meeting and provided such action is adequately disclosed to stockholders and does not include authorization for a merger, consolidation or any matter which may affect substantially the rights or privileges of such stock." See current NYSE Rule 452.10(3). Items where a broker is allowed to vote without specific instructions from the beneficial owner under Rule 452 are often referred to as "routine"

a member generally may not give a proxy to vote without instructions from the beneficial owner, the "election of directors." The proposal contains a specific exception, however, for companies registered under the 1940 Act.

In addition, the Exchange proposes amending NYSE Rule 452 to codify two previously published interpretations.<sup>8</sup> First, the NYSE proposes codifying that NYSE Rule 452 would preclude broker discretionary voting on a matter that materially amends an investment advisory contract with an investment company. Second, the NYSE proposes codifying that a material amendment to an investment advisory contract would include any proposal to obtain shareholder approval of an investment company's investment advisory contract with a new investment adviser for which shareholder approval is required by the 1940 Act and the rules thereunder.

B. Background

A shareholder of a public company may hold shares either directly, as the record holder, or indirectly, as the beneficial holder, with the shares held in the name of the beneficial shareholder's broker-dealer, bank nominee, or custodian ("securities intermediary"), which is the record holder. The latter generally is referred to as holding securities in "street name."

The NYSE's discretionary voting rule dates back to 1937. Historically, the majority of shareholders held their shares directly as record holders. In 1976, for example, shareholders held approximately 71% of securities of record (in their own name), while only approximately 29% of

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matters. NYSE Rule 452 also currently contains a list of eighteen enumerated items where the broker may not vote without specific voting instructions from the beneficial owner. See Notice, supra note 4 and infra note 14.

<sup>8</sup> The codification will place the interpretations into the rule text of Rule 452.

securities were held by securities intermediaries in street name.<sup>9</sup> The number of beneficial owners holding securities in street name, however, has increased significantly since 1976,<sup>10</sup> with the result that securities intermediaries, on behalf of beneficial owners, now hold a substantial majority of exchange traded securities.<sup>11</sup> As a result, NYSE's discretionary voting rule has taken on increased significance in the voting of corporate shares at annual meetings.

Under Rule 451, when a public company furnishes proxy materials to its record shareholders, securities intermediaries that hold securities in street name must deliver the proxy materials to the beneficial shareholders within a certain time frame and request voting instructions from the beneficial shareholders.<sup>12</sup> If beneficial shareholders return voting instructions, the securities intermediaries vote their shares accordingly. However, if beneficial

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<sup>9</sup> Final Report of the U.S. Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other Than the Name of the Beneficial Owner of Such Securities (December 3, 1976), at 54.

<sup>10</sup> This is due, among other things, to the advent of margin accounts, technological developments, and clearing efficiencies.

<sup>11</sup> It has been estimated that approximately 85% of exchange traded shares are held by securities intermediaries in street name. See Securities Exchange Act Release No. 50758 (November 30, 2004), 69 FR 70852 (December 7, 2004) (noting that, at the end of 2002, the Depository Trust Company ("DTC") had on deposit approximately 84% of the shares issued by domestic companies listed on the NYSE and approximately 88% of the shares issued by domestic companies listed on the Nasdaq Stock Exchange). Securities held in "street name" by securities intermediaries are deposited at the DTC.

<sup>12</sup> See NYSE Rule 451(b)(1) (providing, in part, that for matters which may be voted without instructions under Rule 452, if voting instructions "are not received by the tenth day before the meeting, the proxy may be given at discretion by the owner of record of the stock; provided . . . the proxy soliciting material is transmitted to the beneficial owner of the stock . . . at least fifteen days before the meeting."); see also Rule 14b-1, 17 CFR 240.14b-1. Rule 14b-1 under the Act does not require brokers or dealers to request voting instructions from beneficial owners, but they are required under that Rule to forward the proxy materials to the beneficial owners within a certain timeframe. However, Rule 14b-2, 17 CFR 240.14b-2, which applies to banks that exercise fiduciary powers, requires banks to forward proxy materials to beneficial owners within a certain timeframe, as well as an executed proxy or a request for voting instructions.

shareholders do not return voting instructions, securities intermediaries may, in certain situations, vote their shares at the intermediaries' discretion. Specifically, if voting instructions have not been received by the tenth day preceding the meeting date, under current NYSE Rule 452, brokers may vote on behalf of the beneficial shareholders on certain matters where there is no contest and the item does not include authorization for a merger, consolidation, or any matter which may substantially affect the rights or privileges of the stock.<sup>13</sup> The rule also contains eighteen specific items on which the broker generally may not vote without instructions from the beneficial owner.<sup>14</sup> Items where the broker can vote without instructions are referred to as

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<sup>13</sup> See supra note 7.

<sup>14</sup> See Notice, supra note 4. Presently, NYSE Rule 452 lists 18 specific matters that cannot be voted by the broker without instructions and are often referred to as "non-routine" matters. These 18 categories are a matter that: (1) is not submitted to stockholders by means of a proxy statement comparable to that specified in Schedule 14-A of the Commission; (2) is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management (i.e., a contest); (3) relates to a merger or consolidation (except when the company's proposal is to merge with its own wholly owned subsidiary, provided its shareholders dissenting thereto do not have rights of appraisal); (4) involves right of appraisal; (5) authorizes mortgaging of property; (6) authorizes or creates indebtedness or increases the authorized amount of indebtedness; (7) authorizes or creates a preferred stock or increases the authorized amount of an existing preferred stock; (8) alters the terms or conditions of existing stock or indebtedness; (9) involves waiver or modification of preemptive rights (except when the company's proposal is to waive such rights with respect to shares being offered pursuant to stock option or purchase plans involving the additional issuance of not more than 5% of the company's outstanding common shares); (10) changes existing quorum requirements with respect to stockholder meetings; (11) alters voting provisions or the proportionate voting power of a stock, or the number of its votes per share (except where cumulative voting provisions govern the number of votes per share for election of directors and the company's proposal involves a change in the number of its directors by not more than 10% or not more than one); (12) authorizes the implementation of any equity compensation plan, or any material revision to the terms of any existing equity compensation plan (whether or not stockholder approval of such plan is required by subsection 8 of Section 303A of the Exchange's Listed Company Manual); (13) authorizes (a) a new profit-sharing or special remuneration plan, or a new retirement plan, the annual cost of which will amount to more than 10% of average annual income before taxes for the preceding five years, or (b) the amendment of an existing plan which would bring its cost above 10% of such average annual income before taxes, but

“routine” matters. Among other matters, the “uncontested” election of directors is considered a “routine” matter under current NYSE Rule 452, and thus can be voted by the broker in its discretion if the beneficial owner has not returned voting instructions within the required time period.

With the large proportion of shares now held in street name, the impact of the broker vote on the election of directors has become increasingly significant.<sup>15</sup> In the view of some commenters, brokers tend to vote in accordance with management’s recommendation.<sup>16</sup> According to the NYSE, in recent years its interpretation of a “contested election” has been questioned by a variety of persons,<sup>17</sup> as an increasing number of proxy campaigns have targeted the election of directors without a formal contest. These campaigns generally do not involve a

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exceptions may be made in cases of (a) retirement plans based on agreement or negotiations with labor unions (or which have been or are to be approved by such unions), and (b) any related retirement plan for benefit of non-union employees having terms substantially equivalent to the terms of such union-negotiated plan, which is submitted for action of stockholders concurrently with such union-negotiated plan; (14) changes the purposes or powers of a company to an extent which would permit it to change to a materially different line of business and it is the company’s stated intention to make such a change; (15) authorizes the acquisition of property, assets, or a company, where the consideration to be given has a fair value approximating 20% or more of the market value of the previously outstanding shares; (16) authorizes the sale or other disposition of assets or earning power approximating 20% or more of those existing prior to the transaction; (17) authorizes a transaction not in the ordinary course of business in which an officer, director or substantial security holder has a direct or indirect interest; and (18) reduces earned surplus by 51% or more, or reduces earned surplus to an amount less than the aggregate of three years’ common stock dividends computed at the current dividend rate.

<sup>15</sup> See e.g., FSBA 2 Letter; see generally AFSCME Letter; CII 4 Letter; Colorado PERA Letter; CTW Letter; CTW 2 Letter; and FSBA Letter.

<sup>16</sup> See CFA 2 Letter; CII 2 Letter; CII 4 Letter; Colorado PERA Letter; Cox Letter; CTW Letter; CTW 2 Letter; FSBA 2 Letter; Glass Lewis Letter; Hermes Equity Letter; NYSBA Sec. Reg. Letter; OPERS Letter; Relational Investors Letter; TIAA-CREF Letter; and Trillium Letter; see also Notice, *supra* note 4; Report and Recommendation of the Proxy Working Group, dated June 5, 2006 (“PWG Report”), at 9.

<sup>17</sup> See Notice, *supra* note 4.

competing slate of directors or a formal counter-solicitation opposed by management, and hence, are not considered "contests" by the NYSE under NYSE Rule 452.<sup>18</sup> Examples of these campaigns include "just vote no" or "withhold" campaigns, where one or more investors express dissatisfaction with the performance of the company or its management, and urge shareholders to withhold their votes for one or more of management's nominees for director. NYSE views director elections subject to these campaigns as eligible for broker discretionary voting under current Rule 452.<sup>19</sup> Concerns have been expressed that, in certain "just vote no" or "withhold" campaigns, the broker vote for management has made the difference and allowed directors subject to these campaigns to be elected, which would not have happened but for NYSE's discretionary voting rule.<sup>20</sup>

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<sup>18</sup> See NYSE Rule 452.11(2).

<sup>19</sup> See Notice, *supra* note 4.

<sup>20</sup> See AFSCME Letter; CalPERS 3 Letter; CtW Letter; CtW 2 Letter; FSBA Letter; FSBA 2 Letter; and Glass Lewis Letter; see also PWG Report, *infra* note 16, at 9. Several commenters stated that rather than eliminating the broker vote for all elections of directors the Commission should address the problem by making NYSE redefine what constitutes a contested election, see ABA Fed. Reg. Letter; ABC Letter; Alston Letter; BB&T Letter; see also Suburban Letter (urging further consideration of this alternative), and make alternative proxy contest strategies such as "just vote no" campaigns a contest that is not subject to broker discretionary voting under NYSE Rule 452. See ABC Letter; ABC 2 Letter; ABC 3 Letter; Alston Letter; Broadridge Letter (suggesting that the NYSE rules be defined to eliminate broker votes where there is a controversy, such as a "just vote no" campaign); see also ABA Fed. Reg. Letter. The Commission notes that the Proxy Working Group, see *infra* note 21, considered this approach but noted that expanding the definition of contest to include "just vote no" campaigns, especially in light of the increased use of the internet to run proxy contests, could raise significant practical difficulties, such as defining what is a campaign or whether there are any limitations or other minimal requirements for a contest. See PWG Report, *infra* note 16, at 20. Moreover, the Commission notes that merely redefining what constitutes a contested election would still allow brokers who do not have an economic interest in the company to vote in director elections that are uncontested and would not further the goals of the proposed rule change. See *infra* notes 21 through 23 and accompanying text. Finally, the Commission notes that the NYSE, in making its proposal, reviewed the PWG Report, as well as comments submitted to the NYSE on the PWG recommendation. The NYSE states in its rule filing that its proposal on Rule 452 was being made in light of the

In April 2005, the NYSE formed a working group to review its rules regarding the proxy voting process ("Proxy Working Group"). The Proxy Working Group was composed of representatives from listed companies, NYSE member organizations, lawyers, institutional investors, and individual investors.<sup>21</sup> The Proxy Working Group reviewed applicable NYSE rules relating to the proxy process and proxy fees, with a particular focus on NYSE Rule 452.<sup>22</sup> The Proxy Working Group ultimately issued a report recommending that the election of directors be ineligible for broker discretionary voting under NYSE Rule 452, with the result that brokers holding shares in street name could not vote on the election of directors, whether the election is contested or uncontested, without specific voting instructions from the beneficial owners. The Proxy Working Group believed that the election of directors could no longer be viewed as a "routine" matter in the life of a corporation. According to the Proxy Working Group, it "is well

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recommendations of the Proxy Working Group and its own conclusions that the election of directors should no longer be deemed a "routine matter" under its rules.

<sup>21</sup> Members of the Proxy Working Group at the time of the PWG Report were: Larry W. Sonsini, Chairman, Wilson Sonsini Goodrich & Rosati; Rosemary Berkery, Executive Vice President and General Counsel, Merrill Lynch & Co., Inc., represented by Kevin Moynihan of Merrill Lynch & Co.; Glenn Booraem, Principal and Assistant Fund Controller, Vanguard Group; Peter Clapman, Senior Vice President and Chief Counsel for Corporate Governance, TIAA-CREF; Margaret Foran, Vice President-Corporate Governance & Corporate Secretary, Pfizer, Inc.; Gary Glynn, President, US Steel Pension Fund; Amy Goodman, Partner, Gibson, Dunn & Crutcher LLP; Richard H. Koppes, Of Counsel, Jones Day; Jeffrey L. McWaters, Chairman and Chief Executive Officer, Amerigroup Corporation; Stephen P. Norman, Corporate Secretary, American Express Company; James E. Parsons, Corporate and Securities Counsel, Exxon Mobil Corporation; Judith Smith, Managing Director, Morgan Stanley & Co.; Esta Stecher, Executive Vice President and General Counsel, Goldman Sachs & Co., represented by Beverly O'Toole of Goldman Sachs & Co.; and Kurt Stocker, Professor, Northwestern University, Medill School of Journalism. See PWG Report, *supra* note 16. The Exchange attached the PWG Report as part of the proposal. In August 2007, the Proxy Working Group issued an addendum to its report ("Addendum"), available as part of the Exchange's proposal.

<sup>22</sup> In particular, the Proxy Working Group looked at NYSE Rules 450 to 460 and 465.

established under law . . . [that] "the business and affairs of every corporation . . . shall be managed by or under the direction of" the board of directors. Investors, courts, regulators and others expect directors to be accountable for the corporate decision-making process, and the primary way that accountability is expressed is through the director election process."<sup>23</sup> The Proxy Working Group concluded that "[d]irectors are simply too important to the corporation for their election to ever be considered routine."<sup>24</sup> Although the Proxy Working Group recognized that the proposed change to Rule 452 may result in increased costs, it believed that "it is a cost required to be paid for better corporate governance . . . ."<sup>25</sup>

In August 2007, the Proxy Working Group issued an Addendum to its report, recommending that the proposed change to NYSE Rule 452 should not apply to investment companies registered under the 1940 Act. The Proxy Working Group concluded that an exception for registered investment companies was appropriate given the fact, among other things, that they are subject to a unique regulatory regime.<sup>26</sup>

### III. Summary of Comments

The Commission received 153 comment letters from 137 commenters.<sup>27</sup> Twenty-eight commenters explicitly supported the proposal,<sup>28</sup> and twelve commenters explicitly opposed the

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<sup>23</sup> See PWG Report, supra note 16, at 21 (citing Del. Code tit. 8, Section 141(b) (2005)).

<sup>24</sup> See id.

<sup>25</sup> See id.

<sup>26</sup> See Addendum, supra note 21, at 3.

<sup>27</sup> See supra note 5. NYSE also received 39 letters on the PWG Report and Recommendation related to amending Rule 452. NYSE submitted these letters as part of the proposal. See discussion in Notice, supra note 4, and Exhibit 2 to the NYSE's proposed rule change.

<sup>28</sup> See AFSCME Letter; BCIMC Letter; CalPERS Letter; CalPERS 2 Letter; CalPERS 3 Letter; CalSTRS Letter; CCGG Letter; CCGG 2 Letter; CFA Letter; CFA 2 Letter; City of London Letter; CII Letter; CII 2 Letter; CII 3 Letter; CII 4 Letter; Colorado PERA

proposal.<sup>29</sup> Ninety-seven of the commenters neither explicitly supported nor opposed the proposal.<sup>30</sup> Ninety-five of these ninety-seven commenters expressed concerns with the proposal,<sup>31</sup> and ninety-three urged that the Commission not take action on the proposal at this

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Letter; Corporate Governance Letter; Cox Letter; CtW Letter; CtW 2 Letter; Dobkin Letter; FSBA Letter; FSBA 2 Letter; Glass Lewis Letter; GovernanceMetrics Letter; Gratzner Letter (“[e]liminate the rule”); Hagberg Letter; Hermes Equity Letter; ICI 4 Letter (supporting the proposal as amended); Newground Letter; OPERS Letter; PWG Letter (while the PWG continued to believe that the election of directors could no longer be considered a routine event in the life of a corporation, it also believed that the Commission should consider using the opportunity created by the NYSE’s proposal to review the broader proxy process)(see discussion at Section IV.F, Commission Consideration of the Entire Proxy Process, further below); Railpen Letter; Relational Investors Letter; Sod’ali Letter; TIAA-CREF Letter; and Trillium Letter.

<sup>29</sup> See ABC Letter; ABC 2 Letter; ABC 3 Letter; Altman Letter; AmEx Letter; Astoria Financial Letter; BB&T Letter; Corning Letter; FedEx Letter; FPL Letter; NIRI Letter; Stanton Letter; Suffolk Letter; and UQM Letter.

<sup>30</sup> See ABA Fed. Reg. Letter; Aetna Letter; Agilent Letter; Alcoa Letter; Alston Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BNSF Letter; Broadridge Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Central Vermont Letter; Ceridian Letter; Chamber of Commerce 2 Letter; Chevron Letter; Cigna Letter; Cincinnati Financial Letter; Computershare Letter; Connecticut Water Letter; ConocoPhillips Letter; Continental Letter; Crescent Letter; CSX Letter; Cummins Letter; DTE Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Exxon Mobil Letter; Fidelity Letter; First American Letter; First Financial Letter; Furniture Brands Letter; GE Letter; General Mills Letter; GM Letter; Governance Professionals Letter; Gulf Letter; Harman Letter; Helmerich Letter; Honeywell Letter; Illinois Stock Letter; International Paper Letter; Intel Letter; Jacksonville Letter; Johnson Letter; J.P. Morgan Letter; Manifest Letter; McKesson Letter; Medco Letter; MGE Letter; Monster Letter; NS Letter; Nucor Letter; NYSBA Sec. Reg. Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; P&G Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; Provident Letter; Provident Financial Letter; Quest Letter; Realogy Letter; Routh Letter; Royal Gold Letter; Ryder Letter; S&C Letter; SCC Letter; Schwab Letter; Securities Transfer Letter; SIFMA Letter; STA Letter; Standard Letter; StockTrans Letter; Suburban Letter; Superlattice Letter; Sutherland Letter; Synalloy Letter; Textron Letter; TI Letter; Unitrin Letter; Veeco Letter; Verizon Letter; Wachtell Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>31</sup> See ABA Fed. Reg. Letter; Aetna Letter; Agilent Letter; Alcoa Letter; Alston Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Central Vermont Letter;

time.<sup>32</sup> One commenter stated that the proposal raised sufficient issues to warrant consideration by the full Commission at a public meeting, and that consideration of the proposal by delegated authority was inappropriate.<sup>33</sup>

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Ceridian Letter; Chamber of Commerce 2 Letter; Chevron Letter; Cigna Letter; Cincinnati Financial Letter; Computershare Letter; Connecticut Water Letter; ConocoPhillips Letter; Continental Letter; Crescent Letter; CSX Letter; Cummins Letter; DTE Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Exxon Mobil Letter; Fidelity Letter; First American Letter; First Financial Letter; Furniture Brands Letter; GE Letter; General Mills Letter; GM Letter; Governance Professionals Letter; Gulf Letter; Harman Letter; Helmerich Letter; Honeywell Letter; Illinois Stock; Intel Letter; International Paper Letter; Jacksonville Letter; Johnson Letter; J.P. Morgan Letter; Manifest Letter; McKesson Letter; Medco Letter; MGE Letter; Monster Letter; NS Letter; Nucor Letter; NYSBA Sec. Reg. Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; P&G Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; Provident Letter; Provident Financial Letter; Quest Letter; Realogy Letter; Routh Letter; Royal Gold Letter; Ryder Letter; S&C Letter; SCC Letter; SCC 2 Letter; Schwab Letter; Securities Transfer Letter; STA Letter; Standard Letter; StockTrans Letter; Suburban Letter; Superlattice Letter; Sutherland Letter; Synalloy Letter; Textron Letter; TI Letter; Unitrin Letter; Veeco Letter; Verizon Letter; Wachtell Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>32</sup> See ABA Fed. Reg. Letter; Aetna Letter; Agilent Letter; Alcoa Letter; Alston Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Central Vermont Letter; Ceridian Letter; Chamber of Commerce 2 Letter; Chevron Letter; Cigna Letter; Cincinnati Financial Letter; Computershare Letter; Connecticut Water Letter; ConocoPhillips Letter; Continental Letter; Crescent Letter; CSX Letter; Cummins Letter; DTE Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Exxon Mobil Letter; Fidelity Letter; First American Letter; First Financial Letter; Furniture Brands Letter; GE Letter; General Mills Letter; GM Letter; Governance Professionals Letter; Gulf Letter; Harman Letter; Helmerich Letter; Honeywell Letter; Illinois Stock Letter; Intel Letter; International Paper Letter; Jacksonville Letter; Johnson Letter; J.P. Morgan Letter; Manifest Letter; McKesson Letter; Medco Letter; MGE Letter; Monster Letter; NS Letter; Nucor Letter; NYSBA Sec. Reg. Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; P&G Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; Provident Letter; Provident Financial Letter; Quest Letter; Realogy Letter; Routh Letter; Royal Gold Letter; Ryder Letter; S&C Letter; SCC Letter; Schwab Letter; Securities Transfer Letter; STA Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Synalloy Letter; Textron Letter; TI Letter; Unitrin Letter; Veeco Letter; Verizon Letter; Wachtell Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>33</sup> See SCC 2 Letter.

#### IV. Discussion and Analysis of Comment Letters

After careful review and consideration of the comment letters, the Commission finds that the proposed rule change, as modified by Amendment No. 4, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>34</sup> In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,<sup>35</sup> which provides that the rules of the exchange must be designed to prevent

<sup>34</sup> In approving the proposed rule change, the Commission considered the proposed rule change's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f). The Commission notes that several commenters believed that the NYSE's proposal would make the proxy voting system less efficient. See Central Vermont Letter; Connecticut Water Letter; First Financial Letter; Jacksonville Letter; McKesson Letter; Monster Letter; Nucor Letter; Provident Letter; Quest Letter; Synalloy Letter; and Veeco Letter; see also Astoria Financial Letter ("[F]or many public companies, broker voting remains the most efficient means to obtain a quorum for shareholder meetings"); BB&T Letter (cost of obtaining quorum absent broker discretionary voting would "be an enormous loss to investors," and that "redefinition of what constitutes a 'contested' election is the most efficient manner to address the real corporate governance concerns implied by the Amendment"); and Governance Professionals Letter ("The focus should be on solutions that contain costs and make the proxy voting system more efficient, rather than on increased costs and inefficiency."); but see Relational Investors Letter ("The new administrative burdens created by this amendment are far outweighed by the benefits to efficient and effective corporate governance."); see also PWG Report, *supra* note 16. As discussed further below, the Commission believes that the NYSE's proposed rule change should better enfranchise shareholders, and thereby enhance corporate governance and accountability, by assuring that voting is determined by those with an economic interest in the company on matters as critical as the election of directors, rather than permitting brokers to cast votes without instructions for shares beneficially owned by their customers, when the broker has no economic interest in those shares. Therefore, the Commission believes the NYSE's proposed rule change should protect investors and the public interest. Further, the Commission does not believe that the proposed change will necessarily make the voting process materially less efficient. The mechanics of the proxy voting procedure as to how beneficial owners return voting instructions to their brokers are not changing. NYSE Rule 452 would continue to allow the broker to vote on other routine matters, such as the ratification of independent auditors, which will help companies meet quorum requirements, and therefore alleviate the efficiency concerns raised by commenters. As discussed further below, pursuant to Section 19(b) and after reviewing the comments, the Commission believes the proposed rule change should be approved.

<sup>35</sup> 15 U.S.C. 78f(b)(5).

fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission, Congress, states, investors and other market participants have long recognized the critical role that directors play in a corporation. The board of directors has ultimate responsibility for the management of the business and the affairs of the company.<sup>36</sup> Shareholders, through their vote, vest with the directors they elect this critical duty to manage the company with which they have entrusted their resources.<sup>37</sup> The board of directors generally does not participate in the daily business affairs of the company. It delegates these responsibilities to management the board selects and supervises. The board, however, ultimately is accountable to shareholders for corporate decisions.<sup>38</sup> The most fundamental way in which shareholders can ensure that directors remain accountable to them for the directors' performance of these critical duties is through the director election process.<sup>39</sup>

As discussed below, the Commission believes that it is reasonable and consistent with the Act for NYSE to determine that the election of directors should no longer be an item eligible for

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<sup>36</sup> See, e.g., Del. Code Ann. Tit. 8, Section 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.").

<sup>37</sup> See e.g., PWG Report, *supra* note 16, at 21; see also Bruce A. Toth and Jason L. Booth, *The Board of Directors*, Corp. Prac. Series (BNA), at A-3.

<sup>38</sup> See Toth and Booth, *The Board of Directors*, Corp. Prac. Series, at A-3.

<sup>39</sup> See PWG Report, *supra* note 16, at 21.

broker discretionary voting, particularly given the large proportion of shares that today are held in street name, the importance of corporate governance and accountability expressed through the election process, and the concern that the broker vote could potentially distort election results.<sup>40</sup> As the Proxy Working Group also concluded, the election of directors is not a “routine” issue for either the corporation or the shareholders; it is a key event in the operation and direction of the corporation and the shareholders’ exercise of their rights and interests as the owners of the corporation.<sup>41</sup> As such, the Commission believes that NYSE’s proposal should better enfranchise shareholders by helping assure that votes on matters as critical as the election of directors are determined by those with an economic interest in the company,<sup>42</sup> rather than the broker who has no such economic interest, and also should enhance corporate governance and accountability to shareholders.

The Commission also believes that the NYSE’s proposed change codifying existing NYSE interpretations of NYSE Rule 452 is consistent with the requirements of the Act. As discussed below, these proposed amendments will codify two previous interpretations that were adopted by the NYSE to help ensure the full and effective voting rights of investment company

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<sup>40</sup> Broker votes can distort election results both by changing the outcome of an election and by creating a perception that a candidate (or group of candidates) has greater support than would be the case considering only the votes of beneficial owners. That perception, and in particular an understanding of the lack of substantial support for a director, even if he or she receives enough votes to be elected, can affect the decisions of the board and shareholders. See e.g., PWG Report, supra note 16, at 9 and n. 12.

<sup>41</sup> See PWG Report, supra note 16, at 21.

<sup>42</sup> The Commission recognizes that, even under the NYSE’s proposal, certain situations will continue to exist where a person with an economic interest in a company may not be able to vote the shares, such as when shares are purchased after the record date for a shareholder meeting. Nevertheless, the NYSE’s proposal should make substantial strides in aligning a securityholder’s voting decision on director elections with the economic interest in the shares, as it will prohibit a broker holding shares in street name, who does not have an economic interest in the company, from voting on behalf of the beneficial owner in director elections.

shareholders on material matters.<sup>43</sup> The Commission believes that these changes are consistent with the requirements under Section 6(b)(5) of the Act<sup>44</sup> that the rules of the Exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

A. Increased Costs for Companies to Achieve Quorum

Several commenters believed that the NYSE's proposal to eliminate the broker discretionary vote would make it more difficult for companies to obtain a quorum<sup>45</sup> and elect directors.<sup>46</sup> Some commenters believed that the relatively low retail shareholder participation rate in corporate elections would increase the difficulty of obtaining a quorum under NYSE's proposal.<sup>47</sup> Commenters also stated that the proposal would increase the cost to a company of

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<sup>43</sup> See supra note 3. Two commenters supported the proposal regarding investment advisory contracts. See CFA 2 Letter and ICI 4 Letter.

<sup>44</sup> 15 U.S.C. 78f(b)(5).

<sup>45</sup> See ABA Fed. Reg. Letter; ABC 3 Letter; Alston Letter; Altman Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Ceridian Letter; Chamber of Commerce Letter; Chamber of Commerce 2 Letter; Cigna Letter; Computershare Letter; ConocoPhillips Letter; Crescent Letter; CSX Letter; Cummins Letter; Eaton Letter; Eli Lilly Letter; Exxon Mobil Letter; FPL Letter; General Mills Letter; GM Letter; Governance Professionals Letter; Harman Letter; Helmerich Letter; ICI Letter; ICI 2 Letter; ICI 3 Letter; ICI 4 Letter; Intel Letter; International Paper Letter; Johnson Letter; J.P. Morgan Letter; Medco Letter; NS Letter; NYSBA Sec. Reg. Letter; Office Depot Letter; Peabody Letter; Pfizer Letter; Royal Gold Letter; Ryder Letter; S&C Letter; Schwab Letter; Securities Transfer Letter; STA Letter; Suburban Letter; Textron Letter; TI Letter; Unitrin Letter; UQM Letter; Verizon Letter; Wachtell Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; YRC Letter; see also CII Letter; and CII 2 Letter; see also Sutherland Letter.

<sup>46</sup> See ICI Letter; ICI 2 Letter; ICI 3, and ICI 4 Letter.

<sup>47</sup> See Alston Letter; Intel Letter; S&C Letter; Suburban Letter; and Wachtell Letter.

obtaining a quorum,<sup>48</sup> by requiring them to incur higher proxy solicitation costs<sup>49</sup> in order to communicate with shareholders, urge them to participate in director elections<sup>50</sup> and support board-nominated candidates.<sup>51</sup> For example, one commenter believed that it would need “to retain a proxy solicitor even in the absence of a ‘contest’ . . . just to attempt to achieve a quorum.”<sup>52</sup> Several commenters noted that smaller issuers, in particular, would be negatively affected by the NYSE proposal, given their tendency to have a higher proportion of retail

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<sup>48</sup> See ABC Letter; Agilent Letter; Astoria Financial Letter; Central Vermont Letter; Connecticut Water Letter; First Financial Letter; ICI 3 Letter; Jacksonville Letter; McKesson Letter; Monster Letter; Nucor Letter; Provident Letter; Quest Letter; Schwab Letter; Suburban Letter; Suffolk Bank Letter; Synalloy Letter; Veeco Letter; and Wachtell Letter; see also Sutherland-Letter.

<sup>49</sup> See ABC Letter; Chamber of Commerce Letter; Chamber of Commerce 2 Letter; Governance Professionals Letter; ICI 2 Letter; ICI 3 Letter; ICI 4 Letter; NIRI Letter; Praxair Letter; Quest Letter; Realogy Letter; Ryder Letter; Schwab Letter; STA Letter; Suburban Letter; Suffolk Bank Letter; Textron Letter; and YRC Letter; see also ABC Letter.

<sup>50</sup> See ABA Fed. Reg. Letter; ABC Letter; Aetna Letter; Aglient Letter; Alston Letter; Altman Letter; AmEx Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BB&T Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Ceridian Letter; Cigna Letter; ConocoPhillips Letter; CSX Letter; Cummins Letter; Eaton Letter; Eli Lilly Letter; FPL Letter; General Mills Letter; GM Letter; Governance Professionals Letter; Harman Letter; International Paper Letter; Jacksonville Letter; Johnson Letter; Medco Letter; MGE Letter; Monster Letter; NS Letter; Nucor Letter; Office Depot Letter; Peabody Letter; Pfizer Letter; Praxair Letter; Realogy Letter; Ryder Letter; SCC Letter; Synalloy Letter; Textron Letter; UQM Letter, Whirlpool Letter; Xerox Letter; and YRC Letter.

<sup>51</sup> See FedEx Letter.

<sup>52</sup> See Suburban Letter; see also ABC Letter (stating that in “2004, had the broker vote not been in effect, 85 percent of NYSE companies would have been working to reach quorum in the final nine days before their meetings while 23 percent would not have reached quorum by the meeting date. . . . [C]ompanies uncertain of their ability to reach quorum . . . would be forced to hire proxy solicitors. . . .”).

shareholders,<sup>53</sup> so that smaller issuers would have to expend a disproportionate amount of additional resources to solicit shareholder votes, and obtain a quorum.<sup>54</sup>

Some commenters also expressed concern with, or noted the shortcomings of, the current system of communicating with shareholders,<sup>55</sup> and stated that the proposal should be evaluated in connection with a review of shareholder communication rules.<sup>56</sup> Three commenters expressed

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<sup>53</sup> See ABC 3 Letter; Agilent Letter; Alston Letter; AmEx Letter; Central Vermont Letter; Computershare Letter; Connecticut Water Letter; First Financial Letter; Governance Professionals Letter; Jacksonville Letter; McKesson Letter; Monster Letter; Nucor Letter; Provident Letter; Quest Letter; SCC Letter; and Synalloy Letter; see also Sutherland Letter (stating that the exemption should also apply to business development companies).

<sup>54</sup> See ABA Fed. Reg. Letter; ABC 3 Letter; Agilent Letter; Alston Letter; AmEx Letter; Astoria Financial Letter; Central Vermont Letter; Chamber of Commerce 2 Letter; Computershare Letter; Connecticut Water Letter; Crescent Letter; First Financial Letter; Governance Professionals Letter; Helmerich Letter; Jacksonville Letter; McKesson Letter; Monster Letter; Nucor Letter; Provident Letter; Quest Letter; Synalloy Letter; and Washington Banking Letter; see also Sutherland Letter.

<sup>55</sup> See Alcoa Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Ceridian Letter; Chevron Letter; Cincinnati Financial Letter; Computershare Letter; ConocoPhillips Letter; Continental Letter; Corning Letter; Crescent Letter; CSX Letter; Cummins Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Exxon Mobil Letter; Fidelity Letter; First American Letter; FPL Letter; GE Letter; General Mills Letter; GM Letter; Gulf Letter; Helmerich Letter; Illinois Stock Letter; Intel Letter; International Paper Letter; Johnson Letter; Manifest Letter; Medco Letter; MGE Letter; NIRI Letter; NS Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; PWG Letter; Realogy Letter; Routh Letter; Royal Gold Letter; Ryder Letter; STA Letter; Securities Transfer Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Textron Letter; Unitrin Letter; Verizon Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>56</sup> See Aetna Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Ceridian Letter; Chamber of Commerce 2 Letter; Cigna Letter; Cincinnati Financial Letter; Computershare Letter; ConocoPhillips Letter; Continental Letter; Corning Letter; Crescent Letter; CSX Letter; Cummins Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Exxon Mobil Letter; FedEx Letter; Fidelity Letter; First American Letter; GE Letter; General Mills Letter; GM Letter; Gulf Letter; Helmerich Letter; Honeywell Letter; Illinois Stock Letter; Intel Letter; International Paper Letter; Johnson Letter; NS Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; P&G Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; Realogy Letter; Routh Letter; Ryder Letter; STA

concern that the proposed rule change could magnify the difficulties issuers have in communicating with shareholders, especially with objecting beneficial owners ("OBOs").<sup>57</sup> Commenters recommended that Commission rules be revised to facilitate the ability of issuers to contact shareholders directly.<sup>58</sup> According to one commenter, "[p]ermitting issuers to communicate with their shareholders . . . will enable them to 'get out the vote,' enhancing their ability to obtain needed quorums and successfully re-solicit shareholders, if necessary."<sup>59</sup>

Other commenters believed that quorum concerns were not a valid reason for allowing brokers to continue to vote uninstructed shares in the election of directors.<sup>60</sup> For example, one commenter believed that the participation of institutional investors would assure a quorum for most issuers, except for a limited number of small companies.<sup>61</sup> Moreover, several commenters believed that quorum concerns could be addressed simply by including a "routine" item on the ballot,<sup>62</sup> such as the ratification of auditors,<sup>63</sup> or with appropriate changes in state law to permit

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Letter; Securities Transfer Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Textron Letter; TI Letter; Unitrin Letter; Verizon Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>57</sup> See Alcoa Letter; Corning Letter; and NIRI Letter.

OBOs are shareholders who object to having their names and addresses disclosed to companies whose shares they own.

<sup>58</sup> See Alcoa Letter; Computershare Letter; Corning Letter; ICI Letter; ICI 2 Letter; NIRI Letter; PWG Letter; STA Letter; and TI Letter; see also Chamber of Commerce 2 Letter (stating that any amendment to Rule 452 should be accompanied by an improved shareholder communication system).

<sup>59</sup> See ICI 2 Letter.

<sup>60</sup> See CII 4 Letter; Colorado PERA Letter; FSBA Letter; FSBA 2 Letter; Glass Lewis Letter; Hagberg Letter; and TIAA-CREF Letter; see also CCGG Letter (elimination of U.S. broker non-votes would not adversely impact the ability of Canadian issuers to obtain quorum).

<sup>61</sup> See Glass Lewis Letter.

<sup>62</sup> See Hagberg Letter; Glass Lewis Letter; and TIAA-CREF Letter.

shares held by brokers to count solely for purposes of establishing quorum.<sup>64</sup> Also, another commenter believed that “issuers can communicate effectively to shareholders through established, robust and efficient systems currently in place.”<sup>65</sup>

The Commission acknowledges commenters’ concerns regarding the potential for the proposed rule change to impact the ability of some companies to achieve quorum. For example, the Proxy Working Group recognized that smaller issuers may have certain increased costs in obtaining quorum due to the high percentage of shares held by retail investors.<sup>66</sup> However, as noted by several commenters, issuers with a large institutional shareholder base or with another routine matter on their proxies, such as ratification of independent auditors, should not face material additional difficulties in achieving a quorum.<sup>67</sup> The Commission notes that a majority of companies other than registered investment companies include the ratification of independent auditors as a matter for shareholders to approve, even though such approval is not required by law,<sup>68</sup> so that these companies should not, as a practical matter, encounter the quorum issue as articulated by the commenters. Quorum concerns for other companies, including small

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<sup>63</sup> See CII Letter; CII 2 Letter; CII 4 Letter; Colorado PERA Letter; Glass Lewis Letter; Hagberg Letter; and TIAA-CREF Letter; *contra* ICI 3 Letter (stating that “[a]sking funds to take this action for the sole purpose of achieving a quorum” is unacceptable since funds have not been required to ratify the selection of fund auditors since 2001.).

<sup>64</sup> See CalPERS Letter; Computershare Letter; FSBA 2 Letter; ICI 2 Letter; S&C Letter; Sod’ali Letter; and TIAA-CREF Letter; *see also* Suburban Letter (urging further consideration of this alternative).

<sup>65</sup> See SIFMA Letter.

<sup>66</sup> See Addendum, *supra* note 21, at 3; *see also* PWG Report, *supra* note 16, at 21.

<sup>67</sup> See CII Letter; CII 2 Letter; CII 4 Letter; Colorado PERA Letter; Glass Lewis Letter; Hagberg Letter; and TIAA-CREF Letter.

<sup>68</sup> See CII 4 Letter (stating that including an auditor ratification “resolution on the proxy is a step that many corporations already take on their own and one that the Council believes is a best practice for all public companies”).

companies, may be addressed to the extent that these companies include an item on their ballot that may be considered a routine matter. The Commission also notes a report showing that, if NYSE's proposal were implemented, most companies would nevertheless achieve quorum, albeit at a date closer to their annual meetings than previously.<sup>69</sup> More fundamentally, however, although issuers may incur increased proxy solicitation costs under the NYSE's proposal, the Commission agrees with the NYSE and the Proxy Working Group that these costs are justified by, among other things, assuring voting on matters as critical as the election of directors can no longer be determined by brokers without instructions from the beneficial owner, thereby enhancing corporate governance and accountability.<sup>70</sup> Moreover, to the extent there are issues regarding establishing a quorum, we do not believe having uninstructed votes cast on the election of a director by broker-dealers who lack the shareholders' economic interests in the corporation is the appropriate way to address the issue.

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<sup>69</sup> See Broadridge Letter and attached report, Updated Analysis of the Broker Vote, dated February 3, 2009. Moreover, the Commission notes that NYSE's proposed rule change is consistent with the rules of other self-regulatory organizations. For example, the Financial Industry Regulatory Authority, Inc. ("FINRA") and The NASDAQ Stock Market LLC ("Nasdaq") do not permit broker discretionary voting for their members, unless they do so pursuant to the rules of another national securities exchange of which they are also a member and the member clearly indicates which rule it is following. See National Association of Securities Dealers, Inc. ("NASD") Rule 2260 and Nasdaq Rule 2260. We note that NYSE Rule 452 is a member rule. Accordingly, NYSE members would follow the NYSE rule regardless of where a security is listed. Further, while other self-regulatory organizations currently allow discretionary voting, we would expect these markets to make changes to conform to the NYSE's new rules to eliminate any disparities involving voting depending on where shares are held. See NYSE Amex Equities Rule 452 and Chicago Board Options Exchange, Incorporated Rule 31.74.

<sup>70</sup> See PWG Report, *supra* note 16, at 21 and Notice, *supra* note 4. With respect to concerns raised by commenters regarding communications with shareholders, the Commission notes that the proposed rule change would not alter the existing system of shareholder communications, which is outside the scope of NYSE's proposed rule change.

As discussed further below,<sup>71</sup> the Commission believes that shareholder education is important for encouraging retail shareholders to vote, and could play a key role both in reducing any additional proxy solicitation costs incurred by companies, as well as achieving the policy goal of fostering investor participation in corporate governance. The Commission notes that the Proxy Working Group has established an Investor Education Sub-Committee. The Commission supports the Proxy Working Group's efforts to develop, and encourages the NYSE and its member firms to implement, an investor education effort to inform investors about the amendments to NYSE Rule 452, the proxy voting process, and the importance of voting.

B. Disenfranchising Retail Shareholders and Growing Influence of Third Parties

Several commenters stated that the proposal could disenfranchise individual shareholders,<sup>72</sup> because eliminating broker discretionary voting may be counter to shareholders' assumptions that their brokers would vote on their behalf if they did not vote.<sup>73</sup> Other

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<sup>71</sup> See infra Section IV.D., Shareholder Education.

<sup>72</sup> See Aetna Letter; Alcoa Letter; Altman Letter; AmEx Letter; Andarko Letter; Arvin Meritor Letter; Avery Letter; Avis Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Ceridian Letter; Chamber of Commerce 2 Letter; Chevron Letter; Cigna Letter; Cincinnati Financial Letter; Continental Letter; ConocoPhillips Letter; Corning Letter; Crescent Letter; CSX Letter; Cummins Letter; DTE Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Fidelity Letter; First Financial Letter; FPL Letter; Furniture Brands Letter; General Mills Letter; GM Letter; Gulf Letter; Harman Letter; Illinois Stock Letter; Intel Letter; International Paper Letter; Jacksonville Letter; Johnson Letter; J.P. Morgan Letter; McKesson Letter; Medco Letter; MGE Letter; Monster Letter; NS Letter; Nucor Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; Provident Letter; Provident Financial Letter; Quest Letter; Realogy Letter; Routh Letter; Ryder Letter; SCC Letter; STA Letter; Standard Letter; Stanton Letter; StockTrans Letter; Superlattice Letter; Synalloy Letter; Textron Letter; TI Letter; Veeco Letter; Verizon Letter; Wachtell Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>73</sup> See Aetna Letter; Alcoa Letter; AmEx Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Ceridian Letter; Cigna Letter; ConocoPhillips Letter; Crescent Letter; CSX Letter; Cummins Letter; Eaton Letter; Eli Lilly Letter; FPL Letter; General Mills Letter; GM Letter; Harman Letter; International Paper Letter; Johnson Letter;

commenters believed that the proposed rule change would shift voting power toward small blocks of voters<sup>74</sup> and special interest groups wishing to use minority stock positions to pursue their own special interests,<sup>75</sup> and non-investment objectives.<sup>76</sup> Moreover, several commenters expressed concern that retail shareholder participation in company elections has decreased in recent years,<sup>77</sup> especially under e-proxy,<sup>78</sup> so that the NYSE's proposal would shift disproportionate weight to institutional investors,<sup>79</sup> and increase power in the hands of the few shareholders who vote.<sup>80</sup>

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Medco Letter; NS Letter; Office Depot Letter; Peabody Letter; Pfizer Letter; Praxair Letter; Realty Letter; Ryder Letter; STA Letter; Textron Letter; Verizon Letter; Wachtell Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>74</sup> See UQM Letter.

<sup>75</sup> See Astoria Financial Letter; Chamber of Commerce 2 Letter; and S&C Letter.

<sup>76</sup> See Chamber of Commerce Letter and Chamber of Commerce 2 Letter.

<sup>77</sup> See Agilent Letter; Alcoa Letter; Alston Letter; Altman Letter; Central Vermont Letter; Chevron Letter; Computershare Letter; Connecticut Water Letter; Corporate Governance Letter; DTE Letter; Eli Lilly Letter; Exxon Mobil Letter; First Financial Letter; Furniture Brands Letter; Governance Professionals Letter; McKesson Letter; Medco Letter; Monster Letter; Nucor Letter; NYSBA Sec. Reg. Letter; Provident Letter; Provident Financial Letter; Quest Letter; S&C Letter; Synalloy Letter; Veeco Letter; and Wachtell Letter.

<sup>78</sup> See AFSCME Letter; Agilent Letter; Alcoa Letter; Alston Letter; Altman Letter; Central Vermont Letter; Chevron Letter; CII 4 Letter; Colorado PERA Letter; Connecticut Water Letter; Corporate Governance Letter; DTE Letter; Exxon Mobil Letter; First Financial Letter; Furniture Brands Letter; Governance Professionals Letter; McKesson Letter; Monster Letter; Nucor Letter; NYSBA Sec. Reg. Letter; Provident Letter; Provident Financial Letter; Quest Letter; S&C Letter; Synalloy Letter; and Wachtell Letter.

<sup>79</sup> See Agilent Letter; Altman Letter; AmEx Letter; BB&T Letter; Central Vermont Letter; Chevron Letter; Connecticut Water Letter; Corning Letter; DTE Letter; First Financial Letter; Furniture Brands Letter; Governance Professionals Letter; Intel Letter; Jacksonville Letter; J.P. Morgan Letter; McKesson Letter; Medco Letter; Monster Letter; Nucor Letter; Provident Letter; Provident Financial Letter; Quest Letter; Stanton Letter; Synalloy Letter; Veeco Letter; and Wachtell Letter.

<sup>80</sup> See Alston Letter and NIRI Letter. Another commenter opined that the proposal confuses civic governance with corporate governance. See Suffolk Bank Letter.

Several commenters also believed that eliminating broker discretionary voting could increase the influence of proxy advisory firms, which provide, among other things, voting recommendations to their institutional investor clients.<sup>81</sup> A number of commenters expressed concerns about the degree of influence that proxy advisory firms have in corporate elections.<sup>82</sup> Other commenters expressed concern that stock lending and financial derivatives,<sup>83</sup> as well as the

<sup>81</sup> See Aetna Letter; Agilent Letter; Alcoa Letter; Altman Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Central Vermont Letter; Ceridian Letter; Chamber of Commerce 2 Letter; Cigna Letter; Connecticut Water Letter; ConocoPhillips Letter; CSX Letter; Cummins Letter; DTE Letter; Eaton Letter; Eli Lilly Letter; First Financial Letter; FPL Letter; Furniture Brands Letter; General Mills Letter; GM Letter; Governance Professionals Letter; Harman Letter; Intel Letter; International Paper Letter; Jacksonville Letter; Johnson Letter; J.P. Morgan Letter; McKesson Letter; Medco Letter; Monster Letter; NIRI Letter; NS Letter; Nucor Letter; Office Depot Letter; Peabody Letter; Pfizer Letter; Praxair Letter; Provident Letter; Provident Financial Letter; Quest Letter; Ryder Letter; SCC Letter; Synalloy Letter; Textron Letter; Veeco Letter; Wachtell Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter. Another commenter stated that the proposal might result in a conflict of interest for proxy advisory firms. See Cardinal Letter.

<sup>82</sup> See Cincinnati Financial Letter; Computershare Letter; Continental Letter; Corning Letter; Crescent Letter; EV Letter; Exxon Mobil Letter; Fidelity Letter; First American Letter; Gulf Letter; Helmerich Letter; Honeywell Letter; Illinois Stock Letter; Manifest Letter; MGE Letter; OTC Letter; Otter Tail Letter; Platinum Letter; Routh Letter; Royal Gold Letter; S&C Letter; Securities Transfer Letter; Standard Letter; StockTrans Letter; Superlattice Letter; TI Letter; and Washington Banking Letter.

Other commenters noted the lack of competition in the current proxy distribution process. See SCC Letter; and STA Letter. Some commenters suggested that the role of proxy service providers be evaluated in conjunction with the proposal. See Cincinnati Financial Letter; Continental Letter; Crescent Letter; EV Letter; Fidelity Letter; First American Letter; Gulf Letter; Illinois Stock Letter; MGE Letter; OTC Letter; Otter Tail Letter; Platinum Letter; Routh Letter; S&C Letter; Securities Transfer Letter; Standard Letter; StockTrans letter; and Superlattice Letter. The Commission notes that these issues are outside the scope of NYSE's proposal.

<sup>83</sup> See Alcoa Letter; Cardinal Letter; Cincinnati Financial Letter; Continental Letter; Crescent Letter; EV Letter; Fidelity Letter; First American Letter; Gulf Letter; Helmerich Letter; Illinois Stock Letter; MGE Letter; OTC Letter; Otter Tail Letter; Platinum Letter; Routh Letter; Royal Gold Letter; Securities Transfer Letter; SCC Letter; STA Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Unitrin Letter; and Washington Banking Letter.

impact of over-voting and under-voting,<sup>84</sup> distort the shareholder voting process. Commenters urged the Commission to consider these issues in conjunction with the proposal.<sup>85</sup>

However, other commenters believed that the proposal would ensure that voting results were not distorted by broker votes<sup>86</sup> and that the true owners of corporations were not disenfranchised.<sup>87</sup> For example, one commenter stated that “eliminating the ability of brokers to vote uninstructed client shares for the election of directors is an important first step in improving shareholder democracy and enhancing the integrity of the proxy voting system.”<sup>88</sup> Several commenters opined that continuing to count broker votes would diminish the strides being made toward more effective corporate governance, and stressed the importance of shareholder

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<sup>84</sup> See Cardinal Letter; Cincinnati Financial Letter; Continental Letter; Crescent Letter; EV Letter; Fidelity Letter; First American Letter; Gulf Letter; Helmerich Letter; Illinois Stock Letter; MGE Letter; OTC Letter; Otter Tail Letter; Platinum Letter; Routh Letter; Royal Gold Letter; Securities Transfer Letter; SCC Letter; STA Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Unitrin Letter; and Washington Banking Letter; contra SIFMA Letter. Over-voting occurs when a broker-dealer casts more votes on behalf of itself and its customers than it is entitled to cast. An under-vote occurs when the broker-dealer casts less votes on behalf of itself and its customers than it is entitled to cast.

<sup>85</sup> See Cardinal Letter; Cincinnati Financial Letter; Continental Letter; Crescent Letter; EV Letter; Fidelity Letter; First American Letter; Gulf Letter; Helmerich Letter; Illinois Stock Letter; Manifest Letter; OTC Letter; Otter Tail Letter; Platinum Letter; Routh Letter; Royal Gold Letter; Securities Transfer Letter; STA Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Unitrin Letter; and Washington Banking Letter. One commenter, however, stated that brokers are able to accurately calculate the number of equity shares eligible for voting, as “broker-dealers are required to have robust and precise accounting systems in place to ensure the integrity of their records of share ownership.” See SIFMA Letter.

<sup>86</sup> See AFSCME Letter; CCGG Letter; CCGG 2 Letter; CII 2 Letter; CII 4 Letter; Colorado PERA Letter; FSBA Letter; FSBA 2 Letter; Glass Lewis Letter; Hagberg Letter; OPERS Letter; Railpen Letter; see also CalPERS Letter (proposal would “increase the credibility and fairness of the election process”); CtW Letter; CtW 2 Letter; and Trillium Letter.

<sup>87</sup> See CtW Letter; CtW 2 Letter; FSBA Letter; FSBA 2 Letter; Glass Lewis Letter; Railpen Letter; Relational Investors Letter (also noting that brokers do not have direct economic interest); and Trillium Letter.

<sup>88</sup> See CCGG 2 Letter.

participation as more issuers move towards majority voting standards for the election of directors.<sup>89</sup> Commenters also suggested that the broker vote may have impacted the result in some recent corporate elections.<sup>90</sup>

The Commission does not believe that the proposal would disenfranchise retail shareholders, but would instead be enfranchising since it helps assure that only those with an economic interest in a company may vote on matters as critical as the election of directors. Moreover, the Commission notes that research conducted on behalf of the Proxy Working Group indicates that the NYSE's proposal may, in fact, be consistent with an assumption of many shareholders that only they can vote their shares.<sup>91</sup> As noted above, the Commission also encourages the efforts of the Proxy Working Group to develop an investor education effort to inform investors about the amendments to NYSE Rule 452, the proxy voting process, and the importance of voting.

As to the concerns that the proposal could increase the impact of special interest groups holding minority share positions, the Commission believes that it is not a basis for not approving the proposed rule change. Even if this is the result in some cases, it remains consistent with the

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<sup>89</sup> See CII 4 Letter; Colorado PERA Letter; CtW Letter; Hermes Equity Letter; Railpen Letter; and TIAA-CREF Letter.

<sup>90</sup> See AFSCME Letter; CalPERS 3 Letter; CtW Letter; CtW 2 Letter; FSBA Letter; FSBA 2 Letter; and Glass Lewis Letter.

<sup>91</sup> See Investor Attitudes Study, attached as Exhibit B to the NYSE's proposal, at page 18 ("Investor Attitudes Study"). The Investor Attitudes Study showed that while 37 percent of stockholders believed that if they did not vote their proxy on routine matters their shares may be voted by their brokers; 30 percent of stockholders believed that if they did not vote their proxy, their shares would not be voted. The Investor Attitudes Study showed that even those stockholders who understood that their broker may vote their shares failed to completely understand how those shares could be voted. Out of the 37 percent cited to in the Investor Attitudes Study, 10 percent of stockholders believed that their shares would be voted by their brokerage firm based on the firm's preference; while 27 percent believed that their brokerage firm would vote in accordance with the Board of Director's or the company's recommendations. See Investor Attitudes Study at 18.

purposes of the proposed rule change, including assuring that investors with an economic interest in the company vote on matters as critical as the election of directors, thereby enhancing corporate governance and accountability.

With regard to the concern that proxy advisory firm recommendations could have increased influence on director elections,<sup>92</sup> the Commission notes that issues relating to the use of proxy advisory services by institutions and others, and whether that use should be further regulated, is a matter that will be considered by the Commission as it examines broader proxy issues. It is not, however, germane to, and does not need to be resolved to approve, the NYSE's proposal. While the Commission acknowledges the possibility that, with the elimination of the broker vote, the vote of institutions or others that use proxy advisory services may, at least in the short term, represent a larger percentage of the votes returned in director elections, the Commission believes the goals of the NYSE's proposal, as described above, are consistent with Section 6(b)(5) of the Act<sup>93</sup> in that the proposal should protect investors and the public interest by barring brokers from voting on behalf of investors in uncontested elections of directors when they have no economic interest in the corporation or the outcome. The Commission further notes that institutional investors, whether relying on proxy advisory firms or not, must vote the institutions' own shares and, in so doing, must discharge their fiduciary duties to act in the best interest of their investors and avoid conflicts of interest; institutions are not relieved of their fiduciary responsibilities simply by following the recommendations of a proxy advisor.<sup>94</sup>

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<sup>92</sup> See notes supra 81 and 82 and accompanying text.

<sup>93</sup> 15 U.S.C. 78f(b)(5).

<sup>94</sup> See, e.g., 29 U.S.C. 1104 (setting forth the fiduciary duties under the Employee Retirement Income Security Act).

The Commission has also considered the various other concerns raised by commenters about the broader proxy process, including the impact of stock lending and financial derivatives, and over-voting and under-voting issues.<sup>95</sup> While the Commission will separately address issues such as these as it examines proxy and voting matters generally, they do not directly implicate the NYSE's proposal. The fact that there may be more to be done in these areas is not a reason for disapproving the NYSE's proposal if, as the Commission believes, the NYSE's proposed rule change is consistent with Section 6(b)(5) of the Act.<sup>96</sup>

C. Impact on Companies with Majority Vote Standards for Election of Directors

Several commenters raised concerns about the particular impact the proposal could have on companies that have adopted a majority vote standard for the election of directors.<sup>97</sup> Typically, companies that have adopted a majority vote standard require each director to receive a majority of the votes cast in order to be elected.<sup>98</sup> Historically, most public companies elected

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<sup>95</sup> See supra notes 83, 84, 85 and accompanying text.

<sup>96</sup> See also supra note 42.

<sup>97</sup> See Aetna Letter; Alcoa Letter; Anadarko Letter; ArvinMeritor Letter; Astoria Financial Letter; Avery Letter; Avis Letter; BB&T Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Ceridian Letter; Cigna Letter; ConocoPhillips Letter; CSX Letter; Cummins Letter; Eaton Letter; Eli Lilly Letter; FedEx Letter; FPL Letter; GE Letter; General Mills Letter; GM Letter; Harman Letter; Helmerich Letter; International Paper Letter; Johnson Letter; J.P. Morgan Letter; Medco Letter; NS Letter; Office Depot Letter; Peabody Letter; Pfizer Letter; Praxair Letter; Royal Gold Letter; Ryder Letter; S&C Letter; Textron Letter; TI Letter; Unitrin Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>98</sup> Some companies have also adopted a policy that requires a director to resign if not elected by a majority of the votes cast, since under the laws of certain states, if an incumbent director is not elected, he or she continues to serve as a holdover director until a successor is duly elected and qualified. See generally S&C Letter. See also Delaware General Corporation Law Section 141(b) ("Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal.") and California Corporation Code Section 301(b) ("Each director, including a director elected to fill a vacancy, shall hold office until the expiration of the term for which elected and until a successor has been elected and qualified.").

directors under a plurality vote standard, meaning that the person(s) receiving the most votes would serve as a director regardless of whether the shares voted for that person constituted a majority of the shares cast.<sup>99</sup>

Several commenters believed that companies employing a majority vote standard for director elections may have particular difficulty in obtaining majority support for director nominees were NYSE's proposal to be approved.<sup>100</sup> Specifically, commenters noted that the elimination of broker discretionary voting, coupled with majority voting, would make it more difficult for these companies to obtain adequate votes to overcome a "vote no" campaign by activist shareholders,<sup>101</sup> and thus would disproportionately empower minority shareholder groups.<sup>102</sup> Two commenters suggested that the difficulty of obtaining a majority vote without broker discretionary voting might discourage issuers from adopting a majority vote standard.<sup>103</sup>

According to an analysis submitted by one commenter, however, in calendar year 2007, 373 NYSE-listed companies had majority vote standard for the election of directors.<sup>104</sup>

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<sup>99</sup> See PWG Report, supra note 16, at 12-13. Many companies with a majority vote standard for election of directors retain a plurality vote standard in the event of a contested election of directors. As noted by commenters, in recent years, a trend toward majority voting has emerged. See text accompanying note 89, supra.

<sup>100</sup> See FedEx Letter; Helmerich Letter; Royal Gold Letter; Unitrin Letter; Wachtell Letter; and Washington Banking Letter.

<sup>101</sup> See Alcoa Letter and S&C Letter.

<sup>102</sup> See BB&T Letter.

<sup>103</sup> See NYSBA Sec. Reg. Letter and Wachtell Letter.

<sup>104</sup> See Broadridge Letter and attached analysis. The Corporate Library reports that as of December 2008, 49.5 percent of companies in the S&P 500 had made the switch to majority voting for director elections and another 18.4 percent had, while retaining a plurality standard, adopted a policy requiring that a director who does not receive majority support must submit his or her resignation. On the other hand, the plurality voting standard is still the standard at the majority of smaller companies in the Russell 1000 and 3000 indices, with 54.5 percent of companies in the Russell 1000 and 74.9 percent of the companies in the Russell 3000 still using a straight plurality voting

Analyzing the elections of those majority vote companies, the analysis found that only eight out of 2,718 directors received at least 50 percent withhold votes based on actual votes from returned proxy cards by shareholders, while six directors received at least 50 percent withhold votes using broker voting.<sup>105</sup> Thus, according to the commenter, only two more directors out of 2,718 failed to receive a majority without broker votes.

While NYSE's proposal may make it somewhat more difficult for a director in a majority vote company to survive a "just vote no" or similar campaign, the Commission continues to believe the proposal is consistent with the requirements of Section 6(b)(5) of the Act, which requires that the rules of an exchange be designed to protect investors and the public interest, by assuring that voting on matters as critical as the election of directors can no longer be determined by brokers without instructions from the beneficial owner, thereby enhancing corporate governance and accountability. In making this determination, the Commission recognizes that the increasing percentage of shares held in street name, in conjunction with the greater use of just vote no or withhold vote campaigns may have resulted in broker voting under Rule 452 affecting voting on certain non-contested director elections in ways not contemplated in 1937.

Accordingly, in light of these developments and concerns, we believe it is consistent with Section 6(b)(5) of the Act for the NYSE to determine that their member brokers should no longer be voting without instructions on behalf of their customers in director elections.

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standard. See The Corporate Library Analyst Alert, December 2008. As noted earlier, under a plurality vote standard, the person receiving the most votes will serve as the director. Thus, companies that elect directors under a plurality vote standard would have less difficulty in obtaining votes to overcome a "just vote no" or "withhold" campaign.

<sup>105</sup> Broadridge also found that seven directors out of 2,718 directors received greater than or equal to 50 percent withhold votes based on proportional voting. See id.

#### D. Shareholder Education

Several commenters believed that shareholder education was a critical component to making NYSE's proposal workable,<sup>106</sup> and shareholders would need to be educated about the proxy process and the importance of voting before the proposal could be implemented.<sup>107</sup> One commenter stated that the "potential adverse effects" of the proposal were increased if the proposal were adopted without shareholder education.<sup>108</sup> Another commenter believed that director elections should only become ineligible for broker voting when the NYSE and other constituents were satisfied that shareholders would exercise their voting rights.<sup>109</sup> Commenters emphasized the importance of shareholder education with respect to voting rights and director elections,<sup>110</sup> and some commenters urged the Commission (either alone or in conjunction with others) to undertake educational efforts designed to increase voting participation by retail shareholders.<sup>111</sup> One commenter stated that shareholders would generally benefit from shareholder education about broker discretionary voting,<sup>112</sup> while other commenters indicated that approval of the proposal should be in conjunction with a shareholder education initiative.<sup>113</sup>

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<sup>106</sup> See Business Roundtable Letter; Chamber of Commerce 2 Letter; Crescent Letter; GE Letter; and PWG Letter. But see Suburban Letter.

<sup>107</sup> See Chamber of Commerce 2 Letter; Governance Professionals Letter; ICI Letter; and ICI 2 Letter.

<sup>108</sup> See NYSBA Sec. Reg. Letter.

<sup>109</sup> See ICI Letter and ICI 2 Letter.

<sup>110</sup> See Sod'ali Letter; and Verizon Letter.

<sup>111</sup> See Corporate Governance Letter (also encouraging the Commission to encourage institutional investors to announce their proxy votes in advance of meetings and facilitating the development of systems like the Investor Suffrage Movement and ProxyDemocracy) and NIRI Letter.

<sup>112</sup> See Broadridge Letter.

<sup>113</sup> See Computershare Letter; Newground Letter; and S&C Letter.

As noted above, the Commission supports the Proxy Working Group's efforts to develop, and encourages NYSE and its member firms to implement, an investor education effort to inform investors about the amendments to NYSE Rule 452, the proxy voting process, and the importance of voting. The Commission believes the proposal offers substantial investor benefits, as noted above, so that its implementation should not be delayed. In addition, because implementation of the proposal will not occur until January 2010, there should be sufficient time for NYSE to inform market participants of the changes to its rules on broker discretionary voting.

E. Alternatives of Proportional Voting and Client Directed Voting

While not part of the NYSE's proposal, several commenters discussed proportional voting in their letters. In general, under proportional voting, a broker would vote shares held by it in street name, for which voting instructions for directors have not been received, in proportion to the votes cast by other retail clients of that broker.<sup>114</sup> Some commenters endorsed the concept of proportional voting in general,<sup>115</sup> and several supported proportional voting as an alternative to the NYSE's proposal.<sup>116</sup> Other commenters stated that proportional voting should be

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<sup>114</sup> Proportional voting may be implemented in two ways. Each broker would vote based on the proportion of the votes cast: (1) held by such broker or (2) held by all brokers. Proportional voting also could reflect the entirety of votes cast, not just the retail vote.

<sup>115</sup> See ABA Fed. Reg. Letter; ABC Letter; ABC 3 Letter; Agilent Letter; AmEx Letter; Connecticut Water Letter; DTE Letter; Exxon Mobil Letter; First Financial Letter; Furniture Brands Letter; GE Letter; Governance Professionals Letter; Honeywell Letter; ICI Letter; ICI 2 Letter; Jacksonville Letter; J.P. Morgan Letter; McKesson Letter; Medco Letter; Monster Letter; Nucor Letter; NYSBA Sec. Reg. Letter; Provident Letter; Provident Financial Letter; Quest Letter; S&C Letter; Schwab Letter; SIFMA Letter; Synalloy Letter; TI Letter; Veeco Letter; and Wachtell Letter; see also PWG Letter (no objection to members of SIFMA implementing proportional voting).

<sup>116</sup> See ABA Sec. Reg. Letter; ABC Letter (supporting proportional voting on a broker-by-broker basis); ABC 2 Letter (supporting proportional voting on a broker-by-broker basis); ABC 3 Letter; Agilent Letter; Alston Letter; BB&T Letter; Broadridge Letter; Business Roundtable Letter; Connecticut Water Letter; DTE Letter; First Financial Letter;

considered as part of a comprehensive review of the proxy voting system.<sup>117</sup> Several commenters were concerned that proportional voting, although potentially effective, would be eliminated under the proposal.<sup>118</sup> Commenters stated that proportional voting could provide an even more accurate reflection of the sentiment of retail shareholders than eliminating broker discretionary voting.<sup>119</sup>

Several commenters also discussed client directed voting as an alternative to the proposal,<sup>120</sup> or believed that client directed voting should be considered in conjunction with the

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Furniture Brands Letter; ICI Letter; ICI 2 Letter (recommending proportional voting only in instances where a minimum number of beneficial owners vote, or alternatively, a minimum percentage of shares outstanding are voted); Jacksonville Letter; McKesson Letter; Monster Letter; Nucor Letter; Provident Letter; Provident Financial Letter; Quest Letter; S&C Letter; Schwab Letter (proportional voting is a "better first step" than eliminating discretionary broker voting); Synalloy Letter; TI Letter; Unitrin Letter; and Veeco Letter.

<sup>117</sup> See AmEx Letter; Chamber of Commerce 2 Letter; Governance Professionals Letter; and Honeywell Letter. Other commenters believed that proportional voting and/or client directed voting should be considered in conjunction with any change to NYSE Rule 452. See Exxon Mobil Letter; and J.P. Morgan Letter.

<sup>118</sup> See ABA Fed. Reg. Letter; Agilent Letter; Business Roundtable Letter; Connecticut Water Letter; DTE Letter; First Financial Letter; Furniture Brands Letter; GE Letter; Governance Professionals Letter; Jacksonville Letter; J.P. Morgan Letter; McKesson Letter; Medco Letter; Monster Letter; Nucor Letter; Provident Letter; Provident Financial Letter; Quest Letter; Synalloy Letter; Veeco Letter; and Wachtell Letter; see also Intel Letter.

<sup>119</sup> See ABA Fed. Reg. Letter; ABC 3 Letter; Chevron Letter; Connecticut Water Letter; First Financial Letter; Furniture Brands Letter; GE Letter; Jacksonville Letter; J.P. Morgan Letter; McKesson Letter; Medco Letter; Monster Letter; Nucor Letter; NYSBA Sec. Reg. Letter; Provident Letter; Provident Financial Letter; Quest Letter; Synalloy Letter; and Veeco Letter.

<sup>120</sup> See ABA Fed. Reg. Letter; ABC 2 Letter; ABC 3 Letter; Agilent Letter; Business Roundtable Letter; Chamber of Commerce 2 Letter; Connecticut Water Letter; DTE Letter; First Financial Letter; Furniture Brands Letter; GE Letter; Intel Letter; Jacksonville Letter; McKesson Letter; Monster Letter; Nucor Letter; Provident Letter; Provident Financial Letter; Quest Letter; Synalloy Letter; and Veeco Letter.

proposal.<sup>121</sup> Under client directed voting, for those elections where the beneficial owners fail to return specific voting instructions, brokers would vote the shares according to the beneficial owners' standing directions. These standing directions could be given by beneficial owners at the time they sign their brokerage agreements, or periodically thereafter. Some commenters believed that client directed voting had merit, either to complement the NYSE's proposal or as an alternative.<sup>122</sup>

On the other hand, several commenters stated that eliminating broker discretionary voting is preferable to these alternative approaches, including proportional voting.<sup>123</sup> Some commenters believed that proportional voting could complicate the proxy voting process and result in abuses,<sup>124</sup> continue to compromise the integrity of proxy voting,<sup>125</sup> or provide "a disproportionate weight to the votes of disaffected shareholders."<sup>126</sup> Other commenters stated that proportional voting violates the "one share, one vote" principle.<sup>127</sup> Still other commenters recommended further research and consideration on this alternative.<sup>128</sup>

For the reasons discussed above, the Commission continues to believe that it is consistent with the requirements of Section 6(b)(5) of the Act to protect investors and the public interest for

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<sup>121</sup> See AmEx Letter; Governance Professionals Letter; Honeywell Letter; and J.P. Morgan Letter; and SCC Letter.

<sup>122</sup> See ABC 2 Letter; ABC 3 Letter; GE Letter; and Jacksonville Letter.

<sup>123</sup> See CalSTRS Letter, CCGG 2 Letter; CII Letter; CII 2 Letter; CII 4 Letter; Colorado PERA Letter; FSBA 2 Letter; Hagberg Letter; Sod'ali Letter; and TIAA-CREF Letter.

<sup>124</sup> See CII Letter; CII 2 Letter; CII 4 Letter; Colorado PERA Letter; and TIAA-CREF Letter.

<sup>125</sup> See CCGG 2 Letter.

<sup>126</sup> See Hagberg Letter.

<sup>127</sup> See CalSTRS Letter; CII 4 Letter; Colorado PERA Letter; Sod'ali Letter; and TIAA-CREF Letter.

<sup>128</sup> See ABA Fed. Reg. Letter; Alston Letter; CalPERS Letter (recommending proportional voting for those matters requiring a majority or more to pass); Suburban Letter.

NYSE to eliminate broker discretionary voting in director elections. While several commenters believed that proportional voting would most accurately represent the retail vote, the Commission notes that proportional voting could have a distortive impact, depending on how it is implemented.<sup>129</sup> In addition, proportional voting would allow votes to be cast by someone other than the person with an economic interest in the security.<sup>130</sup> With respect to client directed voting, the Commission notes that it raises a variety of questions and concerns, such as requiring shareholders to make a voting determination in advance of receiving a proxy statement with the disclosures mandated under the federal securities laws and without consideration of the issues to be voted upon. Finally, the Commission notes that the fact that there may be other reasonable alternatives does not mean that the rule change proposed by the NYSE is inconsistent with Section 6(b)(5) of the Act.<sup>131</sup> For the reasons discussed above, the Commission finds the proposed rule change consistent with the requirements of the Act.

F. Commission Consideration of the Entire Proxy Process

Many commenters believed that NYSE's proposal to amend NYSE Rule 452 should not be viewed in isolation, but should be considered by the Commission as part of a comprehensive

<sup>129</sup> For example, of the 11 largest brokerage firms using proportional voting, only five of these firms used only the votes of retail account holders when "mirroring" votes for uninstructed retail shares. See Broadridge Letter. According to Broadridge, for purposes of its analysis, all uninstructed brokerage shares were voted on the basis of the instructions received from all brokerage account holders, including those of "professional" investors. Id.

<sup>130</sup> See PWG Report, supra note 16, at 17-18.

<sup>131</sup> 15 U.S.C. 78(f)(b)(5). The Commission notes that, in this regard, Section 19(b) of the Act requires, among other things, that "[t]he Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations thereunder applicable to such organizations." 15 U.S.C. 78s(b)(2).

review of the proxy voting and shareholder communication system.<sup>132</sup> Certain commenters also raised concerns regarding the efficiency of shareholder communications and the proxy voting process as a whole, as well as the merits of other possible alternatives.<sup>133</sup> Commenters stated that the proposal should be examined in light of current circumstances,<sup>134</sup> such as the rapidly shifting corporate governance environment,<sup>135</sup> and in conjunction with alternatives.<sup>136</sup> Commenters urged the Commission not to take action on the proposal until the Commission completed its comprehensive review.<sup>137</sup> For example, one commenter believed that the

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<sup>132</sup> See Alcoa Letter; Alston Letter; Anadarko Letter; Arvin Letter; Avery Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Cardinal Letter; Ceridian Letter; Cigna Letter; Cincinnati Financial Letter; Computershare Letter; Continental Letter; Corning Letter; Crescent Letter; CSX Letter; Cummins Letter; DTE Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Exxon Mobil Letter; Fidelity Letter; First American Letter; First Financial Letter; Furniture Brands Letter; GE Letter; General Mills Letter; GM Letter; Gulf Letter; Harman Letter; Helmerich Letter; Honeywell Letter; Illinois Stock Letter; Intel Letter; International Paper Letter; Jacksonville Letter; Johnson Letter; J.P. Morgan Letter; Manifest Letter; Medco Letter; MGE Letter; Monster Letter; NS Letter; Nucor Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; P&G Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; Provident Letter; Provident Financial Letter; Quest Letter; Realogy Letter; Routh Letter; Ryder Letter; S&C Letter; SCC Letter; Securities Transfer Letter; STA Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Synalloy Letter; Textron Letter; TI Letter; Unitrin Letter; Veeco Letter; Verizon Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>133</sup> See e.g., Aetna Letter; Agilent Letter; GE Letter; and McKesson Letter.

<sup>134</sup> See NYSBA Sec. Reg. Letter and Wachtell Letter.

<sup>135</sup> See Wachtell Letter.

<sup>136</sup> See Central Vermont Letter; and Chevron Letter.

<sup>137</sup> See Aetna Letter; Agilent Letter; Anadarko Letter; ArvinMeritor Letter; Avery Letter; Avis Letter; BNSF Letter; Boeing Letter; Business Roundtable Letter; CA Letter; Ceridian Letter; Chamber of Commerce 2 Letter; Cigna Letter; Cincinnati Financial Letter; Connecticut Water Letter; Conoco Phillips Letter; Continental Letter; Crescent Letter; CSX Letter; Cummins Letter; DTE Letter; Eaton Letter; Eli Lilly Letter; EV Letter; Exxon Mobil Letter; Fidelity Letter; First American Letter; First Financial Letter; Furniture Brands Letter; GE Letter; General Mills Letter; GM Letter; Gulf Letter; Harman Letter; Helmerich Letter; Honeywell Letter; Illinois Stock Letter; Intel Letter; International Paper Letter; Jacksonville Letter; Johnson Letter; J.P. Morgan Letter;

implementation of the NYSE's proposal without other changes to the proxy system could have "unintended and devastating consequences" in the form of increased costs to public companies to ensure quorum, undue influence of minority shareholders, and the like.<sup>138</sup> Moreover, another commenter noted that the Commission may be considering two proposals that relate to the proxy system: requiring companies to include shareholder-selected nominees in the company's proxy materials and allowing shareholders to vote on executive compensation ("say-on-pay").<sup>139</sup> This commenter believed that the Commission should consider NYSE's proposal at the same time as these two proposals, because the issues they raise are intertwined.<sup>140</sup>

In contrast, other commenters saw no reason to delay NYSE's proposal until other issues relating to the proxy voting system had been considered, as sufficient time and resources have been spent on the proposal's development, and it is justifiable as a stand-alone initiative.<sup>141</sup>

The Commission has analyzed and reviewed NYSE's proposal in light of the current proxy process, and with full knowledge that a variety of proxy and shareholder communication

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Manifest Letter; Medco Letter; MGE Letter; Monster Letter; NS Letter; Nucor Letter; Office Depot Letter; OTC Letter; Otter Tail Letter; P&G Letter; Peabody Letter; Pfizer Letter; Platinum Letter; Praxair Letter; Provident Letter; Provident Financial Letter; Quest Letter; Realogy Letter; Routh Letter; Ryder Letter; S&C Letter; SCC Letter; Securities Transfer Letter; STA Letter; Standard Letter; StockTrans Letter; Superlattice Letter; Synalloy Letter; Textron Letter; TI Letter; Unitrin Letter; Veeco Letter; Verizon Letter; Washington Banking Letter; Whirlpool Letter; Xcel Letter; Xerox Letter; and YRC Letter.

<sup>138</sup> See NIRI Letter ("Some of these consequences include the potential for increased costs to public companies to ensure a quorum is achieved, an increased influence of proxy advisory firms through their voting recommendations, additional power in the hands of the few shareholders who vote, and a magnification of the shareholder communications limitations associated with objecting beneficial owners (OBO) who may be unsure of the meaning of this status and are unable to receive direct corporate communications.").

<sup>139</sup> See Computershare Letter.

<sup>140</sup> Id.

<sup>141</sup> See Dobkin Letter and Hagberg Letter.

issues are under review. Given the benefits to investors of the proposal as discussed above, including assuring that voting on matters as critical as the election of directors can no longer be determined by brokers without instructions from the beneficial owner, thereby enhancing corporate governance and accountability, the Commission does not believe it is appropriate to delay action on the NYSE's proposal pending consideration of the myriad important and difficult issues relating to shareholder director nominations, proxy voting, and shareholder communication, which are outside the scope of NYSE's proposed rule change.<sup>142</sup> The Commission believes that approval of the proposal is warranted pursuant to Section 19(b) of the Act<sup>143</sup> even as it considers broader proxy issues in the near future. We do not believe that action on those issues will undermine the fundamental concept that decisions as significant as the election of the board of directors should be made by those with an economic interest in the company, rather than the brokers who have no such economic interest. Further, as noted earlier, under Section 19(b)(2) of the Act, the Commission must approve the proposal presented by NYSE if it finds the proposed rule change consistent with the Act and applicable rules and regulations thereunder.<sup>144</sup>

G. Exemptions for Registered Investment Companies under the Investment Company Act of 1940 and Requests for Additional Exemptions

Seven commenters either supported or did not oppose the exemption for registered investment companies.<sup>145</sup> However, some of these commenters, who support the exemption, recommended that it be reconsidered at a later date.<sup>146</sup>

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<sup>142</sup> See Securities Act Release No. 9046 (June 10, 2009) (File No. S7-10-09).

<sup>143</sup> 15 U.S.C. 78s(b). See also *supra* note 131.

<sup>144</sup> See 15 U.S.C. 78s(b)(2); see also *supra* note 131.

<sup>145</sup> See Altman Letter; CalPERS Letter; CFA 2 Letter; CII Letter; FSBA Letter; FSBA 2 Letter; ICI 4 Letter (supporting amended proposal); and Sutherland Letter.

In addition, three commenters requested the exemption also include business development companies (“BDCs”)<sup>147</sup> or smaller issuers, which tend to have a high percentage of retail ownership.<sup>148</sup> Another commenter believed the exemption favored registered investment companies over other issuers that face similar increased proxy solicitation costs and an increased risk of failed elections.<sup>149</sup> Yet another commenter stated that the proposed exemption was over-broad, as it included closed-end funds.<sup>150</sup> That commenter argued that unlike open-end funds,

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<sup>146</sup> See CalPERS Letter (“CalPERS is not opposed to exempting investment companies from this proposed rule change in the short term”); CII Letter (“Given the corporate governance concerns surrounding mutual funds, we believe the proposed change should also apply to investment companies at some point in the not-too-distant future.”); FSBA Letter (proposed exemption for investment companies “poses no problem, but this should be re-evaluated at some point”); and FSBA 2 Letter (proposed exemption “is currently warranted, but this should be re-evaluated in the future”).

<sup>147</sup> See ICI 4 Letter and Sutherland Letter.

<sup>148</sup> See Altman Letter (requesting an exemption for issuers with similar circumstances to those of investment companies, such as those “with a high percentage of retail ownership and burdensome cost concerns”); see also Suburban Letter (requesting an exemption for Master Limited Partnerships because of the “disparate impact that such amendment would have on MLPs”).

However, one commenter did not support approval of NYSE’s proposal under any circumstances and questioned NYSE’s rationale for letting “investment companies off the hook.” See ABC 2 Letter (stating that it “does not support an expansion of the ‘carve out’ to include smaller public companies. By and large, we believe that ‘carve outs’ are bad public policy.”); see also ABC 3 Letter (stating opposition to NYSE’s proposal). This commenter noted that “the predicament of small and midsize public companies is identical to that of small and midsize investment companies . . . . It is hard to see, on the merits, why the NYSE provides relief to one group and not to the other.” See ABC 2 Letter.

<sup>149</sup> See Alcoa Letter.

<sup>150</sup> See City of London Letter. The commenter noted that closed-end funds typically trade at a discount to net asset value, and suggested that investors in closed-end funds do not view themselves as having the option of “voting with [their] feet.” *Id.*

closed-end funds typically have institutional bases, and do not have the same issues establishing quorum at shareholder meetings.<sup>151</sup>

The Commission believes that it is reasonable and consistent with the Act for the Exchange to exempt registered investment companies from the prohibition in NYSE Rule 452 on broker discretionary voting in director elections. NYSE relied on the Proxy Working Group's conclusion that the unique regulatory regime governing registered investment companies differentiated them from operating companies. In recommending the exemption for registered investment companies, the Proxy Working Group considered the heightened problems that registered investment companies face because of their disproportionately large retail shareholder base, that they often do not include other routine matters on the ballot,<sup>152</sup> which would allow a broker vote to count for quorum purposes, and that they are subject to the 1940 Act, which, among other things, also regulates shareholder participation in key decisions. The 1940 Act, for example, requires that a registered investment company obtain the approval of a majority of its voting securities before changing the nature of its business so as to cease to be an investment company, deviating from its concentration policy with respect to investments in any particular industry or group of industries, or changing its subclassification as an open-end company or closed-end company. The Commission believes that the different regulatory regime for registered investment companies supports the exemption, and finds the exemption should, among

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<sup>151</sup> Id. But see ICI 2 Letter, which states that retail investors own ninety-eight percent of the value of closed-end funds. See also further discussion below on the basis for exempting registered investment companies under the 1940 Act from the NYSE's proposal.

<sup>152</sup> See Rule 32a-4 under the 1940 Act, 17 CFR 270.32a-4, and infra note 156 and accompanying text.

other things, further the public interest and the protection of investors, consistent with Section 6(b)(5) of the Act.<sup>153</sup>

While the Commission understands the concerns raised by commenters urging NYSE to broaden the exemption, the Commission believes that there are sufficient differences between registered investment companies and other entities to conclude that NYSE's proposal is consistent with the Act.<sup>154</sup> For example, the regulation of BDCs and registered investment companies under the 1940 Act differs significantly. Particularly relevant here, the 1940 Act requires a BDC to seek ratification of the independent auditor, which is a routine item under NYSE Rule 452, at each annual meeting.<sup>155</sup> Adoption of the amendment will therefore have no effect on a BDC's ability to obtain a quorum, and expansion of the exemption for registered investment companies to include BDCs is unnecessary. A registered investment company, however, is exempt from the 1940 Act's auditor ratification requirement if it relies on a conditional exemptive rule under the 1940 Act.<sup>156</sup> That exemptive rule is not available to BDCs.

The Commission finds it reasonable for the NYSE to distinguish between registered investment companies and smaller issuers that may have a large retail shareholder base for purposes of allowing broker discretionary voting on director elections. While the Commission recognizes that small issuers could face similar concerns as registered investment companies as a result of the proposed changes to Rule 452, there are significant differences between small issuers and registered investment companies. For example, as noted by the Proxy Working Group, "the unique regulatory regime governing investment companies made such companies

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<sup>153</sup> 15 U.S.C. 78f(b)(5).

<sup>154</sup> See Altman Group Letter; ICI 4 Letter; and Sutherland Letter.

<sup>155</sup> See 15 U.S.C. 80a-31(a) and 15 U.S.C. 80a-59. See 17 CFR 270.32a-4.

<sup>156</sup> Rule 32a-4 under the 1940 Act. See 17 CFR 270.32a-4.

sufficiently different from operating companies (regardless of size) that it was appropriate to treat such companies differently.”<sup>157</sup> Further, operating companies frequently place an item that permits broker discretionary voting, such as the ratification of independent auditors, on the ballot, which will help them obtain quorum.<sup>158</sup> In contrast, pursuant to NYSE Rule 452, for registered investment companies, only the election of directors would qualify as a routine matter on their ballot for purposes of establishing quorum.

Because of these differences, the Commission believes that it is reasonable for the NYSE to distinguish between registered investment companies and other entities in defining the scope of the exemption, and therefore, believes the proposal is consistent with the requirements of Section 6(b)(5) of the Act, which, among other things, requires that the rules of an exchange be designed to protect investors and the public interest and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

#### H. Implementation Date

The NYSE’s proposal to eliminate broker discretionary voting for the election of directors would apply to shareholder meetings held on or after January 1, 2010, except to the extent that a meeting was originally scheduled to be held prior to that date but was properly adjourned to a date on or after it.<sup>159</sup> The Commission received several comments relating to the NYSE’s proposed implementation date. One commenter recommended that, if the Commission approved the proposal, it should initially make the proposal applicable only to large accelerated

<sup>157</sup> See Addendum, supra note 21, at 3.

<sup>158</sup> See supra Section IV.A, Increased Costs for Companies to Achieve Quorum.

<sup>159</sup> NYSE also stated that in the event the proposal is not approved by the Commission on or before August 31, 2009, NYSE would delay the effective date to a date which is at least four months after the approval date, and which does not fall within the first six months of the calendar year. See Notice, supra note 4.

filers, so as to not “unfairly burden smaller public companies and to provide time to observe the effect of the proposed amendments in operation.”<sup>160</sup> However, other commenters recommended that the proposed rule change be implemented earlier.<sup>161</sup>

The Commission believes that the NYSE’s proposed implementation date is reasonable and consistent with the Act. The Commission believes that it is reasonable for the NYSE to implement the proposed rule to apply to all affected issuers at the same time because the NYSE appears to have provided sufficient time for these issuers to adjust to the proposed rule change. The Commission also believes that it is reasonable for the NYSE to delay the effective date of the proposed rule to shareholder meetings held on or after January 1, 2010. The Commission recognizes that, given the significance of the NYSE’s proposed rule change, issuers may need additional time to prepare their proxy materials and inform investors of the changes resulting from the NYSE’s proposal. Accordingly, the Commission believes that the NYSE’s proposal to apply the proposed rule change to shareholder meetings held on or after January 1, 2010 is consistent with the Act.

I. Prior Interpretations to Rule 452

The Exchange proposes amending NYSE Rule 452 to codify two previously published interpretations, which were filed with the Commission pursuant to Section 19(b)(2) of the Act.<sup>162</sup>

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<sup>160</sup> See ABA Fed. Reg. Letter.

<sup>161</sup> See AFSCME Letter (recommending immediate implementation); CII 4 Letter (recommending immediate implementation); Colorado PERA Letter (requesting that the proposal become effective upon final approval); FSBA 2 Letter (recommending that the proposal be implemented earlier than 2010); Hermes Equity Letter (requesting that the Commission “allow the amendment to take effect as soon as possible”); OPERS letter (recommending that the proposal be implemented earlier than 2010); and Sod’ali Letter (recommending that the proposal be immediately effective).

<sup>162</sup> See Securities Exchange Act Release Nos. 30697, supra note 3 (interpreting Rule 452 to allow members organizations to give a proxy on the initial approval of an investment advisory contract if the beneficial holder does not exercise his right to vote, but

First, the NYSE proposes codifying that NYSE Rule 452 would preclude broker discretionary voting on a matter that materially amends an investment advisory contract with an investment company. Second, the NYSE proposes codifying that a material amendment to an investment advisory contract would include any proposal to obtain shareholder approval of an investment company's investment advisory contract with a new investment adviser, which approval is required by the 1940 Act and the rules thereunder.

The Commission received two comment letters on NYSE's codification of its prior interpretations.<sup>163</sup> Both commenters supported this proposal.<sup>164</sup> For example, ICI stated that "[w]e agree that these matters are the types of non-routine matters on which investment company shareholders should be required to vote . . . . When investors become shareholders of an investment company, they already have chosen the adviser in the context of the disclosures in the investment company's prospectus and other documents . . . . Given the importance of the identity of the adviser and the services it provides to investment company shareholders, we believe the benefits of shareholders' voting on material amendment to an advisory contract or an advisory contract with a new investment adviser outweigh the costs associated with such a requirement."<sup>165</sup>

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precluding members organizations from giving proxies on material amendments to the investment advisory contracts without specific client instructions) and 52569, supra note 3 (interpreting Rule 452 to preclude member organizations from giving proxies on any proposal to obtain shareholder approval of an investment company's investment advisory contract with a new investment adviser, which approval is required by the 1940 Act, without specific beneficial owners' voting instructions).

<sup>163</sup> See CFA 2 Letter and ICI 4 Letter.

<sup>164</sup> Id.

<sup>165</sup> See ICI 4 Letter.

The Commission believes that the NYSE's codification of previously published interpretations is consistent with the Act and the rules and regulations thereunder. As the Commission has previously stated, "[f]ull and effective voting rights of investment company shareholders are an important aspect of the investment company structure."<sup>166</sup> The Commission believes that the NYSE, by codifying its prior interpretations to Rule 452, is providing greater transparency and ensuring the consistent application of its interpretations. Further, the proposed amendments codify existing NYSE interpretations, which were the subject of two prior rule filings.<sup>167</sup> Accordingly, these changes raise no new regulatory issues, and are consistent with the Act.

J. Conclusion

The Commission finds, for the reasons set forth above, that the Exchange's proposal, as modified by Amendment No. 4, is consistent with the requirements of the Act. In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,<sup>168</sup> which provides that the rules of the exchange must be designed to protect investors and the public interest, and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission believes that it is reasonable and consistent with the Act for the NYSE to determine that the election of directors should no longer be an item eligible for broker discretionary voting. As noted above, the most fundamental way for shareholders to hold directors accountable for their performance of critical corporate duties is through the director election process. Given the large proportion of shares that today are held in street name, the

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<sup>166</sup> See Release No. 30697, supra note 3.

<sup>167</sup> See supra note 3.

<sup>168</sup> 15 U.S.C. 78f(b)(5).

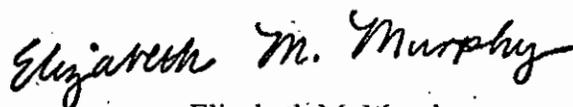
importance of corporate governance matters, and the concern that the broker vote can distort election results, the Commission believes it is appropriate for the NYSE to eliminate broker discretionary voting in director elections.<sup>169</sup> In making this determination, the Commission believes that the NYSE's proposal, among other things, furthers the protection of investors and the public interest by assuring that voting on matters as critical as the election of directors can no longer be determined by brokers without instructions from the beneficial owner, and thus should enhance corporate governance and accountability to shareholders.

The Commission also believes that the NYSE's proposed change codifying prior NYSE interpretations of NYSE Rule 452 is consistent with the requirements of the Act. These proposed amendments help to ensure the full and effective voting rights of investment company shareholders on material matters, and further, codify existing NYSE interpretations.

V. Conclusion

IT IS THEREFORE ORDERED, that pursuant to Section 19(b)(2) of the Act,<sup>170</sup> the proposed rule change, as modified by Amendment No. 4, is hereby approved.

By the Commission.



Elizabeth M. Murphy  
Secretary

<sup>169</sup> As discussed above, NYSE does not propose to eliminate broker discretionary voting for registered investment companies under the 1940 Act.

<sup>170</sup> 15 U.S.C. 78s(b)(2).

## Appendix A

### List of comment letters received

Letter from Keith F. Higgins, Chair, Committee on Federal Regulation of Securities, American Bar Association, dated April 3, 2009 (“ABA Fed. Reg. Letter”); John Endean, President, American Business Conference, dated January 16, 2007 (“ABC Letter”); John Endean, President, American Business Conference, dated June 25, 2007 (“ABC 2 Letter”); John Endean, President, American Business Conference, dated March 31, 2009 (“ABC 3 Letter”); Judith H. Jones, Vice President and Corporate Secretary, Aetna Inc., dated March 26, 2009 (“Aetna Letter”); Charles Jurgonis, Plan Secretary, American Federation of State, County and Municipal Employees, AFL-CIO, dated March 26, 2009 (“AFSCME Letter”); D. Craig Nordlund, Senior Vice President, General Counsel and Secretary, Agilent Technologies, Inc., dated March 24, 2009 (“Agilent Letter”); Donna Dabney, Vice-President, Secretary, and Corporate Governance Counsel, Alcoa, Inc., dated March 24, 2009 (“Alcoa Letter”); David E. Brown, Mark F. McElreath, Justin R. Howard, and William S. Ortwein, Alston & Bird LLP, dated April 1, 2009 (“Alston Letter”); Kenneth L. Altman, President, The Altman Group, Inc., dated March 27, 2009 (“Altman Letter”); Stephen P. Norman, Secretary, American Express Company, dated March 27, 2009 (“AmEx Letter”); David L. Siddall, Vice President, Deputy General Counsel and Corporate Secretary, Anadarko Petroleum Corporation, dated March 25, 2009 (“Anadarko Letter”); Charles G. McClure, Chairman, Chief Executive Officer and President, ArvinMeritor, Inc., dated March 17, 2009 (“ArvinMeritor Letter”); Peter M. Finn, First Vice President, Regulatory Affairs, Astoria Financial Corporation, dated March 25, 2009 (“Astoria Financial Letter”); Dean A. Scarborough, President and Chief Executive Officer, Avery Dennison, dated March 16, 2009 (“Avery Letter”); Ronald L. Nelson, Chairman and Chief Executive Officer, Avis Budget Group, Inc., dated March 23, 2009 (“Avis Letter”); Frances B. Jones, Executive Vice President, Secretary, General Counsel and Chief Corporate Governance Officer, BB&T Corporation, dated March 26, 2009 (“BB&T Letter”); Doug Pearce, Chief Executive Officer and Chief Investment Officer, British Columbia Investment Management Corporation, dated March 31, 2009 (“BCIMC Letter”); Matthew K. Rose, Chairman, President and Chief Executive Officer, Burlington Northern Santa Fe Corporation, dated March 27, 2009 (“BNSF Letter”); Robert Schifellite, President, Investor Communication Solutions, Broadridge Financial Solutions, Inc., dated March 27, 2009 (“Broadridge Letter”); W. James McNerney, Jr., Chairman of the Board, President and Chief Executive Officer, The Boeing Company, dated March 26, 2009 (“Boeing Letter”); Anne M. Mulcahy, Chair, Corporate Leadership Initiative, Business Roundtable, dated March 25, 2009 (Business Roundtable Letter”); Clifford DuPree, Vice President, Corporate Governance and Corporate Secretary, CA, Inc., dated March 27, 2009 (“CA Letter”); Peter H. Mixon, General Counsel, CalPERS, dated June 25, 2007 (“CalPERS Letter”); Peter H. Mixon, General Counsel, CalPERS, dated October 26, 2007 (“CalPERS 2 Letter”); Dennis A. Johnson, Senior Portfolio Manager, CalPERS Corporate Governance, dated April 29, 2008 (“CalPERS 3 Letter”); Anne Sheehan, Director, Corporate Governance, California State Teacher’s Retirement System, dated March 27, 2009 (“CalSTRS Letter”); Sally J. Curley, Senior Vice President, Cardinal Health, Inc., dated March 30, 2009 (“Cardinal Letter”); Doug Pearce, Chairman, Canadian Coalition for Good Governance, dated January 19, 2009 (“CCGG Letter”); Stephen Griggs, Executive Director, Canadian Coalition for Good Governance, dated March 27, 2009 (“CCGG 2 Letter”); Dale A. Rocheleau, Senior Vice President, General Counsel and Corporate

Secretary, Central Vermont Public Service Corporation, dated March 27, 2009 (“Central Vermont Letter”); Kathryn V. Marinello, Chairman and Chief Executive Officer; Ceridian Corporation, dated March 25, 2009 (“Ceridian Letter”); Kurt N. Schacht, Executive Director, CFA Institute Centre for Financial Market Integrity, dated March 31, 2008 (“CFA Letter”); Kurt N. Schacht, Managing Director, and James C. Allen, Director, CFA Institute Centre for Financial Market Integrity, dated March 27, 2009 (“CFA 2 Letter”); David Chavern, Senior Vice President and Chief Legal Officer, Chamber of Commerce of the United States of America, dated November 13, 2006 (“Chamber of Commerce Letter”); David T. Hirshmann, President and Chief Executive Officer, Center for Capital Markets Competitiveness, United States Chamber of Commerce, dated March 27, 2009 (“Chamber of Commerce 2 Letter”); Lydia I. Beebe, Corporate Secretary and Chief Governance Officer, Chevron, dated March 27, 2009 (“Chevron Letter”); H. Edward Hanway, Chairman and Chief Executive Officer, Cigna Corporation, dated March 26, 2009 (“Cigna Letter”); Ann Yerger, Executive Director, Council of Institutional Investors, dated June 5, 2007 (“CII Letter”); Amy Borrus, Deputy Director, Council of Institutional Investors, dated November 5, 2007 (“CII 2 Letter”); Ann Yerger, Executive Director, Council of Institutional Investors, dated April 17, 2008 (“CII 3 Letter”); Jonathan D. Urick, Research Analyst, Council of Institutional Investors, dated March 19, 2009 (“CII 4 Letter”); Steven J. Johnston, Chief Financial Officer, Secretary and Treasurer, Cincinnati Financial Corporation, dated March 25, 2009 (“Cincinnati Financial Letter”); Barry M. Olliff, Chief Investment Officer, City of London Investment Company Limited, dated March 27, 2009 (“City of London Letter”) (also requesting that the proposal not exempt closed-end funds registered under the Investment Company Act of 1940); Gregory W. Smith, General Counsel, Colorado Public Employees’ Retirement Association, dated March 26, 2009 (“Colorado PERA Letter”); Paul Conn, President, Global Capital Markets, Computershare Limited, and David Drake, President, Georgeson Inc., dated March 27, 2009 (“Computershare Letter”); Daniel J. Meaney, Corporate Secretary, Connecticut Water Company, dated March 25, 2009 (“Connecticut Water Letter”); J.J. Mulva, Chairman and Chief Executive Officer, ConocoPhillips, dated March 26, 2009 (“ConocoPhillips Letter”); Steven G. Nelson, President and Chairman of the Board, Continental Stock Transfer and Trust Company, dated March 24, 2009 (“Continental Letter”); James B. Flaws, Vice Chairman and Chief Financial Officer, Corning Incorporated, dated March 24, 2009 (“Corning Letter”); James McRitchie, Publisher, Corporate Governance, dated March 13, 2009 (“Corporate Governance Letter”); Marc Cox, dated April 26, 2009 (“Cox Letter”); Barbara Trivedi, Shareholder Services Manager, Crescent Banking Company, dated March 25, 2009 (“Crescent Letter”); Ellen M. Fitzsimmons, Senior Vice President – Law and Public Affairs and General Counsel, CSX Corporation, dated March 18, 2009 (“CSX Letter”); William B. Patterson, Executive Director, CtW Investment Group, dated June 6, 2007 (“CtW Letter”); William B. Patterson, Executive Director, CtW Investment Group, dated April 17, 2008 (“CtW 2 Letter”); Tim Solso, Chairman and Chief Executive Officer, Cummins Inc., dated March 25, 2009 (“Cummins Letter”); David M. Dobkin, dated March 27, 2009 (“Dobkin Letter”); Patrick B. Carey, Associate General Counsel & Assistant Corporate Secretary, DTE Energy, dated March 27, 2009 (“DTE Letter”); Alexander M. Cutler, Chairman and Chief Executive Officer, Eaton Corporation, dated March 13, 2009 (“Eaton Letter”); Bronwen L. Mantlo, Associate General Counsel and Assistant Secretary, dated March 26, 2009 (“Eli Lilly Letter”); Holly Roseberry, President, EV Innovations, Inc., dated March 25, 2009 (“EV Letter”); David S. Rosenthal, Vice President, Investor Relations and Secretary, Exxon Mobil Corporation, dated March 27, 2009 (“Exxon Mobil Letter”); Christine P. Richards,

Executive Vice President, General Counsel and Secretary, FedEx Corporation, dated March 26, 2009 ("FedEx Letter"); Kevin Kopaunik, President, Fidelity Transfer Company, dated March 24, 2009 ("Fidelity Letter"); Salli Marinov, President and Chief Executive Officer, First American Stock Transfer, Inc., dated March 24, 2009 ("First American Letter"); Dorothy B. Wright, Vice President and Corporate Secretary, First Financial Holdings, Inc., dated March 24, 2009 ("First Financial Letter"); Alissa E. Ballot, Vice President and Corporate Secretary, FPL Group, Inc., dated March 23, 2009 ("FPL Letter"); Michael McCauley, Director, Office of Corporate Governance, State Board of Administration of Florida, dated June 13, 2007 ("FSBA Letter"); Ashbel C. Williams, Executive Director and Chief Executive Officer, State Board of Administration of Florida, dated March 27, 2009 ("FSBA 2 Letter"); Jon D. Botsford, Senior Vice President, General Counsel and Secretary, Furniture Brands International, dated March 23, 2009 ("Furniture Brands Letter"); Michael R. McAlevey, Vice President and Chief Corporate, Securities and Finance Counsel, General Electric Company, dated April 13, 2009 ("GE Letter"); Roderick A. Palmore, Executive Vice President, General Counsel and Chief Compliance and Risk Management Officer, General Mills, dated March 17, 2009 ("General Mills Letter"); Robert McCormick, Chief Policy Officer, Glass Lewis & Co., dated March 13, 2009 ("Glass Lewis Letter"); G. Richard Wagoner, Jr., Chairman and Chief Executive Officer, General Motors Corporation, dated March 27, 2009 ("GM Letter"); Brian Connolly, Director of Sales, GovernanceMetrics International ("GovernanceMetrics Letter"); Neila B. Radin, Chair, Securities Law Committee, The Society of Corporate Secretaries and Governance Professionals, dated March 20, 2009 ("Governance Professionals Letter"); Steven Gratzner, dated April 27, 2009 ("Gratzner Letter"); William A. Little III, President, Gulf Registrar and Transfer Corporation, dated March 24, 2009 ("Gulf Letter"); Carl T. Hagberg, Chairman and CEO, Carl T. Hagberg and Associates, dated March 27, 2009 ("Hagberg Letter"); Dinesh C. Paliwal, Chairman and Chief Executive Officer, Harman International, dated March 26, 2009 ("Harman Letter"); Steven R. Mackey, Executive Vice President, Secretary and General Counsel, Helmerich & Payne, Inc., dated March 24, 2009 ("Helmerich Letter"); Bess Joffe, Associate Director, Hermes Equity Ownership Services Limited, dated March 20, 2009 ("Hermes Equity Letter"); Thomas F. Larkins, Vice President, Corporate Secretary and General Counsel, Honeywell, dated March 27, 2009 ("Honeywell Letter"); Paul Schott Stevens, President, Investment Company Institute, dated November 20, 2006 ("ICI Letter"); Paul Schott Stevens, President, Investment Company Institute, dated December 18, 2006 ("ICI 2 Letter"); Paul Schott Stevens, President, Investment Company Institute, dated February 20, 2007 ("ICI 3 Letter"); Karrie McMillian, General Counsel, Investment Company Institute, dated March 27, 2009 ("ICI 4 Letter") (supporting the proposal, as amended to exempt investment companies); Robert G. Pearson, President and Chief Executive Officer, Illinois Stock Transfer Company, dated March 24, 2009 ("Illinois Stock Letter"); Maura Abelin Smith, Senior Vice President, General Counsel and Corporate Secretary, International Paper Company, dated March 24, 2009 ("International Paper Letter"); Cary Klafter, Vice President, Legal and Corporate Affairs, Intel Corporation, dated March 26, 2009 ("Intel Letter"); Gilbert J. Pomar, III, President and Chief Executive Officer, and Valerie A. Kendall, EVP and Chief Financial Officer, Jacksonville Bancorp Inc., dated March 26, 2009 ("Jacksonville Letter"); Stephen A. Roell, Chairman and Chief Executive Officer, Johnson Controls, Inc., dated March 25, 2009 ("Johnson Letter"); Anthony J. Horan, Corporate Secretary, J.P. Morgan Chase & Co., dated March 27, 2009 ("J.P. Morgan Letter"); Sarah Wilson, Chief Executive, Manifest, dated March 27, 2009 ("Manifest Letter"); McKesson Corporation, dated March 27, 2009 ("McKesson Letter"); Thomas M. Moriaty, General Counsel, Secretary and

SVP, Medco Health Solutions, Inc., dated March 26, 2009 ("Medco Letter"); Kenneth G. Frassetto, Director – Treasury Management and Shareholder Services, MGE Energy, Inc., dated March 26, 2009 ("MGE Letter"); Michael C. Miller, Executive Vice President, General Counsel and Secretary, Monster Worldwide, Inc., dated March 24, 2009 ("Monster Letter"); Larry S. Dohrs, Vice President, Newground Social Investment, dated March 27, 2009 ("Newground Letter"); Jeffrey D. Morgan, CAE, President & CEO, National Investor Relations Institute, dated March 16, 2009 ("NIRI Letter"); C.W. Moorman, Chairman, President and Chief Executive Officer, Norfolk Southern Corporation, dated March 23, 2009 ("NS Letter"); Daniel R. DiMicco, Chairman, President and Chief Executive Officer, Nucor Corporation, dated March 25, 2009 ("Nucor Letter"); Jeffrey W. Rubin, Chair, Business Law Section, Committee on Securities Regulation, New York State Bar Association, dated March 27, 2009 ("NYSBA Sec. Reg. Letter"); Elisa D. Garcia, Executive Vice President and General Counsel, Office Depot, Inc., dated March 24, 2009 ("Office Depot Letter"); Chris DeRose, Chief Executive Officer, Ohio Public Employees Retirement System, dated March 24, 2009 ("OPERS Letter"); Toni Zaks, President, OTC Corporate Transfer Service, dated March 24, 2009 ("OTC Letter"); Loren K. Hanson, Assistant Secretary, Otter Tail Corporation, dated March 24, 2009 ("Otter Tail Letter"); E. J. Wunsch, Assistant Secretary and Associate General Counsel, The Procter & Gamble Company, dated March 27, 2009 ("P&G Letter"); Alexander C. Schoch, Executive Vice President, Chief Legal Officer and Secretary, Peabody Energy, dated March 17, 2009 ("Peabody Letter"); Matthew Lepore, Vice President, Chief President-Corporate Governance, Pfizer, dated March 27, 2009 ("Pfizer Letter"); Laura J. Cataldo, President and Chief Executive Officer, Platinum Stock Transfer, dated March 24, 2009 ("Platinum Letter"); James T. Breedlove, Senior Vice President, General Counsel and Secretary, Praxair, dated March 27, 2009 ("Praxair Letter"); Daniel Rothstein, Executive Vice President, Provident Bank, dated March 27, 2009 ("Provident Letter"); John F. Kuntz, General Counsel and Corporate Secretary, Provident Financial Services, Inc. ("Provident Financial Letter"); Larry W. Sonsini, Chairman, Proxy Working Group, dated March 25, 2009 ("PWG Letter"); William J. O'Shaughnessy, Jr., Assistant General Counsel and Corporate Secretary, Quest Diagnostics Incorporated, dated March 25, 2009 ("Quest Letter"); Frank Curtiss, Head of Corporate Governance, Railways Pension Trustee Company Limited, dated April 15, 2009 ("Railpen Letter"); Marilyn Wasser, Executive Vice President and General Counsel, Realogy Corporation, dated April 2, 2009 ("Realogy Letter"); Ralph V. Whitworth, Principal, Relational Investors LLC, dated March 12, 2009 ("Relational Investors Letter"); Jason Freeman, President, Routh Stock Transfer, Inc., dated March 24, 2009 ("Routh Letter"); Karen Gross, Vice President and Secretary, Royal Gold, Inc., dated March 23, 2009 ("Royal Gold Letter"); Robert D. Fatovic, Executive Vice President, Chief Legal Officer and Corporate Secretary, Ryder, dated March 26, 2009 ("Ryder Letter"); Sullivan & Cromwell LLP, dated March 27, 2009 ("S&C Letter"); Niels Holch, Executive Director, Shareholder Communications Coalition, dated March 27, 2009 ("SCC Letter"); Niels Holch, Executive Director, Shareholder Communications Coalition, dated April 24, 2009 ("SCC 2 Letter"); R. Scott McMillen, Vice President and Associate General Counsel, The Charles Schwab Corporation, dated March 27, 2009 ("Schwab Letter"); George Johnson, Vice President, Securities Transfer Corporation, dated March 24, 2009 ("Securities Transfer Letter"); Thomas F. Price, Managing Director, Securities Industry and Financial Markets Association ("SIFMA Letter") (noting that some of the assertions made by other commenters were "inaccurate and promote confusion," and presenting its own observations on those issues); John C. Wilcox, Chairman, Sod'ali, dated March 27, 2009 ("Sod'ali Letter"); Charles V. Rossi, President, The

Securities Transfer Association, Inc., dated March 27, 2009 (“STA Letter”); Mary Cleo Fernandez, Transfer Agent, Standard Registrar Transfer Agency, Inc., dated March 24, 2009 (“Standard Letter”); Robert M. Stanton, dated March 25, 2009 (“Stanton Letter”); Jonathan Miller, President, StockTrans, Inc., dated March 24, 2009 (“StockTrans Letter”); Paul Abel, General Counsel and Secretary, Suburban Propane Partners, L.P., dated November 16, 2006 (“Suburban Letter”) (resubmitted on March 3, 2009); Douglas Ian Shaw, Senior Vice President and Corporate Secretary, Suffolk County National Bank, Suffolk Bancorp, dated March 13, 2009 (“Suffolk Letter”); Holly Roseberry, Director, Superlattice Power, Inc., dated March 25, 2009 (“Superlattice Letter”); Steven B. Boehm and Cynthia M. Krus, Sutherland Asbill and Brennan LLP, dated March 31, 2009 (“Sutherland Letter”); Cheryl C. Carter, Corporate Secretary, Synalloy Corporation, dated March 25, 2009 (“Synalloy Letter”); Lewis B. Campbell, Chairman and Chief Executive Officer, Textron Inc., dated March 30, 2009 (“Textron Letter”); Cynthia H. Haynes, Vice President, Assistant Secretary and Assistant General Counsel, Texas Instruments Incorporated, dated March 26, 2009 (“TI Letter”); Hye-Won Choi, Senior Vice President and Head of Corporate Governance, TIAA-CREF, dated March 27, 2009 (“TIAA-CREF Letter”); Jonas Kron, Senior Social Research Analyst, Trillium Asset Management, dated March 17, 2009 (“Trillium Letter”); Scott Renwick, Senior Vice President and General Counsel, Unitrin, dated March 27, 2009 (“Unitrin Letter”); Donald A. French, Treasurer, UQM Technologies, Inc., dated March 26, 2009 (“UQM Letter”); Gregory A. Robbins, Senior Vice President and General Counsel, Veeco Instruments Inc., dated March 26, 2009 (“Veeco Letter”); Marianne Drost, Senior Vice President, Deputy General Counsel and Corporate Secretary, Verizon Communications Inc., dated March 27, 2009 (“Verizon Letter”); David A. Katz, Wachtell, Lipton, Rosen & Katz, dated March 26, 2009 (“Wachtell Letter”); Shelly L. Angus, Senior Vice President, Investor Relations, Washington Banking Company, dated March 23, 2009 (“Washington Banking Letter”); Robert J. LaForest, Vice President and Associate General Counsel, Whirlpool Corporation, dated March 26, 2009 (“Whirlpool Letter”); Michael C. Connelly, Vice President and General Counsel, Xcel Energy, dated March 27, 2009 (“Xcel Letter”); Anne M. Mulcahy, Chairman and Chief Executive Officer, Xerox Corporation, dated March 25, 2009 (“Xerox Letter”); and William D. Zollars, Chairman of the Board, President and Chief Executive Officer, and YRC Worldwide Inc., dated March 25, 2009 (“YRC Letter”).

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PART 240**

**[RELEASE NO. 34-60218; File No. S7-12-09]**

**RIN 3235-AK31**

**SHAREHOLDER APPROVAL OF EXECUTIVE COMPENSATION OF TARP RECIPIENTS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** We are proposing amendments to the proxy rules under the Securities Exchange Act of 1934 to set forth certain requirements for U.S. registrants subject to Section 111(e) of the Emergency Economic Stabilization Act of 2008. Section 111(e) of the Emergency Economic Stabilization Act of 2008 requires companies that have received financial assistance under the Troubled Asset Relief Program ("TARP") to permit a separate shareholder advisory vote to approve the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Commission, during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding. The proposed amendments are intended to help implement this requirement by specifying and clarifying it in the context of the federal proxy rules.

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

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);

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- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-12-09 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 S7-12-09. 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/proposed.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:** John Harrington, Attorney-Adviser, or N. Sean Harrison, Special Counsel, Division of Corporation Finance, at (202) 551-3430, or Division of Corporation Finance, at (202) 551-3430, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are proposing a new Rule 14a-20 and amendments to Schedule 14A<sup>1</sup> under the Securities Exchange Act of 1934 ("Exchange Act").<sup>2</sup>

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<sup>1</sup> 17 CFR 240.14a-101.

## I. BACKGROUND

The American Recovery and Reinvestment Act of 2009 (“ARRA”) was enacted on February 17, 2009.<sup>3</sup> Section 7001 of the ARRA amended the executive compensation and corporate governance provisions of Section 111 of the Emergency Economic Stabilization Act of 2008 (“EESA”).<sup>4</sup> Section 111(e) of the EESA,<sup>5</sup> as amended, requires any entity that has received or will receive financial assistance under the Troubled Asset Relief Program (“TARP”) to “permit a separate shareholder vote to approve the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Commission (which disclosure shall include the compensation discussion and analysis, the compensation tables, and any related material).”<sup>6</sup> Companies that have received financial assistance under the TARP are required to provide this

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<sup>2</sup> 15 U.S.C. 78a *et seq.*

<sup>3</sup> Pub. L. No. 111-5, Title II, 110 Stat. (2009).

<sup>4</sup> 12 U.S.C. 5221.

<sup>5</sup> Section 111(e) of the EESA, as amended, states—

(1) ANNUAL SHAREHOLDER APPROVAL OF EXECUTIVE COMPENSATION - Any proxy or consent or authorization for an annual or other meeting of the shareholders of any TARP recipient during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding shall permit a separate shareholder vote to approve the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Commission (which disclosure shall include the compensation discussion and analysis, the compensation tables, and any related material).

(2) NONBINDING VOTE - A shareholder vote described in paragraph (1) shall not be binding on the board of directors of a TARP recipient, and may not be construed as overruling a decision by such board, nor to create or imply any additional fiduciary duty by such board, nor shall such vote be construed to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.

(3) DEADLINE FOR RULEMAKING - Not later than 1 year after the date of enactment of the American Recovery and Reinvestment Act of 2009, the Commission shall issue any final rules and regulations required by this subsection.

<sup>6</sup> We do not believe this provision changes the Commission’s rules for a smaller reporting company that is a TARP recipient under the EESA with respect to the compensation discussion and analysis (“CD&A”) disclosure. Our compensation disclosure rules, as set forth in Item 402 of Regulation S-K [17 CFR 229.402], permit smaller reporting companies to provide scaled disclosure that does not include CD&A.

separate shareholder vote during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding.<sup>7</sup> The shareholder vote required by Section 111(e) of the EESA is not binding on the board of directors of a TARP recipient, and such vote will not be construed as overruling a board decision or as creating or implying any additional fiduciary duty by the board.<sup>8</sup> The vote also will not be construed to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.<sup>9</sup>

## II. DISCUSSION OF THE PROPOSED AMENDMENTS

We are proposing new Rule 14a-20 under the Exchange Act to help implement the requirement under Section 111(e)(1) of the EESA that “TARP recipients” under Section 111(a)(3) of the EESA<sup>10</sup> provide a separate shareholder vote to approve the compensation of the company’s executives.<sup>11</sup> Under proposed Rule 14a-20, registrants that are TARP recipients would be required to provide this separate shareholder vote in proxies solicited during the period

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<sup>7</sup> Section 111 of the EESA defines this period to not include any period during which the Federal Government “only holds warrants to purchase common stock of the TARP recipient.” See 12 U.S.C. 5221(a)(5).

<sup>8</sup> Section 111(e)(2) of the EESA [12 U.S.C. 5221(e)(2)].

<sup>9</sup> Rule 14a-8 under the Exchange Act will continue to apply to shareholder proposals that relate to executive compensation. Rule 14a-8 provides shareholders with an opportunity to place a proposal in a company’s proxy materials for a vote at an annual or special meeting of shareholders. Under this rule, a company generally is required to include the proposal unless the shareholder has not complied with the rule’s procedural requirements or the proposal falls within one of the rule’s 13 substantive bases for exclusion. To date, the staff of the Division of Corporation Finance has considered two requests in which TARP recipients requested the staff’s concurrence that, given the shareholder advisory vote provision in Section 111(e) of the EESA, the companies could rely on Rule 14a-8(i)(9) [17 CFR 240.14a-8(i)(9)] or Rule 14a-8(i)(10) [17 CFR 240.14a-8(i)(10)] to exclude from their proxy materials shareholder proposals that requested policies of holding annual shareholder advisory votes on executive compensation. The staff of the Division of Corporation Finance declined to concur with either request. See Bank of America Corp. (Mar. 11, 2009); CoBiz Financial Inc. (Mar. 25, 2009) (available at [http://www.sec.gov/divisions/corpfm/cf-noaction/2009\\_14a-8.shtml](http://www.sec.gov/divisions/corpfm/cf-noaction/2009_14a-8.shtml)).

<sup>10</sup> Section 111(a)(3) of the EESA defines TARP recipient as “any entity that has received or will receive financial assistance under the financial assistance provided under the TARP.” See 12 U.S.C. 5221(a)(3).

<sup>11</sup> Section 111(e)(3) of the EESA requires the Commission to issue any final rules required by Section 111(e) within one year after the enactment of the ARRA. See 12 U.S.C. 5221(e)(3).

in which any obligation arising from financial assistance provided under the TARP remains outstanding. Proposed Rule 14a-20 would clarify that the separate shareholder vote required by Section 111(e)(1) of the EESA would only be required on a proxy solicited for an annual (or special meeting in lieu of the annual) meeting of security holders for which proxies will be solicited for the election of directors.<sup>12</sup> We are proposing an instruction to new Rule 14a-20 to clarify that smaller reporting companies would not be required to provide a compensation discussion and analysis in order to comply with the requirements of Rule 14a-20.<sup>13</sup>

We are also proposing an amendment to Item 20 of Schedule 14A that would be applicable to registrants that are TARP recipients and are required to provide a separate shareholder vote on executive compensation pursuant to Section 111(e)(1) of the EESA and proposed Rule 14a-20. Pursuant to this amendment, such registrants would be required to disclose in the proxy statement that they are providing a separate shareholder vote on executive compensation pursuant to the requirements of the EESA, and to briefly explain the general effect of the vote, such as whether the vote is non-binding.<sup>14</sup> Under our current disclosure rules, a

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<sup>12</sup> The Commission agrees with the view previously expressed by the Division of Corporation Finance that a separate shareholder vote on executive compensation is required only with respect to an annual meeting of shareholders for which proxies will be solicited for the election of directors or a special meeting in lieu of such annual meeting. See Compliance and Disclosure Interpretations: American Recovery and Reinvestment Act of 2009 (Updated February 26, 2009), Question 1, available at <http://www.sec.gov/divisions/corpfin/guidance/arrainterp.htm>. Although Section 111(e)(1) of the EESA refers to an annual "or other meeting of the shareholders," the subsection is titled "Annual Shareholder Approval of Executive Compensation."<sup>1</sup> Proposed Rule 14a-20 is intended to result in TARP recipients conducting the required advisory vote annually in connection with the election of directors, in which case our rules call for disclosure of executive compensation.

<sup>13</sup> See note 6 above.

<sup>14</sup> We are not proposing to require registrants to use any specific language or form of resolution. However, as stated in Section 111(e)(1) of the EESA, the vote must be to approve "the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Commission (which disclosure shall include the compensation discussion and analysis, the compensation tables, and any related material)." We believe that a vote to approve a proposal on a different subject matter, such as a vote to approve only compensation policies and procedures, would not satisfy the requirements of Section 111(e)(1) of the EESA or proposed Rule 14a-20.

company is required to report the results of the vote in its periodic report for the period in which the vote is taken.<sup>15</sup> This includes the results of the vote required under the EESA and proposed Rule 14a-20. We are proposing in a separate release also considered by the Commission today to accelerate the filing schedule for reporting results of shareholder votes generally by moving the requirement from Forms 10-Q and 10-K to Form 8-K.<sup>16</sup> If that proposal is adopted, it would apply to reporting results of the vote required by Rule 14a-20.<sup>17</sup>

It is our intent that the proposed Rule 14a-20 and the proposed amendments to Schedule 14A afford registrants that are TARP recipients adequate flexibility to meet their obligations under Section 111(e) of the EESA. At the same time, we believe that the proposed amendments, by helping to implement the requirements of Section 111(e) of the EESA in our proxy rules, would provide clarity for registrants that are TARP recipients regarding how they must comply with their obligations under Section 111(e) of the EESA. We also believe that a discussion of the reason why the registrant is providing a separate shareholder vote on the compensation of executives and an explanation of the effect of that vote would provide investors with information that would help them to make informed voting decisions.

Rule 14a-6 under the Exchange Act generally requires registrants to file proxy statements in preliminary form at least ten calendar days before definitive proxy materials are first sent to

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Likewise, a shareholder proposal that asks the company to adopt a policy providing for periodic, non-binding shareholder votes on executive compensation in the future would not satisfy the requirement of Section 111(e) of the EESA or proposed Rule 14a-20. Section 111(e) requires a vote to approve the compensation of executives. A vote to request a voting policy that would apply at future meetings would not satisfy the EESA or proposed Rule 14a-20.

<sup>15</sup> See Item 4 of Part II of Exchange Act Form 10-Q [17 CFR 249.308a] and Item 4 of Part I of Exchange Act Form 10-K [17 CFR 249.310].

<sup>16</sup> 17 CFR 249.308.

<sup>17</sup> In the Proxy Disclosure and Solicitation Enhancements Release, the Commission is proposing amendments that would require reporting companies to disclose on Form 8-K the results of a shareholder vote, and to file that information within four business days after the end of the meeting at which the vote was held.

shareholders, unless the items included for a shareholder vote in the proxy statement are limited to specified matters.<sup>18</sup> During the time before final proxy materials are filed, our staff has the opportunity to comment on the disclosures and registrants are able to incorporate the staff's comments in their final proxy materials. The matters that do not require filing of preliminary materials include various items that regularly arise at annual meetings, such as the election of directors, ratification of the selection of auditors, approval or ratification of certain employee benefits plans, and shareholder proposals under Rule 14a-8.

Absent an amendment to Rule 14a-6, a proxy statement that includes the vote on executive compensation required by Section 111(e) of EESA and proposed Rule 14a-20 must be filed in preliminary form. We are not proposing to amend Rule 14a-6 at this time to add the vote required for TARP recipients to the list of items that do not trigger a preliminary filing. In light of the early stage of the development of disclosures under these requirements and the special policy considerations relating to this shareholder vote for TARP recipients, we believe it is appropriate to provide our staff the opportunity to comment on the disclosure before final proxy materials are filed. However, as indicated below, we are requesting comment on this issue.

#### **Request for Comment**

We request and encourage any interested person to submit comments regarding the proposed amendments described above. In particular, we solicit comment on the following questions:

- Should we include more specific requirements regarding the manner in which registrants that are TARP recipients should present the shareholder vote on executive compensation?

For example, should we designate the specific language to be used and/or require TARP

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<sup>18</sup> 17 CFR 240.14a-6(a).

recipients to frame the shareholder vote to approve executive compensation in the form of a resolution?

- Should we require registrants that are TARP recipients to disclose the reasons why they are providing for a separate shareholder vote on executive compensation and an explanation of the effect of that vote, as proposed?
- Should we require any additional disclosures about TARP recipients or the requirements of Section 111(e) of the EESA to be included with the vote to approve executive compensation? If so, what disclosures should we consider?
- Should we require any additional disclosures to be included with a TARP recipient's compensation discussion and analysis or other disclosures provided under Item 402 of Regulation S-K?
- Should we clarify by instruction, as proposed, that smaller reporting companies that are TARP recipients are not required to include a compensation discussion and analysis in their proxy statements in order to comply with our proposed amendments?
- Should language be added to proposed Rule 14a-20 to indicate explicitly that, as required by Section 111(e) of the EESA, the separate shareholder vote on the compensation of executives would be a non-binding advisory vote, or is the statutory reference sufficient for this purpose?
- Should we amend Rule 14a-6(a) under the Exchange Act so that registrants that are TARP recipients are not required to file a preliminary proxy statement as a consequence of providing a separate shareholder vote on executive compensation?

### III. PAPERWORK REDUCTION ACT

#### A. Background

The proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>19</sup> We are submitting the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with the PRA.<sup>20</sup> The title for the collection of information is:

"Schedule 14A" (OMB Control No. 3235-0059).

Schedule 14A was adopted under the Exchange Act and sets forth the disclosure requirements for proxy statements filed by U.S. issuers to help shareholders make informed voting decisions. The hours and costs associated with preparing, filing and sending the form constitute reporting and cost burdens imposed by each 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. Compliance with the proposed amendments by affected U.S. issuers would be mandatory. Responses to the information collections would not be kept confidential and there would be no mandatory retention period for the information disclosed.

As discussed in more detail above, we are proposing a new Rule 14a-20 under the Exchange Act and an amendment to Item 20 of Schedule 14A. Rule 14a-20 would help implement the requirement under Section 111(e)(1) of the EESA to provide a separate shareholder vote to approve the compensation of executives. Pursuant to the proposed amendment to Item 20 of Schedule 14A, registrants required to provide a separate shareholder

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<sup>19</sup> 44 U.S.C. 3501 *et seq.*

<sup>20</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

vote pursuant to new Rule 14a-20 would be required to disclose the EESA requirement to provide such a vote and the general effect of the vote.

**B. Burden and Cost Estimates Related to the Proposed Amendments**

We believe that the proposed Rule 14a-20 and amendments to Schedule 14A will result in only a modest increase in the burden and cost of preparing and filing a Schedule 14A because they will not cause TARP recipients to collect or disclose any significant additional information. Section 111(e) of the EESA already increased the burdens and costs for registrants that are TARP recipients by requiring a separate shareholder vote on executive compensation and already applied during the 2009 proxy season. Our proposed amendments address the EESA requirement in the context of the federal proxy rules, thereby creating only an incremental increase in the burdens and costs for such registrants. We believe the proposed amendments will remove uncertainty while still providing registrants that are TARP recipients adequate flexibility to comply with Section 111(e) of the EESA.

For purposes of this analysis, we estimate the burden of disclosing the general effect of the vote and otherwise ensuring conformity with the federal proxy rules when complying with Section 111(e)(1) of the EESA will increase by one hour per registrant that is a TARP recipient. We estimate there are approximately 275 registrants that are TARP recipients with outstanding obligations that would be subject to our proposed amendments.<sup>21</sup> Therefore, the total annual PRA burden attributable to the proposed rules is 275 hours. For proxy statements, consistent with our customary assumptions, we estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden is carried by outside professionals retained by

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<sup>21</sup> Our staff made this estimate from publicly-available information about TARP recipients. The estimate is based on the number of TARP recipients that are subject to our proxy rules and that have not repaid their TARP obligations.

the company to review corporate disclosure at an average cost of \$400 per hour.<sup>22</sup> The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours. Based on the foregoing, we calculated the additional annual compliance burdens resulting from the proposed amendments at 206.5 hours (this is 75% of the total 275 hours in increased burden carried by the company internally) and \$27,500 (this is 25% of the total increased hourly burden carried by outside professionals and reflected as a cost). The current total annual burden hours and cost of Schedule 14A approved by the OMB is 555,683 hours and \$63,709,987. Giving effect to the incremental increases in burden hours and costs as a result of the proposed amendments, the total annual burden hours and cost of Schedule 14A would be 555,889.5 hours and \$63,737,487.

### **C. Request for Comment**

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- evaluate the accuracy of our estimate of the burden of the proposed collections of information;
- determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;

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<sup>22</sup> We estimate an hourly cost of \$400 per hour for the service of outside professionals based on our consultations with several registrants and law firms and other persons who regularly assist registrants in preparing and filing proxy statements and related disclosures with the Commission.

- evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy of the comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-12-09. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-12-09 and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street NE, Washington, DC 20549-0213. Because OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if OMB receives them within 30 days of publication.

#### **IV. COST-BENEFIT ANALYSIS**

We are sensitive to the costs and benefits of the proposed amendments. In this section, we examine the benefits and costs of our proposed amendments. We request that commenters provide views and supporting information as to the benefits and costs associated with the

proposals. We seek estimates of these costs and benefits, as well as any costs and benefits not already identified.<sup>23</sup>

#### A. Benefits

We are proposing amendments to the federal proxy rules to help implement the requirement in Section 111(e)(1) of the EESA that TARP recipients provide a separate shareholder vote to approve the compensation of executives. Under the proposed amendments, this separate shareholder vote would be required when registrants that are TARP recipients solicit proxies during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding, and the solicitation relates to an annual meeting (or a special meeting in lieu of an annual meeting) for which proxies will be solicited for the election of directors. Companies required to provide such a separate shareholder vote would also be required to disclose in their proxy statements the EESA requirement to provide such a vote, and to briefly explain the general effect of the vote.

We believe the proposed amendments will benefit registrants that are TARP recipients by clarifying how they must comply with the requirements of Section 111(e)(1) of the EESA in the context of the federal proxy rules. The proposed amendments eliminate uncertainty that may exist among TARP recipients and other market participants regarding what is necessary under the Commission's proxy rules when conducting a shareholder vote required under Section 111(e) of the EESA. In addition to these benefits, we believe the proposed amendments allow TARP recipients adequate flexibility under the proxy rules to comply with the requirements of the

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<sup>23</sup> The cost-benefit analysis in this section addresses the costs and benefits of the proposed amendments. The analysis does not, however, address the costs and benefits of the requirement in Section 111(e)(1) of the EESA that TARP recipients conduct a separate shareholder vote on executive compensation. While the proposed amendments set forth the manner in which registrants that are TARP recipients would implement this requirement when complying with the federal proxy rules, such registrants are already subject to the provisions of Section 111(e)(1) of the EESA and thus we are only addressing the incremental costs and benefits of the proposed amendments.

EESA. By providing clarity while maintaining adequate flexibility, we believe the proposed amendments could reduce the amount of management time and legal expenses necessary to ensure that registrants that are TARP recipients comply with their obligations under both the EESA and the federal proxy rules. This would benefit TARP recipients and their shareholders.

We believe the proposed amendments will benefit investors by resulting in clear disclosure about the requirements of Section 111(e)(1) of the EESA as applied to Exchange Act registrants. When a separate shareholder vote on the compensation of executives is required by the EESA, proposed Rule 14a-20 would specify and clarify that requirement in the context of the federal proxy rules. By doing so, we believe Rule 14a-20 would promote better compliance with the requirements of Section 111(e)(1) of the EESA when registrants that are TARP recipients conduct solicitations subject to our proxy rules. The proposed amendments to Schedule 14A would require disclosure about the EESA requirement to provide a separate shareholder vote and the general effects of such a vote. Together, the proposed amendments are intended to provide useful, comparable and consistent information to assist an informed voting decision when registrants that are TARP recipients present to investors the advisory vote on executive compensation required pursuant to Section 111(e)(1) of the EESA. The specification and clarification of the requirement in our proposed rule would also help provide certainty about the nature of the TARP recipient's responsibility to hold the advisory vote, making it easier for companies to comply.

#### **B. Costs**

We believe the proposed amendments would not add any significant costs to those already created by the requirements of Section 111(e)(1) of the EESA and our proxy rules. The proposed amendments are intended to help implement the existing substantive EESA

requirement in the context of the federal proxy rules. While our proposed amendments to Schedule 14A would require certain disclosures not explicitly required by EESA, we believe any incremental costs imposed by our proposed amendments would be minimal. For purposes of the PRA, we estimate the total annual incremental cost of the amendments to be 275 hours. We request comment on the amount of any additional costs issuers may incur as a result of the proposed amendments.

#### V. **SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"<sup>24</sup> we solicit data to determine whether the proposals constitute a "major" rule.

Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposed amendments on the U.S. economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views if possible.

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<sup>24</sup> 5 U.S.C. 603.

**VI. 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<sup>25</sup> also 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 3(f)<sup>26</sup> of the Exchange Act requires 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 believe the proposed amendments would benefit registrants that are TARP recipients and their shareholders by providing certainty regarding how registrants that are TARP recipients must comply with the EESA requirement to hold an advisory vote on executive compensation in the context of the federal proxy rules, while maintaining adequate flexibility to comply with this requirement. The certainty should promote efficiency. The proposed amendments also would help ensure that shareholders receive disclosure regarding the required vote and the nature of a registrant's responsibilities to hold the vote under the EESA. As discussed in greater detail above, we believe these benefits would be achieved without imposing any significant additional burdens on registrants that are TARP recipients. We do not anticipate any effect on competition or capital formation. We do believe the rules will make compliance with EESA more efficient.

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<sup>25</sup> 15 U.S.C. 78w(a).

<sup>26</sup> 15 U.S.C. 78c(f).

We request comment on whether the proposed amendments, if adopted, would impose a burden on competition. We also request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

## VII. REGULATORY FLEXIBILITY ACT CERTIFICATION

The Commission hereby certifies pursuant to 5 U.S.C. 605(b), that the amendments contained in this release, if adopted, would not have a significant economic impact on a substantial number of small entities. Rule 0-10 under the Exchange Act defines small entities for these purposes as those with total assets of \$5 million or less on the last day of their most recent fiscal year.<sup>27</sup> The proposed amendments would only impact TARP recipients with a class of securities registered pursuant to Section 12 of the Exchange Act and thus subject to the federal proxy rules.<sup>28</sup> We believe no TARP recipients that are required to comply with our proxy rules are small entities. In addition, if any small entities become subject to our proposed amendments, we do not believe the proposed amendments would have a significant economic impact on them. Any small entity subject to our proposed amendments would already be subject to the requirements of Section 111(e)(1) of the EESA. Further, we do not believe the EESA requires "smaller reporting companies" to provide a compensation discussion and analysis. As discussed in greater detail above, we do not believe our proposed rules impose a significant additional cost. For these reasons, the proposed amendments should not have a significant economic impact on a substantial number of small entities.

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<sup>27</sup> 17 CFR 240.0-10.

<sup>28</sup> See 17 CFR 240.14a-2.

We solicit written comments regarding this certification. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

## VIII. STATUTORY AUTHORITY AND TEXT OF THE PROPOSED AMENDMENTS

The amendments described in this release are being proposed under the authority set forth in Section 111(e) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5221(e)) and Sections 14(a) and 23(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a) and 78w(a)).

### List of Subjects

17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

### TEXT OF THE PROPOSED AMENDMENTS

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II, of the Code of Federal Regulations as follows:

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

1. The general authority citation for Part 240 is revised to read 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., 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

\* \* \* \* \*

2. Add §240.14a-20 to read as follows:

**§240.14a-20 Shareholder Approval of Executive Compensation of TARP Recipients.**

If a solicitation is made by a registrant that is a TARP recipient, as defined in section 111(a)(3) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5221(a)(3)), during the period in which any obligation arising from financial assistance provided under the TARP, as defined in section 3(8) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5202(8)), remains outstanding and the solicitation relates to an annual (or special meeting in lieu of the annual) meeting of security holders for which proxies will be solicited for the election of directors, as required pursuant to section 111(e)(1) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5221(e)(1)), the registrant shall provide a separate shareholder vote to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K (§ 229.402 of this chapter), including the compensation discussion and analysis, the compensation tables, and any related material.

Note to §240.14a-20: TARP recipients that are smaller reporting companies entitled to provide scaled disclosure pursuant to Item 402(l) of Regulation S-K are not required to include a compensation discussion and analysis in their proxy statements in order to comply with this section. In the case of these smaller reporting companies, the required vote must be to approve the compensation of executives as disclosed pursuant to Item 402(m) through (r) of Regulation S-K.

3. Amend §240.14a-101 to add a sentence at the end of Item 20 to read as follows:

**§240.14a-101 Schedule 14A. Information Required in Proxy Statement.**

SCHEDULE 14A INFORMATION

\* \* \* \* \*

**Item 20. Other proposed action.** \* \* \* Registrants required to provide a separate shareholder vote pursuant to section 111(e)(1) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5221(e)(1)) and §240.14a-20 shall disclose that they are providing such a vote as required pursuant to the Emergency Economic Stabilization Act of 2008, and briefly explain the general effect of the vote.

\* \* \* \* \*

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

July 1, 2009

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60242 / July 2, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3006 / July 2, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13540

In the Matter of

Vernon Jeffrey Harrell,

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)<sup>1</sup> of the Commission's Rules of Practice against Vernon Jeffrey Harrell ("Respondent").

II.

The Commission finds that:

<sup>1</sup> Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any attorney, accountant, engineer, or other professional or expert who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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A. RESPONDENT

1. Harrell, age 42, resides in Ft. Lauderdale, Florida. From December 1999 through June 28, 2008, Harrell served as Chairman of the Board, President, CEO, Secretary, and Principal Financial and Accounting Officer for Video Without Boundaries, Inc. ("Video"), whose common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). Harrell is not licensed as a CPA and is not registered with the Commission in any capacity.

B. CIVIL INJUNCTION

2. On April 6, 2009, the U.S. District Court for the Southern District of Florida entered by consent a judgment against Harrell, permanently enjoining him from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b), 13(b)(5), 13(d), and 16(a) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1, 13d-1, 13d-2, and 16a-3 thereunder, in the civil action entitled Securities and Exchange Commission v. Video Without Boundaries, Inc., et al., Civil Action Number 08-61517-CIV-GOLD/McALILY.

3. The Commission's complaint in that action alleged that, from at least April 2003 through November 2005, Video, at the direction of Harrell, filed annual and quarterly reports with the Commission that, among other things, materially overstated the company's revenues and assets and understated its net losses. The complaint further alleged that Harrell falsely certified numerous annual and quarterly reports Video filed with the Commission that he knew, or was severely reckless in not knowing, contained material misstatements and omissions. Moreover, according to the complaint, from November 2003 to September 2006, Harrell, along with Video's largest shareholder and creditor, issued false and misleading press releases announcing its acquisition of another company, the availability of large credit facilities, and that it was operating an international subsidiary.

4. The complaint further alleged that Harrell maintained Video's books and records, created its financial statements, and prepared and signed all the related certifications under the Sarbanes-Oxley Act of 2002 as both the principal executive officer and principal financial and accounting officer. As alleged in the complaint, Harrell engaged in fraudulent accounting practices and caused Video to file Forms 10-KSB for 2002 and 2003 and Forms 10-QSB for all quarters of 2004 that materially overstated Video's revenues, improperly accounted for a failed acquisition, and materially understated net losses.

III.

Based on the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Harrell 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 Harrell be temporarily suspended from appearing or practicing before the Commission.

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

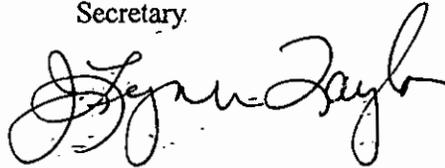
IT IS FURTHER ORDERED that Harrell may within thirty days after service of this Order file a petition with the Commission to lift the temporary suspension. If the Commission within thirty days after service of the Order receives no petition, the suspension shall become permanent pursuant to Rule 102(e)(3)(ii).

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 Harrell personally or by certified mail at his last known address.

By the Commission.

Elizabeth M. Murphy  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

*Commissioner Paredes  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

July 2, 2009

**IN THE MATTER OF GENX  
CORPORATION**

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 GenX Corporation because of questions about the accuracy and adequacy of publicly disseminated information appearing in stock promotional materials, and elsewhere, concerning among other things, the company's purported partnerships and other relationship with certain individuals and entities.

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 company listed above.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above listed company is suspended for the period from 9:30 a.m. EDT on July 2, 2009, through 11:59 p.m. EDT, on July 16, 2009.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

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*Commissioner Aguilar and  
Commissioner Fares  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 2, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13534

In the Matter of

**CONSOLIDATED  
RESOURCES GROUP, INC.,**

Respondent.

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

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate and for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

**II.**

After an investigation, the Division of Enforcement alleges that:

**RESPONDENT**

1. Consolidated Resources Group, Inc. ("Consolidated" or "Respondent") is a Florida corporation headquartered in West Palm Beach, Florida with a class of equity securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. The stock was quoted on the Over-the-Counter Bulletin Board until October 21, 2002, and then was quoted on the Pink Sheets operated by Pink OTC Markets Inc. (symbol CSRZ) until November 5, 2008. It now trades in the so-called grey market (which commonly designates securities that are not quoted in any quotation service or traded on any stock exchange).

**DELINQUENT FILINGS**

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires issuers to file quarterly reports.

3. Consolidated filed its last Form 10-KSB for the year ended May 31, 2001 on November 30, 2001, and its last Form 10-QSB for the three months ended February 28, 2002 on April 15, 2002. Since then, Consolidated has not submitted its required periodic filings.

4. As discussed above, Consolidated is delinquent in its periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1).

5. As a result of the conduct described above, Consolidated has failed to comply with Section 13(a) of the Exchange Act 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 to institute public administrative proceedings 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; 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 Respondent registered pursuant to Section 12 of the Exchange Act.

### IV.

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

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within ten (10) 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 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 mail.

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

## Appendix 1

### **Chart of Delinquent Filings In the Matter of Consolidated Resources Group, Inc.**

Form	Period Ended	Due on or about
10-KSB	05/31/02	08/29/02
10-QSB	08/31/02	10/15/02
10-QSB	11/30/02	1/14/03
10-QSB	02/28/03	04/14/03
10-KSB	05/31/03	08/29/03
10-QSB	08/31/03	10/15/03
10-QSB	11/30/03	01/14/04
10-QSB	02/29/04	04/14/04
10-KSB	05/31/04	08/29/04
10-QSB	08/31/04	10/15/04
10-QSB	11/30/04	01/14/05
10-QSB	02/28/05	04/14/05
10-KSB	05/31/05	08/29/05
10-QSB	08/31/05	10/15/05
10-QSB	11/30/05	01/14/06
10-QSB	02/28/06	04/14/06
10-KSB	05/31/06	08/29/06
10-QSB	08/31/06	10/15/06
10-QSB	11/30/06	01/14/07
10-QSB	02/28/06	04/14/07
10-KSB	05/31/07	08/29/07
10-QSB	08/31/07	10/15/07
10-QSB	11/30/07	01/14/08
10-Q*	02/29/08	04/14/08
10-K*	05/31/08	08/29/08
10-Q*	08/31/08	10/15/08
10-Q*	11/30/08	01/14/09
10-Q*	2/28/09	04/14/09

\* Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. *See* Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now 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) have the option of using new, scaled disclosure requirements that Regulation S-K now includes.



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., paragraph 2 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. Kunkel, age 54, is and has been an attorney licensed to practice in the State of Georgia since 1983. From November 2005 until September 2006, Kunkel provided legal advice to Pinnacle Development Partners, LLC ("Pinnacle") concerning, among other things, whether the general partnership interests Pinnacle sold to members of the public were securities and whether the offering was required to be registered pursuant to the Securities Act of 1933.

2. On June 10, 2009, a final judgment was entered against Kunkel, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Christopher M. Kunkel, Civil Action Number 1:09-CV-1481, in the United States District Court for the Northern District of Georgia. Kunkel consented to the entry of the injunction.

3. The Commission's complaint alleged, among other things, that Pinnacle engaged in a fraudulent and unregistered offering of securities in the form of real estate development partnerships through a nationwide advertising campaign. The complaint alleged that, beginning in October 2005 and continuing until September 2006, more than 2,000 investors throughout the United States invested approximately \$62 million in the Pinnacle partnerships. According to the complaint, Pinnacle offered its investments through an extensive national advertising campaign offering a 25% return in 60 days through investments in Atlanta real estate. The complaint alleged that Kunkel knew, or was reckless in not knowing, that the representations he made to investors that Pinnacle had a sound business plan and was making timely payments to investors were false.

### IV.

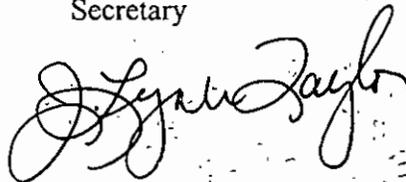
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Kunkel's Offer.

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

Kunkel is suspended from appearing or practicing before the Commission as an attorney.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

By: J. Lynn Taylor  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 2, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13538

In the Matter of

CONVERSION SOLUTIONS  
HOLDINGS CORP.,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted against Conversion Solutions Holdings Corp. ("Conversion" or "Respondent") pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

RESPONDENT

1. Conversion, formerly known as The Fronthaul Group, Inc. and Furia Organization, Inc., is a Delaware corporation headquartered in Lake Dallas, Texas. Conversion has no current operations. Conversion's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act.

DELINQUENT PERIODIC FILINGS

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires issuers to file quarterly reports. Rule 12b-25 requires an issuer to notify the Commission of an 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 the report.

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3. Conversion filed its last Form 10-KSB/A for the year ending June 30, 2006 on October 19, 2006 and filed its last Form 10-QSB for the quarter ended March 31, 2006 on May 12, 2006. Conversion has not filed any periodic reports since.

4. The following periodic filings are delinquent:

<u>Form</u>	<u>Period Ended</u>	<u>Due on or about</u>
10-QSB	9/30/2006	11/14/2006
10-QSB	12/31/2006	2/14/2007
10-QSB	3/31/2007	5/15/2007
10-KSB	6/30/2007	9/29/2007
10-QSB	9/30/2007	11/14/2007
10-QSB	12/31/2007	2/14/2008
10-QSB	3/31/2008	5/15/2008
10-KSB	6/30/2008	9/28/2008
10-QSB	9/30/2008	11/14/2008
10-QSB	12/31/2008	2/17/2009
10-QSB	3/31/2009	5/15/2009

5. Conversion failed to file a notification of late filing on Form 12b-25 for the delinquent reports, with the sole exception of the Form 10-QSB quarterly report for the quarter ended September 30, 2006.

6. As a result of the foregoing, Conversion failed to comply with Exchange Act Section 13(a) and Rules 12b-25, 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 to institute public administrative proceedings to determine:

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke, the registration of each class of securities of the Respondent 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 Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, 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].

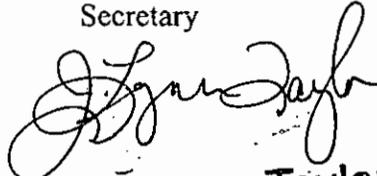
This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission's Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

*Chairman Schapiro and  
Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 2, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13536

In the Matter of

IWORLD PROJECTS &  
SYSTEMS, INC.,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against iWorld Projects & Systems, Inc. ("iWorld" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. iWorld Projects & Systems, Inc. (File No. 814-689) is a defunct business development company ("BDC")<sup>1</sup> that, during relevant periods, was incorporated in Nevada and headquartered in Addison, Texas. Its corporate charter was revoked by the Nevada Secretary of State on January 1, 2006 due to failure to pay franchise taxes. iWorld elected to become a BDC on December 15, 2004 and its common stock is registered under Section 12(g) of the Exchange Act.

<sup>1</sup> A BDC is a closed-end investment company that Congress established for the purpose of making capital more readily available to certain types of companies. Under the Investment Company Act of 1940 ("Company Act"), a company meeting certain eligibility criteria may elect to be regulated as a BDC by filing a notification with the Commission on Form N-54A. A company filing such a notification is regulated under Sections 55 through 65 of the Company Act. These sections set forth rules governing the investments BDCs may make, transactions BDCs may enter into, and the governance of BDCs, as well as various other rules governing BDCs.

iWorld filed for voluntary Chapter 7 bankruptcy in May 2008. In March 2009, the bankruptcy court closed the case because iWorld had no assets.

## **B. DELINQUENT PERIODIC FILINGS**

2. 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.

3. iWorld is delinquent in its periodic Commission reports, in that it has failed to file any annual or quarterly reports since November 15, 2005, when it filed a Form 10-Q report for the quarterly period ended September 30, 2005. As a result of the foregoing, iWorld 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 administrative proceedings be instituted to determine:

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

B. Whether it is necessary and appropriate for the protection of investors to suspend, for a period not exceeding twelve months, or to revoke the registration of each class of iWorld's securities 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 iWorld 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(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If iWorld fails to file the directed Answer, or fails to appear at a hearing after being duly notified, iWorld 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].

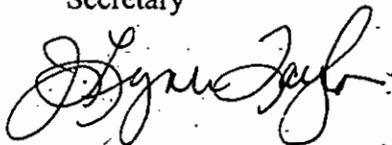
This Order shall be served forthwith upon iWorld personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

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



By: J. Lynn Taylor  
Assistant Secretary

*Chairman Schapiro and  
Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60238 / July 2, 2009

INVESTMENT COMPANY ACT OF 1940  
Release No. 28809 / July 2, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3005 / July 2, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13537

In the Matter of

DAVID LLOYD PELLIS,

Respondent.

**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, 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"), and Section 9(f) of the Investment Company Act of 1940 ("Company Act") against David Lloyd Pellis ("Pellis" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 9(f) of the Investment Company Act of 1940, Making Findings and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

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

#### RESPONDENT

1. David L. Pells, age 58, served in 2004 as president of a private Florida corporation called iWorld Projects & Systems, Inc. ("iWorld Florida"), and President and COO of iWorld Projects & Systems, Inc. ("iWorld") during 2005. During that time, Pells was also on iWorld's board and served as the chairman of its investment committee. He became iWorld's CEO after the prior CEO resigned and remained in that position until February 2008.

#### OTHER RELEVANT ENTITY

2. iWorld is a now-defunct closed-end management investment company that elected in December 2004 to be regulated as a business development company ("BDC") under Section 54 of the Company Act. iWorld has not filed periodic reports with the Commission since its third quarter 2005 Form 10-Q in November 2005. Its corporate charter was revoked by the Nevada Secretary of State on January 1, 2006 due to failure to pay franchise taxes. iWorld was in a voluntary Chapter 7 bankruptcy proceeding, but that case was closed because iWorld had no assets. iWorld's common stock is registered under Section 12(g) of the Exchange Act and is listed for quotation on the Pink OTC Markets.

#### FACTS

3. In May 2004, a business associate of Pells' formed iWorld Florida, a private Florida corporation. The business associate became iWorld Florida's CEO ("iWorld Florida's CEO") and Pells became the company's president and COO. iWorld Florida's CEO envisioned iWorld Florida as a holding company that would acquire operating companies and then be acquired by or merged with a publicly-traded company.

4. During the summer and fall of 2004, iWorld Florida purchased two operating companies in exchange for \$285,000 in working capital payments, \$200,000 in assumed liabilities, and 1.1 million shares of iWorld Florida common stock, which was not publicly traded. iWorld Florida did not obtain independent valuations of these operating companies or their assets.

5. iWorld Florida's CEO introduced Pells to the concept of a BDC and advocated it as a suitable vehicle for iWorld Florida's business. During late 2004, iWorld Florida's CEO orchestrated a series of transactions, including reverse mergers with public shell companies, that resulted in iWorld's creation as a publicly-traded BDC. Pells was unaware of the full extent to which iWorld Florida's CEO controlled iWorld's formation process.

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

6. Shortly after iWorld's formation, it acquired iWorld Florida in a transaction that made iWorld Florida and its subsidiaries the sole portfolio companies of iWorld. As a result of that transaction, iWorld Florida's CEO became the CEO and CFO of iWorld and Pells became its president and COO.

7. Pursuant to Company Act Section 2(a)(41), a BDC's board of directors must determine in good faith the fair value of the BDC's portfolio securities for which market quotations are not readily available.<sup>2</sup> Under generally accepted accounting principles, the fair value of such securities is "the amount at which they could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale."<sup>3</sup> Because there were no market quotations for the portfolio companies' shares, iWorld's board was required to determine in good faith the fair value of those shares each quarter when it prepared its quarterly reports under the Exchange Act.

8. iWorld's board did not conduct the requisite good-faith fair valuation of its portfolio companies. iWorld filed quarterly reports with the Commission on Form 10-Q for the quarters ended March 31, 2005, June 30, 2005 and September 30, 2005, each of which included the financial statements purporting to value iWorld's portfolio companies at \$10 million and forecasting portfolio company revenues in the tens of millions of dollars for 2005 and 2006. iWorld's second and third quarter filings further stated that the "the Company's Investment Committee [has] determine[ed] that the portfolio investments should be valued at \$10 million."

9. iWorld's investment committee had not conducted any valuation of iWorld's portfolio companies and iWorld did not have written records showing the companies were worth the stated \$10 million value. In fact, the portfolio companies had been purchased for much less than \$10 million, were losing money at the time they were purchased, and continued to rapidly lose money and repeatedly fall far short of projected revenues or earnings. Consequently, the representations that the portfolio companies were worth \$10 million, that they were expected to produce millions in revenues, and that iWorld had conducted the requisite valuation were all materially misleading.

10. Pells was aware that iWorld's portfolio companies were losing money. Although Pells did not sign iWorld's public filings or certify them pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, he reviewed them and certified them pursuant to Sarbanes-Oxley Act Section 906.

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<sup>2</sup> See Section 59 of the Company Act (applying Section 2 of the Act, among others, to a BDC to the same extent as if it were a registered closed-end fund).

<sup>3</sup> *AICPA Audit and Accounting Guide: Investment Companies*, Section 2.36. See also, Regulation S-X, Rule 1-01(a), under which Section 404.03.b.iv of the Commission's Codification of Financial Reporting Releases is made applicable to BDCs. Section 404.03.b.iv states, "As a general principle, the current 'fair value' of an issue of securities being valued by the Board of Directors would appear to be the amount which the owner might reasonably expect to receive for them upon their current sale." It further states, "To comply with Section 2(a)(41) of the Investment Company Act, it is incumbent upon the board of directors to satisfy themselves that all appropriate factors relevant to the value of securities for which market quotations are not readily available have been considered and to determine the method of arriving at the fair value of each such security."

11. By April 2006, iWorld's portfolio companies had effectively ceased operations, and iWorld had no revenues, significant assets or employees. At that point, Pells became iWorld's CEO and sole officer and he remained in that position until February 2008. During that period, the company failed to devise and maintain a system of internal accounting controls, and failed to make and keep books and records required of a BDC, including, among other things, ledgers of assets and liabilities. iWorld has not made required periodic reports on Forms 10-Q or 10-K since November 15, 2005, when it filed its third quarter 2005 Form 10-Q.

### VIOLATIONS

12. As a result of Pells' foregoing conduct, iWorld violated and Pells caused iWorld's violations of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

13. iWorld violated and Pells also caused iWorld's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, which require reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets, and require all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

14. Section 31(a) of the Company Act, made applicable to BDCs by Company Act Section 64, requires a BDC to make and keep current certain books and records as the Commission may require pursuant to rule and regulation. Rule 31a-1 under the Company Act sets forth the records a BDC must keep including, among other things, ledgers of all assets, liabilities, reserve capital, income and expense accounts reflecting account balances on each day, and corporate documents such as minutes from meetings of the BDC's shareholders and board of directors. iWorld violated and Pells also caused iWorld's violations of Section 31(a) of the Company Act and Rule 31a-1 thereunder.

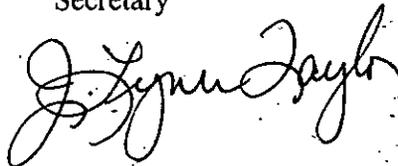
### VI.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Pells' Offer. Accordingly, pursuant to Section 21C of the Exchange Act and Section 9(f) of the Company Act it is hereby ORDERED that:

Respondent cease and desist from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 13a-1, 13a-13 and 12b-20 thereunder, and Section 31(a) of the Company Act and Rule 31a-1 thereunder.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

By: J. Lynn Taylor  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60244 / July 6, 2009

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2899 / July 6, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13541

In the Matter of

CRAIG ALAN RILEY,

Respondent.

ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b)(6) OF  
THE SECURITIES EXCHANGE ACT OF  
1934 AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Craig Alan Riley ("Riley" 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

11 of 64

15(b)(6) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

### III.

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

1. Riley, age 38, currently resides in Phoenix, Arizona, and lived in Austin, Texas and Newport Beach, California during the relevant period. Between June 1996 and October 13, 2006, Riley was a registered representative associated with several Commission-registered broker-dealers. Between September 2006 and February 2008, Riley offered and sold interests in Pressio, L.P. ("Pressio"), an investment fund that he formed and managed.

2. On February 23, 2009, Riley pleaded guilty to one count of mail fraud in violation of Title 18, Section 1341 of the United States Code before the United States District Court for the Central District of California in *United States v. Craig Alan Riley*, Case No. SA CR 09-0001. As part of his criminal plea agreement, Riley acknowledged and agreed to pay restitution in the amount of \$3,044,384.59.

3. The criminal information to which Riley pleaded guilty alleged, *inter alia*, that from at least September 2006 through February 2008, Riley defrauded Pressio investors and obtained money and property from them by means of materially false and misleading statements; that he withdrew funds from Pressio for personal use; that he concealed trading losses by preparing and sending to Pressio investors fictitious statements reflecting non-existent gains, and that in connection with the foregoing, Riley knowingly and willfully caused those statements to be sent and delivered by the United States Postal Service.

### IV.

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

Accordingly, it is hereby ORDERED:

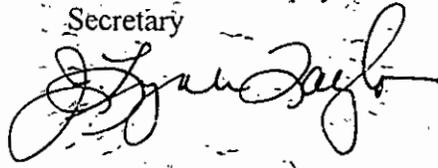
Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Riley be, and hereby is, barred from association with any broker, dealer, or investment adviser.

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

*Commissioner Casey  
not participating  
Commissioner Walter  
Disapproved*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 9048 / July 6, 2009

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60245 / July 6, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13542

In the Matter of

DANNY E. LANDAU

Respondent.

ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS, PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933 AND SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER AS TO DANNY E.  
LANDAU

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Danny E. Landau ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

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

#### Summary

From October 2002 through August 2005 (the "relevant period"), Landau, a registered representative at broker-dealer Finance 500, Inc. ("Finance 500"), violated Sections 5(a) and 5(c) of the Securities Act by selling a massive number of shares in unregistered offerings under so-called employee stock option programs implemented by approximately thirty-five issuer customers (the "Issuers"). The programs functioned as public distributions of securities using the Issuers' employees as conduits so that the Issuers could raise capital without complying with the registration requirements of the federal securities laws. The Issuers improperly registered the shares sold on Form S-8 registration statements and then received at least 85% of the shares' sales proceeds. Landau administered the brokerage aspects of the programs despite red flags indicating that the shares he sold were issued through unregistered offerings.

#### Respondent

1. **Danny E. Landau**, age 38, is a resident of Coto de Caza, California. He holds Series 7, 24, 63 and 65 securities licenses. During the relevant period, he was a registered representative at Finance 500. He currently holds an ownership interest in, and is a registered representative of, Private Equity Securities, Inc., a broker-dealer in Irvine, California.

#### Other Relevant Entities

2. **Finance 500**, a California corporation with its principal offices in Irvine, California, has been registered with the Commission as a broker-dealer since 1982. Finance 500's primary business is selling and underwriting brokered Certificates of Deposit. It also conducts a market making business and a general retail securities business. During the relevant period, the retail business had roughly 80 registered representatives, of which Landau was one, and 15 branch offices.

#### Background

3. Sections 5(a) and 5(c) of the Securities Act prohibit any person from using interstate commerce, directly or indirectly, to sell or offer to sell a security unless a registration statement is filed with the Commission. Registrants that are subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and are current in their filings may use Form S-8

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

registration statements to register the offer and sale of securities to their employees, including consultants, to compensate them for *bona fide* services or to provide incentives. Because of the compensatory purpose and the employees' and consultants' familiarity with the registrant's business, Form S-8's disclosure requirements are abbreviated as compared to statements registering shares to raise capital. A registrant cannot use Form S-8 to issue shares to employees who act as conduits for the sale of S-8 stock to the public because the transaction that takes place – the distribution of securities to the public – is not registered.

4. From October 2002 through August 2005, Landau provided brokerage services for the employee stock option programs implemented by the Issuers. Landau, who had regular contact with the Issuers, administered all brokerage aspects of the Issuers' programs with the aid of his staff acting under his direction. He brought the business with him from his prior brokerage firm and, while the business initially comprised approximately 10% to 15% of Landau's total business, it grew to approximately 60% at its height. Landau became one of the broker-dealer's top producers and eventually earned one of the highest commission rates at the firm.

5. The Issuers were microcap companies that had limited operational histories, generated little revenue and had low priced securities listed on the OTC Bulletin Board that were thinly traded before the Issuers began to issue Form S-8 shares. They used employee stock plans generally titled Employee Stock Incentive Plans ("ESIPs") that issued shares registered on Form S-8. Attached to the Forms S-8 were the ESIPs and attorney opinion letters stating that the S-8 shares, when issued and sold, would be validly issued, fully paid and non-assessable.

6. As administered, the Issuers' ESIP programs<sup>2</sup> shared three key characteristics that, when combined, virtually ensured that the options would be exercised and the underlying shares simultaneously sold to the public at or near the time the options were granted. First, the option exercise price floated with the market value of an Issuer's stock at the time of exercise. The exercise price was typically set by the Issuers at 85% of the proceeds from the sale of the shares underlying the options. This meant that the options were always "in the money" – or that the exercise price was less than the market price at the time of exercise – and that the Issuer, not the employee, would receive most of the benefit from an increase in stock price after the time of grant. Second, the options vested immediately, meaning that the options could be exercised at any time after the date of grant. Third, the programs used a cashless exercise method where the exercise price was remitted to the Issuer from the sales proceeds of the shares underlying the options. Accordingly, the employees did not have to pay any money out-of-pocket to exercise the options.

7. The Issuers and their employees had brokerage accounts with Finance 500. When an Issuer implemented its ESIP program, Landau generally visited its offices and presented the program to its employees. During the presentation, he explained the mechanics of the ESIP program, including how to open an account, how to fill out certain paperwork and how to exercise options and sell the underlying shares under the cashless exercise method.

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<sup>2</sup> "ESIP programs" means the Issuers' employee stock options programs where each Issuer issued Form S-8 shares under a series of ESIPs.

8. When Landau and his staff opened the accounts for the employees, they typically obtained standing orders or other instructions from the employees that the options should be exercised immediately after grant. Also, due to their clearing firm's requirements, they required the employees to fill out and have notarized multiple blank authorizations in advance of the Issuers' granting any options. The Issuers collected and forwarded these authorizations to Landau and his staff as part of setting up the Issuers' ESIP programs. The authorizations gave Finance 500 authority to both sell the shares underlying any options granted and exercise the options using the underlying shares' sales proceeds to pay the exercise price.

9. When the Issuers granted the options, they sent Landau and his staff share certificates representing the number of Form S-8 shares underlying the options. Generally, upon receipt of the share certificates, Landau and his staff sold the shares underlying the options in unsolicited sales to the public. Then they calculated the options' exercise price at 85% of the sales price and credited the exercise price proceeds to the Issuers' accounts and the remainder, minus brokerage and clearing fees, to the employees' accounts.

10. The manner in which the Issuers implemented their ESIP programs (*i.e.*, the high-percentage exercise price that was based on the underlying shares' sale price, the immediate vesting and use of a cashless exercise), combined with the employees' standing orders to exercise immediately, all but ensured that the options were exercised and the underlying shares simultaneously sold within days of grant. Other than the ministerial acts of opening brokerage accounts, creating standing orders and signing blank authorizations, the employees usually did not make any decisions concerning the options' exercise or the sale of the underlying shares during the course of the ESIP programs. In some cases, certain employees were not notified of an option grant until after they received their portion of the sale proceeds of the underlying shares. By virtue of the programs' structure and administration, the Issuers effectively controlled the timing of sales to the public through the timing of their option grants and received the vast majority of the sale proceeds. The employees simply served as conduits.

11. These near-immediate sales of shares underlying the options resulted in millions and, in many cases, billions of shares in each Issuer's stock being sold to the public, which severely diluted the ownership interests of existing shareholders. The Issuers generally received payment for the exercised options that greatly exceeded their revenues and allowed them to fund their otherwise failing operations. By comparison, the employees received approximately 7%-8% of the sales proceeds.

12. The ESIP programs functioned as public offerings to raise capital. The Issuers essentially used their employees as conduits to offer shares to the public without providing the disclosures required by the registration provisions. As such, the employees acted as underwriters.

13. Because the Form S-8 statements cannot be used to raise capital, no registration statements were in effect or filed as to the shares issued under the ESIP programs. As a result, the shares were sold in unregistered offerings.

14. While administering the brokerage aspects of the ESIP programs, Landau encountered red flags indicating that Issuers' employees were underwriters to unregistered offerings. These red flags included: (1) the employees' nearly immediate exercise of options after grant, (2) the simultaneous exercise and sale of the shares underlying the options, (3) the high-percentage, floating exercise price, (4) the huge number of shares sold in previously thinly-traded stock of microcap-companies, (5) the large amounts of money received in each of the Issuers' Finance 500 accounts, (6) the relatively small amounts received in the employee accounts, and (7) the fact that the employees were related to the Issuers.

15. No one else involved in the programs, including securities lawyers, the Issuers' officers and Finance 500's compliance officers, alerted Landau to the programs' capital-raising function. Nonetheless, the red flags noted above should have prompted Landau to inquire further as to whether the employees were underwriters in unregistered offerings. But Landau failed to conduct an inquiry reasonable under the circumstances set forth above.

16. As a result of the conduct described above, Landau willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit using interstate commerce, directly or indirectly, in the absence of any applicable exemption, to sell or offer to sell a security unless a registration statement is filed with the Commission.<sup>3</sup>

#### Disgorgement and Civil Penalties

17. Respondent has submitted a sworn Statement of Financial Condition dated March 31, 2008 and other evidence and has asserted his inability to pay the full amount of disgorgement plus prejudgment interest and a civil penalty.

#### IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. Respondent Landau cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act;

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

B. Respondent Landau be, and hereby is, suspended from association with any broker or dealer for a period of six months, effective on the second Monday following the entry of this Order.

C. IT IS FURTHER ORDERED that Respondent Landau shall pay disgorgement of \$2,972,367 and prejudgment interest of \$966,541, but that payment of such amount except for \$275,000 is waived and a civil penalty is not imposed based upon Respondent's sworn representations in his Statement of Financial Condition dated March 31, 2008 and other documents submitted to the Commission. The payment required by this Order shall be made to the United States Treasury in the following installments:

1. an initial payment of \$100,000 made within ten (10) days of the entry of the Order;
2. a payment of \$17,500 on April 6, 2010;
3. a payment of \$17,500 on July 6, 2010;
4. a payment of \$17,500 on October 6, 2010;
5. a payment of \$17,500 on January 6, 2011;
6. a payment of \$17,500 on April 6, 2011;
7. a payment of \$17,500 on July 6, 2011;
8. a payment of \$17,500 on October 6, 2011;
9. a payment of \$17,500 on January 6, 2012;
10. a payment of \$17,500 on April 6, 2012; and
11. a payment of \$17,500 on July 6, 2012.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement and prejudgment interest, plus any additional interest accrued pursuant to SEC Rule of Practice 600, shall be due and payable immediately, without further application. Payments shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Danny E. Landau 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 Robert J. Burson, Senior Associate Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Boulevard, Suite 900, Chicago, Illinois 60604.

D. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest and of the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment

of disgorgement, interest and a penalty should not be ordered; (3) contest the amount of disgorgement and interest to be ordered or the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

*Chairman Schapiro and  
Commissioner Watter  
not participating*

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28811 / July 7, 2009

In the Matter of )

Deutsche Bank Securities Inc. )  
60 Wall Street )  
New York, NY 10005 )

Deutsche Investment Management Americas, Inc. )  
345 Park Avenue )  
New York, NY 10154 )

Deutsche Asset Management (Hong Kong) Limited )  
48/F Cheung Kong Centre )  
2 Queen's Road Central )  
Hong Kong, China )

Deutsche Asset Management International GmbH )  
Mainzer Landstrasse 178-190 )  
Frankfurt AM Main, 60327. )

Deutsche Asset Management (Japan) Limited )  
Sanno Park Tower, 2-11-1 )  
Nagata-Cho, Chiyoda-Ku )  
Tokyo, 100-6173 )

Deutsche Investments Australia Limited )  
Deutsche Bank Place, Level 16 )  
CNR Hunter and Phillip Streets )  
Sydney, NSW 2000 )

RREEF America L.L.C. )  
875 N. Michigan Avenue, 41st Floor )  
Chicago, IL 60611 )

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RREEF Global Advisors Limited )  
 Winchester House )  
 1 Great Winchester Street )  
 London, United Kingdom EC2N 2DB )  
 )  
 DWS Investments Distributors, Inc. )  
 222 South Riverside Plaza )  
 Chicago, IL 60606 )  
 )  
 (812-13664) )  
 )

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

Deutsche Bank Securities Inc. ("DBSI"), Deutsche Investment Management Americas, Inc., Deutsche Asset Management (Hong Kong) Limited, Deutsche Asset Management International GmbH, Deutsche Asset Management (Japan) Limited, Deutsche Investments Australia Limited, RREEF America L.L.C., RREEF Global Advisors Limited, and DWS Investments Distributors, Inc. (collectively, "Applicants") filed an application on June 9, 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 DBSI 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 June 9, 2009.

On June 9, 2009, 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 from June 9, 2009 until the Commission takes final action on the application for a permanent order (Investment Company Act Release No. 28763). 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 DBSI et al. (File No. 812-13664), 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 June 9, 2009.

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

*Chairman Schapiro and  
Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28810 / July 7, 2009

In the Matter of )

BANC OF AMERICA SECURITIES LLC )  
One Bryant Park )  
New York, NY 10036 )

BANC OF AMERICA INVESTMENT SERVICES, INC. )  
COLUMBIA MANAGEMENT ADVISORS, LLC )  
BANC OF AMERICA INVESTMENT ADVISORS, INC. )  
BANK OF AMERICA CAPITAL ADVISORS LLC )  
100 Federal Street )  
Boston, MA 02110 )

COLUMBIA WANGER ASSET MANAGEMENT, L.P. )  
227 West Monroe Street, Suite 3000 )  
Chicago, IL 60606 )

COLUMBIA MANAGEMENT DISTRIBUTORS, INC. )  
One Financial Center )  
Boston, MA 02111 )

U.S. TRUST HEDGE FUND MANAGEMENT, INC. )  
225 High Ridge Road )  
West Building )  
Stamford, CT 06905 )

MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED )  
IQ INVESTMENT ADVISORS LLC )  
KECALP INC. )  
MERRILL LYNCH VENTURES, LLC )  
North Tower )  
4 World Financial Center )  
New York, NY 10080 )

ROSZEL ADVISORS, LLC )  
1700 Merrill Lynch Drive )  
Pennington, NJ 08534 )

NUVEEN ASSET MANAGEMENT )  
 NUVEEN INVESTMENTS ADVISERS INC. )  
 NUVEEN INVESTMENTS INSTITUTIONAL SERVICES )  
 GROUP, LLC )  
 NUVEEN HYDEPARK GROUP, LLC )  
 NWQ INVESTMENT MANAGEMENT COMPANY LLC )  
 NUVEEN INVESTMENT SOLUTIONS, INC. )  
 SANTA BARBARA ASSET MANAGEMENT, LLC )  
 SYMPHONY ASSET MANAGEMENT LLC )  
 TRADEWINDS GLOBAL INVESTORS, LLC )  
 WINSLOW CAPITAL MANGEMENT, INC. )  
 NUVEEN INVESTMENTS, LLC )  
 333 West Wacker Drive )  
 Chicago, IL 60606 )  
 )  
 (812-13662) )  
 )

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

Banc of America Securities LLC ("BAS"), Banc of America Investment Services, Inc., Columbia Management Advisors, LLC, Columbia Wanger Asset Management, L.P., Columbia Management Distributors, Inc., Banc of America Investment Advisors, Inc., Bank of America Capital Advisors LLC, U.S. Trust Hedge Fund Management, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, IQ Investment Advisors LLC, Roszel Advisors, LLC, Nuveen Asset Management, Nuveen Investments Advisers Inc., Nuveen Investments Institutional Services Group, LLC, Nuveen HydePark Group, LLC, NWQ Investment Management Company LLC, Nuveen Investment Solutions, Inc., Santa Barbara Asset Management, LLC, Symphony Asset Management LLC, Tradewinds Global Investors, LLC, Winslow Capital Management, Inc., Nuveen Investments, LLC, KECALP Inc. and Merrill Lynch Ventures, LLC (collectively, "Applicants") filed an application on June 3, 2009, which was amended on June 10, 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 BAS or Banc of America Investment Services, Inc. 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 June 9, 2009.

On June 9, 2009, 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 from June 9, 2009 until the Commission takes final action on the application for a permanent order (Investment Company Act Release No. 28764). 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 BAS, et al. (File No. 812-13662), 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 June 9, 2009.

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

*Chairman Schapiro and  
Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28812 / July 7, 2009

In the Matter of )

RBC Capital Markets Corporation )  
One Liberty Plaza )  
165 Broadway )  
New York, NY 10006 )

Voyageur Asset Management Inc. )  
100 South Fifth Street )  
Suite 2300 )  
Minneapolis, MN 55402 )

Tamarack Distributors Inc. )  
100 South Fifth Street )  
Suite 2300 )  
Minneapolis, MN 55402 )

Sky Investment Counsel Inc. )  
1 Adelaide Street East )  
Suite 2310 )  
Toronto, ON, Canada M5C 2V9 )

(812-13663) )

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

RBC Capital Markets Corporation ("RBC"), Voyageur Asset Management Inc., Tamarack Distributors Inc., and Sky Investment Counsel Inc. filed an application on June 3, 2009, which was amended on June 26, 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 RBC 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 June 9, 2009.

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On June 9, 2009, 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 from June 9, 2009 until the Commission takes final action on the application for a permanent order (Investment Company Act Release No. 28762). 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 RBC, et al. (File No. 812-13663), 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 June 9, 2009.

By the Commission.



Elizabeth M. Murphy  
Secretary

*Chairman Schapiro and  
Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 9, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13543

In the Matter of  
  
ROBERT JOHN HIPPLE,  
  
Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND  
CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTIONS 9(b) AND 9(f) OF THE INVESTMENT  
COMPANY ACT OF 1940, AND RULE 102(e)(1) OF  
THE COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Robert John Hipple ("Respondent" or "Hipple"), pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

II.

After an investigation, the Division of Enforcement alleges that:

A. Respondent

1. Hipple, age 64, resides in Cocoa, Florida. He is an attorney licensed in Florida and Georgia. Hipple controlled the management and operations of iWorld Projects and Systems, Inc. ("iWorld"), a business development company ("BDC"), in early 2005 when it acquired iWorld Projects & Systems, Inc. ("iWorld Florida"), a private Florida company. At the time, Hipple was the CEO of iWorld Florida. After the acquisition, Hipple formally became iWorld's CEO and remained in that position until he resigned in March 2006. He also acted as iWorld's principal financial officer.

<sup>1</sup> Rule 102(e)(1)(iii) provides, in pertinent 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 [t]o have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

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**B. Relevant Entities**

2. iWorld is a BDC that, during all relevant periods, was incorporated in Nevada and headquartered in Addison, Texas. iWorld has not filed a periodic report with the Commission since it filed its third quarter 2005 Form 10-Q in November 2005. The Nevada Secretary of State revoked iWorld's corporate charter on January 1, 2006 for failure to pay franchise taxes. iWorld filed for voluntary Chapter 7 bankruptcy in May 2008. In March 2009, the bankruptcy court closed the case because iWorld had no assets. iWorld's common stock is registered with the Commission under Section 12(g) of the Exchange Act and is listed for quotation on the Pink OTC Markets.

3. iWorld Florida was, prior to its acquisition by iWorld, a privately-held Florida corporation formed by Hipple in May 2004. iWorld Florida was dissolved September 15, 2006.

**C. Hipple Postures iWorld Florida for Acquisition by iWorld as BDC**

4. Shortly after forming iWorld Florida in May 2004, Hipple caused it to acquire two small private companies in the project management services industry: Applied Management Concepts, Inc. ("AMC") and Process Integrity, Inc. ("PII") (together, "the subsidiaries"). iWorld Florida acquired the subsidiaries for a total of \$285,000 in working capital payments, \$200,000 in assumed liabilities, and 1.1 million shares of iWorld Florida common stock. This stock was not publicly traded and had no market value.

5. When iWorld Florida acquired the subsidiaries, AMC had no operations, while PII had only limited revenues from sales of its only product, a piece of project management software. Specifically, during the six months before the acquisition, PII had total revenues of \$89,000 and was not profitable. Hipple knew these facts at the time.

6. Notwithstanding the subsidiaries' poor performance and negligible operations, Hipple accepted and adopted the subsidiaries' financial forecasts. According to those forecasts, AMC and PII would generate \$2.4 million in revenue in the six-month period after their acquisition by iWorld Florida, and would generate in 2005 a total of \$5.5 million in revenue. Hipple had no objective information in his possession to support these forecasts.

7. In December 2004, Hipple initiated and directed a series of transactions to form iWorld. He first obtained two public, blank-check shell companies, Silesia Enterprises, Inc. ("Silesia") and Organic Solutions, Inc. ("Organic"). He then caused Silesia to file a Form N-54 election to become a BDC.

8. Hipple then directed and caused Silesia's merger into Organic. Among other things, Hipple caused Organic to issue convertible preferred shares to four of his designees, including his wife and a college-aged employee of one of his business partners. Hipple oversaw the conversion of the designee's preferred shares into common shares – which gave them control over Organic – and the voting of those shares to approve actions related to merging Organic with Silesia, with Organic as the surviving corporation. At the conclusion of these transactions, Hipple effectively controlled the post-merger company (a BDC), which, as part of the merger,

changed its name to iWorld. Hipple thereafter obtained a new CUSIP number and trading symbol for iWorld's common shares so they could be publicly traded.

**D. Hipple Causes iWorld to Acquire iWorld Florida and Prepares False Filings Overstating iWorld Florida's Value**

9. On February 25, 2005, iWorld filed a current report on Form 8-K announcing that it had agreed to acquire iWorld Florida through a merger. The Form 8-K was electronically signed by Hipple's partner, David Pells, as iWorld's president, but Hipple drafted this filing and caused it to be filed. The Form 8-K stated that the transaction was "valued at \$10 million, based on the number of shares issued, the market price of the shares, and the assets and businesses acquired." It then described iWorld Florida and the subsidiaries' business, concluding that "combined revenues from [iWorld Florida's] subsidiaries . . . for 2005 are expected to be in the range of \$25 to \$30 million, provided sufficient working capital is obtained."

10. The purported \$10 million valuation was materially false and misleading. Among other things, the Form 8-K failed to disclose that Hipple controlled both iWorld and iWorld Florida at the time of their merger. Consequently, and contrary to the Form 8-K's description of the transaction, the merger did not involve arms-length negotiation and was in fact a related-party transaction. Furthermore, the Form 8-K failed to disclose that, because Hipple controlled both sides of the transaction, he was able to reverse-engineer the number of shares exchanged between iWorld and iWorld Florida to lend legitimacy to the \$10 million figure. In addition, there was no disclosure that iWorld Florida's sole asset – its investments in the subsidiaries – had been acquired during the summer of 2004 for only \$285,000 cash, \$200,000 in assumed liabilities, and 1.1 million shares of iWorld Florida's non-public stock – consideration that was worth, at best, only a fraction of \$10 million.

11. The Form 8-K's representations about the subsidiaries' prospects were also materially false and misleading, since they were wholly speculative and unsupported. As noted above, at the time iWorld Florida acquired them in the summer of 2004, PII and AMC had generated meager revenues over the preceding six months. Their performance after their acquisition by iWorld Florida was no better; indeed, as Hipple knew from internal company reports he received, PII and AMC consistently fell far short of their forecasted performance. Accordingly, Hipple knew or recklessly disregarded that the Form 8-K's assertions of subsidiary revenues of \$25 million to \$30 million were baseless.

**E. Hipple Prepares and Certifies iWorld's False Quarterly Filings**

12. After iWorld acquired iWorld Florida, Hipple became iWorld's Chairman, CEO and CFO and performed the company's accounting and financial reporting functions. In this capacity, he maintained iWorld's books and records, was responsible for its system of internal controls, and drafted and filed with the Commission its periodic reports.

13. In 2005, iWorld filed three quarterly reports on Forms 10-Q: on May 20, 2005, August 12, 2005 and November 15, 2005. Hipple prepared, signed and certified each of the filings.

14. Each of these quarterly reports contained financial statements and other disclosures representing that the subsidiaries (AMC and PII) – including two additional start-up operating companies iWorld had acquired – were valued at \$10 million. These subsidiaries – which the quarterly reports referred to as “portfolio companies” – comprised, as reported in the quarterly reports, approximately 96% of iWorld’s total assets.

15. The reported \$10 million valuation was materially false and misleading. As described above, iWorld’s initial valuation of the subsidiaries at \$10 million was itself false and misleading since it was not the product of arms-length negotiation, was far in excess of what iWorld Florida had paid to acquire the subsidiaries roughly six months earlier, and was unsupported by the subsidiaries’ poor financial performance. None of these circumstances had changed by the time Hipple prepared and filed the quarterly reports. To the contrary, he had continually received information, including reports from the subsidiaries, demonstrating that their performance was deteriorating. For instance, by the time iWorld filed the first quarter Form 10-Q on May 20, 2005, Hipple knew from internal reports that all of the subsidiaries had continued to fall far short of internal projections, with some subsidiaries producing no revenues whatsoever. He also knew that iWorld’s working capital – which was critical to the subsidiaries’ survival – was rapidly diminishing. From these facts alone (which were not publicly disclosed), Hipple knew or recklessly disregarded that the subsidiaries’ reported valuation was grossly overstated.

16. By the time iWorld filed its second quarter Form 10-Q on August 12, 2005, Hipple knew from internal reports the additional fact that, not only were the subsidiaries far below their financial projections, they were in fact deeply unprofitable. Indeed, only PII still had operations by August 2005, due in part to the fact that iWorld had exhausted its working capital, on which the subsidiaries depended. As iWorld’s CEO and CFO, Hipple knew the subsidiaries were dependent on iWorld for working capital and that, without working capital, the subsidiaries would cease operations.

17. By the time iWorld filed its third quarter Form 10-Q on November 15, 2005, Hipple knew that meaningful subsidiary operations had ceased and that there was no prospect of iWorld’s reviving them, since iWorld itself had no cash. Moreover, by December 2005, Hipple learned that PII’s president had previously pledged PII’s sole asset – rights to its software product – to a third party as security for a loan to PII to make payroll.

18. Hipple never revealed the subsidiaries’ dire circumstances in iWorld’s 2005 quarterly filings. To the contrary, each of the filings repeated the \$10 million valuation, which the second and third quarter filings amplified by asserting that “the Company’s Investment Committee [has] determine[d] that the portfolio investments should be valued at \$10 million.” This was false: iWorld’s investment committee never considered the valuation of the subsidiaries. Moreover, each of the quarterly filings represented that the subsidiaries were projected to earn tens of millions of dollars of revenue through the end of 2006. In view of the circumstances described above – including the subsidiaries’ continuous unprofitability and the depletion of iWorld’s working capital – these representations were completely unfounded and, consequently, were materially false and misleading.

19. Even after learning that PII's president had pledged PII's software to secure a loan to PII, Hipple made no effort to amend iWorld's third quarter Form 10-Q.

**F. Hipple Materially Misleads iWorld's Auditor**

20. As a BDC, iWorld was required under Section 2(a)(41) of the Investment Company Act (which applies to BDCs pursuant to Section 59 of that Act) to determine in good faith the fair value of the securities of its portfolio companies, since market quotations for those securities were not readily available. iWorld never made a good faith determination, either when it acquired iWorld Florida and its subsidiaries, or thereafter. Hipple knew that no such determination had been made.

21. Hipple, however, told iWorld's auditor – in connection with the auditor's review of iWorld's first quarter 2005 Form 10-Q – that an "independent investment board" had approved the \$10 million valuation. Hipple knew that this statement was false.

**G. Violations**

22. As a result of the conduct described above, Hipple willfully violated:

a. 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;

b. Section 34(b) of the Investment Company Act, made applicable to BDCs through Section 59 of the Investment Company Act, which provides, among other things, that in any registration statement, application, report, account, record, or other document filed or transmitted by iWorld pursuant to the Investment Company Act or kept by iWorld pursuant to Section 31(a) of the Investment Company Act, it shall be unlawful for any person so filing, transmitting or keeping any such document to make any untrue statement of material fact or to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading;

c. Rule 13a-14 under the Exchange Act, which required Hipple, as iWorld's principal executive and financial officer, to certify in each quarterly and annual report filed or submitted by iWorld under Section 13(a) of the Exchange Act, that: (1) he had reviewed the report; and (2) based on his knowledge, the report did not contain any untrue statement of material fact, or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;

d. Section 13(b)(5) of the Exchange Act, which provides that no person shall knowingly falsify any book, record, or account of an issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, or is required to file reports pursuant to Section 15(d) of the Exchange Act, or knowingly circumvent the registrant's system of internal accounting controls;

e. Rule 13b2-1 under the Exchange Act, which provides that no person shall, directly or indirectly, falsify or cause to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act;

f. Rule 13b2-2(a) under the Exchange Act, which prohibits an officer or director of an issuer from, directly or indirectly: (1) making, or causing to be made, a materially false or misleading statement; or (2) omitting, or causing to be omitted, a statement of a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading to an accountant in connection with a required audit, or the preparation or filing of a required document or report;

g. Section 57(a)(1) of the Investment Company Act, which prohibits persons "related" to a BDC, as defined in Section 57(b) of the Investment Company Act, from acting as principal knowingly selling to the BDC any securities in another company unless at least one of two conditions applies. The first condition is that the sale involves solely securities of which the buyer is the issuer. See Section 57(a)(1)(A). The second is that the sale involves solely securities of which the seller is the issuer and which are part of a general offering to the holders of a class of its securities. See Section 57(a)(1)(B). Section 57(b)(2) defines a "related person of a BDC," in pertinent part, as any person directly or indirectly "controlling" a BDC. Section (2)(a)(9) of the Investment Company Act, in turn, defines "control" as "the power to exercise a controlling influence over the management or policies of a company." Hipple controlled iWorld when he sold, as a principal, his iWorld Florida shares to iWorld in iWorld's acquisition of iWorld Florida. Hipple's sale of his shares did not satisfy either of the two conditions set forth in Section 57(a)(1)(A) or (B). Thus, Hipple violated Section 57(a)(1);

23. As a result of the conduct described above, Hipple willfully aided and abetted and caused iWorld's violations of:

a. Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13, and 12b-20 thereunder, which required iWorld to file information and documents as prescribed by the Commission, including current and quarterly reports, and to include in those reports any material information as may be necessary to make the required statements in those reports not misleading in light of the circumstances under which the statements were made;

b. Section 13(b)(2)(A) of the Exchange Act, which required iWorld, as a reporting company, to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflected its transactions and dispositions of its assets;

c. Section 13(b)(2)(B) of the Exchange Act which required iWorld, as a reporting company, to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles; and

d. Section 31(a) of the Investment Company Act made applicable to BDCs by Section 64 of the Investment Company Act, and Rule 31a-1 thereunder, which required iWorld to make and keep certain books and records, including, among other things, ledgers of all

assets, liabilities, reserve capital, income and expense accounts reflecting account balances on each day, and corporate documents such as minutes from shareholder and board meetings.

24. As a result of the conduct described in Sections II.A. through II. F., above, Hipple willfully violated, and willfully aided and abetted violations of various provisions of the Federal securities laws and rules and regulations thereunder, such that the Commission may, after notice and opportunity for hearing in the matter, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, censure Hipple, or deny to Hipple, temporarily or permanently, the privilege of appearing or practicing before it.

### 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 21C of the Exchange Act and 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 Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1, 13b2-2, and 13a-14 thereunder, and Sections 34(b) and 57(a) of the Investment Company Act, and from causing violations of and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder and Section 31(a) of the Investment Company Act and Rule 31a-1 thereunder;

D. Whether, pursuant to Section 21C(f) of the Exchange Act, Respondent should be prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act; and

E. Whether, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, Respondent should be censured, or denied, temporarily or permanently, the privilege of appearing or practicing before the Commission.

### 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.

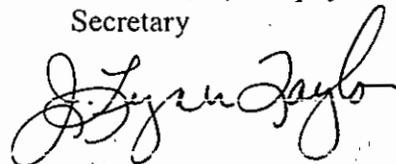
This Order shall be served forthwith upon Respondent personally or by certified mail.

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



By: J. Lynn Taylor  
Assistant Secretary

**UNITED STATES OF AMERICA**  
Before the  
**SECURITIES AND EXCHANGE COMMISSION**  
July 10, 2009

**ADMINISTRATIVE PROCEEDING**  
File No. 3-13545

In the Matter of

**Harvard Scientific Corp.,  
Hathaway Corp.,  
Healthcare Software, Inc.,  
Heartland Technology, Inc.,  
Hedman Resources, Ltd.,  
Hemdale Communications, Inc., and  
Hemokinetics, Inc.,**

**Respondents.**

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

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Harvard Scientific Corp., Hathaway Corp., Healthcare Software, Inc., Heartland Technology, Inc., Hedman Resources, Ltd., Hemdale Communications, Inc., and Hemokinetics, Inc.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Harvard Scientific Corp. (CIK No. 1006598) is a permanently revoked Nevada corporation located in Oakland Park, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Harvard Scientific is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended September 30, 2001, which reported a net loss of \$34,578 for the prior three months. On February 15, 2001, an involuntary Chapter 11 petition was filed against Harvard Scientific in the U.S. Bankruptcy Court for the District of Nevada, which was converted to a Chapter 7 proceeding on January 23, 2002, and the case was terminated on January 12, 2004. On December 11, 2001, Harvard filed

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a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Florida, and the case was terminated on January 18, 2002. As of July 7, 2009, the company's stock (symbol "VGENQ") was traded on the over-the-counter markets.

2. Hathaway Corp. (CIK No. 1093288) is a revoked Nevada corporation located in Idabel, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hathaway is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported a net loss of \$1,700 for the prior three months.

3. Healthcare Software, Inc. (CIK No. 1088758) is a permanently revoked Nevada corporation located in Celebration, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Healthcare Software is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2000, which reported a net loss of \$6,739 for the prior six months.

4. Heartland Technology, Inc. (CIK No. 831115) is a void Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(b). Heartland Technology is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2001, which reported a net loss of \$12 million for the prior twelve months. On June 15, 2005, Heartland Technology filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Illinois, and the case was terminated on December 19, 2007. As of July 7, 2009, the company's stock (symbol "HDTCQ") was traded on the over-the-counter markets.

5. Hedman Resources, Ltd. (CIK No. 1009388) is an Ontario corporation located in Lively, Ontario, Canada with a class of securities and warrants registered with the Commission pursuant to Exchange Act Section 12(g). Hedman is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F registration statement on November 5, 1996, which reported a net loss of \$468,579 (Canadian) for the year ended July 31, 1995. As of July 7, 2009, the company's stock (symbol "HDMRF") was traded on the over-the-counter markets.

6. Hemdale Communications, Inc. (CIK No. 847469) is a void Delaware corporation located in Pompano Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hemdale 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, 1994. On December 11, 1995, Hemdale filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was converted to Chapter 7, and the case was terminated on September 30, 1999. As of July 7, 2009, the company's stock (symbol "HEMD") was traded on the over-the-counter markets.

7. Hemokinetics, Inc. (CIK No. 351297) is a revoked District of Columbia corporation located in Madison, Wisconsin with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hemokinetics 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, 1996.

#### B. DELINQUENT PERIODIC FILINGS

8. 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.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires domestic issuers to file quarterly reports. Rule 13a-16 requires certain foreign private issuers to furnish quarterly and other material reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

### III.

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

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

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

IV.

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

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

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

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

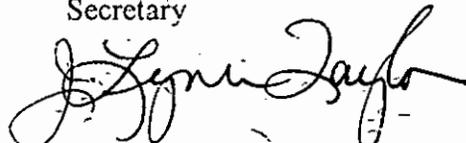
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

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

By the Commission.

Attachment

Elizabeth M. Murphy  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

**Chart of Delinquent Filings  
Harvard Scientific Corp., et al.**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Harvard Scientific Corp.</b>	10-KSB	12/31/01	04/01/02	Not filed	87
	10-QSB	03/31/02	05/15/02	Not filed	86
	10-QSB	06/30/02	08/14/02	Not filed	83
	10-QSB	09/30/02	11/14/02	Not filed	80
	10-KSB	12/31/02	03/31/03	Not filed	76
	10-QSB	03/31/03	05/15/03	Not filed	74
	10-QSB	06/30/03	08/14/03	Not filed	71
	10-QSB	09/30/03	11/14/03	Not filed	68
	10-KSB	12/31/03	03/30/04	Not filed	64
	10-QSB	03/31/04	05/17/04	Not filed	62
	10-QSB	06/30/04	08/16/04	Not filed	59
	10-QSB	09/30/04	11/15/04	Not filed	56
	10-KSB	12/31/04	03/31/05	Not filed	52
	10-QSB	03/31/05	05/16/05	Not filed	50
	10-QSB	06/30/05	08/15/05	Not filed	47
	10-QSB	09/30/05	11/14/05	Not filed	44
	10-KSB	12/31/05	03/31/06	Not filed	40
	10-QSB	03/31/06	05/15/06	Not filed	38
	10-QSB	06/30/06	08/14/06	Not filed	35
	10-QSB	09/30/06	11/14/06	Not filed	32
	10-KSB	12/31/06	04/02/07	Not filed	27
	10-QSB	03/31/07	05/15/07	Not filed	26
	10-QSB	06/30/07	08/14/07	Not filed	23
	10-QSB	09/30/07	11/14/07	Not filed	20
	10-KSB	12/31/07	03/31/08	Not filed	16
	10-Q*	03/31/08	05/15/08	Not filed	14
	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
	10-K*	12/31/08	03/31/09	Not filed	4
	10-Q*	03/31/09	05/15/09	Not filed	2

**Total Filings Delinquent      30**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Hathaway Corp.</b>					
	10-QSB	06/30/01	08/14/01	Not filed	95
	10-QSB	09/30/01	11/14/01	Not filed	92
	10-KSB	12/31/01	04/01/02	Not filed	87
	10-QSB	03/31/02	05/15/02	Not filed	86
	10-QSB	06/30/02	08/14/02	Not filed	83
	10-QSB	09/30/02	11/14/02	Not filed	80
	10-KSB	12/31/02	03/31/03	Not filed	76
	10-QSB	03/31/03	05/15/03	Not filed	74
	10-QSB	06/30/03	08/14/03	Not filed	71
	10-QSB	09/30/03	11/14/03	Not filed	68
	10-KSB	12/31/03	03/30/04	Not filed	64
	10-QSB	03/31/04	05/17/04	Not filed	62
	10-QSB	06/30/04	08/16/04	Not filed	59
	10-QSB	09/30/04	11/15/04	Not filed	56
	10-KSB	12/31/04	03/31/05	Not filed	52
	10-QSB	03/31/05	05/16/05	Not filed	50
	10-QSB	06/30/05	08/15/05	Not filed	47
	10-QSB	09/30/05	11/14/05	Not filed	44
	10-KSB	12/31/05	03/31/06	Not filed	40
	10-QSB	03/31/06	05/15/06	Not filed	38
	10-QSB	06/30/06	08/14/06	Not filed	35
	10-QSB	09/30/06	11/14/06	Not filed	32
	10-KSB	12/31/06	04/02/07	Not filed	27
	10-QSB	03/31/07	05/15/07	Not filed	26
	10-QSB	06/30/07	08/14/07	Not filed	23
	10-QSB	09/30/07	11/14/07	Not filed	20
	10-KSB	12/31/07	03/31/08	Not filed	16
	10-Q*	03/31/08	05/15/08	Not filed	14
	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
	10-K*	12/31/08	03/31/09	Not filed	4
	10-Q*	03/31/09	05/15/09	Not filed	2

Total Filings Delinquent 32

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Healthcare Software, Inc.</b>	10-QSB	09/30/00	11/14/00	Not filed	104
	10-KSB	12/31/00	04/02/01	Not filed	99
	10-QSB	03/31/01	05/15/01	Not filed	98
	10-QSB	06/30/01	08/14/01	Not filed	95
	10-QSB	09/30/01	11/14/01	Not filed	92
	10-KSB	12/31/01	04/01/02	Not filed	87
	10-QSB	03/31/02	05/15/02	Not filed	86
	10-QSB	06/30/02	08/14/02	Not filed	83
	10-QSB	09/30/02	11/14/02	Not filed	80
	10-KSB	12/31/02	03/31/03	Not filed	76
	10-QSB	03/31/03	05/15/03	Not filed	74
	10-QSB	06/30/03	08/14/03	Not filed	71
	10-QSB	09/30/03	11/14/03	Not filed	68
	10-KSB	12/31/03	03/30/04	Not filed	64
	10-QSB	03/31/04	05/17/04	Not filed	62
	10-QSB	06/30/04	08/16/04	Not filed	59
	10-QSB	09/30/04	11/15/04	Not filed	56
	10-KSB	12/31/04	03/31/05	Not filed	52
	10-QSB	03/31/05	05/16/05	Not filed	50
	10-QSB	06/30/05	08/15/05	Not filed	47
	10-QSB	09/30/05	11/14/05	Not filed	44
	10-KSB	12/31/05	03/31/06	Not filed	40
	10-QSB	03/31/06	05/15/06	Not filed	38
	10-QSB	06/30/06	08/14/06	Not filed	35
	10-QSB	09/30/06	11/14/06	Not filed	32
	10-KSB	12/31/06	04/02/07	Not filed	27
	10-QSB	03/31/07	05/15/07	Not filed	26
	10-QSB	06/30/07	08/14/07	Not filed	23
	10-QSB	09/30/07	11/14/07	Not filed	20
	10-KSB	12/31/07	03/31/08	Not filed	16
	10-Q*	03/31/08	05/15/08	Not filed	14
	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
10-K*	12/31/08	03/31/09	Not filed	4	

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q*	03/31/09	05/15/09	Not filed	2
<b>Total Filings Delinquent</b>	<b>35</b>				

**Heartland  
Technology, Inc.**

10-Q	03/31/02	05/15/02	Not filed	86
10-Q	06/30/02	08/14/02	Not filed	83
10-Q	09/30/02	11/14/02	Not filed	80
10-K	12/31/02	03/31/03	Not filed	76
10-Q	03/31/03	05/15/03	Not filed	74
10-Q	06/30/03	08/14/03	Not filed	71
10-Q	09/30/03	11/14/03	Not filed	68
10-K	12/31/03	03/30/04	Not filed	64
10-Q	03/31/04	05/17/04	Not filed	62
10-Q	06/30/04	08/16/04	Not filed	59
10-Q	09/30/04	11/15/04	Not filed	56
10-K	12/31/04	03/31/05	Not filed	52
10-Q	03/31/05	05/16/05	Not filed	50
10-Q	06/30/05	08/15/05	Not filed	47
10-Q	09/30/05	11/14/05	Not filed	44
10-K	12/31/05	03/31/06	Not filed	40
10-Q	03/31/06	05/15/06	Not filed	38
10-Q	06/30/06	08/14/06	Not filed	35
10-Q	09/30/06	11/14/06	Not filed	32
10-K	12/31/06	04/02/07	Not filed	27
10-Q	03/31/07	05/15/07	Not filed	26
10-Q	06/30/07	08/14/07	Not filed	23
10-Q	09/30/07	11/14/07	Not filed	20
10-K	12/31/07	03/31/08	Not filed	16
10-Q	03/31/08	05/15/08	Not filed	14
10-Q	06/30/08	08/14/08	Not filed	11
10-Q	09/30/08	11/14/08	Not filed	8
10-K	12/31/08	03/31/09	Not filed	4
10-Q	03/31/09	05/15/09	Not filed	2

**Total Filings Delinquent 29**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Hedman Resources, Ltd.</b>					
	20-F	07/31/96	01/31/97	Not filed	150
	20-F	07/31/97	02/02/98	Not filed	137
	20-F	07/31/98	02/01/99	Not filed	125
	20-F	07/31/99	01/31/00	Not filed	114
	20-F	07/31/00	01/31/01	Not filed	102
	20-F	07/31/01	01/31/02	Not filed	90
	20-F	07/31/02	01/31/03	Not filed	78
	20-F	07/31/03	02/02/04	Not filed	65
	20-F	07/31/04	01/31/05	Not filed	54
	20-F	07/31/05	01/31/06	Not filed	42
	20-F	07/31/06	01/31/07	Not filed	30
	20-F	07/31/07	01/31/08	Not filed	18
	20-F	07/31/08	02/02/09	Not filed	5

Total Filings Delinquent 13

**Hemdale Communications, Inc.**

10-KSB	12/31/94	03/31/95	Not filed	172
10-QSB	03/31/95	05/15/95	Not filed	170
10-QSB	06/30/95	08/14/95	Not filed	167
10-QSB	09/30/95	11/14/95	Not filed	164
10-KSB	12/31/95	04/01/96	Not filed	159
10-QSB	03/31/96	05/15/96	Not filed	158
10-QSB	06/30/96	08/14/96	Not filed	155
10-QSB	09/30/96	11/14/96	Not filed	152
10-KSB	12/31/96	03/31/97	Not filed	148
10-QSB	03/31/97	05/15/97	Not filed	146
10-QSB	06/30/97	08/14/97	Not filed	143
10-QSB	09/30/97	11/14/97	Not filed	140
10-KSB	12/31/97	03/31/98	Not filed	136
10-QSB	03/31/98	05/15/98	Not filed	134
10-QSB	06/30/98	08/14/98	Not filed	131
10-QSB	09/30/98	11/16/98	Not filed	128
10-KSB	12/31/98	03/31/99	Not filed	124
10-QSB	03/31/99	05/17/99	Not filed	122

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-QSB	06/30/99	08/16/99	Not filed	119
	10-QSB	09/30/99	11/15/99	Not filed	116
	10-KSB	12/31/99	03/30/00	Not filed	112
	10-QSB	03/31/00	05/15/00	Not filed	110
	10-QSB	06/30/00	08/14/00	Not filed	107
	10-QSB	09/30/00	11/14/00	Not filed	104
	10-KSB	12/31/00	04/02/01	Not filed	99
	10-QSB	03/31/01	05/15/01	Not filed	98
	10-QSB	06/30/01	08/14/01	Not filed	95
	10-QSB	09/30/01	11/14/01	Not filed	92
	10-KSB	12/31/01	04/01/02	Not filed	87
	10-QSB	03/31/02	05/15/02	Not filed	86
	10-QSB	06/30/02	08/14/02	Not filed	83
	10-KSB	12/31/02	03/31/03	Not filed	76
	10-QSB	03/31/03	05/15/03	Not filed	74
	10-QSB	06/30/03	08/14/03	Not filed	71
	10-QSB	09/30/03	11/14/03	Not filed	68
	10-KSB	12/31/03	03/30/04	Not filed	64
	10-QSB	03/31/04	05/17/04	Not filed	62
	10-QSB	06/30/04	08/16/04	Not filed	59
	10-QSB	09/30/04	11/15/04	Not filed	56
	10-KSB	12/31/04	03/31/05	Not filed	52
	10-QSB	03/31/05	05/16/05	Not filed	50
	10-QSB	06/30/05	08/15/05	Not filed	47
	10-QSB	09/30/05	11/14/05	Not filed	44
	10-KSB	12/31/05	03/31/06	Not filed	40
	10-QSB	03/31/06	05/15/06	Not filed	38
	10-QSB	06/30/06	08/14/06	Not filed	35
	10-QSB	09/30/06	11/14/06	Not filed	32
	10-KSB	12/31/06	04/02/07	Not filed	27
	10-QSB	03/31/07	05/15/07	Not filed	26
	10-QSB	06/30/07	08/14/07	Not filed	23
	10-QSB	09/30/07	11/14/07	Not filed	20
	10-KSB	12/31/07	03/31/08	Not filed	16
	10-Q*	03/31/08	05/15/08	Not filed	14
	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
	10-K*	12/31/08	03/31/09	Not filed	4

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q*	03/31/09	05/15/09	Not filed	2
Total Filings Delinquent		58			

**Hemokinetics, Inc.**

10-K	06/30/96	09/30/96	Not filed	154
10-Q	09/30/96	11/14/96	Not filed	152
10-Q	12/31/96	02/14/97	Not filed	149
10-Q	03/31/97	05/15/97	Not filed	146
10-K	06/30/97	09/29/97	Not filed	142
10-Q	09/30/97	11/14/97	Not filed	140
10-Q	12/31/97	02/17/98	Not filed	137
10-Q	03/31/98	05/15/98	Not filed	134
10-K	06/30/98	09/28/98	Not filed	130
10-Q	09/30/98	11/16/98	Not filed	128
10-Q	12/31/98	02/16/99	Not filed	125
10-Q	03/31/99	05/17/99	Not filed	122
10-K	06/30/99	09/28/99	Not filed	118
10-Q	09/30/99	11/15/99	Not filed	116
10-Q	12/31/99	02/14/00	Not filed	113
10-Q	03/31/00	05/15/00	Not filed	110
10-K	06/30/00	09/28/00	Not filed	106
10-Q	09/30/00	11/14/00	Not filed	104
10-Q	12/31/00	02/14/01	Not filed	101
10-Q	03/31/01	05/15/01	Not filed	98
10-K	06/30/01	09/28/01	Not filed	94
10-Q	09/30/01	11/14/01	Not filed	92
10-Q	12/31/01	02/14/02	Not filed	89
10-Q	03/31/02	05/15/02	Not filed	86
10-K	06/30/02	09/30/02	Not filed	82
10-Q	09/30/02	11/14/02	Not filed	80
10-Q	12/31/02	02/14/03	Not filed	77
10-Q	03/31/03	05/15/03	Not filed	74
10-K	06/30/03	09/29/03	Not filed	70
10-Q	09/30/03	11/14/03	Not filed	68
10-Q	12/31/03	02/17/04	Not filed	65
10-Q	03/31/04	05/17/04	Not filed	62
10-K	06/30/04	09/28/04	Not filed	58
10-Q	09/30/04	11/15/04	Not filed	56

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	12/31/04	02/14/05	Not filed	53
	10-Q	03/31/05	05/16/05	Not filed	50
	10-K	06/30/05	09/28/05	Not filed	46
	10-Q	09/30/05	11/14/05	Not filed	44
	10-Q	12/31/05	02/14/06	Not filed	41
	10-Q	03/31/06	05/15/06	Not filed	38
	10-K	06/30/06	09/28/06	Not filed	34
	10-Q	09/30/06	11/14/06	Not filed	32
	10-Q	12/31/06	02/14/07	Not filed	29
	10-Q	03/31/07	05/15/07	Not filed	26
	10-K	06/30/07	09/28/07	Not filed	22
	10-Q	09/30/07	11/14/07	Not filed	20
	10-Q	12/31/07	02/14/08	Not filed	17
	10-Q	03/31/08	05/15/08	Not filed	14
	10-K	06/30/08	09/29/08	Not filed	10
	10-Q	09/30/08	11/14/08	Not filed	8
	10-Q	12/31/08	02/17/09	Not filed	5
	10-Q	03/31/09	05/15/09	Not filed	2
<b>Total Filings Delinquent</b>					<b>52</b>

\*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.

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 229, 239, 240, 249, 270 and 274**

**[RELEASE NOS. 33-9052; 34-60280; IC-28817; File No. S7-13-09]**

**RIN 3235-AK28**

**PROXY DISCLOSURE AND SOLICITATION ENHANCEMENTS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** We are proposing amendments to our rules to enhance the compensation and corporate governance disclosures registrants are required to make about: their overall compensation policies and their impact on risk taking; stock and option awards of executives and directors; director and nominee qualifications and legal proceedings; company leadership structure; the board's role in the risk management process; and potential conflicts of interest of compensation consultants that advise companies. The proposed amendments to our disclosure rules would be applicable to proxy and information statements, annual reports and registration statements under the Securities Exchange Act of 1934, and registration statements under the Securities Act of 1933 as well as the Investment Company Act of 1940. We are also proposing amendments to transfer from Forms 10-Q and 10-K to Form 8-K the requirement to disclose shareholder voting results. In addition, we are proposing amendments to our proxy rules to clarify the manner in which they operate and address issues that have arisen in the proxy solicitation process.

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

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

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Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-13-09 on the subject line; or
- Use the Federal Rulemaking ePortal (<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 S7-13-09. 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/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** N. Sean Harrison, Special Counsel, at (202) 551-3430 or Anne Krauskopf, Senior Special Counsel, at (202) 551-3500, in the Division of Corporation Finance; or with respect to questions regarding the proposed proxy solicitation amendments, Mark W. Green, Senior Special Counsel, or Nicholas P. Panos, Senior Special

Counsel at (202) 551-3440, in the Division of Corporation Finance; or with respect to questions regarding investment companies, Marc Oorloff Sharma, Senior Counsel, Division of Investment Management, at (202) 551-6784, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** We are proposing amendments to Items 401,<sup>1</sup> 402,<sup>2</sup> and 407<sup>3</sup> of Regulation S-K;<sup>4</sup> Rules 14a-2,<sup>5</sup> 14a-4,<sup>6</sup> and 14a-12;<sup>7</sup> Schedule 14A<sup>8</sup> and Forms 8-K,<sup>9</sup> 10-Q,<sup>10</sup> and 10-K<sup>11</sup> under the Securities Exchange Act of 1934 (“Exchange Act”);<sup>12</sup> and Forms N-1A,<sup>13</sup> N-2,<sup>14</sup> and N-3,<sup>15</sup> registration forms used by management investment companies to register under the Investment Company Act of 1940 (“Investment Company Act”)<sup>16</sup> and to offer their securities under the Securities Act of 1933 (“Securities Act”).<sup>17</sup>

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<sup>1</sup> 17 CFR 229.401.

<sup>2</sup> 17 CFR 229.402.

<sup>3</sup> 17 CFR 229.407.

<sup>4</sup> 17 CFR 229.10 et al.

<sup>5</sup> 17 CFR 240.14a-2.

<sup>6</sup> 17 CFR 240.14a-4.

<sup>7</sup> 17 CFR 240.14a-12.

<sup>8</sup> 17 CFR 240.14a-101.

<sup>9</sup> 17 CFR 249.308.

<sup>10</sup> 17 CFR 249.308a.

<sup>11</sup> 17 CFR 249.310.

<sup>12</sup> 15 U.S.C. 78a et seq.

<sup>13</sup> 17 CFR 239.15A and 274.11A.

<sup>14</sup> 17 CFR 239.14 and 274.11a-1.

<sup>15</sup> 17 CFR 239.17a and 274.11b.

<sup>16</sup> 15 U.S.C. 80a-1 et seq.

## I. BACKGROUND AND SUMMARY

We are proposing a number of revisions to our rules that would improve the disclosure shareholders of public companies receive regarding compensation and corporate governance, and facilitate communications relating to voting decisions. During the past few years, shareholders have increasingly focused on corporate accountability, and have expressed the desire for additional information that would enhance their ability to make informed voting and investment decisions. Several rulemaking initiatives in recent years have focused on these themes. In addition to proposals that are largely focused on disclosure enhancements, we also are proposing some revisions to the rules governing the proxy solicitation process that would clarify the manner in which soliciting parties communicate with shareholders.

First, we are proposing revisions to our rules governing disclosure of executive and director compensation, director biographical information and qualifications, compensation consultants, and other matters. Over the past several years, we have engaged in a number of rulemaking initiatives designed to improve the presentation of information about executive officer and director compensation and relationships with the company, and thereby assist investors' ability to make more informed voting and investment decisions.<sup>18</sup> The turmoil in the markets during the past 18 months has reinforced the importance of enhancing transparency, especially with regard to activities that materially contribute to a company's risk profile. We

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<sup>17</sup> 15 U.S.C. 77a *et seq.*

<sup>18</sup> See Release No. 33-8340 (Nov. 24, 2003) [68 FR 69204] (adopting rule amendments to improve the disclosure regarding the nominating committee process of public companies and the ways by which security holders may communicate with boards at the companies in which they invest); Release No. 33-8732A (Aug. 29, 2006) [71 FR 53518] (adopting rule amendments that significantly revised the disclosure of executive officer and director compensation, related party transactions, director independence and the security ownership of officers and directors).

have decided to re-examine our disclosure rules to provide investors with important and relevant information upon which to base their proxy voting and investment decisions.

The amendments proposed today would add new disclosure requirements on several topics that are designed to enhance the information included in proxy and information statements,<sup>19</sup> including information about the relationship of a company's overall compensation policies to risk, director and nominee qualifications, company leadership structure, and the potential conflicts of interests of compensation consultants. We believe that some of our current disclosure requirements on these topics could be improved to elicit more informative disclosure for investors. In addition, the proposals would improve Summary Compensation Table reporting of stock and option awards. We are proposing to change the manner in which stock and option awards are reported both in the Summary Compensation Table<sup>20</sup> and Director Compensation Table.<sup>21</sup> We believe the current method for presenting this information may have inadvertently resulted in investor confusion. The proposed amendments would require disclosure in these tables of the aggregate grant date fair value of awards computed in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (FAS 123R), instead of the dollar amount recognized for financial statement reporting purposes. We also propose to accelerate the timing of the reporting of information regarding voting results, so that investors have access to this important information on a more timely basis.

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<sup>19</sup> The proposed amendments to Regulation S-K would also be applicable to registration statements under the Securities Act, and in some cases also Form 10-K under the Exchange Act.

<sup>20</sup> Item 402(c) and 402(n) of Regulation S-K [17 CFR 229.402(c) and 229.402(n)].

<sup>21</sup> Item 402(k) and 402(r) of Regulation S-K [17 CFR 229.402(k) and 229.402(r)].

Finally, we are proposing amendments to Exchange Act Rules 14a-2, 14a-4 and 14a-12 to clarify certain issues relating to the solicitation of proxies and the granting of proxy authority.<sup>22</sup> In 1992, we adopted significant amendments to the proxy rules intended to remove unnecessary impediments to the solicitation of proxy authority and to allow management and other persons seeking proxy authority more efficiently and effectively to communicate with shareholders.<sup>23</sup> Since that time, we have become aware of a few interpretive issues regarding the rules governing proxy solicitations, particularly solicitations by shareholders and other non-management parties. We believe the proposed revisions will provide certainty in how the rules operate and facilitate the proxy solicitation process.

If the amendments proposed in this release are adopted, we anticipate that they would be effective for the 2010 proxy season.

## **II. DISCUSSION OF THE PROPOSED AMENDMENTS**

### **A. Enhanced Compensation Disclosure**

#### **1. Compensation Discussion and Analysis Disclosure**

In 2006, we amended our executive compensation disclosure rules to require a new principles-based, narrative discussion that provides an overview of a company's compensation program for its principal executive officer, principal financial officer and the three most highly compensated executive officers, other than the principal executive officer and principal financial officer, and that provides an analysis of the material elements of the company's compensation

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<sup>22</sup> The Commission has taken action in recent years in regard to proxy materials. For example, in 2007 we provided for the use of electronic proxy solicitations, and recently we proposed to revise our rules to facilitate inclusion of shareholder nominations in company proxy materials. See Release No. 34-56135 (July 26, 2007) [72 FR 42222] (shareholder choice regarding proxy materials); Release No. 33-9046 (June 10, 2009) [74 FR 29024] (proposed amendments to facilitate rights of shareholders to nominate directors).

<sup>23</sup> Release No. 34-31326 (Oct. 16, 1992) [52 FR 48276] ("1992 adopting release").

for these named executive officers.<sup>24</sup> This Compensation Discussion and Analysis (“CD&A”) requirement is designed to elicit disclosure about the material elements of the company’s compensation for the named executive officers, and is intended to put into perspective for investors the tabular compensation data required by our rules.<sup>25</sup>

In addition to the compensation policies for the named executive officers, a company’s broader compensation policies and arrangements for other employees may also be important. It has been suggested that, at some companies, compensation policies have become disconnected from long-term company performance because the interests of management and some employees, in the form of incentive compensation arrangements, and the long-term well-being of the company are not sufficiently aligned.<sup>26</sup> Critics have argued that, in some cases, the structure and the particular application of incentive compensation policies can create inadvertent incentives for management and employees to make decisions that significantly, and

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<sup>24</sup> See Release No. 33-8732A (Aug. 29, 2006) [71 FR 53518]; Release No. 33-8765 (Dec. 22, 2006) [71 FR 78338].

<sup>25</sup> Shortly after implementation of the CD&A requirements, in the spring of 2007, the Commission staff undertook a review of the proxy statements of 350 public companies in an effort to both evaluate compliance with the revised rules and provide guidance on how companies could enhance their disclosures in this area. The staff prepared a report of its observations of the CD&A disclosures of these companies. In the report, the staff described the principal comments they had issued to the companies that were subject to the review. Overall, the staff noted at the time that companies appeared to have generally made a good faith effort to comply with the new rules, and investors had benefited from the new disclosures. At the same time, the staff’s comments highlighted areas where it believed companies may need to provide additional or clearer disclosure in future filings. Furthermore, the staff emphasized in its report that companies should provide security holders and investors with a more robust discussion of the basis and the context for granting different types and amounts of executive compensation, and that companies should continue thinking about how the CD&A can be better organized and presented for both the lay reader and the professional, in order to make the disclosure as useful and meaningful to security holders and investors as possible. U.S. Securities and Exchange Commission, Division of Corporation Finance, Staff Observations in the Review of Executive Compensation Disclosure, (2007) at <http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm>.

<sup>26</sup> See, for example, Financial Stability Forum, FSF Principles of Sound Compensation Practices I (Apr. 2, 2009) (noting that “[h]igh short-term profits led to generous bonus payments to employees without adequate regard to the longer-term risks they imposed on their firms”), at [http://www.financialstabilityboard.org/publications/r\\_0904b.pdf](http://www.financialstabilityboard.org/publications/r_0904b.pdf). The report also noted that “below the level of the executive suite, most employees view the performance of the firm as a whole as being almost independent of their own actions. Actions by other employees or business units are seen as determining the firm’s fate. Similarly, stock performance might be driven by various exogenous factors. Thus, employees heavily discount the value of the stock and act to bring the cash component of bonus up.” *Id.* at 11.

inappropriately, increase the company's risk, without adequate recognition of the risks to the company.<sup>27</sup> Companies, and in turn investors, may be negatively impacted where the design or operation of their compensation programs creates incentives that influence behavior inconsistent with the overall interests of the company. Indeed, one of the many contributing factors cited as a basis for the current market turmoil is that at a number of large financial institutions the short-term incentives created by their compensation policies were misaligned with the long-term well-being of the companies.<sup>28</sup> By contrast, well-designed compensation policies may enhance a company's business interests by encouraging innovation and appropriate levels of risk taking.<sup>29</sup>

We are proposing to amend our CD&A requirements to broaden their scope to include a new section that will provide information about how the company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk. We believe investors would benefit from an expanded discussion and analysis about how the company rewards and incentivizes its employees to the extent it creates risk to the

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<sup>27</sup> See, for example, Calvin H. Johnson, The Disloyalty of Stock and Stock Option Compensation, 11 CONN. INS. L.J. 133 (2004-2005); Michael C. Jensen, et al., Remuneration: Where we've been, how we got here, what are the problems, and how to fix them (2004) (unpublished manuscript on file), available at [www.ssrn.com/abstract=561305](http://www.ssrn.com/abstract=561305). The relationship between compensation incentives and risk also has been recognized in the legislation authorizing the Troubled Asset Relief Program ("TARP"). Specifically, Section 111(b) of the Emergency Economic Stabilization Act of 2008, as amended by Section 7001 of the American Recovery and Reinvestment Act of 2009, requires the Secretary of the Treasury to require each TARP recipient to meet appropriate standards for executive compensation and corporate governance that shall include "limits on compensation that exclude incentives for senior executive officers of the TARP recipient to take unnecessary and excessive risks that threaten the value of such recipient during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding." See Pub. L. 111-5, §7001, 123 Stat. 115, 517 (2009).

<sup>28</sup> See, for example, Financial Stability Forum, FSF Report on Enhancing Market and Institutional Resilience 8 (Apr. 2008) (noting that "[c]ompensation schemes in financial institutions encouraged disproportionate risk-taking with insufficient regard to longer-term risks"), at [http://www.financialstabilityboard.org/publications/r\\_0804.pdf](http://www.financialstabilityboard.org/publications/r_0804.pdf); L. Story, On Wall Street, Bonuses, Not Profits, Were Real, N.Y. TIMES, Dec. 18, 2008.

<sup>29</sup> See, for example, U.S. Chamber of Commerce, Letter to the Treasury Secretary, (Feb. 9, 2009) (suggesting that "corporate governance policies must promote long-term shareholder value and profitability but should not constrain reasonable risk-taking and innovation"), at <http://www.uschamber.com/NR/rdonlyres/ej2mxgcl4qbguyozahqba4xzsht7wyqxcdcjhsyfbvl4jwcurjanaskfm4up6xgxuf5c57ogplxt44shucmryo3ja/ExecutiveCompensationSecretaryGeithnerFeb62009.pdf>.

company. The proposed amendments would require a company to discuss and analyze its broader compensation policies and overall actual compensation practices for employees generally, including non-executive officers, if risks arising from those compensation policies or practices may have a material effect on the company.<sup>30</sup> In preparing this disclosure, we anticipate that companies will need to consider the level of risk that employees might be encouraged to take to meet their incentive compensation elements.<sup>31</sup> We believe that disclosure of a company's overall compensation policies in certain circumstances can help investors identify whether the company has established a system of incentives that can lead to excessive or inappropriate risk taking by employees.

Under the proposed amendments, the situations that would require disclosure will vary depending on the particular company and its compensation programs. We believe situations that potentially could trigger discussion and analysis include, among others, compensation policies and practices:

- At a business unit of the company that carries a significant portion of the company's risk profile;
- At a business unit with compensation structured significantly differently than other units within the company;
- At business units that are significantly more profitable than others within the company;
- At business units where the compensation expense is a significant percentage of the unit's revenues; or

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<sup>30</sup> See proposed Item 402(b)(2) of Regulation S-K. If a company had a policy against providing compensation that encouraged imprudent risk-taking, but actually provided compensation that encouraged such behavior and the effect may be material on the company, disclosure under the new provision would be required.

<sup>31</sup> To the extent that such risk considerations are a material aspect of the company's compensation policies or decisions for named executive officers, the company is required to discuss them as part of its CD&A under the current rules.

- That vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time.

This is a non-exclusive list of situations where compensation programs may have the potential to raise material risks to the company. These are only examples; disclosure under the proposed rule amendment would only be required if the materiality threshold is triggered.

We believe that discussion and analysis of a company's broader compensation policies may be appropriate in these situations because the policies may create risk to the company that is not otherwise apparent from a discussion solely focused on executive compensation policies. For example, if a particular business unit that carries a significant portion of the company's overall risk is significantly more profitable than others within the company, compensation policies relevant to employees of that unit could be just as essential to the company's overall financial condition and performance as those of its senior executives. Similarly, in situations where particular business units compensate their employees significantly differently from other units or carry an overall risk and reward structure that varies significantly from the rest of the company, provided the effects of the compensation policies may be material to the company, those differences should be disclosed and explained so that investors can more readily assess their significance and appropriateness.

Consistent with the principles-based approach of the CD&A, the proposed amendments provide several examples of the types of issues that would be appropriate for a company to discuss and analyze. We wish to emphasize, however, that the application of a particular example must be tailored to the facts and circumstances of the company and that the examples are non-exclusive. We believe that using illustrative examples will help to identify the types of

disclosure that may be appropriate. A company must assess the importance to investors of the information that is identified by the example in light of the particular situation of the company.

Examples of the issues that companies may need to address regarding the compensation policies or practices that may give rise to risks that may have a material effect on the company would include the following:

- The general design philosophy of the company's compensation policies for employees whose behavior would be most affected by the incentives established by the policies, as such policies relate to or affect risk taking by those employees on behalf of the company, and the manner of its implementation;
- The company's risk assessment or incentive considerations, if any, in structuring its compensation policies or in awarding and paying compensation;
- How the company's compensation policies relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;
- The company's policies regarding adjustments to its compensation policies to address changes in its risk profile;
- Material adjustments the company has made to its compensation policies or practices as a result of changes in its risk profile; and
- The extent to which the company monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees.

The level of detail required will necessarily depend on the particular facts at a company and within various business units of a company.

### Request for Comment

- Would expanding the scope of the CD&A to require disclosure concerning a company's overall compensation program as it relates to risk management and or risk-taking incentives provide meaningful disclosures to investors? Should the scope of the amendments be limited in application to specific groups of employees, such as executive officers? Should it be limited to companies of a particular size, like large accelerated filers? Should it be limited to particular industries like financial services, including companies that have segments in such industries? Is the cost of tracking and disclosing the nature of the risk different at different types of companies or company segments and if so, should that be reflected in our rules?
- In light of the complexity of the issue and compensation programs generally, we recognize that it may be difficult to identify and describe which compensation structures may expose a company to material risks. We believe the listed examples are situations where compensation policies may induce risk taking behavior, and therefore, potentially have a material impact on the company. Are the listed examples appropriate issues for companies to consider discussing and analyzing? Are there any other specific items we should list as possibly material information? Are there any items that are listed that should not be? If so, why?
- Should other elements of compensation that may encourage excessive risk taking be highlighted in the CD&A?
- We have included a list of examples of the types of issues that would be appropriate for a company to discuss and analyze. Is that list appropriate? Rather than treat the list as examples, should we require discussion of each item?

- Are there other disclosure requirements that would provide more meaningful information about the effect of the registrant's compensation policies on its risk profile or risk management?
- Are there certain risks that are more clearly aligned with compensation practices the disclosure of which would be important to investors?
- If a company determines that disclosure under the proposed amendments is not required, should we require the company to affirmatively state in its CD&A that it has determined that the risks arising from its broader compensation policies are not reasonably expected to have a material effect on the company?
- Should smaller reporting companies, who are currently not required to provide CD&A disclosure, be required to provide disclosure about their overall compensation policies as they relate to risk management?

## 2. Revisions to the Summary Compensation Table

The Item 402 amendments proposed today also would revise Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards to require disclosure of the aggregate grant date fair value of awards computed in accordance with FAS 123R.<sup>32</sup> The proposed revised disclosure would replace currently mandated disclosure of the dollar amount recognized for financial statement reporting purposes for the fiscal year in accordance with FAS 123R.<sup>33</sup>

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<sup>32</sup> Pursuant to FAS 168, the FASB Accounting Standards Codification has superseded all references to previous FASB standards for interim or annual periods ending on or after September 15, 2009. For purposes of facilitating comments, our proposals retain the well-known FAS 123R nomenclature. However, if we adopt the Summary Compensation Table and Director Compensation Table proposals, we expect in the final rules to update references accordingly.

<sup>33</sup> In proposing these changes to the Summary Compensation Table and Director Compensation Table, we do not suggest that recognizing share-based compensation costs over the periods during which employees perform the related services is an inappropriate measure for financial statement reporting. Instead, we simply acknowledge that

A significant objective of the broad executive compensation disclosure amendments we adopted in 2006 was to provide investors a single total figure that includes all compensation and is comparable across fiscal years and companies.<sup>34</sup> To accomplish this, we needed to include a dollar amount for option awards, which previously had been reported in the Summary Compensation Table as the number of securities underlying stock options granted.<sup>35</sup> When we initially adopted the 2006 amendments, we required Summary Compensation Table and Director Compensation Table disclosure of the aggregate grant date fair value of stock awards and option awards computed in accordance with FAS 123R, the same as we propose today.<sup>36</sup> Before those amendments became effective, however, we reconsidered the issue based on concerns that the actual amounts ultimately paid out could differ from the amounts initially reported in the tables. In December 2006, we adopted the current disclosure requirements for the stock award and option award columns as Interim Final Rules and solicited comment.<sup>37</sup> In the same rulemaking, we amended the Grants of Plan-Based Awards Table to require disclosure of the FAS 123R grant date fair value of the individual equity awards granted to named executive officers in the last completed fiscal year.<sup>38</sup>

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the aggregate grant date fair value measure is more useful to the users of executive compensation disclosure and would facilitate CD&A disclosure.

<sup>34</sup> See Release No. 33-8732A in note 24 above at 53170. We recognized that the timing for disclosing different elements of compensation in the Summary Compensation Table disclosure varies depending on the form of the compensation.

<sup>35</sup> See Release No. 33-6962 (Oct. 16, 1992) [57 FR 48126].

<sup>36</sup> See Release No. 33-8732A in note 24 above at 53172. This approach was consistent with the timing of option and stock awards disclosure that had applied in the Summary Compensation Table since 1992.

<sup>37</sup> See Release No. 33-8765 in note 24 above.

<sup>38</sup> Item 402(d)(2)(viii) of Regulation S-K.

Since the adoption of these current disclosure requirements, we have received comments from a variety of sources that the information that investors would find most useful and informative in the Summary Compensation Table and Director Compensation Table is the full grant date fair value of equity awards made during the covered fiscal year.<sup>39</sup> This is because investors may consider compensation decisions made during the fiscal year – which usually are reflected in the full grant date fair value measure, but not the financial statement recognition measure – to be material to voting and investment decisions.<sup>40</sup> Disclosure of full grant date fair value permits investors to better evaluate the amount of equity compensation awarded. Investors have noted that disclosure in the Summary Compensation Table of how much equity compensation the company decides to award during a fiscal year is more informative to voting and investment decisions than the dollar amount recognized for financial statement reporting purposes.<sup>41</sup> Investors have commented that because full grant date fair value is indicative of which executives the company intends to compensate most highly, it is a more useful measure to

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<sup>39</sup> See, for example, letters regarding File No. S7-03-06 from Ken Belcher (Dec. 28, 2006); Andrew H. Dral (Dec. 30, 2006); Council of Institutional Investors (Jan. 25, 2007); American Federation of Labor and Congress of Industrial Organizations (Jan. 29, 2007); Teachers Insurance and Annuity Association of America (Jan. 16, 2007); CALSTRS (Jan. 16, 2007); Leggett & Platt, Inc. (Apr. 23, 2007); and CFA Institute for Financial Market Integrity (Dec. 20, 2007). These comment letters are available at <http://www.sec.gov/rules/proposed/s70306.shtml>. In its May 5, 2009, meeting with the staff of the Division of Corporation Finance, the Joint Committee on Employee Benefits of the American Bar Association also recommended that we revise Summary Compensation Table disclosure of stock awards and option awards to report aggregate grant date fair value.

<sup>40</sup> See letter regarding File No. S7-03-06 from Council of Institutional Investors (Jan. 25, 2007) (stating that “the Summary Compensation Table should disclose the decisions of the compensation committee in the applicable year...[This] methodology is consistent with the objective of providing investors with the tools needed to evaluate the annual decisions of the compensation committee[.]”). See also letter regarding File No. S7-03-06 from Leggett & Platt, Inc. (Apr. 23, 2007) (stating that “[t]his is clearly the information most investors want”).

<sup>41</sup> See letter regarding File No. S7-03-06 from Teachers Insurance and Annuity Association of America (Jan. 16, 2007) (“Our view is that executive compensation disclosure and financial reporting are separate and distinct. We believe that reporting the aggregate fair value of awards in the Summary Compensation Table is important to give an accurate representation of the compensation committee’s actions and intentions in any given reporting period”). See also letter from American Federation of Labor and Congress of Industrial Organizations in note 39 above (“By spreading out the disclosure of the value of equity awards over a number of years, the total impact of executive compensation decisions will be concealed from shareholders and the public”).

include in the Summary Compensation Table as a component of total compensation.<sup>42</sup> Because total compensation is also the basis for determining which executives, in addition to the principal executive officer and principal financial officer, are the named executive officers whose compensation is reported,<sup>43</sup> the full grant date fair value measure will better align the identification of named executive officers with company compensation decisions. Summary Compensation Table disclosure of the full grant date fair value measure also can facilitate companies' ability to provide a CD&A that clearly and concisely explains and analyzes material compensation policies and decisions.<sup>44</sup>

Some companies have recognized the importance of full grant date fair value information to investors and have provided an "alternative" Summary Compensation Table – substituting full grant date fair value numbers in the Stock Awards and Option Awards columns – in addition to the Summary Compensation Table disclosure prescribed by the current rules.<sup>45</sup> Because companies generally consider the full grant date fair value of these awards in making compensation decisions, they may include such an "alternative" table in the CD&A to illuminate their decision making process. Some users of executive compensation disclosure also

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<sup>42</sup> See letter from American Federation of Labor and Congress of Industrial Organizations in note 39 above ("The methodology used to calculate total compensation in the Summary Compensation Table is extremely important to shaping behavior by compensation committees and investors. Shareholders will evaluate the disclosed total compensation figure when voting in director elections and when asked to ratify equity award plans. Directors will shape their executive compensation decisions to reflect these shareholder views. For this reason, the total compensation figure should represent the current decisions made regarding executive compensation in the most recent fiscal year.")

<sup>43</sup> Pursuant to Instruction 1 to Items 402(a)(3) and Instruction 1 to Item 402(m)(2), this determination is made by reference to total compensation for the last completed fiscal year.

<sup>44</sup> Summary Compensation Table disclosure of the dollar amount recognized for financial statement reporting purposes can frustrate this objective because it can result in lengthy, complex CD&A explanations of the FAS 123R recognition model. See The Corporate Counsel, Mar.-Apr. 2009, at 3-4.

<sup>45</sup> Some compensation experts have also suggested adding an alternative Summary Compensation Table if the mandated Summary Compensation Table "distorts" the compensation of an executive. See Frederick D. Lipman & Steven E. Hall, Executive Compensation Best Practices 50-52 (2008).

independently substitute grant date fair value information from the Grants of Plan-Based Awards Table for the financial statement recognition-based numbers disclosed in the Summary Compensation Table.<sup>46</sup>

Further, correlating Stock Awards and Option Awards disclosure to financial statement recognition can result in the disclosure of a negative number in the relevant column.<sup>47</sup> Such a negative number currently flows through to the Total Compensation column, reducing the amount of total compensation reported. Because decreases in stock price affect the financial reporting of the value of stock options, using the financial statement recognition measure to disclose stock and option awards can result in disclosure of negative total compensation to principal executive officers or principal financial officers, confusing investors.<sup>48</sup>

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<sup>46</sup> See Moody's Investors Service, *A User's Guide to the SEC's New Rules for Reporting Executive Pay* (Apr. 2007), available at [www.law.yale.edu/documents/pdf/CBL/AUsersGuidetotheSECPayDisclosures102762.pdf](http://www.law.yale.edu/documents/pdf/CBL/AUsersGuidetotheSECPayDisclosures102762.pdf), and ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=987914](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=987914)) ("Moody's uses the full Statement 123(R) grant date fair value of stock awarded and options granted, as disclosed in the grants of plan-based awards table, instead of the figures disclosed in the SCT stock awards and options awards columns.").

<sup>47</sup> Correlating Stock Awards and Option Awards reporting to financial statement recognition often can involve negative adjustments to the numbers reported. In particular:

- Awards classified as "liability awards" under FAS 123R (such as an award that is cash settled) are initially measured at grant date fair value, but for purposes of financial statement recognition are re-measured at each financial statement reporting date through the date the awards are settled.
- Under FAS 123R, compensation cost for awards containing a performance-based vesting condition is disclosed only if it is probable that the performance condition will be achieved. If achievement of the performance condition subsequently is no longer considered probable, the amount of compensation cost previously disclosed in the Summary Compensation Table is reversed in the period when it is determined that achievement of the condition is no longer probable.

In addition, pursuant to the Instruction to Item 402(c)(2)(v) and (vi) and the Instruction to Item 402(n)(2)(v) and (vi), the compensation cost reported for stock and option awards in the Summary Compensation Table does not include the estimate of forfeitures related to service-based vesting conditions used for FAS 123R financial statement recognition because this estimate is not considered meaningful in reporting the compensation of individual named executive officers. Instead, compensation cost for awards with service-based vesting is disclosed assuming that a named executive officer will perform the service required for the award to vest. If the named executive officer fails to do so and forfeits the award, the amount of compensation cost previously disclosed in the Summary Compensation Table is deducted in the period when the award is forfeited.

<sup>48</sup> See G. Morgenson, *Weird and Weirder Numbers on Pay Reports*, N.Y. TIMES, Mar. 11, 2007.

Because total compensation also determines identification of some named executive officers, where a company experiences significant volatility in its stock price, such as the significant decreases during 2008, the current rules may also cause the list of named executive officers to change more frequently from year to year due to factors unrelated to the company's compensation decisions.<sup>49</sup> This can potentially exclude from executive compensation disclosure executives that the company considers the most highly compensated based on its compensation decisions, including its decisions with respect to equity awards.<sup>50</sup> One reason for the adoption of the financial statement recognition model was the potential to distort identification of named executive officers when a single large grant, to be earned for services to be performed over multiple years, affects the list of named executive officers in the Summary Compensation Table, even though the executive may earn a consistent level of compensation over the award's term.<sup>51</sup> Our experience with the current rules, however, leads us to believe that it is more meaningful to shareholders if company compensation decisions – including the decision to grant such a large award – rather than factors unrelated to those decisions, cause the named executive officers to change.

A further significant reason for adopting the current rules was concern that disclosing the full grant date fair value would overstate compensation earned related to service rendered for the

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<sup>49</sup> See letter regarding File No. S7-03-06 from the HR Policy Association (Jan. 29, 2007) (“The Amended Rules also will increase the annual variability of the composition of the NEOs based on accounting rules rather than compensation programs. . . . Consistency with financial accounting does not justify re-introducing such variability into the table, especially with respect to a core element of compensation such as equity compensation that cannot be excluded in determining total compensation.”).

<sup>50</sup> See letter regarding File No. S7-03-06 from Ernst & Young (Jan. 29, 2007) (generally supporting the current rules yet stating that “[w]e recommend that the SEC adopt an approach that also excludes the effects of any negative amounts, regardless of their source in the determination of the NEOs. We believe that such an approach would result in more consistency from year to year in the identity of the NEOs included in the SCT. Further, the NEOs determined in this fashion would more likely be those executives that the compensation committee regards as the most highly compensated.”).

<sup>51</sup> See Release No. 33-8765 in note 24 above at 78340 (citing letter from Fenwick & West LLP).

year, and that actual amounts earned later could be substantially different.<sup>52</sup> However, companies have recognized that the current rules also have the potential to over-report compensation for a given year.<sup>53</sup> To the extent that both methods possess this potential, we believe that reporting based on the full grant date fair value method is more informative because it better reflects compensation decisions. If a company does not believe that full grant date fair value reflects a named executive officer's compensation, it can provide appropriate explanatory narrative disclosure.

While we continue to recognize that no one approach to disclosure of stock and option awards addresses all the issues regarding disclosure of equity compensation, our experience and the comment letters received since adoption of the current requirements lead us to believe that the goals of clear, concise and meaningful executive compensation disclosure would be better served by amending the Summary Compensation Table and Director Compensation Table to report stock awards and option awards based on aggregate grant date fair value. Among other things, because presentation of aggregate grant date fair value would include the incremental fair value of options repriced during the fiscal year, the effect of option repricings on total compensation would be clearer. Further, because smaller reporting companies do not provide a Grants of Plan-Based Awards Table, the current rules do not require them to provide any disclosure of the grant date fair value of awards made in the fiscal year (although they are

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<sup>52</sup> See Release No. 33-8765 in note 24 above. See also Release No. 33-8765, in note 24 above at 78340 (citing letters of U.S. Chamber of Commerce (Apr. 7, 2006); Ernst & Young LLP (Apr. 10, 2006)).

<sup>53</sup> See Frederick D. Lipman & Steven E. Hall in note 45 above (stating that "[w]hen shareholders look at the 'Total' column for a 2007 or a subsequent year proxy statement, the executive's compensation would include the allocable share of the 2005 option grant under FAS 123R. This figure could substantially inflate the 'Total' column for 2007 or subsequent years, leading unsophisticated shareholders or financial writers to the conclusion that this amount was received in 2007, when in fact the option grants were received in 2005. If 2007 were a particularly bad year financially for the company or for shareholders' stock values, there could be a hue and cry that this was another example of excessive CEO compensation").

currently required to provide the Summary Compensation Table). The proposals thus would make this information available to smaller reporting company investors.

The amendments we propose also would:

- Rescind the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table<sup>54</sup> and corresponding footnote disclosure<sup>55</sup> to the Director Compensation Table because these disclosures may be considered duplicative of the aggregate grant date fair value disclosure to be provided in the Summary Compensation Table under the proposals; and
- Amend Instruction 2 to the salary and bonus columns of the Summary Compensation Table to provide that registrants will not be required to report in those columns the amount of salary or bonus forgone at a named executive officer's election; and that non-cash awards received instead are reportable in the column applicable to the form of award elected. With this amendment, the Summary Compensation Table disclosure would reflect the form of compensation ultimately received by the named executive officer.<sup>56</sup>

Request for comment:

- Is the proposed Summary Compensation Table reporting of equity awards a better approach for providing investors clear, meaningful, and comparable executive compensation disclosure consistent with the objectives of providing concise analysis

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<sup>54</sup> See Item 402(d)(2)(viii) of Regulation S-K and Instruction 7 to Item 402(d).

<sup>55</sup> Current Instruction to Item 402(k)(2)(iii) and (iv) of Regulation S-K.

<sup>56</sup> This proposed amendment would apply to General Instruction 2 to Item 402(c)(2)(iii) and (iv) and General Instruction 2 to Item 402(n)(2)(iii) and (iv). The current versions of these Instructions, which require such forgone salary or bonus to be reported in the Salary or Bonus column, as applicable, were adopted in Release No. 33-8765 to reflect that the original terms of the award, which would have compensated the named executive officer in cash, are not within the scope of FAS 123R.

in CD&A and a clear understanding of total compensation for the year? Would the proposals facilitate better informed investment and voting decisions?

- The proposal contemplates that the Summary Compensation Table would report the aggregate grant date fair value of stock awards and option awards granted during the relevant fiscal year, just as the Grants of Plan-Based Awards Table reports each grant of an award made to a named executive officer in the last completed fiscal year. Should the Summary Compensation Table instead report the aggregate grant date fair value of equity awards granted for services in the relevant fiscal year, even if the awards were granted after fiscal year end? Explain why or why not. For example, could such an approach be applied in a manner inconsistent with the purposes of our compensation disclosure rules, for example by distorting the determination of named executive officers? If we change our approach with respect to the Summary Compensation Table, should the Grants of Plan-Based Awards Table be amended correspondingly to conform to the scope of awards reported in that table?
- If the Summary Compensation Table is amended as proposed, should the Grants of Plan-Based Awards Table disclosure of the full grant date fair value of each individual award be retained, rather than rescinded as proposed? Should the Grants of Plan Based Awards Table continue to disclose the incremental fair value with respect to individual awards that were repriced or otherwise materially modified during the last completed fiscal year? If so, why? If disclosure of grant date fair value of individual awards is retained, should it also be made applicable to smaller reporting companies?

- As described above, one reason for adopting the financial statement recognition model was the potential for distortion in identifying named executive officers when a single large grant, to be earned by services to be performed over multiple years, affects the list of named executive officers in the Summary Compensation Table, even though the executive earns a consistent level of compensation over the award's term. Are multi-year grants a common practice, so that they would introduce significant year-to-year variability in the list of named executive officers if the proposed amendments are adopted relative to the variability under the current rules? If so, how should our rules address this variability?
- Under the proposal, all stock and option awards would be reported in the Summary Compensation Table at full grant date fair value, including awards with performance conditions. Would the proposal discourage companies from tying stock awards to performance conditions, since the full grant date fair value would be reported without regard to the likelihood of achieving the performance objective? If the proposal is adopted, is any disclosure other than that already currently required (e.g., in the Compensation Discussion and Analysis, the Grants of Plan-Based Awards Table, and the Outstanding Equity Awards at Fiscal Year-End Table) needed to clarify that the amount of compensation ultimately realized under a performance-based equity award may be different?
- As proposed, Instruction 2 to the salary and bonus columns would be revised to provide that any amount of salary or bonus forgone at the election of a named executive officer pursuant to a program under which a different, non-cash form of compensation may be received need not be included in the salary or bonus column,

- but instead would need to be reported in the appropriate other column of the Summary Compensation Table. Should this approach cover elections to receive salary or bonus in the form of equity compensation only if the opportunity to elect equity settlement is within the terms of the original compensatory arrangement, so that the original arrangement is within the scope of FAS 123R? Why or why not?
- The Commission also has received a rulemaking petition requesting that we revise Summary Compensation Table disclosure of stock and option awards a different way.<sup>57</sup> Instead of reporting the aggregate grant date fair value of awards granted during the year, as we propose, the petition's suggested approach would report the annual change in value of awards, which could be a negative number if market values decline. For restricted stock, restricted stock units and performance shares, the reported amount would be the change in stock price from year-end to year-end. For stock options, it would be the change in the in-the-money value over the same period. Would the approach suggested by the rulemaking petition be easy to understand or difficult to understand? Would the information provided under the suggested approach be useful to investors? In particular, would investors be able to evaluate the decision making of directors with respect to executive compensation if the value of equity compensation on the date of the compensation decision is not disclosed, but instead investors are provided information regarding changes in value of the compensation, which changes occur after the compensation decision is made? Would it enhance or diminish the ability of companies to explain in CD&A the relationship between pay and company performance? Would it be more or less informative to

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<sup>57</sup> See May 26, 2009, rulemaking petition submitted by Ira T. Kay and Steven Seelig, Watson Wyatt Worldwide, File No. 4-585, at <http://www.scc.gov/rules/petitions/2009/petn4-585.pdf>.

voting and investment decisions than the aggregate grant date fair value approach we propose? Would it be a better measure for computing total compensation, including for purposes of identifying named executive officers? Are there any other ways of reporting stock and option awards that would better reflect their compensatory value? If so, please explain. For example, are there any potential amendments to the Grants of Plan-Based Awards Table or the Outstanding Equity Awards at Fiscal Year-End Table that we should consider to better illustrate the relationship between pay and company performance?

- The Summary Compensation Table requires disclosure for each of the registrant's last three completed fiscal years,<sup>58</sup> and with respect to smaller reporting companies, for each of the registrant's last two completed fiscal years.<sup>59</sup> Regarding transition, our goal is to facilitate year-to-year comparisons in a cost-effective way. To this end, we are considering whether to require companies providing Item 402 disclosure for a fiscal year ending on or after December 15, 2009 to present recomputed disclosure for each preceding fiscal year required to be included in the Summary Compensation Table, so that the Stock Awards and Option Awards columns would present the applicable full grant date fair values,<sup>60</sup> and Total Compensation would be recomputed correspondingly. If a person who would be a named executive officer for the most recent fiscal year (2009) also was disclosed as a named executive officer for 2007, but not for 2008, we expect to require the named executive officer's compensation for

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<sup>58</sup> See Item 402(c)(1) of Regulation S-K.

<sup>59</sup> See Item 402(n)(1) of Regulation S-K.

<sup>60</sup> This amount would be computed based on the individual award grant date fair values reported in that year's Grants of Plan Based Award Table.

each of those three fiscal years to be reported pursuant to the proposed amendments.<sup>61</sup> However, we would not require companies to include different named executive officers for any preceding fiscal year based on recomputing total compensation for those years pursuant to the proposed amendments or to amend prior years' Item 402 disclosure in previously filed Forms 10-K or other filings. Would recomputation of prior years included in the 2009 Summary Compensation Table to substitute aggregate grant date fair value numbers for the financial statement recognition numbers previously reported for those years cause companies practical difficulties? Is there a better approach that would preserve the objective of year-to-year comparability on a cost-effective basis as a transitional matter?

**B. Enhanced Director and Nominee Disclosure**

We are proposing amendments to Item 401 of Regulation S-K to expand the disclosure requirements regarding the qualifications of directors and nominees, past directorships held by directors and nominees, and the time frame for disclosure of legal proceedings involving directors, nominees and executive officers. Specifically, we are proposing to require disclosure detailing for each director and nominee for director the particular experience, qualifications, attributes or skills that qualify that person to serve as a director of the company as of the time that a filing containing this disclosure is made with the Commission, and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the company's business and structure.<sup>62</sup>

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<sup>61</sup> However, a smaller reporting company, which is required to provide disclosure only for the two most recent fiscal years, could provide Summary Compensation Table disclosure only for 2009 if the person was a named executive officer for 2009 but not for 2008.

<sup>62</sup> We last adopted substantive revisions to the disclosure concerning the background of directors, executive officers and control persons in 1984, when we amended Item 401 of Regulation S-K to require disclosure of legal

Item 401 currently requires only brief biographical information about directors and nominees for the past five years, and Item 407 requires general disclosure about director qualification requirements at a company. The proposed amendments to Item 401 would expand the information required about individual directors and supplement the current director qualification disclosures in Item 407 of Regulation S-K. These revisions are aimed at helping investors determine whether a particular director and the entire board composition is an appropriate choice for a given company as of the time that a filing containing this disclosure is made with the Commission.<sup>63</sup>

Companies today face ever-increasing challenges from the business and social environments in which they operate. As recent market events have demonstrated, the capacity to assess risk and respond to complex financial and operational challenges can be important attributes for directors of public companies. Moreover, developments such as the enactment of the Sarbanes-Oxley Act of 2002<sup>64</sup> and corporate-governance related listing standards of the major stock exchanges<sup>65</sup> also have brought about significant changes in the structure and composition of corporate boards, such as requiring directors to have particular knowledge in areas such as finance and accounting. We believe that the director qualification disclosure requirements in Item 407 have resulted in more general information being provided about the qualifications of

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proceedings involving federal commodities laws and applied the disclosure requirements to promoters and control persons of newly public companies. See Release No. 33-6545 (Aug. 9, 1984) [49 FR 32762].

<sup>63</sup> See, for example, Richard Leblanc & James Gillies, Inside the boardroom: How boards really work and the coming revolution in corporate governance, (2005) (noting that an effective board "must have a set of directors who collectively have all the competencies required by the board to fulfill its duties.").

<sup>64</sup> Pub. L. 107-204, 116 Stat. 745 (2002).

<sup>65</sup> In 2003, we approved revisions to the listing standards of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD") that, among other things, imposed new independent director requirements and enhanced independence standards. See Self-Regulatory Organizations; NYSE and NASD; Order Approving Proposed Rule Changes Relating to Corporate Governance, Release No. 34-48445 (Nov. 12, 2003) [68 FR 64154].

the board as a whole, but not more specific discussions of the background and skills of individual directors.

The proposed amendments are designed to provide investors with more meaningful disclosure to help them in their voting decisions by better enabling them to determine whether and why a director or nominee is a good fit for a particular company, and to allow companies flexibility in disclosing material information on the background and specific qualifications of each director and nominee, including information that goes beyond the five-year biographical requirement of Item 401. We are proposing that, for each director or nominee, disclosure be included that discusses the specific experience, qualifications or skills that qualify that person to serve as a director and committee member. The types of information that may be disclosed include, for example, information about a director's or nominee's risk assessment skills and any specific past experience that would be useful to the company, as well as information about a director's or nominee's particular area of expertise and why the director's or nominee's service as a director would benefit the company at the time at which the relevant filing with the Commission is made. This expanded disclosure would apply to incumbent directors, to nominees for director who are selected by a company's nominating committee, and to any nominees put forward by other proponents. Regardless of who has nominated the director, we believe a discussion of why the particular person is qualified to serve on the company's board would be useful to investors.

In addition to the expanded narrative disclosure regarding director and nominee qualifications, we are proposing two additional changes to our director and nominee biographical disclosure requirements. First, we are proposing to require disclosure of any directorships held by each director and nominee at any time during the past five years at public companies, and

second, we are proposing to lengthen the time during which disclosure of legal proceedings is required from five to 10 years. With respect to other directorships held by directors or nominees, Item 401 requires disclosure of any current director positions held by each director and nominee in any company with a class of securities registered pursuant to Section 12 of the Exchange Act,<sup>66</sup> or subject to the requirements of Section 15(d) of that Act,<sup>67</sup> or any company registered as an investment company under the Investment Company Act. We believe that expanding this disclosure to include membership on corporate boards of those companies for the past five years (even if the director or nominee no longer serves on that board) would allow investors to better evaluate the relevance of a director's or nominee's past board memberships, or professional or financial relationships that might pose potential conflicts of interest (such as membership on boards of major suppliers, customers, or competitors).

Item 401 requires disclosure of specified legal proceedings over the past five years involving directors, executive officers, and persons nominated to become directors that are material to an evaluation of the ability or integrity of any director, director nominee or executive officer.<sup>68</sup> In 1994, we proposed rules that would have increased the reporting period for legal

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<sup>66</sup> 15 U.S.C. 78l.

<sup>67</sup> 15 U.S.C. 78o(d).

<sup>68</sup> Under Item 401(f), the registrant must disclose any of the following events that occurred during the past five years and that are material to an evaluation of the director, director nominee or executive officer:

(1) A petition under Federal bankruptcy laws or any state insolvency law A petition under the Federal bankruptcy laws or any state insolvency law was filed by or against, or a receiver, fiscal agent or similar officer was appointed by a court for the business or property of such person, or any partnership in which he was a general partner at or within two years before the time of such filing, or any corporation or business association of which he was an executive officer at or within two years before the time of such filing;

(2) Such person was convicted in a criminal proceeding or is a named subject of a pending criminal proceeding (excluding traffic violations and other minor offenses);

proceedings from five to ten years.<sup>69</sup> Because the legal proceedings listed in Item 401 reflect upon an individual's competence and character to serve as a public company official, we believe it is appropriate to extend the required reporting period from five to ten years in order to give investors more extensive information regarding an individual's competence and character.<sup>70</sup>

The disclosures that would be required under the proposed amendments to Item 401 would appear in proxy and information statements on Schedules 14A and 14C, annual reports on Form 10-K and the registration statement on Form 10 under the Exchange Act, as well as in registration statements under the Securities Act.

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(3) Such person was the subject of any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining him from, or otherwise limiting, the following activities: (i) Acting as a futures commission merchant, introducing broker, commodity trading advisor, commodity pool operator, floor broker, leverage transaction merchant, any other person regulated by the Commodity Futures Trading Commission, or an associated person of any of the foregoing, or as an investment adviser, underwriter, broker or dealer in securities, or as an affiliated person, director or employee of any investment company, bank, savings and loan association or insurance company, or engaging in or continuing any conduct or practice in connection with such activity; (ii) Engaging in any type of business practice; or (iii) Engaging in any activity in connection with the purchase or sale of any security or commodity or in connection with any violation of Federal or State securities laws or Federal commodities laws;

(4) Such person was the subject of any order, judgment or decree, not subsequently reversed, suspended or vacated, of any Federal or State authority barring, suspending or otherwise limiting for more than 60 days the right of such person to engage in any activity described in paragraph (f)(3)(i) of this section, or to be associated with persons engaged in any such activity;

(5) Such person was found by a court of competent jurisdiction in a civil action or by the Commission to have violated any Federal or State securities law, and the judgment in such civil action or finding by the Commission has not been subsequently reversed, suspended, or vacated; or

(6) Such person was found by a court of competent jurisdiction in a civil action or by the Commodity Futures Trading Commission to have violated any Federal commodities law, and the judgment in such civil action or finding by the Commodity Futures Trading Commission has not been subsequently reversed, suspended or vacated.

The instruction to Item 401(f) indicates that if any event specified in Item 401(f) has occurred and information in a filing is omitted on the grounds that it is not material, the registrant may furnish to the Commission, at the time of filing, as supplemental information and not as part of the registration statement, report, or proxy or information statement, materials to which the omission relates, a description of the event and a statement of the reasons for the omission of the information.

<sup>69</sup> Release No. 33-7106 (Nov. 1, 1994) [59 FR 55385].

<sup>70</sup> Consistent with the current disclosure requirement regarding legal proceedings, the proceedings required to be disclosed under the proposal would not need to be disclosed if they are not material to an evaluation of the director or director nominee. See 17 CFR 229.401(f).

Currently, Item 407(c)(2)(v) of Regulation S-K requires disclosure of any specific minimum qualifications that a nominating committee believes must be met by a nominee for a position on the board.<sup>71</sup> We are interested in understanding whether investors and other market participants believe that diversity in the boardroom is a significant issue. As indicated below, we are requesting comment on whether additional disclosure in this area should be required.

We also are proposing to apply the expanded disclosure requirements regarding director and nominee qualifications, past directorships held by directors and nominees, and the time frame for disclosure of legal proceedings involving directors, nominees, and executive officers to management investment companies that are registered under the Investment Company Act ("funds"). We believe investors in funds would, for the same reasons as investors in operating companies, find this information useful. The proposal would amend the disclosures in Schedules 14A and 14C to apply these expanded requirements to fund proxy and information statements where action is to be taken with respect to the election of directors.<sup>72</sup> We are also proposing to amend Forms N-1A, N-2, and N-3 to require that funds include the expanded disclosures regarding director qualifications and past directorships in their statements of additional information.<sup>73</sup>

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<sup>71</sup> Management investment companies that are registered under the Investment Company Act are subject to the disclosure requirements of Item 407(c)(2)(v) of Regulation S-K pursuant to Item 22(b)(15)(ii)(A) of Schedule 14A. See 17 CFR 240.14a-101, Item 22(b)(15)(ii)(A). Management investment companies typically issue shares representing an interest in a changing pool of securities, and include open-end and closed-end companies. An open-end company is a management company that is offering for sale or has outstanding any redeemable securities of which it is the issuer. A closed-end company is any management company other than an open-end company. See Section 5 of the Investment Company Act [15 U.S.C. 80a-5].

<sup>72</sup> See proposed Item 22(b)(3)(i) of Schedule 14A (qualifications); proposed Item 22(b)(4)(ii) of Schedule 14A (directorships); proposed Item 22(b)(11) of Schedule 14A (legal proceedings).

<sup>73</sup> See proposed Items 17(b)(3)(ii) & 17(b)(10) of Form N-1A; proposed Items 18.6(b) & 18.17 of Form N-2; proposed Items 20(e)(ii) & 20(o) of Form N-3. Form N-1A is used by open-end management investment companies. Form N-2 is used by closed-end management investment companies. Form N-3 is used by separate accounts, organized as management investment companies, which offer variable annuity contracts.

## Request for Comment

- Would the proposed amendments provide investors with important information regarding directors and nominees for director? Are there any additional changes that we should make to further improve the disclosures about director and nominee qualifications?
- If Item 401 is amended as proposed, should the disclosure currently required by Item 407(c)(2)(v) of Regulation S-K regarding disclosure of any minimum qualifications that a nominating committee believes must be met by someone nominated by the committee for a position on the board, be retained? Does the disclosure elicited by Item 407(c)(2)(v) provide useful information that would supplement the information provided pursuant to the proposed amendment to Item 401?
- Should we amend Item 407(c)(2)(v) to require disclosure of any additional factors that a nominating committee considers when selecting someone for a position on the board, such as diversity? Should we amend our rules to require additional or different disclosure related to board diversity?
- Would director qualification disclosure for all of a company's board committees be useful to investors, or should the disclosures be focused on membership of certain key committees, such as the audit, compensation and nominating/governance committees?
- Should we require the proposed director qualification disclosure less frequently than annually? Even though the overall composition of a board may change, is it sufficient to require this disclosure only when a director is first nominated or periodically, such as every three years? Should the disclosure be required only when

the director is standing for election, or should it be required each year, as proposed, in order to facilitate shareholders' assessments of the quality of the board as a whole?

- Would it be helpful to investors if we required companies to list and describe all committees of the board similar to the current disclosure requirements for audit, compensation and nominating/governance committees? Would it also be helpful if we required disclosure of whether the board (or a committee) periodically conducts an evaluation of the performance of the board as a whole, the committees of the board and/or each individual director?
- Should we require disclosure of other directorships for more than the past five years? If so, for how long?
- Could requiring more director and nominee qualification disclosure in any way hinder a company's ability to find potential candidates for the board? If so, explain how.
- Should the current five-year disclosure period for legal proceedings be maintained? Should it be longer than proposed, for example for fifteen or twenty years? Should there be no time limit? Would it be more appropriate to require disclosure of legal proceedings for longer periods with respect to certain types of legal proceedings—for example, criminal fraud convictions, civil or administrative actions based on fraud involving securities, commodities, financial institutions, insurance companies or other businesses? If so, for what period or periods and why?
- Are there additional legal proceeding disclosures that reflect on a director's, executive officer's, or nominee's character and fitness to serve as a public company official that should be required to be disclosed? For example, should we expand the current requirements to require disclosure of:

- Any civil or administrative proceedings resulting from involvement in mail fraud, or wire fraud;
- Any judicial or administrative findings, orders or sanctions based on violations of federal or state securities, commodities, banking or insurance laws and regulations or any settlement to such actions;
- Any disciplinary sanctions imposed by a stock, commodities or derivatives exchange or other self-regulatory organization; or
- Situations where the director, nominee, or executive officer was a general partner of any partnership or served as a director or executive officer of any corporation subject to any federal or state agency receivership?
- Should we continue, as proposed, to permit companies to exclude disclosure of director, director nominee or executive officer legal proceedings, when the registrant concludes that the information would not be material to an evaluation of the ability or integrity of the director, director nominee or executive officer, or should this disclosure be required in all cases?
- Should we make any special accommodations in the proposed amendments to Item 401 for smaller reporting companies? If so, what accommodations should be made and why?
- Should the proposed amendments regarding director and nominee qualifications, past directorships held by directors and nominees, and the time frame for disclosure of legal proceedings apply to registered management investment companies? If so, where should each of the disclosures be required (e.g., proxy statements, statements of additional information, and/or shareholder reports)? Does the disclosure

requirement need to be modified in any way to make it more appropriate for registered management investment companies?

**C. New Disclosure about Company Leadership Structure and the Board's Role in the Risk Management Process**

We are proposing a new disclosure requirement to Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A that would require disclosure of the company's leadership structure and why the company believes it is the best structure for it at the time of the filing. This proposed disclosure would appear in proxy and information statements. Under the proposed amendments, companies also would be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions. In some companies, the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. Those companies would also be required to disclose whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. In proposing this requirement, we note that different leadership structures may be suitable for different companies depending on factors such as the size of a company, the nature of a company's business, or internal control considerations, among other things. Regardless of the type of leadership structure selected by a company, the disclosure would provide investors with insights about why the company has chosen that particular leadership structure.

In making voting and investment decisions, investors should be provided with meaningful information about the corporate governance practices of companies.<sup>74</sup> One important

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<sup>74</sup> See, for example, National Association of Corporate Directors, Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies, (Mar. 2009) ("Every board should explain, in proxy materials and

aspect of a company's corporate governance practices is its board's leadership structure. Our proposed amendments to Item 407 are not intended to influence a company's decision regarding its board leadership structure. Disclosure of board leadership structure and why the company believes this is the best structure will increase the transparency for investors into how boards function.

We also are proposing to require additional disclosure in proxy and information statements about the board's role in the company's risk management process. Companies face a variety of risks, including credit risk, liquidity risk, and operational risk. Similar to disclosure about the leadership structure of a board, disclosure about the board's involvement in the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company. Given the role that risk and the adequacy of risk oversight have played in the recent market crisis, we believe it is important for investors to understand the board's, or board committee's role in this area. For example, how does the board implement and manage its risk management function, through the board as a whole or through a committee, such as the audit committee?<sup>75</sup> Such disclosure might address questions such as whether the persons who oversee risk management report directly to the board as whole, to a committee, such as the audit committee, or to one of the other standing committees of the board; and whether and how the board, or board committee, monitors risk. We believe that this

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other communications with shareholders, why the governance structures and practices it has developed are best suited to the company.")

<sup>75</sup> Section 303A of the NYSE's Listed Company Manual provides that the audit committee of companies listed on the exchange must "discuss guidelines and policies to govern the process by which risk assessment and management is undertaken."

disclosure will provide key insights into how a company's board perceives and manages a company's risks.

We also are proposing that registered management investment companies provide the new Item 407 disclosure about leadership structure and the board's role in the risk management process in proxy and information statements.<sup>76</sup> Similar to the transparency provided to investors in corporate issuers, we believe that providing this disclosure to investors in investment companies should enable them to consider their management structure preference, if any, when deciding where to invest.<sup>77</sup> We have, however, tailored the proposal to the management structure of funds. Accordingly, we propose to require that a fund disclose whether the board chair is an "interested person" of the fund, as defined in Section 2(a)(19) of the Investment Company Act.<sup>78</sup> If the board chair is an interested person, a fund would be required to disclose whether it has a lead independent director and what specific role the lead independent director plays in the leadership of the fund. We are also proposing to require similar disclosure in statements of additional information filed as part of registration statements on Forms N-1A, N-2, and N-3.<sup>79</sup>

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<sup>76</sup> See proposed Item 22(b)(11) of Schedule 14A.

<sup>77</sup> In the context of this rulemaking, we believe it is appropriate to propose to require disclosure about fund management that is similar to the disclosure requirement for corporate issuers. In another context and for other purposes, the Commission previously considered a number of issues, including disclosure, regarding fund governance that we are not addressing here. See Investment Company Governance, File No. S7-03-04.

<sup>78</sup> 15 U.S.C. 80a-2(a)(19).

<sup>79</sup> See proposed Item 17(b)(1) of Form N-1A; proposed Item 18.5(a) of Form N-2; proposed Item 20(d)(i) of Form N-3. We are proposing to require this disclosure in the statement of additional information because not all funds hold annual meetings for the election of directors.

A large number of funds are organized as entities in jurisdictions which do not require funds to hold an annual shareholder meeting to elect directors. See, for example, Md. Code Ann., Corps. & Ass'ns Code § 2-501(b) (2009) (law exempts funds from annual meeting requirement in any year that the fund is not required to act upon the election of directors under the Investment Company Act); Del. Code Ann. tit. 12, § 3806 (2009) (statutory trust law structure has the effect of generally not requiring shareholder meetings). See also Sheldon A. Jones et al., The Massachusetts Business Trust and Registered Investment Companies, 13 DEL. J. CORP. L. 421 (1988) (noting that the organizational and operational requirements of Massachusetts business trusts are not specified by statute, and a fund's essential structure is contained in the trust agreement, which generally includes a provision eliminating the

## Request for Comment

- Are the proposed amendments to Item 407 appropriate? Are there additional disclosure requirements that should also be included in these proposed requirements?
- Are there certain considerations that would affect the company's leadership structure that should be highlighted in the proposed amendment? If so, explain.
- Are there any additional disclosures about a company's leadership that would be helpful to investors?
- Should we require disclosure of the specific duties performed by the board's chair or independent lead director?
- Should we require disclosure of other board structure matters, such as how a company determines the number of independent directors to have on its board, and/or how a company determines the size of the board?
- Are there competitive or proprietary concerns about the level of detail about the company's risk management structure and function that the proposed rule should account for? If so, please identify these concerns and explain how they should be accounted for.
- Should we make any special accommodations in these proposed amendments for smaller reporting companies? If so, what accommodations should be made and why?
- The proposals address risk management oversight by the board of directors as a part of the corporate governance disclosures required in proxy and information statements.

We are considering whether we should revise our existing disclosure requirements,

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need for annual shareholder meetings to elect directors). Closed-end funds registered on national securities exchanges, however, are required to hold an annual meeting to elect directors under the rules of the exchanges. See, for example, AMEX Company Guide §704; New York Stock Exchange Listed Company Manual §302.00.

such as in Items 303<sup>80</sup> and 305<sup>81</sup> of Regulation S-K, to require additional disclosure regarding a registrant's risk management practices in other registrant filings, such as annual and quarterly reports? Should we consider proposing additional requirements? If so, what additional or different disclosure requirements should we consider proposing?

- Should we, as proposed, require a registered management investment company to provide disclosure about its leadership structure and the board's role in the risk management process? Are there alternative disclosures relating to a fund's leadership structure and board involvement in the risk management process that would be more helpful to investors? If we require each of the disclosures, where should such disclosures appear (e.g., proxy statements, statements of additional information, and/or shareholder reports)?
- As proposed, funds would be required to include the proposed disclosure in registration statements filed on Forms N-1A, N-2, and N-3. Should we differentiate between open-end and closed-end funds? For example, should we omit this requirement from Form N-2 because closed-end funds generally hold annual shareholder meetings pursuant to exchange requirements and their shareholders will receive this disclosure in annual proxy or information statements?

#### **D. New Disclosure Regarding Compensation Consultants**

In 2003, we amended Regulation S-K to require new disclosures regarding compensation committees similar to the disclosures required regarding audit and nominating committees of the

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<sup>80</sup> 17 CFR 229.303.

<sup>81</sup> 17 CFR 229.305.

board of directors.<sup>82</sup> In addition, in 2006, we amended Item 407 to require registrants to describe, among other things, any role played by compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying such consultants, stating whether they are engaged directly by the compensation committee or any other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.<sup>83</sup>

Many companies engage compensation consultants to make recommendations on appropriate executive compensation levels, to design and implement incentive plans, and to provide information on industry and peer group pay practices.<sup>84</sup> These services can benefit companies, such as by providing management and the board current information about compensation trends or any regulatory requirements related to executive compensation.

The services offered by compensation consultants, however, are often not limited to recommending executive compensation plans or policies. Many compensation consultants, or their affiliates, provide a broad range of additional services, such as benefits administration, human resources consulting and actuarial services.<sup>85</sup> The fees generated by these additional services may be more significant than the fees earned by the consultants for their executive compensation services.<sup>86</sup> The provision of such additional services by compensation consultants

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<sup>82</sup> See Release No. 33-8340 (Nov. 24, 2003) [68 FR 69204].

<sup>83</sup> 17 CFR 229.407(e)(3)(iii).

<sup>84</sup> See, for example, J. Creswell, Pressing for Independent Advice from Consultants, N.Y. TIMES, Apr. 8 2007.

<sup>85</sup> See, for example, Rulemaking Petition No. 4-558 (May 12, 2008), at <http://www.sec.gov/rules/petitions.shtml>.

<sup>86</sup> In December 2007, the U.S. House of Representatives Committee on Oversight and Government Reform issued a report on the role played by compensation consultants at large, publicly-traded companies. The report found that the fees earned by compensation consultants for providing other services often far exceed those earned for advising on

or their affiliates may create the appearance, or risk, of a conflict of interest that may call into question the objectivity of the consultants' executive pay recommendations. Increasingly, some investors are becoming concerned that the executive compensation services provided by compensation consultants may be influenced by the provision of these additional services.<sup>87</sup>

Presently, companies are not required to disclose the fees paid to compensation consultants and their affiliates for executive compensation consulting or other services, or to describe services that are not related to executive or director compensation. We are proposing amendments to Item 407 of Regulation S-K to require disclosure about the fees paid to compensation consultants and their affiliates when they play any role in determining or recommending the amount or form of executive and director compensation, if they also provide other services to the company. In addition, the proposed amendments would require a description of any additional services provided to the company by the compensation consultants and any affiliates of the consultants. These disclosures are intended to enable investors to assess any incentives a compensation consultant may have in recommending executive compensation and better assess the compensation decisions made by the board.

Under the proposed amendments to Item 407, if a compensation consultant or its affiliates played a role in determining or recommending the amount or form of executive or

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executive compensation, and that on average companies paid compensation consultants over \$2.3 million for other services and less than \$220,000 for executive compensation advice. See Staff of House Comm. on Oversight and Government Reform, 110<sup>th</sup> Cong., Report on Executive Pay: Conflicts of Interest Among Compensation Consultants (Comm. Print 2007).

<sup>87</sup> See Rulemaking Petition No. 4-558 in note 85 above. See also letters regarding File No. S7-03-06 from CalPERS, CalSTRS, New York State Common Retirement System, Florida State Board of Administration, New York City Pension Funds, PGGM, ABP, Hermes, Universities Superannuation Scheme, UniSuper, London Pensions Fund Authority, F&C Asset Management, Co-operative Insurance Society, Illinois State Board of Investment, Ontario Teachers Pension Plan, Public Sector and Commonwealth Super, and Railpen Investments (Apr. 10, 2006); CFA Institute for Financial Market Integrity (Apr. 13, 2006); and Denise Nappier, Connecticut State Treasurer (Apr. 10, 2006) at <http://www.sec.gov/rules/proposed/s70306.shtml>.

director compensation, and also provided additional services, then the company would be required to disclose the following:<sup>88</sup>

- The nature and extent of all additional services provided to the company or its affiliates during the last fiscal year by the compensation consultant and any affiliates of the consultant;
- The aggregate fees paid for all additional services, and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation;
- Whether the decision to engage the compensation consultant or its affiliates for non-executive compensation services was made, recommended, subject to screening or reviewed by management; and
- Whether the board of directors or the compensation committee has approved all of these services in addition to executive compensation services.

These new requirements would apply to all services provided by a compensation consultant and its affiliates if the compensation consultant plays any role in determining or recommending the amount or form of executive or director compensation. The proposed amendments would not apply to those situations in which the compensation consultant's only role in recommending the amount or form of executive or director compensation is in connection with consulting on broad-based plans that do not discriminate in favor of executive officers or directors of the company, such as 401(k) plans or health insurance plans. For example, if a company retains a compensation consultant to assist it in developing a 401(k) plan in which all salaried employees, including executives, will be eligible to participate on the same terms, and

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<sup>88</sup> See proposed Item 407(e)(3)(iii) of Regulation S-K.

the compensation consultant provides other services to the company that are not related to determining or recommending the level of executive or director compensation, the new disclosure requirements would not apply to the services provided by that compensation consultant.<sup>89</sup> When a compensation consultant's only services that touch on the form or amount of executive or director compensation are limited to broad-based, non-discriminatory plans, even though executives or directors may be eligible to participate in them, we do not believe that these services give rise to the type of potential conflict of interest intended to be addressed by our proposed revisions.<sup>90</sup>

#### Request for Comment

- Will this disclosure help investors better assess the role of compensation consultants and potential conflicts of interest, and thereby better assess the compensation decisions made by the board?
- Would the disclosure of additional consulting services and any related fees adversely affect the ability of a company to receive executive compensation consulting or non-executive compensation related services? If so, how might we achieve our goal while minimizing that impact?
- Are there competitive or proprietary concerns that the proposed disclosure requirements should account for? If so, how should the amendments account for them if the compensation consultant provides additional services?

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<sup>89</sup> On the other hand, if a consultant provides other services involving executive or director compensation, and also provides services regarding broad-based, non-discriminatory plans, the new disclosure requirements would be applicable to all services provided by the consultant or its affiliates.

<sup>90</sup> We also propose to amend Item 407 along the same lines to clarify that the existing disclosure requirements are not triggered for a compensation consultant whose only services with regard to executive or director compensation are limited to these types of broad-based, non-discriminatory plans.

- Are there additional disclosures regarding the potential conflicts of interest of compensation consultants that should be required? For example, would requiring disclosure of any ownership interest that an individual consultant may have in the compensation consultant or any affiliates of the compensation consultant that are providing the additional services to the company help provide information about potential conflicts? If so, why?
- The proposed disclosure requirement calls for disclosure of services during the prior year. Should we also require disclosure of any currently contemplated services in order to capture a situation where the compensation consultant provides services related to executive pay in one year and in the next year receives fees for other services? If so, should we require that fees for the currently contemplated services be estimated? Is there a better way to require that information, for instance through the date of the filing? Should we require disclosure for the prior three years?
- Is the proposed exclusion for consulting services that are limited to broad-based, non-discriminatory plans appropriate? Should we consider any other exclusions for services that do not give rise to potential conflicts of interest? If so, describe them.
- Should we establish a disclosure threshold based on the amount of the fees for the non-executive compensation related services, such as above a certain dollar amount or a percentage of income or revenues? If so, how should the threshold be computed?
- Would disclosure of the individual fees paid for non-executive compensation related services provided by the compensation consultants be more useful to investors than disclosure of the aggregate fees paid for non-compensation related service provided as proposed?

- Would disclosure about the fees paid to compensation consultants and their affiliates help highlight potential conflicts of interest on the part of these compensation consultants and their affiliates? Is fee disclosure necessary to achieve this goal, or would it be sufficient to require disclosure of the nature and extent of additional services provided by the compensation consultant and its affiliates? Should disclosure only be required for fees paid in connection with executive compensation related services?
- Should we make any special accommodations in the proposed amendments to Item 407(h) for smaller reporting companies? If so, what accommodations should be made and why?
- Are there other categories of consultants or advisors whose activities on behalf of companies should be disclosed to shareholders? If so, what kind of disclosure would be appropriate?

**E. Reporting of Voting Results on Form 8-K**

We are proposing to transfer the requirement to disclose vote results from Forms 10-Q and 10-K to Form 8-K. Currently, Item 4 in Part II of Form 10-Q and Item 4 in Form 10-K require the disclosure of vote results of any matter that was submitted to a vote of shareholders during the fiscal quarter covered by either the Form 10-Q or Form 10-K with respect to the fourth fiscal quarter. Under the proposals, we would add a new Item 5.07 to Form 8-K to require a company to disclose on the Form 8-K the results of a shareholder vote, and to have that information filed within four business days after the end of the meeting at which the vote was held. If the proposal is adopted, we would delete the requirement from Forms 10-Q and 10-K.

We believe that more timely disclosure of the voting result of an annual or special meeting would benefit investors and the markets. While quarterly and annual reports generally

reflect historical information, we are concerned that the delay between the end of an annual or special meeting and when the voting result of the meeting is disclosed in a Form 10-Q or 10-K may make the information less useful to investors and the markets. Depending on the date of the shareholder meeting, it could take a few months before the vote is disclosed in a Form 10-Q or 10-K. Because matters submitted for a shareholder vote at an annual or special meeting often involve issues that directly impact shareholder interests -- for example, the composition of the board, executive compensation policies, or changes in shareholder rights -- we believe more timely disclosure of those voting results is appropriate. In short, we believe that if a matter is important enough to submit to a vote at a meeting of shareholders, it likely is important enough to warrant current reporting of the results on Form 8-K.

We understand that technological advances in shareholder communications and the growing use of third-party proxy services have increased the ability of companies to tabulate vote results and disseminate this information on a more expedited basis than is currently required. However, we recognize that in situations such as contested elections, companies may not have definitive vote results within four business days after the meeting. We have included an instruction to the proposed item that states that if the matter voted upon at the meeting relates to a contested election of directors and the voting results are not definitively determined at the end of the meeting, companies should disclose on Form 8-K the preliminary voting results within four business days after the preliminary voting results are determined, and file an amended report on Form 8-K within four business days after the final voting results are certified. We think it is important for investors to have at least preliminary voting results because the certification process may take a longer amount of time.

## Request for Comment

- To what extent would requiring the reporting of voting results on Form 8-K provide more timely information to investors and the markets?
- Are there any possible adverse consequences to requiring the disclosure of preliminary voting results in a contested election when the outcome is not final? For example, could the preliminary disclosure affect the final outcome?
- Should the filing period under Form 8-K for the reporting of voting results be longer than four business days? Should we require the reporting of preliminary voting results? Are there unique difficulties or significant costs in finalizing voting results at smaller reporting companies that would warrant a longer filing period for those companies? What factors should we consider in deciding whether to make the filing period longer? Are there situations other than contested elections that might warrant a longer filing period?
- Are there alternative methods to disseminate this information to investors sooner or within a similar time frame that would be more effective or appropriate?
- We are moving and accelerating the disclosure requirement but not proposing any other revisions to the disclosures that are currently required by Item 4 of Form 10-Q and Form 10-K. Are there any changes to the requirements as to what should be disclosed that we should consider? For instance, since disclosure must be provided for all matters voted, on including a separate tabulation for the election of each director, should we eliminate the portion of Instruction 4 that provides when paragraph (b) need not be answered?

- Would the proposal impose any significant costs or difficulties on companies? If so, what type and amount of costs? Are these short-term or one-time costs to adjust a company's reporting procedures, or long-term, ongoing costs?
- Would the proposal create any special burdens for smaller reporting companies? If so, would scaled disclosure be appropriate for these companies and how should it be accomplished? Alternatively, should these requirements be phased in for smaller reporting companies?
- Would the accuracy of disclosure of voting results be affected as a result of a Form 8-K filing requirement?
- Section 13a-11(c) under the Exchange Act provides that "[n]o failure to file a report on Form 8-K that is required solely pursuant to Item 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e) or 6.03 of Form 8-K shall be deemed to be a violation of" Section 10(b) of the Exchange Act or Rule 10b-5 thereunder. Should we amend Section 13a-11(c) to include proposed Item 5.07 in this list of Items with respect to which the failure to file a report on Form 8-K will not be deemed to be a violation of Section 10(b) or Rule 10b-5? Similarly, should we amend General Instruction I.A.3(b) of Form S-3 to add proposed Item 5.07 to the corresponding list of Items on Form 8-K with respect to which a company's failure timely to file the Form 8-K will not result in the loss of S-3 eligibility? Why or why not?

**F. Proxy Solicitation Process**

We are proposing revisions to our rules governing the proxy solicitation process to provide clarity and address issues that have arisen. We believe these proposals, if adopted,

would provide greater certainty to soliciting parties, help shareholders receive timely and complete information and facilitate shareholder voting.

Specifically, the amendments would provide that:

- an unmarked copy of management's proxy card that is requested to be returned directly to management is not a "form of revocation" under Exchange Act Rule 14a-2(b)(1)<sup>91</sup> so that a person who furnishes such a duplicate proxy card is not disqualified from relying on the exemption provided by that rule;
- a person need not be a security holder of the class of securities being solicited and a benefit need not be related to or derived from any security holdings in the class being solicited for Exchange Act Rule 14a-2(b)(1)(ix)<sup>92</sup> to disqualify the person from relying on the Exchange Act Rule 14a-2(b)(1) exemption;
- a person soliciting in support of nominees who, if elected, would constitute a minority of the board may seek authority to vote for another soliciting person's nominees in addition to or instead of the issuer's nominees to round out its short slate consistent with Exchange Act Rule 14a-4(d)(4)'s limitations on proxy authority;<sup>93</sup>
- the "reasonable specified conditions" under which the shares represented by a proxy will not be voted under Exchange Act Rule 14a-4(e) must be objectively determinable;<sup>94</sup> and

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<sup>91</sup> 17 CFR 240.14a-2(b)(1).

<sup>92</sup> 17 CFR 240.14a-2(b)(1)(ix).

<sup>93</sup> 17 CFR 240.14a-4(d)(4).

<sup>94</sup> 17 CFR 240.14a-4(e).

- the participant information required by Exchange Act Rule 14a-12(a)(1)(i)<sup>95</sup> must be filed under cover of Schedule 14A in a proxy statement or other soliciting materials no later than the time the first soliciting communication is made.

**1. Exchange Act Rule 14a-2(b)(1) Introductory Text**

Exchange Act Rule 14a-2(b)(1) exempts from the generally applicable disclosure, filing and most other requirements of the proxy rules solicitations by shareholders or other non-management parties who are not seeking proxy authority and do not have a substantial interest in the subject matter of the solicitation. When the Commission adopted this rule in 1992, we stated that the purpose of the rule was to remove obstacles to the free and unrestrained expression of views by disinterested shareholders who do not seek authority for themselves.<sup>96</sup> Accordingly, the exemption is unavailable to, among others, a person who “furnish[es] or otherwise request[s], or act[s] on behalf of a person who furnishes or requests, a form of revocation.”<sup>97</sup>

Over time, questions have arisen related to the scope of the term “form of revocation,” in particular, whether a person otherwise qualified to rely on the exemption would be providing a “form of revocation” and, therefore, be ineligible to rely on the exemption if the person provided a solicited shareholder with an unmarked copy of management’s proxy card and asked that the card be returned directly to management. Consistent with the purpose underlying the exemption, we believe that a person providing a solicited shareholder with an unmarked copy of management’s proxy card requested to be returned directly to management would not be seeking authority for itself.<sup>98</sup> As a result, this action would not be providing a “form of revocation”

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<sup>95</sup> 17 CFR 240.14a-12(a)(1)(i).

<sup>96</sup> 1992 adopting release in note 23 above.

<sup>97</sup> Exchange Act Rule 14a-2(b)(1).

<sup>98</sup> Indeed, the soliciting person has not foreclosed any voting option available to the shareholder.

within the meaning of the rule even if a solicited shareholder's use of that proxy card resulted in a revocation of the shareholder's prior vote. We acknowledge that the U.S. Court of Appeals for the Second Circuit has concluded that in the case of a proxy vote to authorize a proposed merger under Delaware law, a duplicate of management's proxy card, when included in a mailing opposing a proposed merger, was a form of revocation under the rule.<sup>99</sup>

We propose to clarify the rule to align with our view by amending it to provide expressly that a "form of revocation" does not include an unmarked copy of management's proxy card that the soliciting shareholder requests be returned directly to management.<sup>100</sup> This amendment would aid efforts by persons not seeking proxy authority to facilitate voting by shareholders sharing their views on matters submitted for shareholder approval—such as in a "just vote no" campaign—without having to incur the costs and efforts of conducting a fully-regulated proxy solicitation and provide shareholders a convenient opportunity to indicate their votes after hearing those views without having to request another proxy card from management.<sup>101</sup>

#### Request for Comment

- Is the proposed amendment appropriate, or should a form of proxy provided in this setting be treated as a form of revocation, thereby disqualifying the soliciting person from relying upon the exemption?

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<sup>99</sup> See Mony Group, Inc. v. Highfields Capital Mgmt. L.P., 368 F.3d 138 (May 13, 2004). The Second Circuit reversed the district court's decision that, consistent with the staff's views, the unmarked copy of management's proxy card was not a "form of revocation" within the meaning of Exchange Act Rule 14a-2(b)(1). See Mony Group, Inc. v. Highfields Capital Mgmt. L.P., 2004 U.S. Dist. LEXIS 1840 (S.D.N.Y., Feb. 11, 2004).

<sup>100</sup> This clarification is consistent with advice the staff informally has provided in response to related inquiries since the rule was adopted.

<sup>101</sup> Providing shareholders with a marked copy of a proxy card would be inconsistent with the availability of the Rule 14a-2(b)(1) exemption because it would be an attempt to indirectly solicit proxy authority. Providing shareholders with a marked copy of a proxy card in a non-exempt solicitation would be impermissible because it would violate the requirement of Rule 14a-4(b) [17 CFR 240.14a-4(b)] to provide shareholders the opportunity to specify a choice.

- Should a soliciting person that provides an unmarked copy of management's proxy card be required to file a Notice of Exempt Solicitation<sup>102</sup> even if the person does not meet the thresholds for filing such notice under Exchange Act Rule 14a-6(g)?<sup>103</sup>  
Should such a soliciting person be required to file and provide to solicited persons any other information about itself, such as any relationships with the registrant or its affiliates, the amount of shares it holds, whether such person intends to hold its shares through the date of the meeting at which the vote will take place, or other information?
- Should the determination as to whether an unmarked management proxy card is a "form of revocation" depend on whether a non-management soliciting person requests that shareholders return the proxy card directly to management, as proposed, or should this treatment be available even if the card is returned to the soliciting person?
- Would the proposed amendment have an effect on shareholder communications in general or the practices of shareholders and companies with regard to unmarked proxy cards in particular?
- Would the proposed amendment raise concerns under applicable state law?

2. **Exchange Act Rule 14a-2(b)(1)(ix)**

Exchange Act Rule 14a-2(b)(1)(ix) provides that the Rule 14a-2(b)(1) exemption is not available to "[a]ny person who, because of a substantial interest in the subject matter of the solicitation, is likely to receive a benefit from a successful solicitation that would not be shared

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<sup>102</sup> 17 CFR 240.14a-103.

<sup>103</sup> 17 CFR 240.14a-6(g).

pro rata by all other holders of the same class of securities, other than a benefit arising from the person's employment with the registrant." A question has arisen as to whether this limitation applies only when both the person is a security holder of the class being solicited and the benefit relates to or is derived from such holdings, or is generally applicable to any person with a substantial interest as described in the rule. We believe the nature of the "substantial interest" contemplated by the rule is broader, and propose to amend the rule to clarify this point.<sup>104</sup>

If a soliciting person has a substantial interest in the matter, we believe shareholders should have the benefit of the disclosure required by our rules when deciding how to vote. We do not believe it is appropriate to limit this disclosure obligation to cases when the soliciting party is a shareholder.<sup>105</sup> Otherwise, a solicited holder may not have sufficient information to make an informed voting decision if the holder is not aware of the soliciting person's substantial interest in the matter. Consistent with our intent to limit the exemption to disinterested persons and to provide clarity and certainty to those wishing to rely on the exemption, we propose to amend the rule to clarify that a person need not be a security holder of the class of securities being solicited and a benefit need not be related to or derived from any security holdings in the class being solicited for a person to be disqualified from relying on the exemption.

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<sup>104</sup> In adopting this provision, the Commission noted in the 1992 adopting release that the substantial interest "standard is similar to that used in Item 5 of Schedule 14A, which requires specified persons conducting solicitations to describe briefly any substantial interest in the matter to be acted upon, other than an interest as a shareholder." Specifically, Item 5 required at the time of the 1992 adopting release and requires now a description of "any substantial interest, direct or indirect, by security holdings or otherwise, . . . in any matter to be acted upon, other than elections to office."

<sup>105</sup> For example, a soliciting party could have a significant financial interest in the subject matter of a solicitation without owning any shares of the company whose shareholders are solicited if the solicitation relates to a merger with a company that the soliciting party wishes to acquire.

### Request for Comment

- Does the proposed amendment clearly specify when the Rule 14a-2(b)(1) exemption would be unavailable? Is additional detail necessary to understand when the exemption would be unavailable? If so, please provide examples of details that would be helpful.
- Would the proposed amendment inappropriately narrow or broaden the scope of the Rule 14a-2(b)(1) exemption and, if so, how?

### 3. **Exchange Act Rule 14a-4(d)(4)**

Exchange Act Rule 14a-4(d)(1) requires that, in order to solicit authority to vote for the election of a person to office, the person must be a bona fide nominee who consents to being named in the soliciting person's proxy statement and to serving if elected. Exchange Act Rule 14a-4(d)(4) is an exception to the bona fide nominee requirement. This exception permits a person soliciting support for nominees who, if elected, would constitute a minority of the board of directors (commonly referred to as a "short slate"), to round out its short slate of nominees up to the total number of director positions then subject to election by seeking authority to vote for nominees named in the registrant's proxy statement.<sup>106</sup> We adopted the exception in 1992 to permit a form of proxy that allows persons soliciting in support of a short slate to exercise their state law right to nominate and run independently their own nominees and vote for both company and shareholder nominees.<sup>107</sup> The current form of the rule expressly permits rounding out a short slate by seeking authority to vote for nominees named in the registrant's proxy statement, but does not address nominees named in other soliciting persons' proxy statements.

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<sup>106</sup> See Exchange Act Rule 14a-4(d)(4).

<sup>107</sup> 1992 adopting release in note 23 above at 48288.

Recently, however, questions have arisen regarding non-management groups that each sought to solicit support of a short slate and wished to round out its short slate with nominees named in the other group's and the registrant's proxy statement.<sup>108</sup> We propose to revise the rule so the short slate rounding exception to the bona fide nominee requirement is available whether a non-management soliciting person attempts to round out its short slate by seeking authority to vote for nominees named in the registrant's or any other persons' proxy statements.

Our intention in adopting the short slate exception was to eliminate unnecessary impediments to short slate elections and ameliorate "the difficulty experienced by shareholders in gaining a voice in determining the composition of the board of directors," especially those seeking minority representation.<sup>109</sup> We recognized the need to address an unintended consequence of the "bona fide nominee" rule that effectively forced security holders to choose between voting for the management slate in order to exercise their full voting rights or voting for a less than full complement of directors.<sup>110</sup> Under the current rule, however, only the registrant's nominees may be used to fill out the non-management slate and, as a result, are effectively advantaged, as security holders may vote for them on two or more proxy cards where non-management nominees can only be voted for on one. To modify the rule as we propose is, therefore, consistent with our intention in adopting the rule.

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<sup>108</sup> See Eastbourne Capital, L.L.C., SEC No-Action Letter (Mar. 30, 2009) and Icahn Associates Corp., SEC No-Action Letter (Mar. 30, 2009) at <http://www.sec.gov/divisions/corpfin/cf-noaction.shtml>. The Division issued a letter to each of two non-management groups stating that, based on the facts and representations presented, and conditioned on the two groups' acting and continuing to act independently of each other, the Division would not recommend enforcement action under Exchange Act Rule 14a-4(d)(4) and Section 14(a) of the Exchange Act [15 U.S.C. 78m(a)] if the group solicited votes for its own short slate and sought the authority to round out its short slate by voting for nominees of the other group as well as management's nominees. While the Division would continue to consider issuing such letters in the absence of the adoption of the proposed amendment, only the parties to whom the letters were addressed can rely upon them.

<sup>109</sup> 1992 adopting release in note 23 above at 48288.

<sup>110</sup> 1992 adopting release in note 23 above at 48287-48288.

The proposed exception would be available only when non-management parties are not acting together. Persons acting together may incur reporting obligations under Sections 13(d)<sup>111</sup> and 13(g)<sup>112</sup> of the Exchange Act. In this regard, a non-management person who actively recommends or whose proxy solicitor actively recommends nominees in addition to those for whom the non-management person expressly solicits support would be considered to be soliciting in support of both sets of nominees for purposes of determining whether the non-management person were soliciting in support of nominees who, if elected, would constitute more than a minority of the board.<sup>113</sup> Similarly, a non-management person would be considered to be soliciting in support of not only the nominees for whom it expressly solicits support but also the nominees for whom any other non-management person solicits support if the non-management persons are not acting independently of one another. Accordingly, a non-management soliciting person that seeks to round out its short slate with any nominee named in another non-management person's proxy statement would be required by the proposed rule to represent in its proxy statement that it has not agreed and will not agree to act, directly or indirectly, as a group or otherwise engage in any activities that would be deemed to cause the formation of a group as determined under Section 13(d)(3)<sup>114</sup> and in Regulation 13D-G<sup>115</sup> with the other non-management person.

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<sup>111</sup> 15 U.S.C. 78m(d).

<sup>112</sup> 15 U.S.C. 78m(g).

<sup>113</sup> A non-management person and its proxy solicitor would not be actively recommending nominees in addition to those for whom the person expressly solicits support if the person and proxy solicitor only state the person's intention to vote for another person's nominees or expected nominees other than those specifically named on the person's proxy card.

<sup>114</sup> 15 U.S.C. 78m(d)(3).

<sup>115</sup> 17 CFR 240.13d-1 et seq.

When a non-management person actively recommends or solicits proxies in support of another person's nominees in addition to those for whom the person expressly solicits support and identifies by name in its proxy statement, that person may be a participant within the meaning of Instruction 3(a)(vi) to Item 4 of Schedule 14A in the other person's solicitation. Being a participant in the other person's solicitation potentially may result in the person soliciting in support of a total number of persons that would not constitute a minority of the board of directors if elected. Therefore, a non-management soliciting person that seeks to round out its short slate with any nominee named in another non-management person's proxy statement would also be required by the proposed rule to represent in its proxy statement that it is not a participant in the other non-management person's solicitation.

Request for Comment

- Are there different policy or practical concerns we should take into consideration when a short slate is rounded out with other persons' nominees rather than with the registrant's nominees alone? Would the proposed amendment increase the risk that a person would attempt to appear to be eligible for the short slate rounding exception even though the person, as a practical matter, was alone, or in combination with one or more other non-management persons, soliciting in support of more than a short slate? Are there appropriate safeguards in the rule to address this concern?
- As proposed, amended Exchange Act Rule 14a-4(d)(4) would only permit a soliciting person to round out a short slate with both a registrant's and other persons' nominees so long as the soliciting person does not form a group with the other persons as determined under Section 13(d)(3) and in Regulation 13D-G and is not a participant in the other persons' solicitations. Are these restrictions appropriate? Should Rule

14a-4(d)(4) impose other conditions or limitations on the availability of the proposed amendment to the short slate exception? For example, should a soliciting person be permitted to seek authority to vote for the nominees of other non-management persons only if the other non-management persons are seeking minority representation on the board? Should the Commission limit use of the rule to situations where a soliciting person will need to use its proxy authority to vote for one or more of the registrant's nominees? For example, should it be limited to require a soliciting person to use its proxy authority to vote for at least a specified number of the registrant's nominees or at least the number of management nominees that would constitute a majority?

- It is possible that permitting a soliciting person to round out its short slate with other persons' nominees instead of or in addition to a registrant's nominees under amended Rule 14a-4(d)(4), as proposed, could lead to a change in a majority of a board. What are the concerns, if any, about the possible effects of a change in a majority of a board, including the triggering of takeover defensive measures, such as poison pills, and other change in control provisions, such as those found in loan agreements, leases and employment agreements? What are the issues, if any, associated with a change in a majority of a board where a company is subject to the standards of a national securities exchange or a national securities association, including exchange rules regarding director independence and board and committee composition standards?
- Would the proposed amendment encourage shareholders to run more short slates? In particular, is it likely that such shareholders will run more short slates, possibly targeting particular companies, knowing that other shareholders may also run short

slates, with the intent that, where another shareholder targets the same company, each shareholder can then round out its own short slate with one or more nominees from the other shareholder's slate, and thus increase the likelihood of displacing management nominees and potentially increasing each shareholder's negotiating power with management? Does the proposed rule adequately prevent shareholders from relying upon the provision when they are acting in concert with other shareholders? While the current rule distinguishes between a person soliciting support for its nominees named in its proxy statement and seeking proxy authority to vote for a registrant's nominees, does a meaningful difference exist between these actions if a soliciting person is permitted, as proposed, to round out its slate with a non-management person's nominees?

- The amended rule, as proposed, would require a person to include in its proxy statement representations regarding the restrictions on forming a group and acting as a participant. Are these representations necessary, or should the amended rule merely include the restrictions as conditions to reliance on the rule?
- Rule 14a-4(d)(4) currently, and as proposed to be amended, would permit a non-management person to round out its short slate with one or more shareholder nominees named in the registrant's proxy statement regardless of whether the non-management person nominated such shareholder nominees and regardless of how the shareholder nominees came to be named in the registrant's proxy statement.<sup>116</sup> Should we amend Rule 14a-4(d)(4) to make it unavailable to some or all shareholder

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<sup>116</sup> We currently have pending rule proposals related to shareholder nominees that, if adopted, could result in a registrant being required to include shareholder nominees in its proxy statement under specified circumstances. See Release No. 33-9046 in note 22 above.

nominees named in the registrant's proxy statement and, if so, why and how? For example, should the rule be unavailable where such a shareholder nominee was nominated by the non-management person, a person with whom the non-management person has formed or intends to form a group under Section 13(d)(3) and Regulation 13D-G or a person in whose solicitation the non-management person is a participant?

- Should we amend Rule 14a-4(d)(4) so the exception it provides to the Rule 14a-4(d)(1) bona fide nominee requirement extends to non-management persons who do not have their own nominees for whom to solicit support but seek authority to vote for nominees named in the registrant's or other persons' proxy statements?

#### 4. Exchange Act Rule 14a-4(c)

Exchange Act Rule 14a-4(e) requires that a proxy statement or form of proxy provide that the shares represented by the proxy be voted "subject to reasonable specified conditions." When the Commission adopted the rule, it stated that it previously had taken the position that the solicitation of proxies constitutes an implied representation by the persons making the solicitation that the shares represented by the proxy will be voted and that the rule was amended in order to make this representation more explicit.<sup>117</sup>

As the Commission stated in 1992, "[p]rior to a shareholder granting the legal power to someone else – whether management or an outsider – to vote his or her stock, the shareholder needs to know what matters will be voted on, and how the recipient of the proxy intends to vote the shareholder's shares."<sup>118</sup> Similarly, a shareholder needs to know whether the recipient of a proxy will only vote the shareholder's shares subject to some condition. We believe that in order

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<sup>117</sup> Release No. 34-4185 (Nov. 5, 1948) [13 FR 6680].

<sup>118</sup> 1992 adopting release in note 23 above at 48277.

for there to be “reasonable specified conditions,” the conditions must be objectively determinable to enable the shareholder to make an informed decision in regard to granting proxy authority and confirm that any later withholding of shares from voting is consistent with the authority granted.<sup>119</sup> In addition, if the conditions were not objectively determinable, the recipient of the proxy could seek to exercise a degree of discretion that would be inconsistent with Rule 14a-4(c)’s limits on when a proxy can confer discretionary authority.<sup>120</sup> Accordingly, we propose to amend Rule 14a-4(e) to clarify that the reasonable specified conditions must be objectively determinable.

#### Request for Comment

- Will specifying that reasonable specified conditions must be objectively determinable have any harmful effect on proxy solicitation practices?
- Does the phrase “objectively determinable” achieve the objective of clarifying the conditions shareholders should know about before giving their proxies or deciding to revoke their proxies?

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<sup>119</sup> In a related context, we have stressed that conditions must be objective for shareholders to be able to understand what they are being asked to do. In 2000, we published our views on the disclosure and dissemination of “mini-tender” offers that result in the bidder holding five percent or less of the outstanding securities of a company. There, we stated that “[i]t is important for security holders to be able to evaluate the genuineness of the [tender] offer” and “[w]e believe therefore that a tender offer can be subject to conditions only where the conditions are based on objective criteria, and the conditions are not within the bidder’s control.” See Release No. 34-43069 (July 24, 2000) [65 FR 46581].

<sup>120</sup> 17 CFR 240.14a-4(c). The conditions would not be objectively determinable, for example, if voting the shares was subject to the proxy holder concluding in its sole discretion that it would not be advisable to vote the shares. The conditions would be objectively determinable, for example, if voting the shares was subject to a third party’s filing with the Commission, within seven days before the scheduled date for the meeting for which proxies were solicited, a Schedule TO [17 CFR 240.14d-100] for a tender offer for over half of the issuer’s shares.

## 5. Exchange Act Rule 14a-12(a)(1)(i)

Exchange Act Rule 14a-12 permits a solicitation to be made before furnishing security holders with a proxy statement meeting the requirements of Exchange Act Rule 14a-3(a)<sup>121</sup> if, among other requirements, each written communication that is part of the solicitation contains specified participant information. Rule 14a-12(a)(1)(i) requires such information to include the identity of the participants in the solicitation and a description of their direct or indirect interests or a legend advising security holders where they can obtain that information.

Questions have arisen regarding when and how the participant information to which the legend refers must be filed. The Commission amended Exchange Act Rule 14a-12 in 1999 to, among other things, provide that participant information could be provided directly in written materials as historically required or, as a new alternative, indirectly through the legend described above.<sup>122</sup> In affording the option to provide participant information indirectly through a legend, we intended to offer a convenience but did not intend to permit the participant information to be provided later than it would be if provided directly in the written materials. If the legend is to give meaningful information to shareholders, the information referenced in the legend must be available when the soliciting person uses the soliciting material with the legend. Accordingly, we propose to amend the rule to clarify that the required participant information must be filed under cover of Schedule 14A as part of a proxy statement or other soliciting materials no later than the time the first soliciting communication is made. It is not sufficient to provide the information in a document filed later.

### Request for Comment

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<sup>121</sup> 17 CFR 240.14a-3(a).

<sup>122</sup> See Release No. 33-7760 (Oct. 22, 1999) [64 FR 61408].

- Does the proposed amendment adequately clarify the need to have the participant information to which a legend refers on file no later than when the written material containing the legend is first sent or given to security holders?
- Does the proposed amendment adequately clarify how the participant information must be filed?
- Does the requirement to have the participant information on file no later than when the written material containing the legend is first sent or given to security holders create practical difficulties for parties soliciting proxies? If so, to what extent does the requirement impede the ability to solicit and how much of a delay in providing the participant information would be needed to avoid impeding that ability? If the requirement was revised to permit any such delay, what would be the effect of the delay on the ability of solicited shareholders to make a voting decision?

#### **G. Transition**

We anticipate that if the proposed amendments are adopted, compliance with the amendments would begin in the 2010 proxy season following their publication in the Federal Register.

#### **Request for Comment**

- Would this compliance schedule be workable?
- Are any special transition provisions necessary for any aspects of the proposed amendments? If so, please explain what would be needed and why.
- Would any of the proposed amendments to Regulation S-K present any particular difficulty or expense in preparing?

## H. Other Requests for Comment

The Commission is exploring other ways in which we could improve proxy disclosures. We invite interested persons to submit comments on the advisability of pursuing any or all of the following possible reforms, as well as to provide other approaches that we might consider to achieve our goals. We expect to benefit from the comments we receive before deciding whether to propose changes.

- Are there any disclosures required in the proxy statement that we should consider proposing to eliminate in light of the proposed amendments?
- Are there other initiatives we should consider in order to improve the disclosure in proxy statements, particularly with regard to disclosure regarding executive compensation? For instance should we propose requiring disclosure of the compensation paid to each executive officer, not just the named executive officers? Should we consider proposing to eliminate the instruction that provides that performance targets can be excluded based on the potential adverse competitive effect on the company of their disclosure? Alternatively, should we consider proposing to revise the CD&A to require disclosure of performance targets on an after-the-fact basis, after the performance related to the award is measured, such as three or more fiscal years later, whether or not the disclosure may result in competitive harm?
- Under current Item 407(e)(5) of Regulation S-K, the Compensation Committee Report must state whether the committee: (1) has reviewed and discussed the CD&A with management; and (2) recommended to the board of directors that the CD&A be included in the company's annual report and the proxy or information

statement. Although the CD&A is considered “filed”, the Compensation Committee Report is “furnished.”<sup>123</sup> Because it is furnished, the Compensation Committee Report does not have the same liability as the CD&A and other information that is “filed.” For example, it is not incorporated by reference or otherwise considered a part of the company’s Form 10-K, registration statements and other filings, and is not covered by the principal executive officer and principal financial officer certifications required under Exchange Act Rules 13a-17<sup>124</sup> and 15d-14.<sup>125</sup> Should we consider proposing to amend this rule to make the CD&A be a part of the Compensation Committee Report? Why or why not? If we make the CD&A part of the Compensation Committee Report, should the Compensation Committee Report be “filed”? If we were to make the CD&A part of the Compensation Committee Report, are there any requirements to the CD&A that we should change?

- Should we consider requiring disclosure regarding whether a member of the compensation committee has expertise in compensation matters and whether the committee has the resources to hire its own independent legal counsel?
- Some investors may want more information regarding whether compensation arrangements are reasonably designed to create incentives among executives to increase long-term enterprise value. Should we consider supplementing any of the tabular and narrative disclosure requirements to require additional disclosure

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<sup>123</sup> For a discussion of the differences between the Compensation Committee Report and the CD&A, see Section II.3. “Filed” status of Compensation Discussion and Analysis and the “Furnished” Compensation Committee Report’ in Release 33-8732A.

<sup>124</sup> 17 CFR 240.13a-14.

<sup>125</sup> 17 CFR 240.15d-14.

about whether or not a company has “hold to retirement” and/or claw back provisions and if not, why not?

- Are investors interested in disclosure of whether the amounts of executive compensation reflect any considerations of internal pay equity? For example, would investors find such disclosure relevant in considering the motivation and effectiveness of broad based compensation plans? Should we consider proposing additional requirements to address this? For instance, should we consider proposing required disclosure regarding internal pay ratios of a company, such as disclosure of the ratio of the total compensation of the named executive officers, or total compensation of each individual named executive officer, to the total compensation of the average non-executive employee of the company?
- In order to give investors a better understanding of the breadth and depth of a company’s focus on compensation, should we require disclosure regarding the total number of compensation plans a company has and the total number of variables in all of its compensation plans? Are there other ways to convey the complexity and significance of all of a company’s plans?
- Should we consider proposing to supplement the required disclosure of tax gross-up arrangements that the company has for the named executive officers to include a requirement to disclose and quantify the savings to each executive?

#### **General Request for Comment**

We request and encourage any interested person to submit comments on any aspect of our proposals, other matters that might have an impact on the amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest

assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

### III. PAPERWORK REDUCTION ACT

#### A. Background

Certain provisions of the proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA).<sup>126</sup> We are submitting the proposed amendments to the Office of Management and Budget (OMB) for review in accordance with the PRA.<sup>127</sup> The titles for the collection of information are:

- (1) "Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059);
- (2) "Regulation 14C and Schedule 14C" (OMB Control No. 3235-0057);
- (3) "Form 10-K" (OMB Control No. 3235-0063);
- (4) "Form 10-Q" (OMB Control No. 3235-0070);
- (5) "Form 10" (OMB Control No. 3235-0064);
- (6) "Form S-1" (OMB Control No. 3235-0065);
- (7) "Form S-4" (OMB Control No. 3235-0324);
- (8) "Form S-11" (OMB Control No. 3235-0067);
- (9) "Form 8-K" (OMB Control No. 3235-0060);
- (10) "Rule 20a-1 under the Investment Company Act of 1940, Solicitations of Proxies, Consents, and Authorizations" (OMB Control No. 3235-0158);
- (11) "Form N-1A" (OMB Control No. 3235-0307);
- (12) "Form N-2" (OMB Control No. 3235-0026);

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<sup>126</sup> 44 U.S.C. 3501 *et seq.*

<sup>127</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

(13) "Form N-3" (OMB Control No. 3235-0316); and

(14) "Regulation S-K" (OMB Control No. 3235-0071).

The regulations, schedules and forms were adopted under the Securities Act and the Exchange Act, except for Forms N-1A, N-2, and N-3, which we adopted pursuant to the Securities Act and the Investment Company Act, and Rule 20a-1, which we adopted pursuant to the Investment Company Act. The regulations, forms and schedules set forth the disclosure requirements for periodic reports; registration statements; and proxy and information statements filed by companies to help investors make informed investment and voting decisions. The hours and costs associated with preparing, filing and sending the form or schedule constitute reporting and cost burdens imposed by each 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. Compliance with the proposed amendments would be mandatory. Responses to the information collections would not be kept confidential and there would be no mandatory retention period for the information disclosed.

As discussed in more detail above, the proposed amendments to Items 401, 402(b) and 407 of Regulation S-K would increase existing disclosure burdens for proxy and information statements, annual reports on Form 10-K, and registration statements on Forms 10, S-1, S-4, and S-11 by requiring:

- New disclosure and analysis of how a company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk if it may have a material effect on the company;
- New disclosure of the qualifications of directors and nominees for director, and the reason why a company or other proponent believes each director or nominee is

- qualified to serve as a director of the company at the time at which the relevant filing with the Commission is made, and as a member of any committee that the person serves on or is chosen to serve on, in light of the company's business and structure;
- Additional disclosure of any directorships held by each director and nominee at any time during the past five years at public companies;
  - Lengthening the time during which disclosure of legal proceedings involving a company's directors, nominees for director and executive officers is required from five to 10 years;
  - New disclosure about a company's board leadership structure and the board's role in the risk management process;
  - New disclosure about the fees paid to compensation consultants and their affiliates when they play any role in determining or recommending the amount or form of executive and director compensation, if they also provide other services to the company. In addition, new disclosure of any additional services provided to the company by the compensation consultants and any affiliates of the consultants; and
  - Transferring the requirement for companies to disclose the results of shareholder votes on Forms 10-Q or 10-K to Form 8-K.

The proposed amendments to Forms N-1A, N-2, and N-3 would increase existing disclosure burdens for such forms by requiring:

- New disclosure of the qualifications of directors and nominees for director, and the reason why a company or other proponent believes each director or nominee is qualified to serve as a director of the company at the time at which the relevant filing

with the Commission is made, and as a member of any committee that the person serves on or is chosen to serve on, in light of the company's business and structure;

- Additional disclosure of any directorships held by each director and nominee at any time during the past five years at public companies; and
- New disclosure about a company's board leadership structure and the board's role in the risk management process.

At the same time, the proposals would not increase existing disclosure burdens for proxy and information statements, annual reports on Form 10-K, and registration statements on Forms 10, S-1, S-4 and S-11 by:

- Revising Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards to require disclosure of the aggregate grant date fair value of such awards, computed in accordance with FAS 123R, rather than the dollar amount recognized for financial statement purposes for the fiscal year in accordance with FAS 123R; and
- Eliminating the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table and corresponding footnote disclosure to the Director Compensation Table.

The proposed amendments to the Summary Compensation Table, Grants of Plan-Based Awards Table and Director Compensation Table are intended to provide investors with clearer and more meaningful executive compensation disclosure, to facilitate informative and concise Compensation Discussion and Analysis disclosure of company policies and decisions regarding named executive officers' compensation, and to provide investors with a clearer view of the annual compensation earned by executives and directors consistent with the timing of current

actions regarding plan awards, including the effect on total compensation of decisions to reprice option awards.

Together, the proposed amendments to the Summary Compensation Table, Grants of Plan-Based Awards Table and Director Compensation Table will simplify executive compensation disclosure because companies no longer will need to report two separate measures of equity compensation in their compensation disclosure. For purposes of Item 402 disclosure, companies no longer will need to explain or analyze a second, separate measure of equity compensation that is based on financial statement recognition rather than compensation decisions. In addition, we believe it is likely that these proposals will make companies' identification of named executive officers more consistent from year-to-year, providing investors more meaningful disclosure and reducing executive compensation tracking burdens in determining which executive officers are the most highly compensated.

The proposed amendments to the rules governing the proxy solicitation process would not increase any existing disclosure burden. We believe these proposals, if adopted, would provide certainty to soliciting parties and facilitate communications with shareholders. The proposed amendments to Exchange Act Rules 14a-2(b)(1), 14a-2(b)(1)(ix), 14a-4(e) and 14a-12(a)(1)(i) merely would clarify existing requirements. As a result, these amendments would not affect any existing disclosure burden. The proposed amendment to Rule 14a-4(d) would make the short slate rounding exception to the bona fide nominee requirement available whether a non-management soliciting person attempts to round out its short slate by seeking authority to vote for nominees named in the registrant's proxy statement, as currently permitted, or seeks to round out its short slate with nominees named in one or more other persons' proxy statements. Consequently, the proposed amendment to Rule 14a-4(d) simply would provide more flexibility

to non-management persons that seek to round out their short slates and, as a result, would not increase any existing disclosure burden.<sup>128</sup>

#### **B. Burden and Cost Estimates Related to the Proposed Amendments**

We anticipate that the proposed disclosure amendments would increase the burdens and costs for companies that would be subject to the proposed amendments. We estimated the average number of hours a company would spend completing the forms and the average hourly rate for outside professionals. In deriving our estimates, we recognize that the burdens will likely vary among individual companies based on a number of factors, including the size and complexity of their organizations, and the nature of their operations. We believe that some companies will experience costs in excess of this average in the first year of compliance with proposals and some companies may experience less than the average costs.

We estimate no annual incremental increase in the paperwork burden for companies to comply with the proposed amendments to the Summary Compensation Table, Director Compensation Table, and Grants of Plan-Based Awards Table. We base this estimate on the fact that the amended approach would require disclosure of information that is collected to comply with financial reporting requirements, and will not impose additional burdens compared to the burdens associated with applying the currently required disclosure. We also base this estimate on the likelihood that, by eliminating factors unrelated to company compensation decisions, the proposed amendments will make companies' identification of named executive officers more consistent from year-to-year, thereby potentially reducing the burden of tracking the

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<sup>128</sup> The proposed amendment to Exchange Act Rule 14a-4(d)(4) would require that a non-management soliciting person that attempts to round out its short slate by seeking authority to vote for nominees named in another non-management person's proxy statement provide specified representations to the effect that it is not acting together with any such other non-management person. The required representations would not, however, affect any existing disclosure burden in more than a negligible way.

compensation of all executive officers in order to determine which executive officers are the most highly compensated.

For purposes of the PRA, we estimate the annual incremental paperwork burden for all companies (other than registered management investment companies) to prepare the disclosure that would be required under our proposals to be approximately 247,773 hours of company personnel time and a cost of approximately \$47,413,161 for the services of outside professionals. These estimates include the time and the cost of preparing and reviewing disclosure, filing documents and retaining records.

We derived the above estimates by estimating the total amount of time it would take a company to prepare and review the proposed disclosure requirements. This estimate represents the average burden for all companies, both large and small. Our estimates have been adjusted to reflect the fact that some of the proposed amendments would be required in some but not all of the above listed documents, and would not apply to all companies.

With respect to reporting companies (other than registered management investment companies), all of the proposed revisions to Regulation S-K would be required in proxy and information statements; however, only the proposed revisions to Items 401 and 402 of Regulation S-K would be required in Forms 10, 10-K, S-1, S-4 and S-11. Furthermore, the proposed amendments to CD&A would not be applicable to smaller reporting companies because under current CD&A reporting requirements these companies are not required to provide CD&A in their Commission filings. Based on the number of proxy filings we received in the 2008 fiscal year, we estimate that approximately 3,922 domestic companies are smaller reporting companies that have a public float of less than \$75 million. With respect to registered

management investment companies, the proposed revisions would be reflected in certain Regulation S-K items, Schedule 14A, and Forms N-1A, N-2 and N-3.

Our annual burden estimates are also based on other assumptions. First, we assumed that the burden hours of the proposed amendments would be comparable to the burden hours related to similar disclosure requirements under current reporting requirements, such as the disclosure of audit fees and non-audit services,<sup>129</sup> CD&A and executive compensation reporting,<sup>130</sup> and the disclosure of the activities of nominating committees.<sup>131</sup> Second, we assumed that substantially all of the burdens associated with the proposed amendments to Items 401 and 402 of Regulation S-K would be associated with Schedules 14A and 14C as these would be the primary disclosure documents that CD&A would be prepared and presented.<sup>132</sup> For each reporting company (other than registered management investment companies), we estimated that the proposed amendments would impose on average the following incremental burden hours:

- Sixteen hours for the proposed amendments to CD&A;
- Four hours for the proposed enhanced director and nominee disclosure;
- Six hours for the proposed disclosures about company leadership structure and the board's role in risk management;
- Four hours for the proposed disclosures regarding compensation consultants; and

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<sup>129</sup> Release No. 33-8183 (Jan. 28, 2003) [68 FR 6006] (which we estimated to be two hours).

<sup>130</sup> Release No. 33-8732A in note 24 above (which we estimated to be 95 hours). For purposes of the proposed amendments to CD&A, we adjusted this number downward in recognition that the 95 hours included, among other things, the estimated burdens of the preparation and review of additional tabular and related narrative disclosures required by Item 402 of Regulation S-K.

<sup>131</sup> Release No. 33-8340 (Nov. 24, 2003) [68 FR 69204] (which we estimated to be three hours).

<sup>132</sup> The burden estimates for Form 10-K assume that the proposed amendments to Items 401 and 402 of Regulation S-K would be satisfied by either including the information directly in an annual report or incorporating the information by reference from the proxy statement or information statement on Schedule 14A or Schedule 14C. Our PRA estimates include an estimate 1 hour burden in the Form 10-K and schedules to account for the incorporation of the information that would be required under proposed amendments to Items 401 and 402 of Regulation S-K.

- One hour for the proposed reporting of voting results on Form 8-K.

With respect to registered management investment companies, we estimated that the proposed amendments would impose on average the following incremental burden hours:

- Four hours for the proposed enhanced director and nominee disclosure in proxy statements and three hours for such proposed disclosure in registration statements;<sup>133</sup> and
- Six hours for the proposed disclosures about company leadership structure and the board's role in risk management.

1. Proxy and Information Statements

For purposes of the PRA, in the case of reporting companies (other than registered management investment companies) we estimated the annual incremental paperwork burden for proxy and information statements under the proposed amendments would be approximately 14 hours per form for companies that are smaller reporting companies, and 30 hours per form for companies that are either accelerated or large accelerated filers. In the case of registered management investment companies, we estimate the annual incremental paperwork burden for proxy and information statements under the proposed amendments would be approximately ten hours per form. These estimates include the time and the cost of preparing disclosure that has been appropriately reviewed by management, in-house counsel, outside counsel, and members of the board of directors.

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<sup>133</sup> We estimated that the disclosure burden for registration statements on Forms N-1A, N-2, and N-3 is less than for proxy statements because the proposed disclosure relating to involvement in legal proceedings for the past 10 years applies only to proxy statements and not to registration statements.

2. Exchange Act Periodic Reports

For purposes of the PRA, we estimate the annual incremental paperwork burden for Form 10-K under the proposed amendments would be approximately 1 hour per form. This estimate includes the time and the cost of preparing disclosure that has been appropriately reviewed by management, in-house counsel, outside counsel, and members of the board of directors.

3. Securities Act Registration Statements and Exchange Act Registration Statements

For purposes of the PRA, in the case of reporting companies (other than registered management investment companies) we estimate the annual incremental paperwork burden for Securities Act registration statements under the proposed amendments would be approximately 20 hours per form.<sup>134</sup> For registered management investment companies, we estimate that the annual incremental paperwork burden under the proposed amendments to Forms N-1A, N-2, and N-3 would be approximately 9 hours per form. These estimates include the time and the cost of preparing disclosure that has been appropriately reviewed by management, in-house counsel, outside counsel, and members of the board of directors.

The tables below illustrate the total annual compliance burden of the collection of information in hours and in cost under the proposed amendments for annual reports; quarterly reports; current reports; proxy and information statements; Form 10; Forms S-1, S-4, S-11, N-1A, N-2, and N-3; and Regulation S-K.<sup>135</sup> The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take a company to prepare and review the proposed disclosure requirements. For the Exchange Act reports on Form 10-K, 10-Q, and Form 8-K, and the proxy and information statements we

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<sup>134</sup> We calculated the 20 hours by adding 16 hours for the proposed amendments to CD&A to 4 hours for the proposed enhanced director and nominee disclosure.

<sup>135</sup> Figures in both tables have been rounded to the nearest whole number.

estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the company at an average cost of \$400 per hour. For the registration statements on Forms S-1, S-4, S-11, N-1A, N-2, and N-3, and the Exchange Act registration statement on Form 10, we estimate that 25% of the burden of preparation is carried by the company internally and that 75% of the burden of preparation is carried by outside professionals retained by the company at an average cost of \$400 per hour. There is no change to the estimated burden of the collections of information under Regulation S-K because the burdens that this regulation imposes are reflected in our revised estimates for the forms. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours.

Table 1. Incremental Paperwork Burden under the proposed amendments for annual reports; quarterly reports; proxy and information statements:

	Number of Responses <sup>136</sup> (A)	Incremental Burden Hours/Form (B)	Total Incremental Burden Hours (C)=(A)*(B)	75% Company (D)=(C)*0.75	25% Professional (E)=(C)*0.25	Professional Costs (F)=(E)*\$400
10-K	13,545	1	13,545	10,159	3,386	\$1,354,500
10-Q <sup>137</sup>	32,462	(1)	(7,300)	(5,475)	(1,825)	\$(730,000)
8-K <sup>138</sup>	115,795	1	115,795	86,846	28,949	\$11,579,500
Form 10 <sup>139</sup>	238	20	4,760	1,190	3,570	\$1,428,000

<sup>136</sup> The number of responses reflected in the table equals the actual number of forms and schedules filed with the Commission during the 2008 fiscal year, except for Form 8-K. The number of responses for Form 8-K reflects the number of Form 8-Ks filed during the 2008 fiscal year plus an additional 7,371 filings.

<sup>137</sup> We calculated the reduction in the burden hours for Form 10-Q based on the number of proxy statements filed with the Commission during the 2008 fiscal year. We assumed that there would be, at a minimum, an equal number of Form 10-Qs filed to report the voting results from a meeting of shareholders. The reduction reflects the proposed deletion of the disclosure of voting results from the form.

<sup>138</sup> We have included an additional 7,300 responses to Form 8-K to reflect the additional Form 8-Ks that would be filed to report final voting results. We have also included an additional 71 Form 8-Ks to reflect the number of Form 8-Ks that would be filed to report preliminary voting results which we based on the actual number of proxy statements involving contested elections that were filed with the Commission during the 2008 fiscal year.

<sup>139</sup> The burden allocation for Form 10 uses a 25% internal to 75% outside professional allocation.

Sch. 14A <sup>140</sup>	7,300					
Accel. Filers	3,378	30	101,340	76,005	25,335	\$10,134,000
SRC Filers	3,922	14	54,908	41,181	13,727	\$5,490,800
Sch. 14C	680					
Accel. Filers	315	30	9,440	7,080	2,360	\$1,415,984
SRC Filers	365	14	5,115	3,836	1,279	\$511,472
Rule 20a-1	1,225	10	12,250	9,188	3,062	\$1,225,000
Reg. S-K	N/A	N/A	N/A	N/A	N/A	N/A
Total			317,153	235,485		\$32,667,261

Table 2. Incremental Paperwork Burden under the proposed amendments for registration statements:

	Number of Responses <sup>141</sup> (A)	Incremental Burden Hours/Form (B)	Total Incremental Burden Hours (C)=(A)*(B)	25% Company (D)=(C)*0.25	75% Professional (E)=(C)*0.75	Professional Costs (F)=(E)*\$400
Form S-1	768	20	15,360	3,840	11,520	\$4,608,000
Form S-4	619	20	12,380	3,095	9,285	\$3,714,000
Form S-11	100	20	2,000	500	1,500	\$600,000
Form N-1A	1,935	9	17,415	4,354	13,061	\$5,224,500
Form N-2	205	9	1,845	461	1,384	\$553,500
Form N-3	17	9	153	38	115	\$45,900
Reg. S-K	N/A	N/A	N/A	N/A	N/A	N/A
Total			49,153	12,288		\$14,745,900

### C. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;

<sup>140</sup> The estimates for Schedule 14A and Schedule 14C are separated to reflect our estimate of the burden hours and costs related to the proposed amendments to CD&A which would be applicable to companies that are either accelerated or large accelerated filers, but not applicable to companies that are smaller reporting companies. We estimate that 3,378 Schedule 14A responses were filed by accelerated or large accelerated filers, and 315 Schedule 14C responses were filed by accelerated or large accelerated filers.

<sup>141</sup> The number of responses reflected in the table equals the actual number of forms filed with the Commission during the 2008 fiscal year, except for Forms N-1A and N-3. The number of responses for Forms N-1A and N-3 reflect the number of open-ended management investment companies registered with the Commission.

- Evaluate the accuracy of our estimates of the burden of the proposed collections of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;
- Evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- Evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy of the comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-13-09. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-13-09 and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street NE, Washington DC 20549-0213. Because the OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication.

#### IV. COST-BENEFIT ANALYSIS

##### A. Introduction

We are proposing amendments to enhance the disclosures with respect to a company's overall compensation policy and its impact on risk taking, director and nominee qualifications and legal proceedings, company leadership structure and the board's role in the risk management process, and the interests of compensation consultants. In addition, we are proposing amendments to transfer the requirement to disclose voting results from Forms 10-Q and 10-K to Form 8-K.

We also are proposing amendments to the disclosure requirements for executive and director compensation to require stock awards and option awards reporting based on a measure that will represent the aggregate grant date fair value of the compensation decision in the grant year, rather than the current rule, which allocates the grant date fair value over time commensurate with financial statement recognition of compensation costs.

Finally, we also are proposing amendments to Exchange Act Rules 14a-2, 14a-4, and 14a-12 to provide clarity and address issues that have arisen in regard to the proxy solicitation process. These amendments, discussed in detail above,<sup>142</sup> and their potential consequences that could result in benefits and costs are as follows.

##### 1. Exchange Act Rule 14a-2(b)(1)

We propose to clarify the introductory text of Exchange Act Rule 14a-2(b)(1) by revising it to provide specifically that a "form of revocation" does not include an unmarked copy of management's proxy card that the soliciting shareholder requests be returned directly to management. As a result, a person otherwise qualified to rely on the exemption the rule provides

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<sup>142</sup> See Part II.F above.

still could rely on it if the person provided a solicited shareholder with an unmarked copy of management's proxy card and requested that the card be returned directly to management.<sup>143</sup>

Consequently, the proposed amendment would provide certainty regarding the availability of the exemption in relation to this procedure. There may be persons who have different views or are uncertain about the application of the exemption to the procedure and would not, in the absence of the clarification, undertake it. As a result, the clarification may cause more persons to avail themselves of the procedure.<sup>144</sup>

## 2. Exchange Act Rule 14a-2(b)(1)(ix)

We propose to clarify Exchange Act Rule 14a-2(b)(1)(ix) by revising it to provide specifically that a person need not be a security holder of the class of securities being solicited and a benefit need not be related to or derived from any security holdings in the class being solicited for a person to have a substantial interest in a matter that would disqualify the person from relying on the exemption Exchange Act Rule 14a-2(b)(1) otherwise would provide in regard to that matter. As a result, the proposed amendment would provide certainty regarding the fact that a person need not be a security holder of the class of securities being solicited and a benefit need not be related to or derived from any security holdings in the class being solicited for the person to have a substantial interest. There may be persons who have different views or are uncertain about this fact and would not, in the absence of the clarification, recognize that the

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<sup>143</sup> Rule 14a-2(b)(1) exempts from the generally applicable disclosure filing and most other requirements of the proxy rules solicitations by non-management persons who are not seeking proxy authority and do not have a substantial interest in the subject matter of the solicitation. The exemption is unavailable to, among others, a person who "furnish[es] or otherwise request[s], or act[s] on behalf of a person who furnishes or requests, a form of revocation."

<sup>144</sup> If more non-management persons use the procedure and provide solicited shareholders with more opportunities to vote as they suggest, then it is possible that these non-management persons will succeed more often in defeating management proposals. As a practical matter, however, it seems unlikely that many solicited shareholders would vote differently merely because they have more opportunities to vote as a non-management soliciting person suggests.

exemption is not available and act accordingly. Consequently, the clarification may cause more persons to refrain from soliciting in the absence of an exemption or to solicit in compliance with all of the generally applicable proxy solicitation requirements.

### 3. Exchange Act Rule 14a-4(d)(4)

We propose to revise Exchange Act Rule 14a-4(d)(4) to provide that the short slate rounding exception to the bona fide nominee requirement would be available whether a non-management soliciting person attempts to round out its short slate by seeking authority to vote for nominees named in the registrant's proxy statement, as currently permitted, or seeks to round out its short slate with nominees named in any other persons' proxy statement.<sup>145</sup> As a result, the proposed amendment would end the situation under the current rule in which only the registrant's nominees may be used to fill out the non-management slate and, as a result, are effectively advantaged as security holders may vote for them on two or more proxy cards where non-management nominees can only be voted for on one. Consequently, the proposed amendment would provide additional flexibility to non-management persons with regard to the nominees with whom they seek to round out their short slates without their seeking a no-action letter from the staff.<sup>146</sup> The codified additional flexibility may cause more non-management

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<sup>145</sup> Rule 14a-4(d)(1) requires that, in order to solicit authority to vote for the election of a person to office, the person must be a bona fide nominee, consenting to being named in the soliciting person's proxy statement and serving if elected. Rule 14a-4(d)(4) is an exception to the bona fide nominee requirement. This exception permits a person soliciting support of nominees who, if elected, would constitute a minority of the board of directors (commonly referred to as a "short slate"), to round out its short slate of nominees up to the total number of director positions then subject to election by seeking authority to vote for nominees named in the registrant's proxy statement

<sup>146</sup> As discussed above, the Division of Corporation Finance has issued two no-action letters in regard to short slate rounding with persons named in a non-management person's proxy statement under circumstances generally the same as those contemplated by the proposed amendment. While the Division would continue to consider issuing such letters in the absence of the adoption of the proposed amendment, only the parties to whom the letters were addressed can rely upon them. See Eastbourne Capital, L.L.C. in note 108 above; Icahn Associates Corp. in note 108 above.

soliciting persons to seek to round out their short slates with other non-management persons' nominees.<sup>147</sup>

#### 4. Exchange Act Rule 14a-4(e)

We propose to clarify Exchange Act Rule 14a-4(e) by revising it to provide specifically that the "reasonable specified conditions" under which the shares represented by a proxy will not be voted must be objectively determinable.<sup>148</sup> As a result, the proposed amendment would provide certainty regarding the fact that the "reasonable specified conditions" under which the shares represented by a proxy will not be voted must be objectively determinable. There may be persons who have different views or are uncertain about this fact and would not, in the absence of the clarification, recognize that the conditions must be objectively determinable and act accordingly. Consequently, the clarification may cause some persons to revise the conditions they otherwise would state to make them objectively determinable or refrain from soliciting because they do not wish to state objectively determinable conditions.

#### 5. Exchange Act Rule 14a-12(a)(1)(i)

We propose to clarify Exchange Act Rule 14a-12(a)(1)(i) by revising it to provide specifically that when a soliciting communication is made before providing shareholders with a full proxy statement and that communication includes required participant information through a legend advising security holders where they can obtain the information, the information to which

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<sup>147</sup> It is possible that more non-management soliciting persons will seek to round out their short slates with other non-management persons' nominees and, as a result, more non-management nominees and fewer management nominees will be elected. As a practical matter, however, it is unclear how often non-management persons would seek to round out their short slates in this manner and, if they did, whether they would attract enough votes to increase the number of successful non-management nominees and decrease the number of successful management nominees. In this regard, we note that there appear to have been few instances in the past in which more than one non-management person sought to round out a short slate with respect to a single election of directors.

<sup>148</sup> Exchange Act Rule 14a-4(e) requires that a proxy statement or form of proxy provide that the shares represented by the proxy be voted "subject to reasonable specified conditions."

the legend refers must be filed under cover of Schedule 14A, as part of a proxy statement or other soliciting materials, no later than the time the first soliciting communication is made.<sup>149</sup> As a result, the proposed amendment would provide certainty regarding when the participant information to which the legend refers must be filed. There may be persons who have different views or are uncertain about this fact and would not, in the absence of the clarification, recognize that the participant information must be filed by the time the first soliciting communication is made. Consequently, the clarification may cause some persons to file the participant information earlier than they otherwise would or delay the start of a solicitation due to taking additional time to prepare and file the participant information.

**B. Benefits**

**1. Disclosure Amendments**

The proposed disclosure amendments are intended to enhance transparency of a company's compensation policies and its impact on risk taking; director and nominee qualifications; company leadership structure and the role of the board in the risk management process; potential conflicts of interest of compensation consultants; and voting results at annual and special meetings.

**a. Benefits Related to Expanded Compensation Discussion and Analysis Disclosure**

Expanding the Compensation Discussion and Analysis to include a discussion of the company's overall compensation program and how it relates to the company's approach to risk management may benefit investors in several ways. Incentive schemes and other compensation

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<sup>149</sup> Exchange Act Rule 14a-12 permits a solicitation to be made before furnishing security holders with a proxy statement meeting the requirements of Rule 14a-3(a) if, among other requirements, each written communication that is part of the solicitation contains specified participant information. Rule 14a-12(a)(1)(i) requires such information to include the identity of the participants in the solicitation and a description of their direct or indirect interests or a legend advising security holders where they can obtain that information.

for employees may affect risk-taking behavior in the company's operations. To the extent that risks arising from a company's overall compensation policies for employees generally may have a material effect on the company, investors will benefit through an enhanced ability to monitor it. They would also potentially benefit from the ability to use this additional information in allocating capital across companies, toward companies where employee incentives appear better aligned with operational success and investors' appetite for risk. The new disclosure may also encourage the board and senior management to examine and improve incentive structures for management and employees of the company. These benefits should also lead to increased value to investors.

b. Benefits Related to Revisions to Summary Compensation Table Disclosure

As a result of the proposed Summary Compensation Table revision, companies would no longer need to prepare and report the allocation of equity awards' grant date fair value over time commensurate with financial statement recognition of compensation costs for executive and director compensation tabular reporting or as a footnote to the Director Compensation Table. Further, in preparing stock awards and option awards disclosure in the Summary Compensation Table and Director Compensation Table, companies no longer would need to incur additional costs to exclude the estimate for forfeitures related to service-based vesting used for financial statement reporting purposes. The elimination of costs of preparing and reporting this information is a benefit of the proposed amendments. The effects of the proposed amendments in making this information more readily available to investors may be useful to their voting and investment decisions.

Reporting stock awards and option awards in the Summary Compensation Table based on aggregate grant date fair value is designed to make it easier for investors to assess compensation

decisions and evaluate the decisions of the compensation committee. For example, under the amendments the Summary Compensation Table values will correspond to awards granted for the fiscal year, potentially allowing companies to better explain in Compensation Discussion and Analysis how decisions with respect to these awards relate to other compensation decisions in the context of total compensation for the year. Further, the effect on total compensation of decisions to reprice options will be more evident because aggregate grant date fair value will be a component of total compensation reported in the Summary Compensation Table. However, because the proposals would eliminate the requirement to report the grant date fair value of individual awards in the Grants of Plan-Based Awards Table, there would not be disclosure of incremental fair value with respect to individual awards that were repriced or otherwise materially modified during the year, potentially limiting this benefit.

Under the proposed amendments, the identification of named executive officers based on total compensation for the last completed fiscal year will reflect the aggregate grant date fair value of equity awards granted in that year. As a result, the named executive officers other than the principal executive officer and principal financial officer may change. Investors may benefit from receiving compensation disclosure with respect to executives who would not have been named executive officers under the current rules. To the extent that this proposed change better aligns the identification of named executive officers with compensation decisions for the year, it may make it easier for companies to track executive compensation for reporting purposes.

Smaller reporting companies are not required to provide a Grants of Plan-Based Awards Table or a Compensation Discussion and Analysis, but are required to provide a Summary Compensation Table. Investors in these companies may benefit from reporting stock awards and

option awards based on full grant date fair value in the grant year, as opposed to the current reporting approach based on financial statement recognition of the awards.

c. Benefits Related to Enhanced Director and Nominee Disclosure

The proposed amendments to Item 401 of Regulation S-K would potentially benefit investors by increasing the amount and quality of information that they receive concerning the background and skills of directors and nominees for director, enabling investors to make better-informed voting and investment decisions. This increased information also may improve investor confidence because investors could determine more easily whether a particular director and the entire board composition is an appropriate choice for a given company at the time.

Disclosure of management's or other proponents' rationale for their nominees' membership on the board and on specific committees may benefit investors by enabling them to better assess the rationale in favor of a particular nominee. Investors would be able to adjust their holdings, allocating more capital to companies in which they believe board members are most likely to be able to effectively fulfill their duties to shareholders. In particular, in cases that do not meet investors' expectations, investors may respond by attempting to exert more influence on management or the board than would occur otherwise, thereby enhancing shareholder value.

Expanded disclosure of membership on previous corporate boards may also benefit investors by making it easier for them to evaluate whether nominees' past board memberships present potential conflicts of interest (such as membership on boards of major suppliers, customers, or competitors). Investors may also be able to more easily evaluate the performance, in both operations and governance, of the other companies on whose boards the nominees serve or have served. The public may also benefit from better understanding any potential positive or negative effects on corporate performance resulting from directors serving on other boards.

Expanded disclosure of legal proceedings involving directors, nominees and executive officers, from the current five year requirement to ten years, would benefit investors by providing more information by which they could determine the suitability of a director or nominee.

d. Benefits Related to New Disclosure about Company Leadership Structure and the Board's Role in the Risk Management Process

Investors may benefit from new disclosure about company leadership structure. In particular, they may benefit from understanding management's explanation regarding whether or not the principal executive officer serves as chairman of the board and, in the case of registered investment management company, whether the chairman is an "interested person" of the fund. In deciding whether to separate principal executive officer and chairman positions, companies may consider several factors, including the effectiveness of communication with the board and the degree to which the board can exercise independent judgment about management performance, and shareholders may, in different cases, be best served by different decisions.

Disclosures of the board's role in the risk management process may also benefit investors. Expanded disclosure of the board's role in risk management may enable investors to better evaluate whether the board is exercising appropriate oversight of risk management. Investors would be able to adjust their holdings, allocating more capital to companies in which they believe the board is adequately focused on risks. Improved capital allocation will also benefit the financial markets by increasing market efficiency.

e. Benefits Related to New Disclosure Regarding Compensation Consultants

New disclosure regarding compensation consultants may benefit investors by illuminating potential conflicts of interest. Providing better, more complete information in cases where non-executive compensation services occur allows investors to determine for themselves

whether there are concerns related to the compensation consultants' financial interests and objectivity. Compensation consultants may earn fees from other services to the company, including benefits administration, human resources consulting, and actuarial services. With an incentive to retain these additional revenue streams, they may face incentives to cater, to some degree, to management preferences in recommending executive compensation packages. To the degree that these relationships are more transparent under the proposed amendments, investors benefit through their ability to better monitor the process of setting executive pay. This benefit may be limited to the degree that compensation consultants have potential conflicts of interest related to other material relationships with the company or other conflicts not specifically enumerated in the proposed amendments.

f. Benefits Related to Reporting of Voting Results on Form 8-K

The proposed amendments to Form 8-K would facilitate security holder access to faster disclosure of the vote results of a company's annual or special meeting. To find this information, investors no longer would need to wait for this information to be disclosed in a Form 10-Q or 10-K, which could be filed months after the end of the meeting.

2. **Proxy Solicitation Process Amendments**

We believe the proposed proxy solicitation process amendments may result in benefits as follows.

a. Exchange Act Rule 14a-2(b)(1) Introductory Text

The proposed amendment to the introductory text of Exchange Act Rule 14a-2(b)(1) may cause more persons to furnish an unmarked copy of management's proxy card requested to be returned directly to management.<sup>150</sup> Consequently, the proposed amendment may result in the

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<sup>150</sup> See Part IV.A.1 above.

benefit of aiding efforts by persons not seeking proxy authority to facilitate voting by shareholders sharing their views on matters submitted for shareholder approval—such as in a “just vote no” campaign—without having to incur the costs and efforts of conducting a fully-regulated proxy solicitation and provide shareholders a convenient opportunity to indicate their votes after hearing those views.

b. Exchange Act Rule 14a-2(b)(1)(ix)

The proposed amendment to Exchange Act Rule 14a-2(b)(1)(ix) may cause more persons to refrain from soliciting in the absence of an exemption or solicit in compliance with all of the generally applicable proxy solicitation requirements.<sup>151</sup> To the extent such persons refrain from soliciting without an exemption, shareholders may benefit by not being called upon to make a voting decision in regard to a matter while possibly being unaware of the soliciting person’s substantial interest in the matter. To the extent such persons solicit in compliance with all of the generally applicable proxy solicitation requirements, shareholders may benefit by having information regarding the soliciting person’s substantial interest in the matter that they otherwise might not have.

c. Exchange Act Rule 14a-4(d)(4)

The proposed amendment to Exchange Act Rule 14a-4(d)(4) may cause more non-management soliciting persons to seek to round out their short slates with other non-management persons’ nominees.<sup>152</sup> The amendment’s effective codification of a no-action position the staff has taken in the past may benefit non-management soliciting persons who wish to round out their short slates with other non-management persons’ nominees by enabling them

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<sup>151</sup> See Part IV.A.2 above.

<sup>152</sup> See Part IV.A.3 above.

to avoid the cost of seeking a no-action letter. To the extent more non-management soliciting persons seek to round out their slates with other non-management persons' nominees, shareholders may benefit from having more choices in deciding for whom they will vote.

d. Exchange Act Rule 14a-4(e)

The proposed amendment to Exchange Act Rule 14a-4(e) may cause some persons to revise the conditions they otherwise would state to make them objectively determinable or refrain from soliciting because they do not wish to state objectively determinable conditions.<sup>153</sup> To the extent such persons revise the conditions they state to make them objectively determinable, solicited shareholders may benefit by being better able to make an informed decision in regard to granting proxy authority and confirm that any later withholding of shares from voting is consistent with the authority granted. To the extent such persons refrain from soliciting, shareholders may benefit from not being called upon to make a decision in regard to granting proxy authority or confirming that any later withholding of shares from voting is consistent with the authority granted where such decisions would be more difficult due to a lack of objectively determinable conditions.

e. Exchange Act Rule 14a-12(a)(1)(i)

The proposed amendment to Exchange Act Rule 14a-12(a)(1)(i) may cause some persons to file legend-referenced participant information earlier than they otherwise would or delay the start of a solicitation due to taking additional time to prepare and file the participant information.<sup>154</sup> To the extent such persons file the participant information sooner or delay the start of a solicitation until ready to file the participant information, shareholders may benefit

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<sup>153</sup> See Part IV.A.4 above.

<sup>154</sup> See Part II.A.5 above.

from having the participant information with which they can begin to evaluate the solicitation from the time they first are solicited.

**C. Costs**

**1. Disclosure Amendments**

The proposed rules would impose new disclosure requirements on companies. Some of the proposed disclosures are designed to build upon existing requirements to elicit a more detailed discussion of overall compensation policy and its impact on risk taking, director and nominee qualifications and legal proceedings and the interests of compensation consultants. To the degree that the proposed amendments require collecting information currently available, costs related to information collection will be limited.

a. Costs Related to Expanded Compensation Discussion and Analysis Disclosure

Expanded Compensation Discussion and Analysis disclosure will increase costs to companies as the proposed amendments would impose additional information gathering and drafting requirements. We believe that there may be information gathering costs, even though the information required may be readily available because this information may need to be reported up from business units and analyzed. Using our PRA burden estimates, we estimate the aggregate annual cost of the proposed amendments to CD&A to be approximately \$29,950,652.<sup>155</sup> In addition, there may be costs in assessing whether risk arising from compensation policies and practices may have a material effect on the company, and if they may, there will be cost in drafting the additional disclosure. This could include the cost of hiring

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<sup>155</sup> This estimate is based on the estimated total burden hours of 86,683 (the annual responses for the schedules and forms that would include the proposed CD&A amendments multiplied by 16 hours), an assumed split of the burden hours between internal staff and external professionals with respect to proxy and information statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

additional advisors to assist in the analysis as well as potential liability if risk is not identified as having a material effect on the company.

b. Costs Related to Revisions to Summary Compensation Table Disclosure

Investors may face some costs related to revisions in executive compensation reporting. The proposed amendments would rescind the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table and corresponding footnote disclosure in the Director Compensation Table. Although the Outstanding Equity Awards at Fiscal Year-End Table would continue to provide useful disclosure of the contractual terms of outstanding equity awards, the contribution of an individual grant to the aggregate grant date fair value of awards would not be disclosed under the proposed amendments. Investors will therefore be less able to determine the manner in which an individual grant affects the aggregate grant date fair value of equity awards granted in the year.

Grant date fair value guidelines under FAS 123R call for management to exercise judgment. For example, the valuation of stock options requires assumptions about stock volatility and choice among several valuation methods. For financial statement recognition purposes, this grant date fair value measure of compensation cost is expensed over the expected term of the option. Compensation cost for awards containing a performance-based vesting condition is recognized only if it is probable that the performance condition will be achieved. If achievement of the performance condition later is no longer considered probable, the amount of compensation cost previously recognized is reversed in the period when it is determined that achievement of the condition is no longer probable. In addition, awards that are classified as "liability awards" under FAS 123R (such as an award that is cash settled) are re-measured at each financial statement reporting date through the date the awards are settled. Some investors

may believe that Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards measured based on financial statement recognition principles provides a clearer understanding of compensation earned in the reporting period because it takes into account potential adjustments regarding such factors as term of the option and changes in market value over time. To the extent that an investor would prefer to also see disclosure of this measure for purposes of voting or investment decisions, the proposed amendments may entail a cost.

In particular, the required re-measurement of liability awards under the current rules may help to reveal situations in which companies grant awards that subsequently change in value. For example, if a company grants an option-based liability award under the proposed amendments, the impact of subsequent events on the stock price, and therefore on the award value, would not be reflected in the Summary Compensation Table in the current or subsequent year. In contrast, under the current rule, reported compensation in the next year could be higher or lower as the result of re-measurement. To the extent that investors prefer to see changes in value of liability award compensation decisions reflected in the Summary Compensation Table, presentation of grant date fair value in the table may represent a cost. This cost, however, is limited to the degree that changes in value of liability based awards are reflected elsewhere in the proxy statement or can be inferred from previously disclosed award terms. Additionally, awards classified as "equity awards" under FAS 123R are not re-measured, and therefore any changes in the value of such awards are not currently reflected in the Summary Compensation Table and will also not be reflected under the proposed amendments.

Under the proposed amendments to the Summary Compensation Table and as noted in the Benefits section, the identification of named executive officers based on total compensation

for the last completed fiscal year will reflect the aggregate grant date fair value of equity awards granted in that year, so that some executives subject to executive compensation disclosure may be different.

Smaller reporting companies, which are not required to provide the Grants of Plan-Based Awards Table, may incur some costs on a transitional basis in switching from the currently required measure of stock awards and option awards to full grant date fair value reporting. We expect that any such additional costs will be limited by the fact that full grant date fair value information required under the proposals is also collected to comply with financial reporting purposes. Because companies other than smaller reporting companies currently are required to report the grant date fair value of individual equity awards, we expect that they will incur only negligible costs in switching to the proposed Summary Compensation Table and Director Compensation Table disclosure requirements.

c. Costs Related to Enhanced Director and Nominee Disclosure

Companies may face some information gathering and reporting costs related to enhanced director and nominee disclosure. Using our PRA burden estimates, we estimate the aggregate annual cost to operating companies to be approximately \$11,775,000.<sup>156</sup> With respect to our PRA burden estimates for registered management investment companies, we estimate the aggregate annual cost to be approximately \$3,489,800.<sup>157</sup> Companies may also experience

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<sup>156</sup> This estimate is based on the estimated total burden hours of 38,820 (the annual responses for the schedules and forms that would include the proposed enhanced director and nominee disclosure multiplied by 4 hours), an assumed 75%/25% split of the burden hours between internal staff and external professionals with respect to proxy and information statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>157</sup> This estimate is based on the estimated total burden hours of 11,371, an assumed 75%/25% split of the burden hours between internal staff and external professionals with respect to proxy statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

increased costs as it may be more difficult to find candidates willing to serve on boards if they do not want this information disclosed in a Commission filing. To the extent that information is available and verifiable, however, we expect that certain costs will be limited.

d. Costs Related to New Disclosure about Company Leadership Structure and the Board's Role in the Risk Management Process

Companies may face some costs related to new disclosure about company leadership structure. Disclosure of the board's role in the risk management process may have some similar costs. The information gathering costs are likely to be less significant than the costs to prepare the disclosure. Using our PRA burden estimates, we estimate the aggregate annual cost to operating companies to be approximately \$11,970,000.<sup>158</sup> With respect to our PRA burden estimates for registered management investment companies, we estimate the aggregate annual cost to be approximately \$6,367,200.<sup>159</sup> Although the amendments are not intended to drive behavior, there may be possible costs if a company re-evaluates its leadership structure or the board's role in the risk management process.

e. Costs Related to New Disclosure Regarding Compensation Consultants

Companies may face some costs related to new disclosure about other services provided by compensation consultants and aggregate fees. Using our PRA burden estimates, we estimate the aggregate annual cost to be approximately \$7,980,000.<sup>160</sup> The costs to a company in

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<sup>158</sup> This estimate is based on the estimated total burden hours of 47,880 (the annual responses for Schedules 14A and 14C multiplied by 6 hours), an assumed 75%/25% split of the burden hours, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>159</sup> This estimate is based on the estimated total burden hours of 20,292, an assumed 75%/25% split of the burden hours between internal staff and external professionals with respect to proxy statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>160</sup> This estimate is based on the estimated total burden hours of 31,920 (the annual responses for Schedules 14A and 14C multiplied by 4 hours), an assumed 75%/25% split of the burden hours, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

contracting with compensation consultants could be increased under these amendments, and compensation consultants also may alter their mix of services. For instance, costs may increase if companies decide to contract with multiple different compensation consultants for services that had previously been provided by only one compensation consultant. Possible increased costs might include the costs associated with the time each new compensation consultant will need to learn about the company and decline in any economies of scale the compensation consultant may have factored into fees charged to the company. To the extent that fees for compensation consultants decline, rather than increase as a result of any improvement in competition under the proposed amendments, this represents a potential cost to compensation consultants, if any increase in the volume of business does not offset fee reductions.

f. Costs Related to Reporting of Voting Results on Form 8-K

Shareholders who are used to receiving this information in Form 10-Q filing may incur costs of adapting their research practices to find this information in 8-K filings, which may involve searching through a number of filings. This adjustment may be costly, in particular, to those investors who process this information using automated systems. A separate filing to report the information and potentially report both preliminary and final voting results may also increase direct costs to companies for filing fees, filing creation, and report dissemination because it may require two Form 8-K filings. However, the cost for preparing a quarterly report on Form 10-Q would be less because this disclosure would not appear in that Form. Companies engaged in a contested election may face some additional information gathering and reporting costs related to reporting shareholder voting results on Form 8-K, as these companies would need to file a Form 8-K to report preliminary voting results in addition to reporting final vote

results. Using our PRA burden estimates, we estimate the aggregate annual cost to be approximately \$1,842,750.<sup>161</sup>

## 2. Proxy Solicitation Process Amendments

We believe the proposed proxy solicitation process amendments may result in costs as follows.

### a. Exchange Act Rule 14a-2(b)(1) Introductory Text

The proposed amendment to the introductory text of Exchange Act Rule 14a-2(b)(1) may cause more persons to furnish an unmarked copy of management's proxy card requested to be returned directly to management.<sup>162</sup> If more persons avail themselves of that procedure, companies may increase soliciting activity in an effort to counterbalance its use and, as a result, incur additional costs.

### b. Exchange Act Rule 14a-2(b)(1)(ix)

The proposed amendment to Exchange Act Rule 14a-2(b)(1)(ix) may cause more persons to refrain from soliciting in the absence of an exemption or solicit in compliance with all of the generally applicable proxy solicitation requirements.<sup>163</sup> To the extent such persons refrain from soliciting, shareholders may be denied the opportunity to consider such persons' views in making a voting decision. To the extent such persons solicit in compliance with all of the generally

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<sup>161</sup> This estimate is based on the estimated 7,371 additional Form 8-K filings, an assumed 75%/25% split of one burden hour between internal staff and external professionals, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>162</sup> See Part IV.A.1 above.

<sup>163</sup> See Part IV.A.2 above.

applicable proxy solicitation requirements, they may incur greater costs than they otherwise would have.<sup>164</sup>

c. Exchange Act Rule 14a-4(d)(4)

The proposed amendment to Exchange Act Rule 14a-4(d)(4) may cause more non-management soliciting persons to seek to round out their short slates with other non-management persons' nominees.<sup>165</sup> Consequently, companies may increase soliciting activity in an effort to counterbalance such rounding out and, as a result, incur additional costs.

d. Exchange Act Rule 14a-4(e)

The proposed amendment to Exchange Act Rule 14a-4(e) may cause some persons to revise the conditions they otherwise would state to make them objectively determinable or refrain from soliciting because they do not wish to state objectively determinable conditions.<sup>166</sup> To the extent such persons revise the conditions to make them objectively determinable or refrain from soliciting, shareholders may lose the opportunity to grant proxy authority to a person that might exercise some degree of discretion in a manner that could be beneficial to the shareholders. The inability to grant proxy authority to a person that might exercise some degree of discretion may cause some shareholders to decide to attend a meeting and, as a result, incur costs accordingly.

e. Exchange Act Rule 14a-12(a)(1)(i)

The proposed amendment to Exchange Act Rule 14a-12(a)(1)(i) may cause some persons to file legend-referenced participant information earlier than they otherwise would or delay the

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<sup>164</sup> We recently cited certain evidence that indicated the average cost to a soliciting shareholder engaged in a proxy contest is \$368,000. See Release No. 33-9046 in 22 above at 29073.

<sup>165</sup> See Part IV.A.3 above.

<sup>166</sup> See Part IV.A.4 above.

start of a solicitation due to taking additional time to prepare and file the participant information.<sup>167</sup> To the extent such persons file the participant information sooner, they may incur additional costs to accelerate the preparation and filing of the information. To the extent such persons delay the start of a solicitation until when ready to file the participant information, they may lose time during which the shareholders can consider the solicitation and, thereby, reduce the likelihood of a successful solicitation.

#### **D. Request for Comment**

We request data to quantify the costs and the value of the benefits described above. We seek estimates of these costs and benefits, as well as any costs and benefits not already defined, that may result from the adoption of these proposed amendments. We also request qualitative feedback on the nature of the benefits and costs described above and any benefits and costs we may have overlooked.

#### **V. 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 also requires us,<sup>168</sup> when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Section 2(b) of the Securities Act,<sup>169</sup> Section 3(f) of the Exchange Act,<sup>170</sup> and Section 2(c) of the Investment Company Act require us,<sup>171</sup> when engaging in rulemaking where we are

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<sup>167</sup> See Part IV.A.5 above.

<sup>168</sup> 15 U.S.C. 78w(a)(2).

<sup>169</sup> 15 U.S.C. 77b(b).

<sup>170</sup> 15 U.S.C. 78c(f).

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 proposed amendments to Regulation S-K are intended to provide additional important information to investors about corporate boards and management structure; and the clarity of executive compensation available to investors and the financial markets. These proposals would enhance investors' understanding of how corporate resources are used, and enable shareholders to better evaluate the actions of the board of directors and executive officers in fulfilling their responsibilities.

The proposed disclosure amendments would enhance our reporting requirements. These proposed amendments are designed to enhance transparency of a company's compensation policies and its impact on risk taking; director and nominee qualifications; board leadership structure; the potential conflicts of compensation consultants; and to provide investors with clearer and more meaningful executive compensation disclosure. The proposed amendments would also accelerate the reporting of the results of shareholder votes at a company's annual or special meeting. The proposed amendments should improve the ability of investors to make informed voting and investment decisions, and, therefore lead to increased efficiency and competitiveness of the U.S. capital markets.

The proposed disclosure amendments should also increase efficiency and competitiveness of the U.S. capital markets by providing investors with additional information on risk incentives and companies' risk management practices. This information could be used by investors in allocating capital across companies, toward companies where the risk incentives appear better aligned with an investor's appetite for risk. The new disclosure may also

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<sup>171</sup> 15 U.S.C. 80a-2(c).

encourage competition amongst companies to demonstrate superior risk management practices and improved incentive structures for management and employees of the company.

The proposed disclosure amendments also may affect competition among compensation consultants. Additional disclosure of consulting fees may provide an informational advantage to firms and increase competition as firms can use this information to bid for additional services and potentially negotiate lower rates.

The proposed amendments to our rules governing the proxy solicitation process are intended to provide clarity and address issues that have arisen. We believe these proposals would provide certainty to soliciting parties and facilitate communications with shareholders. Additional clarity and facilitated communications would promote efficiency.

We request comment on whether the proposed amendments would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

## **VI. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA)<sup>172</sup> we solicit data to determine whether the proposed rule amendments constitute a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

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<sup>172</sup> 5 U.S.C. 603.

Commenters should provide empirical data on (a) the annual effect on the economy; (b) any increase in costs or prices for consumers or individual industries; and (c) any effect on competition, investment or innovation. We request your comments on the reasonableness of this estimate.

## **VII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS**

This Initial Regulatory Flexibility Analysis (IRFA) has been prepared in accordance with the Regulatory Flexibility Act.<sup>173</sup> It relates to proposed revisions to the rules under the Securities Act, Exchange Act and Investment Company Act regarding executive compensation and corporate governance disclosures and the proxy solicitation process.

### **A. Reasons for, and Objectives of, the Proposed Action**

These proposals are designed to enhance the executive compensation and corporate governance disclosures provided by companies, and clarify and address issues that have arisen in the proxy solicitation process. Specifically, in regard to disclosure, the proposals are intended to enhance the transparency of a company's compensation policies and its impact on risk taking; director and nominee qualifications; board leadership structure; the potential conflicts of compensation consultants; and to provide investors with clearer and more meaningful executive compensation disclosure. We are also proposing amendments to our proxy rules that would clarify the manner in which they operate and to eliminate potential obstacles to shareholder communication.

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<sup>173</sup> 5 U.S.C. 601.

## **B. Legal Basis**

We are proposing the amendments pursuant to Sections 3(b), 6, 7, 10 and 19(a) of the Securities Act; Sections 12, 13, 14(a), 15(d), and 23(a) of the Exchange Act, and Sections 8, 20(a), 24(a), 30, and 38 of the Investment Company Act.

## **C. Small Entities Subject to the Proposed Action**

The proposed amendments would affect some companies that are small entities. The Regulatory Flexibility Act defines “small entity” to mean “small business,” “small organization,” or “small governmental jurisdiction.”<sup>174</sup> 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. Securities Act Rule 157<sup>175</sup> and Exchange Act Rule 0-10(a)<sup>176</sup> defines a company, other than an investment company, to be a “small business” or “small organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,229 companies, other than registered investment companies, that may be considered small entities. The proposed amendments would affect small entities that have a class of securities that are registered under Section 12 of the Exchange Act or that are required to file reports under Section 15(d) of the Exchange Act. In addition, the proposals also would affect small entities that file, or have filed, a registration statement that has not yet become effective under the Securities Act and that has not been withdrawn. An investment company is considered to be a “small business” if it, together with other investment companies in the same group of related investment companies, has net assets of

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<sup>174</sup> 5 U.S.C. 601(6).

<sup>175</sup> 17 CFR 230.157.

<sup>176</sup> 17 CFR 240.0-10(a).

\$50 million or less as of the end of its most recent fiscal year.<sup>177</sup> We believe that the proposals would affect small entities that are investment companies. We estimate that there are approximately 212 investment companies that may be considered small entities.

**D. Reporting, Recordkeeping, and other Compliance Requirements**

The proposed disclosure amendments are designed to enhance the transparency of boards of directors, provide investors with a better understanding of the functions and activities of boards, and to provide investors with clearer and more meaningful compensation disclosure. These amendments would require small entities that are operating companies to provide:<sup>178</sup>

- Disclosure of the aggregate grant date fair value of equity awards computed in accordance with FAS 123R;
- Additional disclosure about compensation consultants employed by companies, including disclosure about the full scope of services provided by the consultants or its affiliates and the related fees for such services; and
- Disclosure of the results of shareholder votes on Form 8-K within four business days after the end of the meeting.

In addition, these amendments would require small entities that are operating companies or registered management investment companies to provide:

- Disclosure of the qualifications of directors and nominees for director, and a brief discussion of the specific experience, qualifications, attributes or skills that qualify that person to serve as a director for the company at that time, and as a member of

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<sup>177</sup> 17 CFR 270.0-10(a).

<sup>178</sup> The proposed requirements to discuss and analyze a company's overall compensation programs as they may have a material impact on risk management practices would not apply to smaller reporting companies.

any committee that the person serves on or is chosen to serve on, in light of the company's business and structure;

- Added disclosure regarding certain legal proceedings involving a company's directors, nominees for director and executive officers; and
- Disclosure about a company's board leadership structure and the board's role in the risk management process.

The proposed proxy rule amendments would provide certainty to soliciting parties and facilitate communications with shareholders and, as a result, would not impose any reporting or recordkeeping requirements on small entities. These proposed amendments would affect both large and small entities equally. The proposed proxy rule amendments set forth clear, uniform standards to aid companies and other soliciting parties in the process of soliciting proxies under our rules.

**E. Duplicative, Overlapping, or Conflicting Federal Rules**

We believe the proposed amendments would not duplicate, overlap, or conflict with other federal rules.

**F. Significant Alternatives**

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed disclosure amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;

- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

Currently, small entities are subject to some different compliance or reporting requirements under Regulation S-K and the proposed amendments would not affect these requirements. Under Regulation S-K, small entities are required to provide abbreviated compensation disclosure with respect to the principal executive officer and two most highly compensated executive officers for the last two completed fiscal years. Specifically, small entities may provide the executive compensation disclosure specified in Items 402(l) through (r) of Regulation S-K, rather than the corresponding disclosure specified in Items 402(a) through (k) of Regulation S-K. Items 402(l) through (r) also do not require small entities to provide CD&A or the Grants of Plan-Based Awards Table. Therefore small entities would not be required to disclose their overall compensation practices. Other than the proposed amendments to the Grants of Plan-Based Awards Table, the remaining proposed disclosure requirements would apply to small entities to the same extent as larger issuers.

As noted above, the proposed amendments to CD&A would not apply to small entities. We are not proposing to expand the existing alternative reporting requirements under Item 402 of Regulation S-K, or establish additional different compliance requirements or an exemption from coverage of the proposed amendments for small entities. The proposed amendments would provide investors with greater transparency regarding director and nominee qualifications; board leadership structure and their role in the risk management process; potential conflicts of compensation consultants; and voting results at annual and special meetings. We do not believe these disclosures will create a significant new burden; we do, however, believe uniform, comparable disclosures across all companies will help shareholders and the markets.

The proposed amendments would clarify, consolidate and simplify the reporting requirements for all public companies including small entities. The proposed amendments would require clear and straightforward disclosure of director and nominee qualifications, board leadership structure and the potential conflicts of interest of compensation consultants. We have used design rather than performance standards in connection with the proposed amendments for two reasons. First, based on our past experience, we believe the proposed revisions would be more useful to investors if there were specific disclosure requirements. The proposed disclosures are intended to result in more comprehensive and clear disclosure. Second, the specific disclosure requirements in the proposed amendments would promote consistent disclosure among all companies. We seek comment on whether we should exempt small entities from any of the proposed disclosures or scale the proposed amendments to reflect the characteristics of small entities and the needs of their investors.

#### **G. Solicitation of Comments**

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- How the proposed amendments can achieve their objective while lowering the burden on smaller entities;
- The number of small entity companies that may be affected by the proposed amendments;
- The existence or nature of the potential impact of the proposed amendments on small entity companies discussed in the analysis; and
- How to quantify the impact of the proposed amendments.

Respondents are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

### **VIII. STATUTORY AUTHORITY AND TEXT OF THE PROPOSED AMENDMENTS**

The amendments contained in this release are being proposed under the authority set forth in Sections 3(b), 6, 7, 10, and 19(a) of the Securities Act; Sections 12, 13, 14, 15(d) and 23(a) of the Exchange Act; and Sections 8, 20(a), 24(a), 30 and 38 of the Investment Company Act.

#### **List of Subjects**

17 CFR Parts 229, 239, 240, 249, 270 and 279

Reporting and recordkeeping requirements, Securities.

#### **TEXT OF THE PROPOSED AMENDMENTS**

For the reasons set out in the preamble, the Commission proposes to 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, 77iii, 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.

\* \* \* \* \*

2. Amend §229.401 by:

a. revising paragraph (e)(1);

b. in paragraph (e)(2) revising the phrase "Indicate any other directorships" to read "Indicate any other directorships held, including any other directorships held during the past five years,";

c. in paragraph (f), introductory text, revise the phrase "during the past five years" to read "during the past ten years".

The revisions read as follows:

**§229.401 (Item 401) Directors, executive officers, promoters and control persons.**

\* \* \* \* \*

(e) Business experience. (1) Background. Briefly describe the business experience during the past five years of each director, executive officer, person nominated or chosen to become a director or executive officer, and each person named in answer to paragraph (c) of Item 401, including: Each person's principal occupations and employment during the past five years; the name and principal business of any corporation or other organization in which such occupations and employment were carried on; and whether such corporation or organization is a parent, subsidiary or other affiliate of the registrant. In addition, for each director or person nominated or chosen to become a director, briefly discuss the specific experience, qualifications, attributes or skills that qualify that person to serve as a director for the registrant at the time that the disclosure is made, and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the registrant's business and structure. If material, this disclosure should cover more than the past five years, and include information about the person's risk assessment skills, particular areas of expertise, or other relevant qualifications. When an

executive officer or person named in response to paragraph (c) of Item 401 has been employed by the registrant or a subsidiary of the registrant for less than five years, a brief explanation shall be included as to the nature of the responsibility undertaken by the individual in prior positions to provide adequate disclosure of his or her prior business experience. What is required is information relating to the level of his professional competence, which may include, depending upon the circumstances, such specific information as the size of the operation supervised.

\* \* \* \* \*

3. Amend §229.402 by:
  - a. redesignating paragraph (b)(1), introductory text, paragraph (b)(1)(i) through paragraph (b)(1)(vi) as paragraph (b)(1)(i), introductory text, and paragraph (b)(1)(i)(A) through paragraph (b)(1)(i)(F);
  - b. redesignating paragraph (b)(2), introductory text, paragraph (b)(2)(i) through paragraph (b)(2)(xv) as paragraph (b)(1)(ii), introductory text, paragraphs (b)(1)(ii)(A) through paragraph (b)(1)(ii)(O);
  - c. redesignating the Instructions to Item 402(b) as Instructions to Item 402(b)(1)(i) and (b)(1)(ii);
  - d. adding a heading to newly redesignated paragraph (b)(1)(i);
  - e. revising the introductory text to newly redesignated paragraph (b)(1)(ii);
  - f. revising newly redesignated Instructions to Item 402(b)(1)(i) and (b)(1)(ii);
  - g. adding new paragraph (b)(2);
  - h. adding Instructions to Item 402(b);
  - i. revising Instruction 2 to Item 402(c)(2)(iii) and (iv), paragraphs (c)(2)(v) and (c)(2)(vi), the Instructions to Item (c)(2)(v) and (vi), and paragraph (c)(2)(ix)(G);

- j. revising the Grants of Plan-Based Awards Table in paragraph (d)(1);
- k. removing the period at the end of paragraphs (d)(2)(iii) and (d)(2)(iv) and adding a semi colon in its place;
  - l. adding "and" at the end of paragraph (d)(2)(vi), removing "and" at the end of paragraph (d)(2)(vii) and adding a period in its place;
  - m. removing paragraph (d)(2)(viii) and Instruction 7 to Item 402(d);
  - n. revising paragraphs (k)(2)(iii) and (k)(2)(iv) and the Instruction to Item (k)(2)(iii) and (iv);
  - o. revising paragraph (k)(2)(vii)(1) and Instruction to Item 402(k);
  - p. revising Instruction 2 to Item 402(n)(2)(iii) and (iv);
  - q. revising paragraphs (n)(2)(v), (n)(2)(vi) and the Instruction to Item 402(n)(2)(v) and (vi);
  - r. revising paragraph (n)(2)(ix)(G);
  - s. revising paragraphs (r)(2)(iii), (r)(2)(iv) and (r)(2)(vii)(1) before the Instruction, and Instruction to Item 402(r).

The revisions and additions read as follows:

**§229.402 (Item 402) Compensation.**

\* \* \* \* \*

(b) Compensation discussion and analysis. (1)(i) Compensation discussion and analysis for the named executive officers. \* \* \*

\* \* \* \* \*

(ii) While the material information to be disclosed under Compensation Discussion and Analysis for the Named Executive Officers will vary depending upon the facts and

circumstances, examples of such information may include, in a given case, among other things, the following:

\* \* \* \* \*

Instruction 1 to Item 402(b)(1)(i) and (b)(1)(ii). The purpose of the Compensation Discussion and Analysis for the Named Executive Officers is to provide to investors material information that is necessary to an understanding of the registrant's compensation policies and decisions regarding the named executive officers.

Instruction 2 to Item 402(b)(1)(i) and (b)(1)(ii). The Compensation Discussion and Analysis for the Named Executive Officers should be of the information contained in the tables and otherwise disclosed pursuant to this Item. It should also cover actions regarding executive compensation that were taken after the registrant's last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.

(2) Compensation discussion and analysis of the registrant's overall compensation program as it relates to the registrant's risk management. To the extent that risks arising from the registrant's compensation policies and overall actual compensation practices for employees generally may have a material effect on the registrant, discuss the registrant's policies or practices of compensating its employees, including non-executive officers, as they relate to risk management practices and/or risk-taking incentives. While the situations requiring disclosure will vary depending on the particular registrant and compensation policies, situations that may

trigger disclosure include, among others, compensation policies: at a business unit of the company that carries a significant portion of the registrant's risk profile; at a business unit with compensation structured significantly differently than other units within the registrant; at business units that are significantly more profitable than others within the registrant; at business units where compensation expense is a significant percentage of the unit's revenues; and that vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the registrant from the task extend over a significantly longer period of time. The purpose of this paragraph (b)(2) is to provide investors material information concerning how the registrant compensates and incentivizes its employees that may create risk. While the information to be disclosed pursuant to this paragraph (b)(2) will vary depending upon the nature of the registrant's business and the compensation approach, the following are examples of the issues that the registrant may need to address for the business units or employees discussed:

(i) The general design philosophy of the registrant's compensation policies for employees whose behavior would be most impacted by the incentives established by the policies, as such policies relate to or affect risk taking by employees on behalf of the registrant, and the manner of its implementation;

(ii) The registrant's risk assessment or incentive considerations, if any, in structuring compensation policies or in awarding and paying compensation;

(iii) How the registrant's compensation policies relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;

(iv) The registrant's policies regarding adjustments to its compensation policies to address changes in its risk profile;

(vi) Material adjustments the company has made to its compensation policies or practices as a result of changes in risk profile; and

(vii) The extent to which the registrant monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees.

Instruction 1 to Item 402(b). The Compensation Discussion and Analyses provided pursuant to paragraph (b) should focus on the material principles underlying the registrant's compensation policies and decisions and the most important factors relevant to analysis of those policies and decisions. The Compensation Discussion and Analyses shall reflect the individual circumstances of the registrant and shall avoid boilerplate language and repetition of the more detailed information set forth in the tables and narrative disclosures that follow.

Instruction 2 to Item 402(b). Registrants are not required to disclose target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant. The standard to use when determining whether disclosure would cause competitive harm for the registrant is the same standard that would apply when a registrant requests confidential treatment of confidential trade secrets or confidential commercial or financial information pursuant to Securities Act Rule 406 (17 CFR 230.406) and Exchange Act Rule 24b-2 (17 CFR 240.24b-2), each of which incorporates the criteria for non-disclosure when relying upon Exemption 4 of the Freedom of Information Act (5

U.S.C. 552(b)(4)) and Rule 80(b)(4) (17 CFR 200.80(b)(4)) thereunder. A registrant is not required to seek confidential treatment under the procedures in Securities Act Rule 406 and Exchange Act Rule 24b-2 if it determines that the disclosure would cause competitive harm in reliance on this instruction; however, in that case, the registrant must discuss how difficult it will be for the executive or how likely it will be for the registrant to achieve the undisclosed target levels or other factors.

Instruction 3 to Item 402(b). Disclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G (17 CFR 244.100 through 244.102) and Item 10(e) (§229.10(e)); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements.

(c) \* \* \*

(2) \* \* \*

Instructions to Item 402(c)(2)(iii) and (iv).

\* \* \* \* \*

2. Registrants need not include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer pursuant to a registrant's program under which stock, equity-based or other forms of non-cash compensation may be received by a named executive officer instead of a portion of annual compensation earned in a covered fiscal year. However, the receipt of any such form of non-cash compensation instead of salary or bonus earned for a covered fiscal year must be disclosed in the appropriate column of the Summary Compensation Table corresponding to that fiscal year (e.g., stock awards (column (e)); option awards (column (f)); all other compensation (column (i))), or, if made pursuant to a non-equity incentive plan and therefore not reportable in the

Summary Compensation Table when granted, a footnote must be added to the salary or bonus column so disclosing and referring to the Grants of Plan-Based Awards Table (required by paragraph (d) of this Item) where the award is reported.

(v) For awards of stock, the aggregate grant date fair value computed in accordance with FAS 123R (column (e));

(vi) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FAS 123R (column (f));

Instruction 1 to Item 402(c)(2)(v) and (vi). For awards reported in columns (e) and (f), include a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the registrant's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

Instruction 2 to Item 402(c)(2)(v) and (vi). If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise price of options or SARs previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means ("repriced"), or otherwise has materially modified such awards, the registrant shall include, as awards required to be reported in column (f), the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R, with respect to that repriced or modified award.

\* \* \* \* \*

(ix) \* \* \*

(G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in columns (e) or (f); and

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

GRANTS OF PLAN-BASED AWARDS

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Sh)
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
PEO										
PFO										
A										
B										
C										

\* \* \* \* \*

(k) \* \* \*

(2) \* \* \*

(iii) For awards of stock, the aggregate grant date fair value computed in accordance with FAS 123R (column (c));

(iv) For awards of stock options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FAS 123R (column (d));

Instruction to Item 402(k)(2)(iii) and (iv). For each director, disclose by footnote to the appropriate column, the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year end.

\* \* \* \* \*

(vii) \* \* \*

(I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (c) or (d); and

\* \* \* \* \*

Instruction to Item 402(k). In addition to the Instructions to paragraph (k)(2)(vii) of this Item, the following apply equally to paragraph (k) of this Item: Instructions 2 and 4 to paragraph (c) of this Item; Instructions to paragraphs (c)(2)(iii) and (iv) of this Item; Instructions to paragraphs (c)(2)(v) and (vi) of this Item; Instructions to paragraph (c)(2)(vii) of this Item; and Instructions to paragraph (c)(2)(viii) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (k) of this Item that correspond to analogous disclosures provided for in paragraph (c) of this Item to which they refer.

\* \* \* \* \*

(n) \* \* \*

(2) \* \* \*

Instructions to Item 402(n)(2)(iii) and (n)(2)(iv). 1. \* \* \*

2. Smaller reporting companies need not include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer pursuant to a smaller reporting company's program under which stock, equity-based or other forms of non-cash compensation may be received by a named executive officer instead of a portion of annual compensation earned in a covered fiscal year. However, the receipt of any such form of non-cash compensation instead of salary or bonus earned for a covered fiscal year must be disclosed in the appropriate column of the Summary Compensation Table corresponding to that fiscal year (e.g., stock awards (column (e)); option awards (column (f)); all other compensation (column (i))), or, if made pursuant to a non-equity incentive plan and therefore not reportable in the Summary Compensation Table when granted, a footnote must be added to the salary or bonus column so disclosing and referring to the narrative disclosure to the Summary Compensation Table (required by paragraph (o) of this Item) where the material terms of the award are reported.

(v) For awards of stock, the aggregate grant date fair value computed in accordance with FAS 123R (column (e));

(vi) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FAS 123R (column (f));

Instruction 1 to Item 402(n)(2)(v) and (n)(2)(vi). For awards reported in columns (e) and (f), include a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the smaller reporting company's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

Instruction 2 to Item 402(n)(2)(v) and (n)(2)(vi). If at any time during the last completed fiscal year, the smaller reporting company has adjusted or amended the exercise price of options or SARs previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means ("repriced"), or otherwise has materially modified such awards, the smaller reporting company shall include, as awards required to be reported in column (f), the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R, with respect to that repriced or modified award.

\* \* \* \* \*

(ix) \* \* \*

(G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (e) or (f); and

\* \* \* \* \*

(r) \* \* \*

(2) \* \* \*

(iii) For awards of stock, the aggregate grant date fair value computed in accordance with FAS 123R (column (c));

(iv) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FAS 123R (column (d));

\* \* \* \* \*

(vii) \* \* \*

(I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (c) or (d); and

\* \* \* \* \*

Instruction to Item 402(r). In addition to the Instruction to paragraph (r)(2)(vii) of this Item, the following apply equally to paragraph (r) of this Item: Instructions 2 and 4 to paragraph (n) of this Item; the Instructions to paragraphs (n)(2)(iii) and (iv) of this Item; the Instructions to paragraphs (n)(2)(v) and (vi) of this Item; the Instructions to paragraph (n)(2)(vii) of this Item; the Instruction to paragraph (n)(2)(viii) of this Item; the Instructions to paragraph (n)(2)(ix) of this Item; and paragraph (o)(7) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (r) of this Item that correspond to analogous disclosures provided for in paragraph (n) of this Item to which they refer.

\* \* \* \* \*

4. Amend §229.407 by revising paragraph (e)(3)(iii) and adding paragraph (h) before the Instructions to Item 407 read as follows:

**§229.407 (Item 407) Corporate governance.**

\* \* \* \* \*

(e) \* \* \*

(3) \* \* \*

(iii) Any role of compensation consultants in determining or recommending the amount or form of executive and director compensation (other than any role limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees) during the registrant's last completed fiscal year, identifying such consultants, stating whether such consultants were engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement. If any compensation consultants or their affiliates played a role in determining or recommending the amount or form of executive and director compensation and they also provided additional services to the registrant or its affiliates during the registrant's last completed fiscal year (including consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees), then disclose the nature and the extent of all additional services provided, as well as the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for such additional services. Disclose whether the decision to engage the compensation consultant or their affiliates for these other services was made, subject to screening, or recommended, by management, and whether the compensation committee or the board approved such other services of the compensation consultants or their affiliates.

\* \* \* \* \*

(h) Company leadership structure. Briefly describe the registrant's leadership structure, such as whether the same person serves as both principal executive officer and chairman of the board, or whether two individuals serve in those positions, and, in the case of a registrant that is an investment company, whether the chairman of the board is an "interested person" of the registrant as defined in section 2(a)(19) of the Investment Company Act. If one person serves as both principal executive officer and chairman of the board, or if the chairman of the board of a registrant that is an investment company is an "interested person" of the registrant, disclose whether the registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the registrant. This disclosure should indicate why the registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the registrant. In addition, disclose the extent of the board's role in the registrant's risk management and the effect that this has on the company's leadership structure.

\* \* \* \* \*

#### **PART 239 — FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

5. 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.

\* \* \* \* \*

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

6. 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.

\* \* \* \* \*

7. Amend §240.14a-2 by revising paragraph (b)(1) introductory text; and paragraph (b)(1)(ix) to read as follows:

§240.14a-2 Solicitations to which §240.14a-3 to §240.14a-15 apply.

\* \* \* \* \*

(b) \* \* \*

(1) Any solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization. Provided, however, that for purposes of this paragraph (b)(1), the term "form of revocation" does not include an unmarked duplicate of a form of proxy that the registrant provides to security holders if the person who furnishes such unmarked duplicate requests that it be returned directly to the registrant, and provided further that the exemption set forth in this paragraph shall not apply to:

\* \* \* \* \*

(ix) Any person, whether or not a security holder of the registrant who, because of a substantial interest in the subject matter of the solicitation, is likely to receive a benefit from a successful solicitation other than a benefit:

(A) Realized as a security holder of the registrant that would be shared pro rata by all other holders of the same class of securities; or

(B) Arising from the person's employment with the registrant; and

\* \* \* \* \*

8. Amend §240.14a-4 by revising paragraphs (d)(4) and (e) to read as follows:

**§240.14a-4 Requirements as to proxy.**

\* \* \* \* \*

(d) \* \* \* \*

(4) To consent to or authorize any action other than the action proposed to be taken in the proxy statement, or matters referred to in paragraph (c) of this section. A person shall not be deemed to be a bona fide nominee and the person shall not be named as such unless the person has consented to being named in the proxy statement and to serve if elected. Provided, however, that nothing in this §240.14a-4 shall prevent any person soliciting in support of nominees who, if elected, would constitute a minority of the board of directors, from seeking authority to vote for nominees named in the registrant's or one or more other persons' proxy statements, so long as the soliciting party:

(i) Seeks authority to vote in the aggregate for the number of director positions then subject to election;

(ii) Represents that it will vote for all the nominees named in such other proxy statements, other than those nominees specified by the soliciting party;

(iii) Provides the security holder an opportunity to withhold authority with respect to any other nominee named in such other proxy statements by writing the name of that nominee on the form of proxy;

(iv) States on the form of proxy and in the proxy statement that there is no assurance that the nominees named in such other proxy statements will serve if elected with any of the soliciting party's nominees; and

(v) If seeking authority to vote for nominees named in one or more other non-registrant persons' proxy statements, represents in the proxy statement that:

(A) It has not agreed and will not agree to act, directly or indirectly, as a group or otherwise engage in any activities that would be deemed to cause the formation of a "group" as determined under section 13(d)(3) of the Exchange Act (15 U.S.C. 78m(d)(3)) and in Regulation 13D-G (§§240.13d-1 through 240.13d-102) with any such other non-registrant person or persons; and

(B) It has not acted and otherwise will not act as a "participant," as defined in Schedule 14A (§240.14a-101), in any solicitation by any such other non-registrant person or persons.

(e) The proxy statement or form of proxy shall provide, subject to objectively determinable reasonable specified conditions, that the shares represented by the proxy will be voted and that where the person solicited specifies by means of a ballot provided pursuant to paragraph (b) of this section a choice with respect to any matter to be acted upon, the shares will be voted in accordance with the specifications so made.

\* \* \* \* \*

9. Amend §240.14a-12 by revising paragraph (a)(1)(i) to read as follows:

**§240.14a-12 Solicitation before furnishing a proxy statement.**

(a) \* \* \*

(1) \* \* \*

(i) The identity of the participants in the solicitation (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101)) and a description of their direct or indirect interests, by security holdings or otherwise, or, if that information previously has been filed either as part of a proxy statement or other soliciting materials under a cover page in the form set forth in Schedule 14A (§240.14a-101) in connection with the solicitation, a prominent legend in clear, plain language advising security holders where they can obtain that filed information; and

\* \* \* \* \*

- 10. Amend §240.14a-101 by:
  - a. revising paragraph (b) of Item 7;
  - b. in Item 22:
    - i. redesignating paragraph (b)(3) as paragraph (b)(3)(ii);
    - ii. adding new paragraph (b)(3)(i); and
    - iii. redesignating Instruction to paragraph (b)(3) as Instruction to paragraph (b)(3)(ii);
    - iv. redesignating paragraph (b)(4), introductory text, and paragraph (b)(4)(i) through paragraph (b)(4)(iv) as new paragraph (b)(4)(i), introductory text, and paragraph (b)(4)(i)(A) through paragraph (b)(4)(i)(D);
    - v. adding new paragraph (b)(4)(ii); and
    - vi. revising paragraph (b)(11).

The revisions and additions read as follows:

**§240.14a-101 Schedule 14A. Information required in proxy statement.**

\* \* \* \* \*

Item 7. Directors and executive officers.

\* \* \* \* \*

(b) The information required by Items 401, 404(a) and (b), 405 and 407(d)(4), (d)(5) and (h) of Regulation S-K (§229.401, §229.404(a) and (b), §229.405 and §229.407(d)(4), (d)(5) and (h) of this chapter).

\* \* \* \* \*

Item 22. Information required in investment company proxy statement.

\* \* \* \* \*

(b) Election of Directors. \* \* \*

(3)(i) For each director or nominee for election as director, briefly discuss the specific experience, qualifications, attributes, or skills that qualify that person to serve as a director for the Fund at the time that the disclosure is made, and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the Fund's business and structure. If material, this disclosure should cover more than the past five years, and include information about the person's risk assessment skills, particular areas of expertise, or other relevant qualifications.

\* \* \* \* \*

(4) \* \* \*

(ii) Unless disclosed in the table required by paragraph (b)(1) of this Item or in response to paragraph (b)(4)(i) of this Item, indicate any directorships held during the past five years by each director or nominee for election as director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78j) or subject to the requirements of section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered

as an investment company under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), as amended, and name the companies in which the directorships were held.

\* \* \* \* \*

(11) Provide in tabular form, to the extent practicable, the information required by Items 401(f) and (g), 404(a), 405, and 407(h) of Regulation S-K (§§229.401(f) and (g), 229.404(a), 229.405, and 229.407(h) of this chapter).

Instruction to Item 22(b)(11). Information provided under paragraph (b)(8) of this Item 22 is deemed to satisfy the requirements of Item 404(a) of Regulation S-K for information about directors, nominees for election as directors, and Immediate Family Members of directors and nominees, and need not be provided under this paragraph (b)(11).

#### **PART 249 -- FORMS, SECURITIES EXCHANGE ACT OF 1934**

11. 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.

\* \* \* \* \*

12. By amending Form 8-K (referenced in §249.308) by adding Item 5.07 under the caption "Information to Be Included in the Report" after the General Instructions read as follows:

**Note: The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.**

#### **Form 8-K**

\* \* \* \* \*

#### **General Instructions**

\* \* \* \* \*

## Information to Be Included in the Report

\* \* \* \* \*

### Item 5.07 Submission of Matters to a Vote of Security Holders.

If any matter was submitted to a vote of security holders, through the solicitation of proxies or otherwise, furnish the following information:

(a) The date of the meeting and whether it was an annual or special meeting.

(b) If the meeting involved the election of directors, the name of each director elected at the meeting and the name of each other director whose term of office as a director continued after the meeting.

(c) A brief description of each other matter voted upon at the meeting and state the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes as to each such matter, including a separate tabulation with respect to each nominee for office.

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (17 CFR 240.14a-101)) terminating any solicitation subject to Rule 14a-12(c), including the cost or anticipated cost to the registrant.

Instruction 1 to Item 5.07. The four business day period for reporting the event under this Item 5.07 shall begin to run on the day on which the meeting ended. If the matter voted upon at the meeting relates to a contested election of directors and the information called for by this Item is not definitively determined at the end of the meeting, the registrant shall disclose on Form 8-K under this Item 5.07 the preliminary voting results within four business days after the preliminary voting results are determined; provided that in such an event, the registrant shall file

an amended report on Form 8-K under this Item 5.07 within four business days after the final voting results are certified.

Instruction 2 to Item 5.07. If any matter has been submitted to a vote of security holders otherwise than at a meeting of such security holders, corresponding information with respect to such submission shall be furnished. The solicitation of any authorization or consent (other than a proxy to vote at a stockholders' meeting) with respect to any matter shall be deemed a submission of such matter to a vote of security holders within the meaning of this item.

Instruction 3 to Item 5.07. Paragraph (a) need be answered only if paragraph (b) or (c) is required to be answered.

Instruction 4 to Item 5.07. Paragraph (b) need not be answered if (i) proxies for the meeting were solicited pursuant to Regulation 14A under the Act, (ii) there was no solicitation in opposition to the management's nominees as listed in the proxy statement, and (iii) all of such nominees were elected. If the registrant did not solicit proxies and the board of directors as previously reported to the Commission was re-elected in its entirety, a statement to that effect in answer to paragraph (b) will suffice as an answer thereto.

Instruction 5 to Item 5.07. Paragraph (c) must be answered for all matters voted upon at the meeting, including both contested and uncontested elections of directors.

Instruction 6 to Item 5.07. If the registrant has furnished to its security holders proxy soliciting material containing the information called for by paragraph (d), the paragraph may be answered by reference to the information contained in such material.

Instruction 7 to Item 5.07. If the registrant has published a report containing all the information called for by this item, the item may be answered by a reference to the information contained in such report.

\* \* \* \* \*

13. Amend Form 10-Q (referenced in §249.308a) by removing Item 4 in Part II—  
Other Information, and redesignating Items 5 and 6 as Items 4 and 5.

14. Amend Form 10-K (referenced in §249.310) by removing Item 4 in Part I, and  
redesignating Items 5 through 15 as Items 4 through 14.

**PART 274 — FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF  
1940**

15. 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.

\* \* \* \* \*

16. Form N-1A (referenced in §§239.15A and 274.11A), Item 17 is amended by:

- a. revising the heading to paragraph (b);
- b. revising paragraph (b)(1);
- c. redesignating paragraph (b)(3), introductory text, and paragraph (b)(3)(i) through  
paragraph (b)(3)(iv) as paragraph (b)(3)(i), introductory text, and paragraph (b)(3)(i)(A) through  
paragraph (b)(3)(i)(D);
- d. adding new paragraph (b)(3)(ii); and
- e. adding paragraph (b)(10).

The revisions and additions 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**

\* \* \* \* \*

**Item 17. Management of the Fund**

\* \* \* \* \*

(b) Leadership Structure and Board of Directors.

(1) Briefly describe the Fund's leadership structure, including the responsibilities of the board of directors with respect to the Fund's management and whether the chairman of the board is an interested person of the Fund. If the chairman of the board is an interested person of the Fund, disclose whether the Fund has a lead independent director and what specific role the lead independent director plays in the leadership of the Fund. This disclosure should indicate why the Fund has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Fund. In addition, disclose the extent of the board's role in the Fund's risk management and the effect that this has on the Fund's leadership structure.

\* \* \* \* \*

(3) \* \* \*

(ii) Unless disclosed in the table required by paragraph (a)(1) of this Item 17 or in response to paragraph (b)(3)(i) of this Item 17, indicate any directorships held during the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Securities Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act, and name the companies in which the directorships were held.

\* \* \* \* \*

(10) For each director, briefly discuss the specific experience, qualifications, attributes, or skills that qualify that person to serve as a director for the Fund at the time that the disclosure

is made, and as a member of any committee that the person serves on, in light of the Fund's business and structure. If material, this disclosure should cover more than the past five years, and include information about the person's risk assessment skills, particular areas of expertise, or other relevant qualifications.

\* \* \* \* \*

17. Form N-2 (referenced in §§239.14 and 274.11 a-1), Item 18 is amended by:

a. redesignating paragraph 5, introductory text, and paragraph 5(a) through paragraph 5(d) as paragraph 5(b), introductory text, and paragraph 5(b)(1) through paragraph 5(b)(4);

b. adding new paragraph 5(a);

c. redesignating paragraph 6, introductory text, and paragraph 6(a) through paragraph 6(d) as paragraph 6(a), introductory text, and paragraph 6(a)(1) through paragraph 6(a)(4);

d. adding new paragraph 6(b); and

e. adding paragraph 17.

The additions read as follows:

**Note: The text of Form N-2 does not, and these amendments will not, appear in the Code of Federal Regulations.**

#### Form N-2

\* \* \* \* \*

#### Item 18. Management

\* \* \* \* \*

5.(a) Briefly describe the Registrant's leadership structure, including whether the chairman of the board is an interested person of the Registrant, as defined in section 2(a)(19) of

the 1940 Act (15 U.S.C. 80a-2(a)(19)). If the chairman of the board is an interested person of the Registrant, disclose whether the Registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the Registrant. This disclosure should indicate why the Registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Registrant. In addition, disclose the extent of the board's role in the Registrant's risk management and the effect that this has on the Registrant's leadership structure.

\* \* \* \* \*

6. \* \* \*

(b) Unless disclosed in the table required by paragraph 1 of this Item 18 or in response to paragraph 6(a) of this Item 18, indicate any directorships held during the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the 1940 Act, and name the companies in which the directorships were held.

\* \* \* \* \*

17. For each director, briefly discuss the specific experience, qualifications, attributes, or skills that qualify that person to serve as a director for the Registrant at the time that the disclosure is made, and as a member of any committee that the person serves on, in light of the Registrant's business and structure. If material, this disclosure should cover more than the past five years, and include information about the person's risk assessment skills, particular areas of expertise, or other relevant qualifications.

\* \* \* \* \*

18. Form N-3 (referenced in §§239.17a and 274.11b), Item 20 is amended by:

a. redesignating paragraph (d), introductory text, and paragraph (d)(i) through paragraph (d)(iv) as paragraph (d)(ii), introductory text, and paragraph (d)(ii)(A) through paragraph (d)(ii)(D);

b. adding new paragraph (d)(i);

c. redesignating paragraph (e), introductory text, and paragraph (e)(i) through paragraph (e)(iv) as paragraph (e)(i), introductory text, and paragraph (e)(i)(A) through paragraph (e)(i)(D);

e. adding new paragraph (e)(ii); and

f. adding paragraph (o).

The additions read as follows:

**Note: The text of Form N-3 does not, and these amendments will not, appear in the Code of Federal Regulations.**

**Form N-3**

\* \* \* \* \*

**Item 20. Management**

\* \* \* \* \*

(d)(i) Briefly describe the Registrant's leadership structure, including whether the chairman of the board is an interested person of the Registrant, as defined in Section 2(a)(19) of the 1940 Act (15 U.S.C. 80a-2(a)(19)) and the rules thereunder. If the chairman of the board is an interested person of the Registrant, disclose whether the Registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the Registrant. This disclosure should indicate why the Registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Registrant. In

addition, disclose the extent of the board's role in the Registrant's risk management and the effect that this has on the Registrant's leadership structure.

(e) \* \* \*

(ii) Unless disclosed in the table required by paragraph (a) of this Item 20 or in response to paragraph (e)(i) of this Item 20, indicate any directorships held during the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78j) or subject to the requirements of section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the 1940 Act, and name the companies in which the directorships were held.

\* \* \* \* \*

(o) For each director, briefly discuss the specific experience, qualifications, attributes, or skills that qualify that person to serve as a director for the Registrant at the time that the disclosure is made, and as a member of any committee that the person serves on, in light of the Registrant's business and structure. If material, this disclosure should cover more than the past five years, and include information about the person's risk assessment skills, particular areas of expertise, or other relevant qualifications.

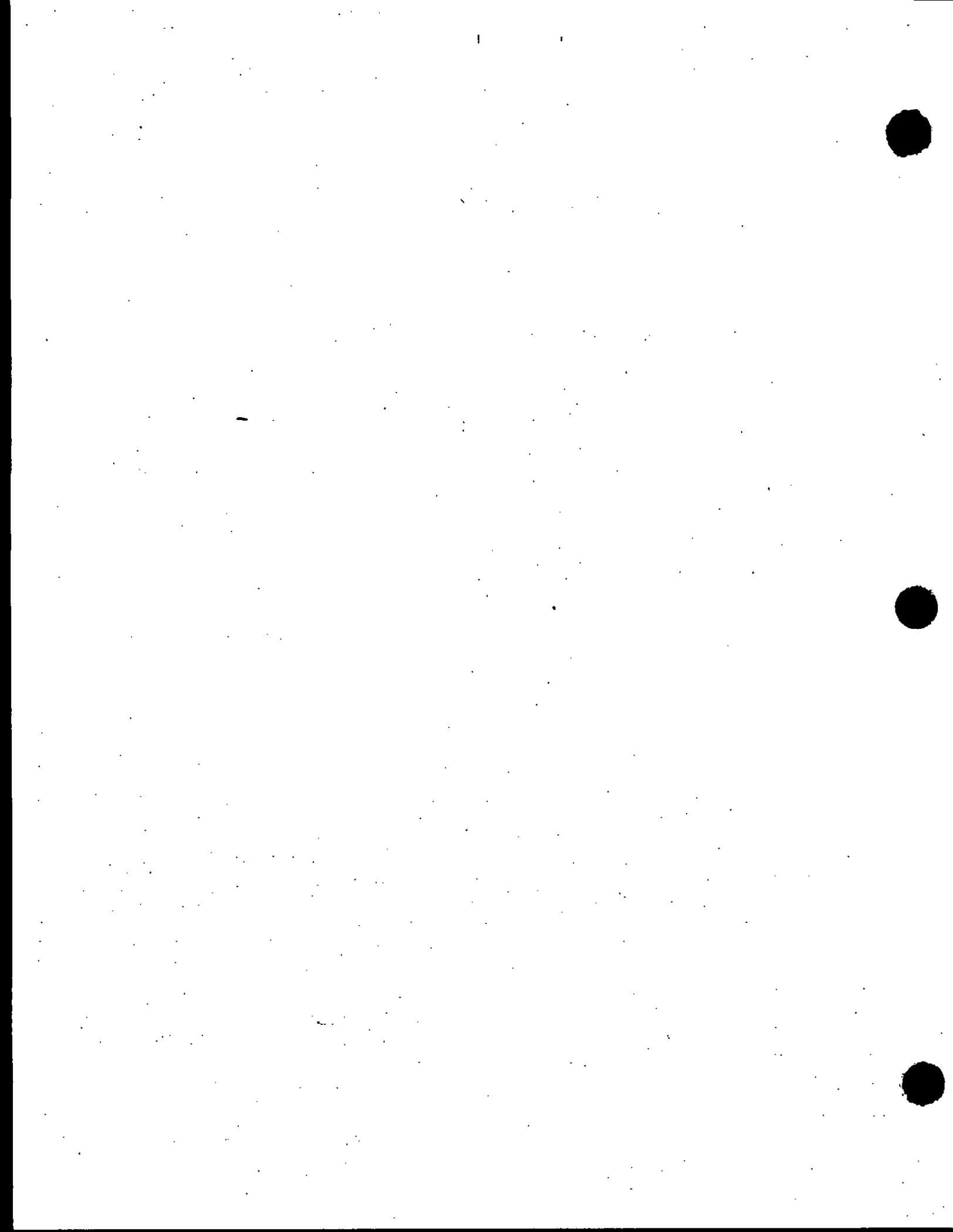
\* \* \* \* \*

By the Commission.



Elizabeth M. Murphy  
Secretary

July 10, 2009



*Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 9051 / July 10, 2009

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60279 / July 10, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13544

In the Matter of

Ameriprise Financial  
Services, Inc.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTION 8A OF THE  
SECURITIES ACT OF 1933 AND SECTIONS  
15(b) AND 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934, 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 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Ameriprise Financial Services, Inc. ("Ameriprise" 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 Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

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

#### Summary

These proceedings arise out of Ameriprise's receipt of approximately \$30.8 million in undisclosed compensation in connection with Ameriprise's offer and sale to its brokerage customers of certain real estate investment trusts ("REITs") between 2000 and May 2004 (the "Relevant Period"). Ameriprise demanded this undisclosed compensation, which it referred to as "revenue sharing," in exchange for including the REITs on Ameriprise's brokerage platform. This matter also involves Ameriprise's unlawful offer and sale of at least \$100 million worth of shares of one such REIT to its brokerage customers in the absence of an effective registration statement.

#### Respondent

1. Ameriprise, the successor entity to American Express Financial Advisors, Inc., is a Delaware corporation with headquarters located in Minneapolis, Minnesota. Ameriprise has been registered with the Commission as a broker-dealer since 1971 and as an investment adviser since 1979. Ameriprise is a wholly-owned subsidiary of Ameriprise Financial, Inc., the successor entity to American Express Financial Corporation ("AEFC"). Prior to September 30, 2005, AEFC was a wholly-owned subsidiary of American Express Corp.

#### Other Relevant Entities

2. The "Carey REITs," as referred to herein, consist of: Corporate Property Associates 10 ("CPA:10"), Carey Institutional Properties ("CIP"), Corporate Property Associates 12 ("CPA:12"), Corporate Property Associates 14 ("CPA:14"), Corporate Property Associates 15 ("CPA:15"), and Corporate Property Associates 16 ("CPA:16"); and all predecessor and successor entities thereof. W.P. Carey & Co. LLC, a Delaware limited liability company, and various wholly-owned direct and indirect subsidiaries thereof (collectively, "Carey"), were the creators, managers, and advisers of the Carey REITs at all relevant times. Ameriprise offered and sold shares of the Carey REITs to its brokerage customers. At all relevant times, the offerings of the shares of the Carey REITs were registered with the Commission but did not trade on any exchange.

3. The "CNL REITs," as referred to herein, consist of: CNL Hospitality Properties, Inc., CNL Retirement Properties, Inc., and CNL American Properties Fund; and all predecessor and successor entities thereof. CNL Holdings Group, Inc., a Florida corporation, and various wholly-owned direct and indirect subsidiaries thereof (collectively, "CNL"), were the creators, managers, and advisers to the CNL REITs at all relevant times. Ameriprise offered and sold shares of the CNL REITs to its brokerage customers. At all relevant times, the offerings of the shares of the CNL REITs were registered with the Commission but did not trade on any exchange.

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

### Undisclosed Revenue Sharing Payments

4. During the Relevant Period, Ameriprise demanded and received approximately \$30.8 million in undisclosed supplementary payments from the Carey REITs and CNL REITs, and/or affiliates thereof, in connection with Ameriprise's offers and sales to its brokerage customers of shares of the Carey REITs and CNL REITs. These undisclosed payments were in addition to the compensation Ameriprise was entitled to receive under its distribution agreements concerning the Carey REITs and CNL REITs. None of this \$30.8 million – or the conflicts of interest created by these payments – was disclosed by either Ameriprise or the Carey REITs and CNL REITs. As a result, Ameriprise sold more than \$3.5 billion worth of shares of the Carey REITs and CNL REITs to its brokerage customers during the Relevant Period without disclosing such payments.

5. During the late 1990's, Ameriprise began to offer an increased amount of non-proprietary products to its customers, including non-exchange traded REITs. In early 2000, Ameriprise approached the Carey REITs and CNL REITs, the only non-exchange traded REITs then offered on Ameriprise's brokerage platform, and demanded supplementary remuneration (the "revenue sharing payments") in order to increase Ameriprise's revenues. As of early 2000, Ameriprise had been responsible for the sale of in excess of 75 percent of the shares of the Carey REITs and CNL REITs sold to investors pursuant to public offerings and was the only major broker-dealer firm that then offered and sold the Carey REITs and CNL REITs. In exchange for these revenue sharing payments, Ameriprise continued to offer and sell shares of the Carey REITs and CNL REITs on its brokerage platform.

6. During the Relevant Period, Ameriprise only offered and sold non-exchange traded REITs that agreed to pay revenue sharing – *i.e.*, the Carey REITs and CNL REITs, and explicitly considered the willingness of non-exchange traded REITs to make revenue sharing payments when evaluating whether to offer such products on its platform. For example, an internal Ameriprise presentation provided to, among others, Ameriprise's CEO and CFO, in approximately September 2003 described the criteria that Ameriprise personnel used in selecting potential new non-exchange traded REITs and explicitly included, among other factors, "[a]bility to meet revenue sharing requirements."

7. Under the revenue sharing arrangements, Ameriprise received undisclosed cash payments in the form of checks and wire transfers during the Relevant Period from the Carey REITs and CNL REITs totaling approximately \$9.7 million and \$21.1 million, respectively. These cash payments were in addition to standard sales commissions, dealer fees, expense reimbursements, and other fees that Ameriprise received that were specified in the distribution agreements entered into by Ameriprise concerning the Carey REITs and CNL REITs, and that were disclosed in the prospectuses and other public offering documents of the Carey REITs and CNL REITs.

8. To facilitate its receipt of the revenue sharing payments, Ameriprise issued a series of mislabeled invoices for the revenue sharing payments that gave the appearance that the

payments were legitimate reimbursements for services provided by Ameriprise. These invoices largely used separate labels referring to particular services or expenses that together totaled the amount Ameriprise demanded under the revenue sharing arrangements. In fact, none of the invoiced amounts directly corresponded to *bona fide* services rendered and/or expenses incurred by Ameriprise as claimed on the invoices.

9. In exchange for the revenue sharing payments, Ameriprise continued to offer and sell the Carey REITs and CNL REITs on its brokerage platform. In addition, during the Relevant Period Ameriprise increased the compensation that it paid to its registered representatives in connection with the sale of the Carey REITs and CNL REITs, and the revenue sharing payments Ameriprise obtained were designed in part to cover this increased compensation to its registered representatives.

10. Ameriprise's revenue sharing arrangements with the Carey REITs and CNL REITs were part of a company-wide practice instituted and/or authorized by Ameriprise's senior management, in which Ameriprise offered and/or promoted certain non-proprietary investment products, primarily mutual funds, but also including non-exchange traded REITs, in exchange for the receipt of revenue sharing payments from almost all of these investment vehicles, including through what Ameriprise called its Preferred Provider Program and Select Group Program.<sup>2</sup> As part of this practice and through these programs, Ameriprise received substantial revenue sharing payments in exchange for shelf space and/or enhanced marketing in Ameriprise's retail distribution network. In particular, Ameriprise made available to the Carey REITs and CNL REITs substantially the same enhanced marketing as the non-proprietary mutual funds that paid among the highest revenue sharing rates. Ameriprise employees responsible for Ameriprise's dealings with the Carey REITs and CNL REITs gave frequent presentations to Ameriprise's senior management during the Relevant Period that detailed Ameriprise's revenue sharing arrangements with the Carey REITs and CNL REITs, including comparisons to Ameriprise's revenue sharing arrangements with non-proprietary mutual funds.

11. During the Relevant Period, Ameriprise's senior management did not take any actions or instruct anyone else to take any actions to investigate or determine the adequacy of the disclosures that Ameriprise made or relied upon relating to the remuneration it received in connection with its offers and sales of the Carey REITs and CNL REITs to its brokerage customers.

12. At all relevant times, the National Association of Securities Dealers ("NASD," now known as the Financial Industry Regulatory Authority), of which Ameriprise was a member

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<sup>2</sup> On December 1, 2005, the Commission issued an order finding that Ameriprise violated provisions of the Securities Act and Exchange Act by failing to disclose its receipt of cash and directed brokerage revenue sharing payments from the non-proprietary mutual fund families that participated in Ameriprise's revenue sharing programs between January 2001 and August 2004. The Commission's order censured Ameriprise, and ordered Ameriprise to cease and desist from committing or causing violations of these provisions and to pay disgorgement plus prejudgment interest of \$15 million and a civil penalty of \$15 million.

broker-dealer, limited the compensation that may be paid to broker-dealers that sell non-exchange traded REITs, capping the total underwriting compensation at 10 percent of the total proceeds raised (the "10 percent cap"), plus an additional 0.5 percent for reimbursement of bona fide due diligence expenses. Underwriting compensation is defined by NASD regulations to include "[a]ll items of compensation paid . . . directly or indirectly from whatever source to [broker-dealers]. . . which are deemed to be in connection with or related to the public offering." NASD regulations prohibit member broker-dealers, such as Ameriprise, from participating in any non-exchange traded REIT offering that exceeds the 10 percent cap. A portion of the revenue sharing payments made to Ameriprise, when added to other payments made to broker-dealers, caused some of the Carey REITs to exceed their respective 10 percent caps on broker-dealer compensation imposed by the NASD.

### **Ameriprise's Undisclosed Revenue Sharing Arrangement with the Carey REITs**

13. During the Relevant Period, the Carey REITs paid Ameriprise undisclosed revenue sharing totaling approximately \$9.7 million.<sup>3</sup> For 2000, the Carey REITs paid Ameriprise revenue sharing in the form of a fixed fee for the year that totaled approximately \$1.5 million. For 2001, Ameriprise increased the revenue sharing to \$2.5 million per year, and in late 2002, Ameriprise again increased the revenue sharing arrangements to an amount equaling 25 basis points ("bps") annually on all Ameriprise brokerage customer assets invested in the Carey REITs. None of the \$9.7 million in revenue sharing payments was disclosed by Ameriprise or in the Carey REITs' offering documents, despite the fact that those offering documents disclosed certain fees payable to broker-dealers that were quantitatively smaller than the revenue sharing paid to Ameriprise.

14. To facilitate Ameriprise's receipt of the revenue sharing payments, Ameriprise issued a series of invoices to the Carey REITs that divided or allocated the revenue sharing payments into separate invoices that were mislabeled "account maintenance," "field access," "due diligence," and "conference" fees. The particular allocation and/or language appearing on the invoices that Ameriprise issued was requested by the Carey REITs. Each of the invoice labels was primarily a conduit for Ameriprise to receive the payments Ameriprise demanded under the revenue sharing arrangements and was not a legitimate fee charged for services provided by Ameriprise or a reimbursement of actual expenses incurred by Ameriprise. The total of the invoices with these false labels equaled the amount of revenue sharing payments that Ameriprise had demanded under the revenue sharing arrangement for a particular year, quarter, or month.

15. For example, during the Relevant Period, Ameriprise periodically held conferences for its registered representatives at which certain non-proprietary products that paid among the highest levels of revenue sharing, such as the Carey REITs and CNL REITs, could pay set fees to

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<sup>3</sup> In March 2008, Carey settled a Commission action relating to the undisclosed revenue sharing payments and registration violations at issue here, among other violations, by agreeing to a permanent injunction against violations of the antifraud, reporting, proxy, and registration provisions of the federal securities laws and paying disgorgement, prejudgment interest, and civil penalties totaling approximately \$30 million. See SEC v. W.P. Carey & Co. LLC et al., 08 Civ. 2846 (S.D.N.Y.).

have a certain number of attendees present at the conferences or provide sponsorship of particular events at the conference. In addition to attendance and payment of these fees in the normal course by affiliates of the Carey REITs, Ameriprise and the Carey REITs arranged for one of the Carey REITs to intentionally overpay for certain conferences as a conduit for making undisclosed revenue sharing payments to Ameriprise in 2000 and 2001. No additional attendees or conference-related benefits were provided in exchange for the amount paid in excess of the amounts due for the conference. An internal Ameriprise email dated August 12, 2002, explained that while the revenue sharing arrangement with the Carey REITs was for \$2.5 million per year, the amounts that Ameriprise had issued invoices for (as due diligence, field access, and account maintenance) totaled only \$2.3 million, with "the additional \$200,000 [being] added to their conference fee check" and then Ameriprise personnel "split out the check, sending the appropriate [sic] amount to [the Ameriprise division responsible for organizing conferences.]"

16. During the Relevant Period, Ameriprise also issued invoices to the Carey REITs labeled "due diligence" purportedly seeking reimbursement for *bona fide* due diligence expenses incurred but that actually were undisclosed revenue sharing payments that were designed to count towards the amount of revenue sharing that Ameriprise demanded from the Carey REITs. Relevant NASD regulations require that broker-dealers seeking reimbursement for *bona fide* due diligence expenses strictly limit such reimbursements to actual expenses incurred in conducting due diligence for a particular program, without a profit margin of any kind. Notwithstanding this requirement, Ameriprise did not do any *bona fide* due diligence in exchange for these payments. Ameriprise issued invoices purportedly seeking reimbursement for *bona fide* due diligence expenses that did not include any documentation or itemization of the expenses. In one instance Ameriprise sought a six-year *back-payment* of purported expenses, and in some instances the due diligence invoices issued covered periods in which no *bona fide* due diligence could have been performed (e.g., after a particular Carey REIT offering had ended). An internal Ameriprise email dated March 19, 2001, explained that in 2000 Ameriprise "asked [Carey and CNL] to come up with over a million dollars each in additional revenue, and, at least for Carey, they came up with this amount by using funds they had earmarked as due diligence related costs."

17. Ameriprise also issued invoices labeled "account maintenance," the payment of which would satisfy a portion of the amount Ameriprise had demanded under the revenue sharing arrangement. None of these invoices reflected actual or estimated expenses incurred by Ameriprise in providing account maintenance services for which the Carey REITs were obligated to reimburse Ameriprise. In fact, the undisclosed fee charged by Ameriprise purportedly for "account maintenance" was duplicative of a separately disclosed fee offered by some of the Carey REITs that Ameriprise also received. These Carey REITs disclosed in their respective prospectuses that an "annual servicing fee" or "annual monitoring fee" may be paid to selling broker-dealers. The stated purpose of the fee, as described in the prospectus of one of the Carey REITs was "to compensate [selling broker-dealers] for their continuing due diligence of the Company, for expenses incurred in maintaining and providing information about the Company to their representatives and their clients and for the costs incurred in maintaining [the Carey REIT's] investor accounts."

18. A portion of the revenue sharing payments made to Ameriprise, when added to other payments made to broker-dealers, caused some of the Carey REITs to exceed their respective 10 percent caps on broker-dealer compensation imposed by the NASD. The particular allocation and/or language appearing on the invoices Ameriprise issued for the revenue sharing payments was the means through which the Carey REITs circumvented the 10 percent cap, enabling Ameriprise to receive higher fees than permitted. The Carey REITs excluded the payments of invoices that Ameriprise agreed to label "account maintenance" from counting towards their respective 10 percent caps on the basis that the payments purportedly were not made in connection with the offering of the Carey REITs. In mid-2002, in order to circumvent the 10 percent cap, the Carey REITs requested, and Ameriprise agreed, to issue all invoices for revenue sharing to the Carey REITs as "account maintenance." The Carey REITs also requested, and Ameriprise agreed, that Ameriprise cancel and re-issue certain invoices under a different label in furtherance of the Carey REITs' circumvention of the 10 percent cap. Specifically, Ameriprise canceled and re-issued previously separate invoices labeled "due diligence," "field access," and "account maintenance" as one invoice labeled "account maintenance" for the same total amount as the previously issued separate invoices for each of the second and third quarters of 2002.

19. With respect to each public offering of the Carey REITs of which Ameriprise offered and sold shares to its brokerage customers, Ameriprise entered into a written dealer agreement concerning the applicable Carey REIT consistent with the form of dealer agreement provided in the registration statement of the applicable Carey REIT that, among other things, specified the fees to be paid in connection with Ameriprise's sales of shares. However, none of these written dealer agreements disclosed or included the revenue sharing payments.

20. In addition, at various times, Ameriprise attempted to obtain a written side letter from the Carey REITs documenting their undisclosed revenue sharing arrangements. The Carey REITs declined to enter into such written agreements because the revenue sharing arrangements had not been properly disclosed in the prospectuses of the Carey REITs, a fact of which some Ameriprise employees were aware and discussed. For example, an internal Ameriprise email dated August 14, 2003, by an Ameriprise employee who managed Ameriprise's relationships with the Carey REITs and CNL REITs stated: "I will continue to work with [Carey] on obtaining a [side letter] but the difficulty with them is the 25 bps on assets we currently are billing them is not in the prospectus. . . ." Another internal Ameriprise email dated October 28, 2002, by another Ameriprise employee stated, with respect to non-exchange traded REITs, including the Carey REITs and CNL REITs, that "[m]any have prospectus-imposed limits, and they are reluctant to enter into a written agreement because of additional disclosure that they feel would be required."

#### **Ameriprise's Undisclosed Revenue Sharing Arrangement with the CNL REITs**

21. During the Relevant Period, the CNL REITs paid Ameriprise undisclosed revenue sharing totaling approximately \$21.1 million. None of the \$21.1 million in revenue sharing payments was disclosed by Ameriprise or in the CNL REITs' offering documents, despite the fact that those offering documents disclosed certain fees payable to broker-dealers that were quantitatively smaller than the revenue sharing fees paid to Ameriprise.

22. For 2000, the CNL REITs paid Ameriprise revenue sharing in the form of a fixed fee for the year totaling approximately \$1.7 million. For 2001, Ameriprise increased the revenue sharing to \$2.5 million per year. In mid-2002, Ameriprise again increased the revenue sharing arrangements to an amount equaling 25 bps annually on all Ameriprise brokerage customer assets invested in the CNL REITs.

23. In February 2003, the CNL REITs proposed, and Ameriprise accepted, an alternative revenue sharing arrangement of 70 bps on each new sale of CNL REIT shares, designed to approximate the 25 bps fee on assets in the form of a sales based fee. An Ameriprise employee's notes from a February 2003 meeting between representatives of the CNL REITs and Ameriprise personnel in which this proposed change was discussed recorded that the representatives of the CNL REITs could not "justify taking 25 bps from past [CNL REITs'] operating expenses that are no longer bringing in sales to the product" or "justify/disclose to [the CNL REITs' shareholders] they [are] paying 25 bps on assets in past [CNL REITs]."

24. Ameriprise issued two types of invoices to the CNL REITs that divided or allocated the revenue sharing payments into separate invoices mislabeled "preferred sponsorship" and either "shareholder support" or "customer service support" to provide the appearance that the payments were legitimate reimbursements for services provided by Ameriprise. The particular allocation and/or language appearing on the invoices that Ameriprise issued was requested by the CNL REITs. As with the invoices that Ameriprise issued to the Carey REITs, the invoices labeled "preferred sponsorship" and either "shareholder support" or "customer service support" bore no direct relationship to documented expenses incurred by Ameriprise or a legitimate fee charged for services claimed. The total of these invoices issued to the CNL REITs equaled the amount that Ameriprise had demanded under the revenue sharing arrangement for a particular year, quarter, or month. Ameriprise had no legitimate basis by which it determined the amounts that it charged on the invoices issued for the services for which it claimed to be seeking payment.

25. For example, in 2001, Ameriprise received equal revenue sharing payments of \$2.5 million from the Carey REITs and CNL REITs and Ameriprise provided the Carey REITs and CNL REITs with approximately equivalent services and benefits in exchange for those payments. With respect to the CNL REITs, Ameriprise issued two separate types of invoices for the revenue sharing payments for that year: (i) invoices labeled "shareholder support" or "customer service support" totaling \$1.7 million; and (ii) invoices labeled "preferred sponsorship" totaling \$800,000. Notwithstanding that Ameriprise's revenue sharing arrangements with the Carey REITs and CNL REITs were for the same amount in 2001, with respect to the Carey REITs, Ameriprise issued invoices for and/or received four separate types of payments for the revenue sharing owed for that year: (i) an invoice labeled "account maintenance" for \$800,000; (ii) an invoice labeled "field access" for \$1.2 million; (iii) an invoice labeled "due diligence" for \$300,000; and (iv) a payment of \$200,000 included as part of a check purportedly for conference fees. In addition, the invoices labeled "shareholder support" or "customer service support" that Ameriprise issued to the CNL REITs were purportedly for the same services as the invoices labeled "account maintenance" that Ameriprise issued to the Carey REITs. Notwithstanding that the services or benefits claimed on these invoices were the same, Ameriprise purportedly charged the CNL REITs \$1.7 million for account servicing while Ameriprise purportedly charged the Carey REITs only \$800,000 for that

same purported service. Likewise, the invoices labeled "preferred sponsorship" that Ameriprise issued to the CNL REITs were purported fees for the same benefits as the invoices labeled "field access" that Ameriprise issued to the Carey REITs. Notwithstanding that the purported benefits were the same, Ameriprise charged the CNL REITs only \$800,000 for this purported "access" while Ameriprise charged the Carey REITs \$1.2 million. Ameriprise had no legitimate basis by which it determined the charges invoiced for the purported services or benefits claimed on the invoices. Ameriprise simply issued the invoices with the particular allocation and language that was requested by the Carey REITs and CNL REITs.

26. With respect to each public offering of the CNL REITs of which Ameriprise offered and sold shares to its brokerage customers, Ameriprise entered into a written dealer agreement concerning the applicable CNL REIT consistent with the form of dealer agreement provided in the registration statement of the applicable CNL REIT that, among other things, specified the fees to be paid in connection with Ameriprise's sales of shares. However, none of these written dealer agreements disclosed or included the revenue sharing payments.

27. In addition, at various times, Ameriprise attempted to obtain a written side letter from the CNL REITs documenting their undisclosed revenue sharing arrangements. The CNL REITs declined to enter into such written agreements because the revenue sharing arrangements had not been properly disclosed in the prospectuses of the CNL REITs, a fact of which some Ameriprise employees were aware and discussed. For example, the internal Ameriprise email dated August 14, 2003, referenced above, by an Ameriprise employee that managed Ameriprise's relationships with the Carey REITs and CNL REITs, stated that a CNL REIT would be filing its next offering in approximately five months and at that time would be "changing their prospectus to allow them to pay brokered dealers [sic] 1.5% on sales for marketing, managing dealer, and soliciting dealer fee[s]. Currently today their prospectus only allows for .5%. Once they file, they begin paying us the 1.5% instead of the .70% they send us today and at that time they will put it in writing. . . . Let me know if you are OK will [sic] waiting for 5 months to obtain the [side letter]."

#### **Ameriprise Did Not Disclose the Revenue Sharing Payments**

28. During the Relevant Period, Ameriprise did not make any disclosures to its brokerage customers relating to its receipt of revenue sharing payments from the Carey REITs and CNL REITs. Moreover, the registration statements, prospectuses, and other offering documents filed with the Commission by the Carey REITs and CNL REITs did not disclose material information concerning the additional remuneration that Ameriprise received above and beyond the amounts disclosed as selling commissions, dealer fees, expense reimbursements, and other fees. Quantitatively, the undisclosed revenue sharing payments were higher than several of the fees disclosed in the prospectuses of the Carey REITs and CNL REITs.

29. As a result, Ameriprise's brokerage customers who purchased shares of the Carey REITs and CNL REITs were not provided with any disclosures by Ameriprise or by the Carey REITs and CNL REITs concerning Ameriprise's receipt of the undisclosed revenue sharing payments or the conflicts of interest these payments created.

### Participation in Unlawful Sales

30. The initial public offering of shares of one of the Carey REITs was declared effective on November 1, 2001, and was closed to new investors in November 2002, having sold out its initial registration of 40 million shares ("Phase I"). A registration statement for a second offering of an additional 69 million shares ("Phase II") was filed with the Commission on October 11, 2002, and was declared effective on March 19, 2003.

31. Throughout the period from November 2002 until March 19, 2003, Ameriprise continued to offer and sell shares of this REIT to its brokerage customers even though the Phase I offering had sold out and the Phase II registration statement was not yet effective. As of March 18, 2003, Ameriprise had offered and sold at least \$100 million worth of Phase II shares to its brokerage customers prior to the effective date of the registration statement. Ameriprise also received sales commissions and marketing fees in connection with its sales of Phase II shares prior to the effectiveness of the registration statement.

### Violations

32. As a result of the conduct described above, Ameriprise willfully<sup>4</sup> violated:

- a. Sections 17(a)(2) and 17(a)(3) of the Securities Act, which provide that it is "unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . (2) to obtain money or property by means of any untrue statement of 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; or (3) to engage in any transactions, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser";
- b. Exchange Act Rule 10b-10, which provides in pertinent part that it is "unlawful for any broker or dealer to effect for or with an account of a customer any transaction in, or to induce the purchase or sale by such customer of, any security . . . unless such broker or dealer, at or before completion of such transaction; gives or sends to such customer written notification disclosing . . . the source and amount of any other remuneration

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<sup>4</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

received or to be received by the broker in connection with the transaction"; and

- c. Section 5(a) of the Securities Act, which provides that "[u]nless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly – (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

#### IV.

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

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

A. Ameriprise shall cease and desist from committing or causing any violations and any future violations of Sections 5(a), 17(a)(2), and 17(a)(3) of the Securities Act, and Exchange Act Rule 10b-10.

B. Ameriprise is censured.

C. Ameriprise shall, within 10 days of the entry of this Order, pay disgorgement in the total amount of \$8.65 million ("Disgorgement") to the Securities and Exchange Commission. Ameriprise also shall, within 10 days of the entry of this Order, pay a civil monetary penalty in the amount of \$8.65 million ("Penalties") to the Securities and Exchange Commission. Such payments shall be (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Ameriprise as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to David Rosenfeld, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, New York 10281. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717.

D. Such Penalties may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the

deterrent effect of the civil penalty, Respondent agrees that it shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that it is entitled to, nor shall it further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

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

ADMINISTRATIVE PROCEEDING  
File No. 3-13546

In the Matter of

N.U. Pizza Holding Corp.,  
Nahama & Weagent Energy Co.,  
Namsco Corp.,  
Nemdaco, Inc.,  
Net Telecommunications, Inc.,  
Network Commerce, Inc.,  
Network One Holdings Corp.,  
New Bridge Products, Inc.,  
New Capital iWorks, Inc., and  
Nextpath Technologies, Inc.,  
(n/k/a Central American  
Development Group, Inc.)

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents N.U. Pizza Holding Corp., Nahama & Weagent Energy Co., Namsco Corp., Nemdaco, Inc., Net Telecommunications, Inc., Network Commerce, Inc., Network One Holdings Corp., New Bridge Products, Inc., New Capital iWorks, Inc., and Nextpath Technologies, Inc. (n/k/a Central American Development Group, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. N.U. Pizza Holding Corp. (CIK No. 879124) is a revoked Nevada corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). N.U. Pizza is delinquent in its

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periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2001, which reported a net loss of \$18,600 for the prior nine months. As of June 18, 2009, the company's stock (symbol "NUPZ") was traded on the over-the-counter markets.

2. Nahama & Weagent Energy Co. (CIK No. 350070) is a suspended California corporation located in Bakersfield, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Nahama is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1994, which reported a net loss of \$345,345 for the prior three months.

3. Namsco Corp. (CIK No. 822373) is an expired Utah corporation located in Spokane, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Namsco is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended September 30, 1996, which reported a net loss of \$827,469 for the prior nine months. As of June 18, 2009, the company's stock (symbol "NAMS") was traded on the over-the-counter markets.

4. Nemdaco, Inc. (CIK No. 793036) is a delinquent Colorado corporation located in Bell Canyon, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Nemdaco 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 January 31, 1997, which reported a net loss of \$383,000 for the prior nine months. As of June 18, 2009, the company's stock (symbol "NMDO") was traded on the over-the-counter markets.

5. Net Telecommunications, Inc. (CIK No. 90357) is a Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Net Telecommunications 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, 1997, which reported a net loss of over \$1.2 million since inception on October 24, 1994. As of June 18, 2009, the company's stock (symbol "NETQ") was traded on the over-the-counter markets.

6. Network Commerce, Inc. (CIK No. 1087879) is a dissolved Washington corporation located in Spokane, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Network is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002, which reported a net loss of \$7.4 million for the prior nine months. As of June 18, 2009, the company's stock (symbol "NWKC") was traded on the over-the-counter markets.

7. Network One Holdings Corp. (CIK No. 1053498) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Network One is delinquent in its periodic filings with the Commission, having not filed any periodic

reports since it filed a Form 20-FR registration statement on January 21, 1998, which reported a net loss of \$83,209 (Canadian) for the year ended March 31, 1997.

8. New Bridge Products, Inc. (CIK No. 1101192) is a revoked Nevada corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). New Bridge is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on December 20, 1999, which reported a net loss of \$730,957 for the nine months ended September 30, 1999.

9. New Capital iWorks, Inc. (CIK No. 1218634) is a void Delaware corporation located in El Segundo, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). New Capital 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, 2003. A Form 10-SB/A registration statement filed on June 29, 2004 reported a net loss of over \$2.3 million since the company's October 21, 1999 inception.

10. Nextpath Technologies, Inc. (n/k/a Central American Development Group, Inc.) (CIK No. 1088788) is a Nevada corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Nextpath is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2000, which reported a net loss of over \$7.75 million for the prior nine months. While the company filed a Form 15 to voluntarily deregister its stock on December 12, 2006, the filing was invalid on its face because the company claimed too many stockholders to permit voluntary deregistration. As of June 18, 2009, the company's stock (symbol "NPTK") was traded on the over-the-counter markets.

## B. DELINQUENT PERIODIC FILINGS

11. 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.

12. 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. Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which

their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

13. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

### III.

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

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

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

### IV.

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

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

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

This Order shall be served forthwith upon 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  
"N" Delinquent Issuers II**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>N.U. Pizza Holding Corp.</b>					
	10-K	06/30/01	09/28/01	Not filed	93
	10-Q	09/30/01	11/14/01	Not filed	91
	10-Q	12/31/01	02/14/02	Not filed	88
	10-Q	03/31/02	05/15/02	Not filed	85
	10-K	06/30/02	09/30/02	Not filed	81
	10-Q	09/30/02	11/14/02	Not filed	79
	10-Q	12/31/02	02/14/03	Not filed	76
	10-Q	03/31/03	05/15/03	Not filed	73
	10-K	06/30/03	09/29/03	Not filed	69
	10-Q	09/30/03	11/14/03	Not filed	67
	10-Q	12/31/03	02/17/04	Not filed	64
	10-Q	03/31/04	05/17/04	Not filed	61
	10-K	06/30/04	09/28/04	Not filed	57
	10-Q	09/30/04	11/15/04	Not filed	55
	10-Q	12/31/04	02/14/05	Not filed	52
	10-Q	03/31/05	05/16/05	Not filed	49
	10-K	06/30/05	09/28/05	Not filed	45
	10-Q	09/30/05	11/14/05	Not filed	43
	10-Q	12/31/05	02/14/06	Not filed	40
	10-Q	03/31/06	05/15/06	Not filed	37
	10-K	06/30/06	09/28/06	Not filed	33
	10-Q	09/30/06	11/14/06	Not filed	31
	10-Q	12/31/06	02/14/07	Not filed	28
	10-Q	03/31/07	05/15/07	Not filed	25
	10-K	06/30/07	09/28/07	Not filed	21
	10-Q	09/30/07	11/14/07	Not filed	19
	10-Q	12/31/07	02/14/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	13
	10-K	06/30/08	09/29/08	Not filed	9
	10-Q	09/30/08	11/14/08	Not filed	7
	10-Q	12/31/08	02/17/09	Not filed	4
	10-Q	03/31/09	05/15/09	Not filed	1
<b>Total Filings Delinquent</b>		<b>32</b>			

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Nahama &amp; Weagent Energy Co.</b>	10-K	12/31/94	03/31/95	Not filed	171
	10-Q	03/31/95	05/15/95	Not filed	169
	10-Q	06/30/95	08/14/95	Not filed	166
	10-Q	09/30/95	11/14/95	Not filed	163
	10-K	12/31/95	04/01/96	Not filed	158
	10-Q	03/31/96	05/15/96	Not filed	157
	10-Q	06/30/96	08/14/96	Not filed	154
	10-Q	09/30/96	11/14/96	Not filed	151
	10-K	12/31/96	03/31/97	Not filed	147
	10-Q	03/31/97	05/15/97	Not filed	145
	10-Q	06/30/97	08/14/97	Not filed	142
	10-Q	09/30/97	11/14/97	Not filed	139
	10-K	12/31/97	03/31/98	Not filed	135
	10-Q	03/31/98	05/15/98	Not filed	133
	10-Q	06/30/98	08/14/98	Not filed	130
	10-Q	09/30/98	11/16/98	Not filed	127
	10-K	12/31/98	03/31/99	Not filed	123
	10-Q	03/31/99	05/17/99	Not filed	121
	10-Q	06/30/99	08/16/99	Not filed	118
	10-Q	09/30/99	11/15/99	Not filed	115
	10-K	12/31/99	03/30/00	Not filed	111
	10-Q	03/31/00	05/15/00	Not filed	109
	10-Q	06/30/00	08/14/00	Not filed	106
	10-Q	09/30/00	11/14/00	Not filed	103
	10-K	12/31/00	04/02/01	Not filed	98
	10-Q	03/31/01	05/15/01	Not filed	97
	10-Q	06/30/01	08/14/01	Not filed	94
	10-Q	09/30/01	11/14/01	Not filed	91
	10-K	12/31/01	04/01/02	Not filed	86
	10-Q	03/31/02	05/15/02	Not filed	85
	10-Q	06/30/02	08/14/02	Not filed	82
	10-Q	09/30/02	11/14/02	Not filed	79
	10-K	12/31/02	03/31/03	Not filed	75
	10-Q	03/31/03	05/15/03	Not filed	73
	10-Q	06/30/03	08/14/03	Not filed	70
	10-Q	09/30/03	11/14/03	Not filed	67
	10-K	12/31/03	03/30/04	Not filed	63
	10-Q	03/31/04	05/17/04	Not filed	61
	10-Q	06/30/04	08/16/04	Not filed	58
	10-Q	09/30/04	11/15/04	Not filed	55

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Nahama &amp; Weagent Energy Co.</b> (continued)	10-K	12/31/04	03/31/05	Not filed	51
	10-Q	03/31/05	05/16/05	Not filed	49
	10-Q	06/30/05	08/15/05	Not filed	46
	10-Q	09/30/05	11/14/05	Not filed	43
	10-K	12/31/05	03/31/06	Not filed	39
	10-Q	03/31/06	05/15/06	Not filed	37
	10-Q	06/30/06	08/14/06	Not filed	34
	10-Q	09/30/06	11/14/06	Not filed	31
	10-K	12/31/06	04/02/07	Not filed	26
	10-Q	03/31/07	05/15/07	Not filed	25
	10-Q	06/30/07	08/14/07	Not filed	22
	10-Q	09/30/07	11/14/07	Not filed	19
	10-K	12/31/07	03/31/08	Not filed	15
	10-Q	03/31/08	05/15/08	Not filed	13
	10-Q	06/30/08	08/14/08	Not filed	10
	10-Q	09/30/08	11/14/08	Not filed	7
	10-K	12/31/08	03/31/09	Not filed	3
	10-Q	03/31/09	05/15/09	Not filed	1

Total Filings Delinquent 58

**Namsco Corp.**

10-KSB	12/31/96	03/31/97	Not filed	147
10-QSB	03/31/97	05/15/97	Not filed	145
10-QSB	06/30/97	08/14/97	Not filed	142
10-QSB	09/30/97	11/14/97	Not filed	139
10-KSB	12/31/97	03/31/98	Not filed	135
10-QSB	03/31/98	05/15/98	Not filed	133
10-QSB	06/30/98	08/14/98	Not filed	130
10-QSB	09/30/98	11/16/98	Not filed	127
10-KSB	12/31/98	03/31/99	Not filed	123
10-QSB	03/31/99	05/17/99	Not filed	121
10-QSB	06/30/99	08/16/99	Not filed	118
10-QSB	09/30/99	11/15/99	Not filed	115
10-KSB	12/31/99	03/30/00	Not filed	111
10-QSB	03/31/00	05/15/00	Not filed	109
10-QSB	06/30/00	08/14/00	Not filed	106
10-QSB	09/30/00	11/14/00	Not filed	103
10-KSB	12/31/00	04/02/01	Not filed	98
10-QSB	03/31/01	05/15/01	Not filed	97
10-QSB	06/30/01	08/14/01	Not filed	94

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Namsco Corp.</b> (continued)	10-QSB	09/30/01	11/14/01	Not filed	91
	10-KSB	12/31/01	04/01/02	Not filed	86
	10-QSB	03/31/02	05/15/02	Not filed	85
	10-QSB	06/30/02	08/14/02	Not filed	82
	10-QSB	09/30/02	11/14/02	Not filed	79
	10-KSB	12/31/02	03/31/03	Not filed	75
	10-QSB	03/31/03	05/15/03	Not filed	73
	10-QSB	06/30/03	08/14/03	Not filed	70
	10-QSB	09/30/03	11/14/03	Not filed	67
	10-KSB	12/31/03	03/30/04	Not filed	63
	10-QSB	03/31/04	05/17/04	Not filed	61
	10-QSB	06/30/04	08/16/04	Not filed	58
	10-QSB	09/30/04	11/15/04	Not filed	55
	10-KSB	12/31/04	03/31/05	Not filed	51
	10-QSB	03/31/05	05/16/05	Not filed	49
	10-QSB	06/30/05	08/15/05	Not filed	46
	10-QSB	09/30/05	11/14/05	Not filed	43
	10-KSB	12/31/05	03/31/06	Not filed	39
	10-QSB	03/31/06	05/15/06	Not filed	37
	10-QSB	06/30/06	08/14/06	Not filed	34
	10-QSB	09/30/06	11/14/06	Not filed	31
	10-KSB	12/31/06	04/02/07	Not filed	26
	10-QSB	03/31/07	05/15/07	Not filed	25
	10-QSB	06/30/07	08/14/07	Not filed	22
	10-QSB	09/30/07	11/14/07	Not filed	19
	10-KSB	12/31/07	03/31/08	Not filed	15
	10-Q*	03/31/08	05/15/08	Not filed	13
	10-Q*	06/30/08	08/14/08	Not filed	10
	10-Q*	09/30/08	11/14/08	Not filed	7
	10-K*	12/31/08	03/31/09	Not filed	3
10-Q*	03/31/09	05/15/09	Not filed	1	
<b>Total Filings Delinquent</b>		<b>50</b>			
<b>Nemdaco, Inc.</b>	10-KSB	04/30/97	07/29/97	Not filed	143
	10-QSB	07/31/97	09/15/97	Not filed	141
	10-QSB	10/31/97	12/15/97	Not filed	138
	10-QSB	01/31/98	03/17/98	Not filed	135
	10-KSB	04/30/98	07/29/98	Not filed	131
	10-QSB	07/31/98	09/14/98	Not filed	129

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Nemdaco, Inc.</b> (continued)	10-QSB	10/31/98	12/15/98	Not filed	126
	10-QSB	01/31/99	03/17/99	Not filed	123
	10-KSB	04/30/99	07/29/99	Not filed	119
	10-QSB	07/31/99	09/14/99	Not filed	117
	10-QSB	10/31/99	12/15/99	Not filed	114
	10-QSB	01/31/00	03/16/00	Not filed	111
	10-KSB	04/30/00	07/31/00	Not filed	107
	10-QSB	07/31/00	09/14/00	Not filed	105
	10-QSB	10/31/00	12/15/00	Not filed	102
	10-QSB	01/31/01	03/19/01	Not filed	99
	10-KSB	04/30/01	07/30/01	Not filed	95
	10-QSB	07/31/01	09/14/01	Not filed	93
	10-QSB	10/31/01	12/17/01	Not filed	90
	10-QSB	01/31/02	03/18/02	Not filed	87
	10-KSB	04/30/02	07/29/02	Not filed	83
	10-QSB	07/31/02	09/16/02	Not filed	81
	10-QSB	10/31/02	12/16/02	Not filed	78
	10-QSB	01/31/03	03/17/03	Not filed	75
	10-KSB	04/30/03	07/29/03	Not filed	71
	10-QSB	07/31/03	09/15/03	Not filed	69
	10-QSB	10/31/03	12/15/03	Not filed	66
	10-QSB	01/31/04	03/16/04	Not filed	63
	10-KSB	04/30/04	07/29/04	Not filed	59
	10-QSB	07/31/04	09/14/04	Not filed	57
	10-QSB	10/31/04	12/15/04	Not filed	54
	10-QSB	01/31/05	03/17/05	Not filed	51
	10-KSB	04/30/05	07/29/05	Not filed	47
	10-QSB	07/31/05	09/14/05	Not filed	45
	10-QSB	10/31/05	12/15/05	Not filed	42
	10-QSB	01/31/06	03/17/06	Not filed	39
	10-KSB	04/30/06	07/31/06	Not filed	35
	10-QSB	07/31/06	09/14/06	Not filed	33
10-QSB	10/31/06	12/15/06	Not filed	30	
10-QSB	01/31/07	03/19/07	Not filed	27	
10-KSB	04/30/07	07/30/07	Not filed	23	
10-QSB	07/31/07	09/14/07	Not filed	21	
10-QSB	10/31/07	12/17/07	Not filed	18	
10-QSB	01/31/08	03/17/08	Not filed	15	

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Nemdaco, Inc.</b>	10-KSB	04/30/08	07/29/08	Not filed	11
(continued)	10-Q*	07/31/08	09/15/08	Not filed	9
	10-Q*	10/31/08	12/15/08	Not filed	6
	10-Q*	01/31/09	03/18/09	Not filed	3

Total Filings Delinquent 48

**Net Telecommunications, Inc.**

10-KSB	12/31/97	03/31/98	Not filed	135
10-QSB	03/31/98	05/15/98	Not filed	133
10-QSB	06/30/98	08/14/98	Not filed	130
10-QSB	09/30/98	11/16/98	Not filed	127
10-KSB	12/31/98	03/31/99	Not filed	123
10-QSB	03/31/99	05/17/99	Not filed	121
10-QSB	06/30/99	08/16/99	Not filed	118
10-QSB	09/30/99	11/15/99	Not filed	115
10-KSB	12/31/99	03/30/00	Not filed	111
10-QSB	03/31/00	05/15/00	Not filed	109
10-QSB	06/30/00	08/14/00	Not filed	106
10-QSB	09/30/00	11/14/00	Not filed	103
10-KSB	12/31/00	04/02/01	Not filed	98
10-QSB	03/31/01	05/15/01	Not filed	97
10-QSB	06/30/01	08/14/01	Not filed	94
10-QSB	09/30/01	11/14/01	Not filed	91
10-KSB	12/31/01	04/01/02	Not filed	86
10-QSB	03/31/02	05/15/02	Not filed	85
10-QSB	06/30/02	08/14/02	Not filed	82
10-QSB	09/30/02	11/14/02	Not filed	79
10-KSB	12/31/02	03/31/03	Not filed	75
10-QSB	03/31/03	05/15/03	Not filed	73
10-QSB	06/30/03	08/14/03	Not filed	70
10-QSB	09/30/03	11/14/03	Not filed	67
10-KSB	12/31/03	03/30/04	Not filed	63
10-QSB	03/31/04	05/17/04	Not filed	61
10-QSB	06/30/04	08/16/04	Not filed	58
10-QSB	09/30/04	11/15/04	Not filed	55
10-KSB	12/31/04	03/31/05	Not filed	51
10-QSB	03/31/05	05/16/05	Not filed	49
10-QSB	06/30/05	08/15/05	Not filed	46
10-QSB	09/30/05	11/14/05	Not filed	43
10-KSB	12/31/05	03/31/06	Not filed	39

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Net Telecommunications, Inc.</b> (continued)	10-QSB	03/31/06	05/15/06	Not filed	37
	10-QSB	06/30/06	08/14/06	Not filed	34
	10-QSB	09/30/06	11/14/06	Not filed	31
	10-KSB	12/31/06	04/02/07	Not filed	26
	10-QSB	03/31/07	05/15/07	Not filed	25
	10-QSB	06/30/07	08/14/07	Not filed	22
	10-QSB	09/30/07	11/14/07	Not filed	19
	10-KSB	12/31/07	03/31/08	Not filed	15
	10-Q*	03/31/08	05/15/08	Not filed	13
	10-Q*	06/30/08	08/14/08	Not filed	10
	10-Q*	09/30/08	11/14/08	Not filed	7
	10-K*	12/31/08	03/31/09	Not filed	3
	10-Q*	03/31/09	05/16/09	Not filed	1
	<b>Total Filings Delinquent</b>		<b>46</b>		

**Network Commerce, Inc.**

10-K	12/31/02	03/31/03	Not filed	75
10-Q	03/31/03	05/15/03	Not filed	73
10-Q	06/30/03	08/14/03	Not filed	70
10-Q	09/30/03	11/14/03	Not filed	67
10-K	12/31/03	03/30/04	Not filed	63
10-Q	03/31/04	05/17/04	Not filed	61
10-Q	06/30/04	08/16/04	Not filed	58
10-Q	09/30/04	11/15/04	Not filed	55
10-K	12/31/04	03/31/05	Not filed	51
10-Q	03/31/05	05/16/05	Not filed	49
10-Q	06/30/05	08/15/05	Not filed	46
10-Q	09/30/05	11/14/05	Not filed	43
10-K	12/31/05	03/31/06	Not filed	39
10-Q	03/31/06	05/15/06	Not filed	37
10-Q	06/30/06	08/14/06	Not filed	34
10-Q	09/30/06	11/14/06	Not filed	31
10-K	12/31/06	04/02/07	Not filed	26
10-Q	03/31/07	05/15/07	Not filed	25
10-Q	06/30/07	08/14/07	Not filed	22
10-Q	09/30/07	11/14/07	Not filed	19
10-K	12/31/07	03/31/08	Not filed	15
10-Q	03/31/08	05/15/08	Not filed	13

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Network Commerce, Inc.</b> (continued)	10-Q	06/30/08	08/14/08	Not filed	10
	10-Q	09/30/08	11/14/08	Not filed	7
	10-K	12/31/08	03/31/09	Not filed	3
	10-Q	03/31/09	05/16/09	Not filed	1
Total Filings Delinquent		26			
<b>Network One Holdings Corp.</b>					
	20-F	03/31/98	09/30/99	Not filed	117
	20-F	03/31/99	10/02/00	Not filed	104
	20-F	03/31/00	10/01/01	Not filed	92
	20-F	03/31/01	09/30/02	Not filed	81
	20-F	03/31/02	09/30/03	Not filed	69
	20-F	03/31/03	09/30/04	Not filed	57
	20-F	03/31/04	09/30/05	Not filed	45
	20-F	03/31/05	10/02/06	Not filed	32
	20-F	03/31/06	10/01/07	Not filed	20
	20-F	03/31/07	09/30/08	Not filed	9
Total Filings Delinquent		10			
<b>New Bridge Products, Inc.</b>					
	10-KSB	12/31/99	03/30/00	Not filed	111
	10-QSB	03/31/00	05/15/00	Not filed	109
	10-QSB	06/30/00	08/14/00	Not filed	106
	10-QSB	09/30/00	11/14/00	Not filed	103
	10-KSB	12/31/00	04/02/01	Not filed	98
	10-QSB	03/31/01	05/15/01	Not filed	97
	10-QSB	06/30/01	08/14/01	Not filed	94
	10-QSB	09/30/01	11/14/01	Not filed	91
	10-KSB	12/31/01	04/04/02	Not filed	86
	10-QSB	03/31/02	05/15/02	Not filed	85
	10-QSB	06/30/02	08/14/02	Not filed	82
	10-QSB	09/30/02	11/14/02	Not filed	79
	10-KSB	12/31/02	03/31/03	Not filed	75
	10-QSB	03/31/03	05/15/03	Not filed	73
	10-QSB	06/30/03	08/14/03	Not filed	70
	10-QSB	09/30/03	11/14/03	Not filed	67
	10-KSB	12/31/03	03/30/04	Not filed	63
	10-QSB	03/31/04	05/17/04	Not filed	61
	10-QSB	06/30/04	08/16/04	Not filed	58

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>New Bridge Products, Inc.</b> (continued)	10-QSB	09/30/04	11/15/04	Not filed	55
	10-KSB	12/31/04	03/31/05	Not filed	51
	10-QSB	03/31/05	05/16/05	Not filed	49
	10-QSB	06/30/05	08/15/05	Not filed	46
	10-QSB	09/30/05	11/14/05	Not filed	43
	10-KSB	12/31/05	03/31/06	Not filed	39
	10-QSB	03/31/06	05/15/06	Not filed	37
	10-QSB	06/30/06	08/14/06	Not filed	34
	10-QSB	09/30/06	11/14/06	Not filed	31
	10-KSB	12/31/06	04/02/07	Not filed	26
	10-QSB	03/31/07	05/15/07	Not filed	25
	10-QSB	06/30/07	08/14/07	Not filed	22
	10-QSB	09/30/07	11/14/07	Not filed	19
	10-KSB	12/31/07	03/31/08	Not filed	15
	10-Q*	03/31/08	05/15/08	Not filed	13
	10-Q*	06/30/08	08/14/08	Not filed	10
	10-Q*	09/30/08	11/14/08	Not filed	7
	10-K*	12/31/08	03/31/09	Not filed	3
	10-Q*	03/31/09	05/16/09	Not filed	1

Total Filings Delinquent 38

**New Capital iWorks, Inc.**

10-KSB	12/31/03	03/30/04	Not filed	63
10-QSB	03/31/04	05/17/04	Not filed	61
10-QSB	06/30/04	08/16/04	Not filed	58
10-QSB	09/30/04	11/15/04	Not filed	55
10-KSB	12/31/04	03/31/05	Not filed	51
10-QSB	03/31/05	05/16/05	Not filed	49
10-QSB	06/30/05	08/15/05	Not filed	46
10-QSB	09/30/05	11/14/05	Not filed	43
10-KSB	12/31/05	03/31/06	Not filed	39
10-QSB	03/31/06	05/15/06	Not filed	37
10-QSB	06/30/06	08/14/06	Not filed	34
10-QSB	09/30/06	11/14/06	Not filed	31
10-KSB	12/31/06	04/02/07	Not filed	26
10-QSB	03/31/07	05/15/07	Not filed	25
10-QSB	06/30/07	08/14/07	Not filed	22
10-QSB	09/30/07	11/14/07	Not filed	19
10-KSB	12/31/07	03/31/08	Not filed	15
10-Q*	03/31/08	05/15/08	Not filed	13

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>New Capital iWorks, Inc.</b> (continued)	10-Q*	06/30/08	08/14/08	Not filed	10
	10-Q*	09/30/08	11/14/08	Not filed	7
	10-K*	12/31/08	03/31/09	Not filed	3
	10-Q*	03/31/09	05/16/09	Not filed	1

Total Filings Delinquent 22

**Nextpath Technologies, Inc.**  
(n/k/a Central American  
Development Group, Inc.)

10-K	12/31/00	04/02/01	Not filed	98
10-Q	03/31/01	05/15/01	Not filed	97
10-Q	06/30/01	08/14/01	Not filed	94
10-Q	09/30/01	11/14/01	Not filed	91
10-K	12/31/01	04/01/02	Not filed	86
10-Q	03/31/02	05/15/02	Not filed	85
10-Q	06/30/02	08/14/02	Not filed	82
10-Q	09/30/02	11/14/02	Not filed	79
10-K	12/31/02	03/31/03	Not filed	75
10-Q	03/31/03	05/15/03	Not filed	73
10-Q	06/30/03	08/14/03	Not filed	70
10-Q	09/30/03	11/14/03	Not filed	67
10-K	12/31/03	03/30/04	Not filed	63
10-Q	03/31/04	05/17/04	Not filed	61
10-Q	06/30/04	08/16/04	Not filed	58
10-Q	09/30/04	11/15/04	Not filed	55
10-K	12/31/04	03/31/05	Not filed	51
10-Q	03/31/05	05/16/05	Not filed	49
10-Q	06/30/05	08/15/05	Not filed	46
10-Q	09/30/05	11/14/05	Not filed	43
10-K	12/31/05	03/31/06	Not filed	39
10-Q	03/31/06	05/15/06	Not filed	37
10-Q	06/30/06	08/14/06	Not filed	34
10-Q	09/30/06	11/14/06	Not filed	31
10-K	12/31/06	04/02/07	Not filed	26

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Nextpath Technologies, Inc.</b> <i>(n/k/a Central American Development Group, Inc.)</i> <i>(continued)</i>	10-Q	03/31/07	05/15/07	Not filed	25
	10-Q	06/30/07	08/14/07	Not filed	22
	10-Q	09/30/07	11/14/07	Not filed	19
	10-K	12/31/07	03/31/08	Not filed	15
	10-Q	03/31/08	05/15/08	Not filed	13
	10-Q	06/30/08	08/14/08	Not filed	10
	10-Q	09/30/08	11/14/08	Not filed	7
	10-K	12/31/08	03/31/09	Not filed	3
	10-Q	03/31/09	05/15/09	Not filed	1
<b>Total Filings Delinquent</b>					<b>34</b>

\* Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. See Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now 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) have the option of using new, scaled disclosure requirements that Regulation S-K now includes.

*Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60308 / July 15, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13547

In the Matter of

DONALD F. MCCRACKEN,

Respondent.

ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTIONS 15(b) and  
17A(c) 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 Sections 15(b) and 17A(c) of the Securities Exchange Act of 1934 ("Exchange Act") against Donald McCracken ("Respondent" or "McCracken").

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 Sections 15(b) and 17A(c) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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### III.

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

1. McCracken is a former Managing Director and Head of Global Operations Services for Putnam Fiduciary Trust Company ("PFTC"), a transfer agent registered with the Commission and under the common control with a broker-dealer also registered with the Commission. McCracken, age 62, is a resident of Naples, Maine.

2. On June 29, 2009, a final judgment was entered by consent against McCracken, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") in the civil action entitled Securities and Exchange Commission v. Karnig H. Durgarian, Jr., et al., Civil Action No. 05-12618-NMG, in the United States District Court for the District of Massachusetts.

3. The Commission's complaint alleged that beginning in January 2001, various PFTC employees, including McCracken, engaged in transactions in violation of Section 17(a)(3) of the Securities Act and other provisions, which prevented disclosure of an error that had occurred in the account of a client of PFTC. According to the Complaint, the transactions involved reversing and re-executing certain trades in the client's account and adjusting expense accounting entries in certain mutual funds. The Complaint alleged that these actions transferred the loss arising from the error from one client to others and prevented discovery of the error.

### IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Sections 15(b)(6) and 17A(c)(4) of the Exchange Act, that Respondent McCracken be, and hereby is, barred from association with any broker, dealer, or transfer agent, with the right to reapply for association after one year 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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 15, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13548

In the Matter of

FREDERICK J. BARTON,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO SECTION  
15(b) OF THE SECURITIES EXCHANGE  
ACT OF 1934 AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940  
AND NOTICE OF HEARING**

**I.**

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

**II.**

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT, RELATED ENTITIES AND THE PERMANENT  
INJUNCTION

1. Barton, 48, previously of Atlanta, Georgia, is the founder, principal, control person, and through Barton Asset Management, LLC ("Barton Asset Management"), the majority interest holder of TwinSpan Capital Management, LLC ("TwinSpan"). A.G. Edwards & Sons, Inc. ("AGE") employed Barton from 1988 to 2002 as a registered representative associated with AGE, and who served as the branch manager of AGE's Atlanta office. During the pertinent period, AGE was registered with the Commission as a broker-dealer and an investment adviser. Barton founded TwinSpan in January 2003.

2. Barton Asset Management, a Georgia limited liability corporation founded by Barton in November 2002, operated as an unregistered investment adviser. Barton Asset

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Management was dissolved by the Georgia Secretary of State in May 2008, and the company has no assets. Barton was the firm's owner.

3. TwinSpan was a Georgia limited liability company, which was owned and operated by Barton, and was based in Atlanta, Georgia. TwinSpan was formed in January 2003 and operated as a non-custodial investment adviser with discretion over client accounts. It was registered with the Commission from September 2005 to June 2007, when it filed an ADV-W ending its registration with the Commission. In May 2008, TwinSpan was dissolved by the Georgia Secretary of State. TwinSpan has no assets.

4. On April 27, 2009, a default judgment was entered against Barton permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-9 thereunder, and from future violations of Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Frederick J. Barton, et al., Civil Action No. 1:08-cv-1917-RWS, in the United States District Court for the Northern District of Georgia.

5. The Commission's complaint alleged that, between May 1999 and December 2003, Barton, acting individually or through Barton Asset Management, fraudulently misappropriated almost the entire life savings of R.F., a single elderly customer of the broker-dealer employing Barton, who suffered from diminished mental capacity and Alzheimer's disease. Barton individually and through Barton Asset Management misappropriated \$970,000 in this scheme.

6. The Commission's complaint alleged that later, between October 2004 and October 2005, Barton and TwinSpan engaged in a fraudulent private placement, ostensibly to raise funds to finance TwinSpan. Barton and TwinSpan raised \$1.515 million from ten investors, falsely representing to all of them in the private placement memorandum that the funds would only be used upon reaching a minimum offering amount and then would only be used for TwinSpan's general corporate purposes. Despite those representations, the complaint alleged that Barton and TwinSpan diverted funds from the offering for Barton's personal use, and without disclosure to investors used a substantial portion of the offering proceeds in advance of reaching the minimum offering amount in violation of the terms of the private placement.

7. Finally, the Commission's complaint alleged that between October 2006 and January 2007, Barton and TwinSpan misappropriated \$685,000 from an investment advisory client of TwinSpan, J.C. First, acting through TwinSpan, Barton forged J.C.'s signature on four wire-transfer authorizations and used them to transfer \$185,000 of J.C.'s assets under TwinSpan's management into a bank account in the name of Barton Asset Management. Shortly thereafter, Barton borrowed an additional \$500,000 from J.C., ostensibly to fund TwinSpan's business plan, without disclosing to her that he had previously misappropriated \$185,000 of her funds.

B. BARTON'S CRIMINAL CONVICTION

8. On March 25, 2009, Barton pled guilty to one count of wire fraud in violation of Title 18 United States Code Section 1343, before the United States District Court for the Northern District of Georgia, in United States v. Frederick Barton, Case No. 1:08-CR-477-TWT.

9. The count of the indictment to which Barton pled guilty alleged, among other things, that from in or about May 1999 through in or about September 2004, Barton knowingly and willfully devised a scheme and artifice to defraud R.F., an elderly client suffering from Alzheimer's disease, by means of materially false and fraudulent pretenses, representations and promises. R.F.'s funds were deposited into Barton's account and used to fund his personal lifestyle and eventually to fund TwinSpan.

C. THE CEASE-AND-DESIST ORDER ISSUED AGAINST BARTON

10. In May 2007, in connection with a portion of the misconduct outlined above, the Georgia Secretary of State (i) ordered Barton to cease-and-desist all offers for sale and sales of securities in violation of the Georgia Securities Act of 1973, as amended, and (ii) permanently barred Barton from associating with a registered dealer, limited dealer, or investment adviser in Georgia.

III.

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

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

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

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

IV.

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

IT IS FURTHER ORDERED that the Respondent shall file his 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 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 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 the Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Rel. No. 2901 / July 16, 2009

Admin. Proc. File No. 3-13008

In the Matter of

MITCHELL M. MAYNARD  
and  
DORICE A. MAYNARD  
3099 West Chapman Ave., Apt. 426  
Orange, California 92868

ORDER DENYING MOTION FOR RECONSIDERATION

I.

On May 15, 2009, we issued an opinion ("the May 15 Opinion") and order barring Mitchell M. Maynard and Dorice A. Maynard (collectively, the "Maynards"), formerly associated with Leveraged Index Management Company ("LIMCO"), a former registered investment adviser, from association with an investment adviser.<sup>1</sup> Our order barring the Maynards was based upon a final order issued by the Commissioner of the Vermont Department of Banking, Insurance, Securities, and Health Care Administration (the "Vermont BISHCA") that imposed a five-year bar from association with registered broker-dealers and investment advisers and other sanctions on the Maynards as a result of the Vermont Commissioner's finding that the Maynards had, among other things, (i) misappropriated investor funds, including by diverting large investments in LIMCO to themselves; (ii) made numerous misrepresentations or omissions about LIMCO's performance and financial condition, including giving investors projections of high returns that had no reasonable basis; and (iii) engaged in unethical or dishonest practices, including by failing to disclose a prior bankruptcy to investors ("Vermont Order"). The Maynards have now filed a motion for reconsideration. For the reasons discussed below, we have determined to deny the Maynards' motion.

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<sup>1</sup> *Mitchell M. Maynard*, Investment Advisors Act Rel. No. 2875 (May 15, 2009), \_\_  
SEC Docket \_\_\_\_.

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## II.

We review the Maynards' motion to reconsider under Rule 470 of the Commission's Rules of Practice.<sup>2</sup> A motion for reconsideration is designed to correct manifest errors of law or fact or to permit the presentation of newly discovered evidence,<sup>3</sup> but may not be used to repeat arguments previously made.<sup>4</sup>

For the most part, the Maynards' motion reiterates arguments previously presented and facts previously considered. For example, the May 15 Opinion considered and rejected the Maynards' contentions that the "Division's choice of initiating a 'back door' follow-on administrative proceeding at this particular time instead of initiating a full hearing was [not] appropriate" and that a hearing is required to review the Pacific Regional Office's (the "PRO") September 2000 examination of LIMCO to determine whether the PRO was "deliberately misleading [the Maynards] as to their true intent, which was to postpone any action of its own, knowing it could more easily secure sanctions via the 'back door' of a follow-on proceeding." Similarly, the Maynards charge that we ignored "[m]itigative or exculpatory evidence" they had presented showing that "large sections of their current business activities are devoted to business ethics, ethical sales practices, and encouraging agents and advisors to make appropriate product recommendations to clients" and that they "have remained clear of any direct interactions with the general public - let alone investment advisory activity."<sup>5</sup> They also argue that it was "manifest error" to conclude that the Maynards' current business activities (which here they describe as providing "training services and software tools to advisors") provide opportunity for future violations of the Advisers Act "simply because of an inference drawn from the customer base or product niche of a company." However, these matters were addressed at length in the May 15 Opinion and provide no basis for reconsidering the conclusions reached there.

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<sup>2</sup> 17 C.F.R. § 201.470.

<sup>3</sup> *Leslie A. Arouh*, Securities Exchange Act. Rel. No. 51254 (Feb. 25, 2005), 84 SEC Docket 3652, 3653. *See also KPMG Peat Marwick LLP*, Order Denying Request for Reconsideration, 55 S.E.C. 1, 3 n.7 (2001) (specifying that efficiency and fairness concerns embodied in federal court practice of rejecting motions for reconsideration unless correction of manifest errors of law or fact or presentation of newly discovered evidence is sought "likewise inform our review of motions for reconsideration under Rule 470").

<sup>4</sup> *Arouh*, 84 SEC Docket at 3653 (holding that respondents cannot use motions for reconsideration "to reiterate arguments previously made or to cite authorities previously available").

<sup>5</sup> The Maynards fault the opinion for not taking into account the fact that the violations occurred nearly ten years ago. This proceeding is based on the 2007 Vermont Order, which the Maynards contested. *See Proffitt v. FDIC*, 200 F.3d 855 (D.C. Cir. 2000). We do not find that the age of the Maynards' underlying misconduct is a significant mitigating factor in light of all of the other circumstances discussed in the opinion and the entire record of the case.

The Maynards claim that the discussion in our opinion of the denial by the California Department of Corporations of their application to register as an investment adviser on behalf of Terra Vista Financial Planners ("Terra Vista") "implies a desire to seek adviser registration on the part of Respondents, which is not supported by the facts or records."<sup>6</sup> In our opinion, we noted the Maynards' assertion to us that they had abandoned their interest in the California registration several years before the California Corporations Commissioner issued his order and their contention that they had not withdrawn the application only because they desired to refute misconceptions that their application contained false statements. We note that the California Corporations Commissioner found that the Maynards declined to withdraw their application when requested in 2002. Thus, as we stated in our opinion, "Terra Vista's application remained pending until it was denied in 2007 and, during this period, the Maynards neither withdrew the application nor advised the agency of their purported intent to abandon it." In light of this, we see no reason to change our finding that "[t]heir actions undercut their assertions that they have no further interest in entering the securities industry."

The Maynards take issue with the statement in the May 15 Opinion that they "provided false answers in their filings with the California Department of Corporations that inquired as to whether Terra Vista was affiliated with any person that was subject to a regulatory proceeding." Although the original charging document issued by the California Department of Corporations made such a charge, the decision by the California Corporations Commissioner barring the Maynards from association with a broker, dealer, or adviser noted that, when the Terra Vista application was submitted in December 2001, the Maynards were being investigated by the Vermont BISHCA, but that no formal action had been filed against them. The California Corporations Commissioner found that an investigation is not a "proceeding," as that term is defined in the Form ADV on which the question had been asked and that therefore the question concerning proceedings had not been answered incorrectly. The May 15 Opinion overlooked this conclusion of the California Corporations Commissioner in making the statement quoted. The California Commissioner's conclusion, however, does not change our view that, "[g]iven the egregiousness of the Maynards' conduct in making numerous misrepresentations or omissions to the LIMCO investors over an extended period of time and continually misleading them as to the financial condition of the company," barring respondents is in the public interest. Our observation in the May 15 Opinion about the Terra Vista application was simply "noted" after the Maynards' misconduct as found by the Vermont Order had been detailed extensively. This oversight provides no basis for reconsideration of our finding that a bar is in the public interest.

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<sup>6</sup> The Maynards assert that the Division "stipulated" that they abandoned the Terra Vista application, citing the Division's motion for summary disposition. The Division's motion submits that it will not dispute Respondents' statement "that they 'believed they had abandoned'" the Terra Vista application because it was "blocked" by the Vermont proceeding. The Division also observes that the Maynards stated at the prehearing conference that in 2003 they asked California Department of Corporations to keep Terra Vista's application open.

Finally, the Maynards also seek to adduce new evidence which, they assert, has "been recently located in file storage and are being brought to the attention of the Commission, as being material to the issues raised in this matter." This new evidence consists of "a copy of a Memorandum received from Respondents' counsel in regards to his discussions with the PRO enforcement attorney . . . which adds credence to their claim that an implicit 'no-action' agreement was in place with the PRO," as well as "a copy of a 25-page set of documents exchanged between Vermont BISHCA and respondents' counsel, especially those signed by LIMCO investors."<sup>7</sup> On a motion for reconsideration, we accept, as do the federal courts, only that evidence the movant could not have known about or adduced before entry of the order subject to the motion for reconsideration.<sup>8</sup> The Maynards have not established that this evidence was either unknown to them or could not have been reasonably discovered and produced before the law judge. They admit to having received the Memorandum from their counsel. In any event, the May 15 Opinion expressly stated that "[w]hether the PRO agreed to close its file in 2001, or whether the PRO did, in fact, close its file is irrelevant. This proceeding is not based on the PRO's 2001 examination, but rather on the Vermont Order and the findings contained in that order." Moreover, the Maynards offer no reason why they could not have obtained the documents exchanged between the Vermont BISHCA and their own counsel at an earlier time. Accordingly, the documents "recently located" by the Maynards provide no basis for us to reconsider the May 15 Opinion.

Given the Maynards' egregious and recurrent actions in dealing with LIMCO's investors, their lack of appreciation for the responsibilities of an investment adviser and lack of remorse for the impact of their misconduct on their investors, the close nexus between the Maynards' current

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<sup>7</sup> Rule 452 of the Commission's Rules of Practice, 17 C.F.R. § 201.452, does not apply under these circumstances. See *Feeley & Willcox Asset Mgmt. Corp.*, Order Denying Motion for Reconsideration, 56 S.E.C. 1264, 1269 n.17 (finding that the time had passed for respondents to move for leave to adduce additional evidence under Rule 452 since that rule was only applicable "at any time prior to issuance of a decision by the Commission").

<sup>8</sup> *Feeley*, 56 S.E.C. at 1269-70 n.18. See, e.g., *Caisse Nationale de Credit Agricole v. CBI Indus., Inc.*, 90 F.3d 1264, 1269 (7th Cir. 1996) (moving party must establish that evidence was not only newly discovered or unknown to it, but also that it could not have been reasonably discovered and produced during pendency of matter).

business and the investment advisory business, and the opportunities to rejoin the investment advisory business that may arise unless they are permanently barred, we see no basis for reconsidering our conclusion in the May 15 Opinion that barring the Maynards serves the public interest and is remedial.

Accordingly, IT IS ORDERED that the motion for reconsideration filed by Mitchell M. Maynard and Dorice A. Maynard, be, and it hereby is, DENIED.

By the Commission. (Chairman SCHAPIRO and Commissioners CASEY, WALTER, AGUILAR, and PAREDES).

Elizabeth M. Murphy  
Secretary

*Florence E. Harmon*  
By: Florence E. Harmon  
Deputy Secretary

**UNITED STATES OF AMERICA**  
Before the  
**SECURITIES AND EXCHANGE COMMISSION**  
July 16, 2009

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13549**

**In the Matter of**

**Absolute Entertainment, Inc.,  
Advanced Computer Techniques Corp.,  
AGP & Co., Inc.,  
Aid Auto Stores, Inc.,  
Allure Cosmetics, Ltd.,  
Alpha-Beta Technology, Inc., and  
Alpha Fibre, Inc. (f/k/a Oak Brook Capital  
III, Inc.),**

**Respondents.**

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

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Absolute Entertainment, Inc., Advanced Computer Techniques Corp., AGP & Co., Inc., Aid Auto Stores, Inc., Allure Cosmetics, Ltd., Alpha-Beta Technology, Inc., and Alpha Fibre, Inc. (f/k/a Oak Brook Capital III, Inc.).

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Absolute Entertainment, Inc. (CIK No. 898739) is a New Jersey corporation located in Upper Saddle River, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Absolute is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1995 that did not include financial statements. The company's Form 10-Q for the period ended June 30, 1995 reported a net loss of over \$1.78 million for the prior six months. As of July 8, 2009, the company's stock (symbol "ABSO") was traded on the over-the-counter markets.

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2. Advanced Computer Techniques Corp. (CIK No. 2467) is an inactive New York corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Computer is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1993.

3. AGP & Co., Inc. (CIK No. 799241) is a New Jersey corporation located in Shrewsbury, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AGP is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended September 30, 1995, which reported a net loss of over \$1 million for the prior nine months.

4. Aid Auto Stores, Inc. (CIK No. 937599) is a void Delaware corporation located in Westbury, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aid Auto 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, 1998, which reported a net loss of over \$1.7 million for the prior six months.

5. Allure Cosmetics, Ltd. (CIK No. 789932) is a Delaware corporation located in Long Island City, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Allure 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 end November 30, 2001, which reported a net loss of \$3,799 for the prior three months. As of July 8, 2009, the company's stock (symbol "ALUR") was traded on the over-the-counter markets.

6. Alpha-Beta Technology, Inc. (CIK No. 841168) is a dissolved Massachusetts corporation located in Worcester, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Alpha-Beta is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1998, which reported a net loss of over \$156 million since its inception on March 2, 1988. As of July 8, 2009, the company's stock (symbol "ABTI") was traded on the over-the-counter markets.

7. Alpha Fibre, Inc. (f/k/a Oak Brook Capital III, Inc.) (CIK No. 1072569) is a dissolved Colorado corporation located in Providence, Rhode Island with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Alpha Fibre is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of \$5,910 for the prior nine months.

## B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*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.

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

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 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 registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

## IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against 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 Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

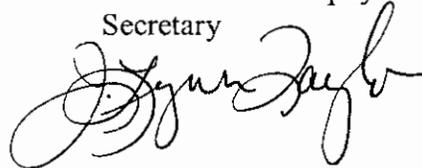
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

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.

Attachment

Elizabeth M. Murphy  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

Appendix 1

Chart of Delinquent Filings  
*Absolute Entertainment, Inc., et al.*

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<i>Absolute Entertainment, Inc.</i>	<i>10-Q</i>	09/30/95	11/14/95	Not filed	164
	<i>10-K</i>	12/31/95	04/01/96	Not filed	159
	<i>10-Q</i>	03/31/96	05/15/96	Not filed	158
	<i>10-Q</i>	06/30/96	08/14/96	Not filed	155
	<i>10-Q</i>	09/30/96	11/14/96	Not filed	152
	<i>10-K</i>	12/31/96	03/31/97	Not filed	148
	<i>10-Q</i>	03/31/97	05/15/97	Not filed	146
	<i>10-Q</i>	06/30/97	08/14/97	Not filed	143
	<i>10-Q</i>	09/30/97	11/14/97	Not filed	140
	<i>10-K</i>	12/31/97	03/31/98	Not filed	136
	<i>10-Q</i>	03/31/98	05/15/98	Not filed	134
	<i>10-Q</i>	06/30/98	08/14/98	Not filed	131
	<i>10-Q</i>	09/30/98	11/16/98	Not filed	128
	<i>10-K</i>	12/31/98	03/31/99	Not filed	124
	<i>10-Q</i>	03/31/99	05/17/99	Not filed	122
	<i>10-Q</i>	06/30/99	08/16/99	Not filed	119
	<i>10-Q</i>	09/30/99	11/15/99	Not filed	116
	<i>10-K</i>	12/31/99	03/30/00	Not filed	112
	<i>10-Q</i>	03/31/00	05/15/00	Not filed	110
	<i>10-Q</i>	06/30/00	08/14/00	Not filed	107
	<i>10-Q</i>	09/30/00	11/14/00	Not filed	104
	<i>10-K</i>	12/31/00	04/02/01	Not filed	99
	<i>10-Q</i>	03/31/01	05/15/01	Not filed	98
	<i>10-Q</i>	06/30/01	08/14/01	Not filed	95
	<i>10-Q</i>	09/30/01	11/14/01	Not filed	92
	<i>10-K</i>	12/31/01	04/01/02	Not filed	87
	<i>10-Q</i>	03/31/02	05/15/02	Not filed	86
	<i>10-Q</i>	06/30/02	08/14/02	Not filed	83
	<i>10-Q</i>	09/30/02	11/14/02	Not filed	80
	<i>10-K</i>	12/31/02	03/31/03	Not filed	76
	<i>10-Q</i>	03/31/03	05/15/03	Not filed	74
	<i>10-Q</i>	06/30/03	08/14/03	Not filed	71
	<i>10-Q</i>	09/30/03	11/14/03	Not filed	68
	<i>10-K</i>	12/31/03	03/30/04	Not filed	64

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Absolute Entertainment, Inc.</b>	10-Q	03/31/04	05/17/04	Not filed	62
	10-Q	06/30/04	08/16/04	Not filed	59
	10-Q	09/30/04	11/15/04	Not filed	56
	10-K	12/31/04	03/31/05	Not filed	52
	10-Q	03/31/05	05/16/05	Not filed	50
	10-Q	06/30/05	08/15/05	Not filed	47
	10-Q	09/30/05	11/14/05	Not filed	44
	10-K	12/31/05	03/31/06	Not filed	40
	10-Q	03/31/06	05/15/06	Not filed	38
	10-Q	06/30/06	08/14/06	Not filed	35
	10-Q	09/30/06	11/14/06	Not filed	32
	10-K	12/31/06	04/02/07	Not filed	27
	10-Q	03/31/07	05/15/07	Not filed	26
	10-Q	06/30/07	08/14/07	Not filed	23
	10-Q	09/30/07	11/14/07	Not filed	20
	10-K	12/31/07	03/31/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	14
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-K	12/31/08	03/31/09	Not filed	4
10-Q	03/31/09	05/15/09	Not filed	2	

Total Filings Delinquent **55**

**Advanced Computer Techniques Corp.**

10-K	12/31/93	03/31/94	Not filed	184
10-Q	03/31/94	05/16/94	Not filed	182
10-Q	06/30/94	08/15/94	Not filed	179
10-Q	09/30/94	11/14/94	Not filed	176
10-K	12/31/94	03/31/95	Not filed	172
10-Q	03/31/95	05/15/95	Not filed	170
10-Q	06/30/95	08/14/95	Not filed	167
10-Q	09/30/95	11/14/95	Not filed	164
10-K	12/31/95	04/01/96	Not filed	159
10-Q	03/31/96	05/15/96	Not filed	158
10-Q	06/30/96	08/14/96	Not filed	155
10-Q	09/30/96	11/14/96	Not filed	152

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Advanced Computer Techniques Corp.	10-K	12/31/96	03/31/97	Not filed	148
	10-Q	03/31/97	05/15/97	Not filed	146
	10-Q	06/30/97	08/14/97	Not filed	143
	10-Q	09/30/97	11/14/97	Not filed	140
	10-K	12/31/97	03/31/98	Not filed	136
	10-Q	03/31/98	05/15/98	Not filed	134
	10-Q	06/30/98	08/14/98	Not filed	131
	10-Q	09/30/98	11/16/98	Not filed	128
	10-K	12/31/98	03/31/99	Not filed	124
	10-Q	03/31/99	05/17/99	Not filed	122
	10-Q	06/30/99	08/16/99	Not filed	119
	10-Q	09/30/99	11/15/99	Not filed	116
	10-K	12/31/99	03/30/00	Not filed	112
	10-Q	03/31/00	05/15/00	Not filed	110
	10-Q	06/30/00	08/14/00	Not filed	107
	10-Q	09/30/00	11/14/00	Not filed	104
	10-K	12/31/00	04/02/01	Not filed	99
	10-Q	03/31/01	05/15/01	Not filed	98
	10-Q	06/30/01	08/14/01	Not filed	95
	10-Q	09/30/01	11/14/01	Not filed	92
	10-K	12/31/01	04/01/02	Not filed	87
	10-Q	03/31/02	05/15/02	Not filed	86
	10-Q	06/30/02	08/14/02	Not filed	83
	10-Q	09/30/02	11/14/02	Not filed	80
	10-K	12/31/02	03/31/03	Not filed	76
	10-Q	03/31/03	05/15/03	Not filed	74
	10-Q	06/30/03	08/14/03	Not filed	71
	10-Q	09/30/03	11/14/03	Not filed	68
	10-K	12/31/03	03/30/04	Not filed	64
	10-Q	03/31/04	05/17/04	Not filed	62
	10-Q	06/30/04	08/16/04	Not filed	59
	10-Q	09/30/04	11/15/04	Not filed	56
	10-K	12/31/04	03/31/05	Not filed	52
	10-Q	03/31/05	05/16/05	Not filed	50
	10-Q	06/30/05	08/15/05	Not filed	47
	10-Q	09/30/05	11/14/05	Not filed	44
	10-K	12/31/05	03/31/06	Not filed	40

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Advanced Computer Techniques Corp.	10-Q	03/31/06	05/15/06	Not filed	38
	10-Q	06/30/06	08/14/06	Not filed	35
	10-Q	09/30/06	11/14/06	Not filed	32
	10-K	12/31/06	04/02/07	Not filed	27
	10-Q	03/31/07	05/15/07	Not filed	26
	10-Q	06/30/07	08/14/07	Not filed	23
	10-Q	09/30/07	11/14/07	Not filed	20
	10-K	12/31/07	03/31/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	14
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-K	12/31/08	03/31/09	Not filed	4
	10-Q	03/31/09	05/15/09	Not filed	2

Total Filings Delinquent

62

**AGP & Co., Inc.**

10-K	12/31/95	04/01/96	Not filed	159
10-Q	03/31/96	05/15/96	Not filed	158
10-Q	06/30/96	08/14/96	Not filed	155
10-Q	09/30/96	11/14/96	Not filed	152
10-K	12/31/96	03/31/97	Not filed	148
10-Q	03/31/97	05/15/97	Not filed	146
10-Q	06/30/97	08/14/97	Not filed	143
10-Q	09/30/97	11/14/97	Not filed	140
10-K	12/31/97	03/31/98	Not filed	136
10-Q	03/31/98	05/15/98	Not filed	134
10-Q	06/30/98	08/14/98	Not filed	131
10-Q	09/30/98	11/16/98	Not filed	128
10-K	12/31/98	03/31/99	Not filed	124
10-Q	03/31/99	05/17/99	Not filed	122
10-Q	06/30/99	08/16/99	Not filed	119
10-Q	09/30/99	11/15/99	Not filed	116
10-K	12/31/99	03/30/00	Not filed	112
10-Q	03/31/00	05/15/00	Not filed	110
10-Q	06/30/00	08/14/00	Not filed	107
10-Q	09/30/00	11/14/00	Not filed	104
10-K	12/31/00	04/02/01	Not filed	99

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
AGP & Co., Inc.	10-Q	03/31/01	05/15/01	Not filed	98
	10-Q	06/30/01	08/14/01	Not filed	95
	10-Q	09/30/01	11/14/01	Not filed	92
	10-K	12/31/01	04/01/02	Not filed	87
	10-Q	03/31/02	05/15/02	Not filed	86
	10-Q	06/30/02	08/14/02	Not filed	83
	10-Q	09/30/02	11/14/02	Not filed	80
	10-K	12/31/02	03/31/03	Not filed	76
	10-Q	03/31/03	05/15/03	Not filed	74
	10-Q	06/30/03	08/14/03	Not filed	71
	10-Q	09/30/03	11/14/03	Not filed	68
	10-K	12/31/03	03/30/04	Not filed	64
	10-Q	03/31/04	05/17/04	Not filed	62
	10-Q	06/30/04	08/16/04	Not filed	59
	10-Q	09/30/04	11/15/04	Not filed	56
	10-K	12/31/04	03/31/05	Not filed	52
	10-Q	03/31/05	05/16/05	Not filed	50
	10-Q	06/30/05	08/15/05	Not filed	47
	10-Q	09/30/05	11/14/05	Not filed	44
	10-K	12/31/05	03/31/06	Not filed	40
	10-Q	03/31/06	05/15/06	Not filed	38
	10-Q	06/30/06	08/14/06	Not filed	35
	10-Q	09/30/06	11/14/06	Not filed	32
	10-K	12/31/06	04/02/07	Not filed	27
	10-Q	03/31/07	05/15/07	Not filed	26
	10-Q	06/30/07	08/14/07	Not filed	23
	10-Q	09/30/07	11/14/07	Not filed	20
	10-K	12/31/07	03/31/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	14
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-K	12/31/08	03/31/09	Not filed	4
	10-Q	03/31/09	05/15/09	Not filed	2

Total Filings Delinquent **54**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Aid Auto Stores, Inc.	10-Q	09/30/98	11/16/98	Not filed	128
	10-K	12/31/98	03/31/99	Not filed	124
	10-Q	03/31/99	05/17/99	Not filed	122
	10-Q	06/30/99	08/16/99	Not filed	119
	10-Q	09/30/99	11/15/99	Not filed	116
	10-K	12/31/99	03/30/00	Not filed	112
	10-Q	03/31/00	05/15/00	Not filed	110
	10-Q	06/30/00	08/14/00	Not filed	107
	10-Q	09/30/00	11/14/00	Not filed	104
	10-K	12/31/00	04/02/01	Not filed	99
	10-Q	03/31/01	05/15/01	Not filed	98
	10-Q	06/30/01	08/14/01	Not filed	95
	10-Q	09/30/01	11/14/01	Not filed	92
	10-K	12/31/01	04/01/02	Not filed	87
	10-Q	03/31/02	05/15/02	Not filed	86
	10-Q	06/30/02	08/14/02	Not filed	83
	10-Q	09/30/02	11/14/02	Not filed	80
	10-K	12/31/02	03/31/03	Not filed	76
	10-Q	03/31/03	05/15/03	Not filed	74
	10-Q	06/30/03	08/14/03	Not filed	71
	10-Q	09/30/03	11/14/03	Not filed	68
	10-K	12/31/03	03/30/04	Not filed	64
	10-Q	03/31/04	05/17/04	Not filed	62
	10-Q	06/30/04	08/16/04	Not filed	59
	10-Q	09/30/04	11/15/04	Not filed	56
	10-K	12/31/04	03/31/05	Not filed	52
	10-Q	03/31/05	05/16/05	Not filed	50
	10-Q	06/30/05	08/15/05	Not filed	47
	10-Q	09/30/05	11/14/05	Not filed	44
	10-K	12/31/05	03/31/06	Not filed	40
	10-Q	03/31/06	05/15/06	Not filed	38
	10-Q	06/30/06	08/14/06	Not filed	35
	10-Q	09/30/06	11/14/06	Not filed	32
	10-K	12/31/06	04/02/07	Not filed	27
	10-Q	03/31/07	05/15/07	Not filed	26
	10-Q	06/30/07	08/14/07	Not filed	23
	10-Q	09/30/07	11/14/07	Not filed	20

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Aid Auto Stores, Inc.</b>	10-K	12/31/07	03/31/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	14
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-K	12/31/08	03/31/09	Not filed	4
	10-Q	03/31/09	05/15/09	Not filed	2
	<b>Total Filings Delinquent</b>	<b>43</b>			

**Allure Cosmetics, Ltd.**

10-Q	02/28/02	04/15/02	Not filed	87
10-Q	05/31/02	07/15/02	Not filed	84
10-K	08/31/02	11/29/02	Not filed	80
10-Q	11/30/02	01/14/03	Not filed	78
10-Q	02/28/03	04/14/03	Not filed	75
10-Q	05/31/03	07/15/03	Not filed	72
10-K	08/31/03	12/01/03	Not filed	67
10-Q	11/30/03	01/14/04	Not filed	66
10-Q	02/28/04	04/13/04	Not filed	63
10-Q	05/31/04	07/15/04	Not filed	60
10-K	08/31/04	11/29/04	Not filed	56
10-Q	11/30/04	01/14/05	Not filed	54
10-Q	02/28/05	04/14/05	Not filed	51
10-Q	05/31/05	07/15/05	Not filed	48
10-K	08/31/05	11/29/05	Not filed	44
10-Q	11/30/05	01/16/06	Not filed	42
10-Q	02/28/06	04/14/06	Not filed	39
10-Q	05/31/06	07/17/06	Not filed	36
10-K	08/31/06	11/29/06	Not filed	32
10-Q	11/30/06	01/16/07	Not filed	30
10-Q	02/28/07	04/16/07	Not filed	27
10-Q	05/31/07	07/16/07	Not filed	24
10-K	08/31/07	11/29/07	Not filed	20
10-Q	11/30/07	01/14/08	Not filed	18
10-Q	02/28/08	04/14/08	Not filed	15
10-Q	05/31/08	07/15/08	Not filed	12

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Allure Cosmetics, Ltd.</b>	10-K	08/31/08	12/01/08	Not filed	7
	10-Q	11/30/08	01/14/09	Not filed	6
	10-Q	02/28/09	04/14/09	Not filed	3
<b>Total Filings Delinquent</b>	<b>29</b>				

**Alpha-Beta  
Technology, Inc.**

10-KSB	12/31/98	03/31/99	Not filed	124
10-QSB	03/31/99	05/17/99	Not filed	122
10-QSB	06/30/99	08/16/99	Not filed	119
10-QSB	09/30/99	11/15/99	Not filed	116
10-KSB	12/31/99	03/30/00	Not filed	112
10-QSB	03/31/00	05/15/00	Not filed	110
10-QSB	06/30/00	08/14/00	Not filed	107
10-QSB	09/30/00	11/14/00	Not filed	104
10-KSB	12/31/00	04/02/01	Not filed	99
10-QSB	03/31/01	05/15/01	Not filed	98
10-QSB	06/30/01	08/14/01	Not filed	95
10-QSB	09/30/01	11/14/01	Not filed	92
10-KSB	12/31/01	04/01/02	Not filed	87
10-QSB	03/31/02	05/15/02	Not filed	86
10-QSB	06/30/02	08/14/02	Not filed	83
10-QSB	09/30/02	11/14/02	Not filed	80
10-KSB	12/31/02	03/31/03	Not filed	76
10-QSB	03/31/03	05/15/03	Not filed	74
10-QSB	06/30/03	08/14/03	Not filed	71
10-QSB	09/30/03	11/14/03	Not filed	68
10-KSB	12/31/03	03/30/04	Not filed	64
10-QSB	03/31/04	05/17/04	Not filed	62
10-QSB	06/30/04	08/16/04	Not filed	59
10-QSB	09/30/04	11/15/04	Not filed	56
10-KSB	12/31/04	03/31/05	Not filed	52
10-QSB	03/31/05	05/16/05	Not filed	50
10-QSB	06/30/05	08/15/05	Not filed	47
10-QSB	09/30/05	11/14/05	Not filed	44
10-KSB	12/31/05	03/31/06	Not filed	40
10-QSB	03/31/06	05/15/06	Not filed	38

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)	
Alpha-Beta Technology, Inc.	10-QSB	06/30/06	08/14/06	Not filed	35	
	10-QSB	09/30/06	11/14/06	Not filed	32	
	10-KSB	12/31/06	04/02/07	Not filed	27	
	10-QSB	03/31/07	05/15/07	Not filed	26	
	10-QSB	06/30/07	08/14/07	Not filed	23	
	10-QSB	09/30/07	11/14/07	Not filed	20	
	10-KSB	12/31/07	03/31/08	Not filed	16	
	10-Q*	03/31/08	05/15/08	Not filed	14	
	10-Q*	06/30/08	08/14/08	Not filed	11	
	10-Q*	09/30/08	11/14/08	Not filed	8	
	10-K*	12/31/08	03/31/09	Not filed	4	
	10-Q*	03/31/09	05/15/09	Not filed	2	
	Total Filings Delinquent					42

Alpha Fibre, Inc. (f/k/a  
Oak Brook Capital III,  
Inc.)

10-KSB	12/31/00	04/02/01	Not filed	99
10-QSB	03/31/01	05/15/01	Not filed	98
10-QSB	06/30/01	08/14/01	Not filed	95
10-QSB	09/30/01	11/14/01	Not filed	92
10-KSB	12/31/01	04/01/02	Not filed	87
10-QSB	03/31/02	05/15/02	Not filed	86
10-QSB	06/30/02	08/14/02	Not filed	83
10-QSB	09/30/02	11/14/02	Not filed	80
10-KSB	12/31/02	03/31/03	Not filed	76
10-QSB	03/31/03	05/15/03	Not filed	74
10-QSB	06/30/03	08/14/03	Not filed	71
10-QSB	09/30/03	11/14/03	Not filed	68
10-KSB	12/31/03	03/30/04	Not filed	64
10-QSB	03/31/04	05/17/04	Not filed	62
10-QSB	06/30/04	08/16/04	Not filed	59
10-QSB	09/30/04	11/15/04	Not filed	56
10-KSB	12/31/04	03/31/05	Not filed	52
10-QSB	03/31/05	05/16/05	Not filed	50
10-QSB	06/30/05	08/15/05	Not filed	47
10-QSB	09/30/05	11/14/05	Not filed	44

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Alpha Fibre, Inc. (f/k/a Oak Brook Capital III, Inc.)	10-KSB	12/31/05	03/31/06	Not filed	40
	10-QSB	03/31/06	05/15/06	Not filed	38
	10-QSB	06/30/06	08/14/06	Not filed	35
	10-QSB	09/30/06	11/14/06	Not filed	32
	10-KSB	12/31/06	04/02/07	Not filed	27
	10-QSB	03/31/07	05/15/07	Not filed	26
	10-QSB	06/30/07	08/14/07	Not filed	23
	10-QSB	09/30/07	11/14/07	Not filed	20
	10-KSB	12/31/07	03/31/08	Not filed	16
	10-Q*	03/31/08	05/15/08	Not filed	14
	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
	10-K*	12/31/08	03/31/09	Not filed	4
	10-Q*	03/31/09	05/15/09	Not filed	2

Total Filings Delinquent      **27**

\*Regulation S-B and its accompanying forms, including Forms 10-Q and 10-K, 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-Q and 10-K will be required to use Forms 10-Q and 10-K instead. Forms 10-Q and 10-K 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.

## SECURITIES AND EXCHANGE COMMISSION

[Release No. PA-39; File No. S7-14-09]

**Privacy Act of 1974:** Systems of Records.

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Notice to establish systems of records.

**SUMMARY:** In accordance with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a, the Securities and Exchange Commission ("Commission" or "SEC") gives notice of proposing to establish the following five new Privacy Act systems of records: "Information Pertaining or Relevant to SEC Registrants and Their Activities (SEC-55)", "Mailing, Contact and Other Lists (SEC-56)", "International Program Oversight Database (International-POD) (SEC-57)", "System for Enforcement Case Tracking and Routing (SEC-58)", and "Office of Interpretation and Guidance Log; Office of Broker-Dealer Finances NRSRO Log; and Office of Financial Responsibility Log (SEC-59)".

**DATES:** The proposed systems will become effective [insert date that is 40 days after publication in the Federal Register] unless further notice is given. The Commission will publish a new notice if the effective date is delayed to review comments or if changes are made based on comments received. To be assured of consideration, comments should be received on or before [insert date that is 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

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- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-14-09 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 S7-14-09. 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 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:** Barbara A. Stance, Chief Privacy Officer, Office of Information Technology, 202-551-7209.

**SUPPLEMENTARY INFORMATION:** The Commission gives notice of the proposed establishment of five new systems of records as follows: "Information Pertaining or Relevant to SEC Registrants and Their Activities (SEC-55)", which contains records on individuals associated with entities or persons that are registered with the SEC; "Mailing, Contact and Other Lists (SEC-56)", which contains records related to individuals and employees who submit request for information, subscriptions, inquiries, guidance,

informal advice and other assistance to the SEC; "International Program Oversight Database (International-POD) (SEC-57)", which contains information related to an SEC investigation, international institute training, foreign regulators and stock exchanges, SEC travel records and United States Agency for International Development (USAID) reimbursable programs; "System for Enforcement Case Tracking and Routing (SEC-58)", which contains correspondence related to litigation, pleadings in administrative proceedings, and other documents; and "Office of Interpretation and Guidance Log; Office of Broker-Dealer Finances NRSRO Log; and Office of Financial Responsibility Log (SEC-59)", which contains records of inquiries, requests, comments or other communications submitted to the Division of Trading and Markets' Office of Interpretation and Guidance, the Office of Broker-Dealer Finances relating to NRSROs or to the Office of Financial Responsibility, respectively.

The Commission has submitted a report of the new systems of records to the appropriate Congressional committees and to the Director of the Office of Management and Budget ("OMB") as required by 5 U.S.C. 552a(r) (Privacy Act of 1974) and guidelines issued by OMB on December 12, 2000 (65 FR 77677).

Accordingly, the Commission is proposing five new systems of records to read as follows:

**SEC-55**

**SYSTEM NAME:**

Information Pertaining or Relevant to SEC Registrants and Their Activities.

**SYSTEM LOCATION:**

Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

Records also are maintained in the SEC Regional Offices.

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

Records concern individuals associated with entities or persons that are registered with the SEC as broker-dealers, investment advisers, investment companies, self-regulatory organizations, clearing agencies, nationally recognized statistical rating organizations, and transfer agents (individually, a "Registrant;" collectively, "Registrants"). Records may also concern persons, directly or indirectly, with whom Registrants or their affiliates have client relations or business arrangements.

**CATEGORIES OF RECORDS IN THE SYSTEM:**

Records may contain information relating to the business activities and transactions of Registrants and their associated persons, as well as their compliance with provisions of the federal securities laws and with rules of self-regulatory organizations and clearing agencies. Records may also contain information regarding the business activities and transactions of individuals or entities with whom Registrants have client relations or business arrangements.

**AUTHORITY FOR MAINTENANCE OF THE SYSTEM:**

15 U.S.C. 78a et seq., 80a-1 et seq., and 80b-1 et seq.

**PURPOSE(S):**

1. For use by authorized SEC personnel in connection with their official functions including, but not limited to, the conduct of examinations for compliance with federal securities laws, investigations into possible violations of the federal securities laws, and other matters relating to the SEC's regulatory and law enforcement functions.

2. To maintain continuity within the SEC as to each Registrant and to provide SEC staff with the background and results of earlier examinations of Registrants, as well as an insight into current industry practices or possible regulatory compliance issues.
3. To conduct lawful relational searches or analysis or filtering of data in matters relating to the SEC's examination, regulatory or law enforcement functions.

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

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the Commission as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

1. When (1) it is suspected or confirmed that the security or confidentiality of information in the system of records has been compromised; (2) the SEC has determined that as a result of the suspected or confirmed compromise there is a risk of harm to economic or property interests, identity theft or fraud, or harm to the security or integrity of this system or other systems or programs (whether maintained by the SEC or another agency or entity) that rely upon the compromised information; and (3) the disclosure is made to such agencies, entities, and persons who are reasonably necessary to assist in connection with the SEC's efforts to respond to the suspected or confirmed compromise and prevent, minimize, or remedy such harm.
2. To coordinate law enforcement activities between the SEC and other federal, state, local or foreign law enforcement agencies, securities self-regulatory organizations and foreign securities authorities.

3. By SEC personnel for purposes of investigating possible violations of, or to conduct investigations authorized by, the federal securities laws.
4. In connection with investigations or disciplinary proceedings by a state securities regulatory authority, a foreign securities authority, or by a self-regulatory organization involving one or more of its members.
5. Where there is an indication of a violation or potential violation of law, whether civil, criminal or regulatory in nature, and whether arising by general statute or particular program statute, or by regulation, rule or order issued pursuant thereto, the relevant records in the system of records may be referred, as a routine use, to the appropriate agency, whether federal, state, local, foreign or a securities-related self-regulatory organization charged with the responsibility of investigating or prosecuting such violation or charged with enforcing or implementing the statute, or rule, regulation or order issued pursuant thereto.
6. In connection with their regulatory and enforcement responsibilities mandated by the federal securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47)), or state or foreign laws regulating securities or other related matters, records in this system of records may be disclosed to national securities exchanges and national securities associations that are registered with the SEC, the Municipal Securities Rulemaking Board, the Securities Investor Protection Corporation, the federal banking authorities, including, but not limited to, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, state securities regulatory or law

enforcement agencies or organizations, or regulatory or law enforcement agencies of a foreign government.

7. In any proceeding where the federal securities laws are in issue or in which the SEC or past or present members of its staff is a party or otherwise involved in an official capacity.
8. In connection with proceedings by the SEC pursuant to Rule 102(e) of its Rules of Practice, 17 CFR 201.102(e).
9. When considered appropriate, referred to a bar association or similar federal, state or local licensing authority for possible disciplinary action.
10. To disclose as a "routine use" to a federal, state or local governmental authority maintaining civil, criminal or other relevant enforcement information or other pertinent information, such as current licenses, if necessary to obtain information relevant to an agency decision concerning the hiring or retention of an employee, the issuance of a security clearance, the letting of a contract, or the issuance of a license, grant or other benefit.
11. To disclose to a federal, state or local governmental authority, in response to its request, in connection with the hiring or retention of an employee, the issuance of a security clearance, the reporting of an investigation of an employee, the letting of a contract, or the issuance of a license, grant, or other benefit by the requesting agency, to the extent that the information is relevant and necessary to the requesting agency's decision on the matter.
12. As a data source for management information for production of summary descriptive statistics and analytical studies in support of the function for which the records are

collected and maintained or for related personnel management functions or manpower studies; may also be utilized to respond to general requests for statistical information (without personal identification of individuals) under the Freedom of Information Act or to locate specific individuals for personnel research or other personnel management functions.

13. To disclose as a routine use to any trustee, receiver, master, special counsel, or other individual or entity that is appointed by a court of competent jurisdiction, or as a result of an agreement between the parties in connection with litigation or administrative proceedings involving allegations of violations of the federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47) or the SEC's Rules of Practice, 17 CFR 201 et seq. or otherwise, where such trustee, receiver, master, special counsel or other individual or entity is specifically designated to perform particular functions with respect to, or as a result of, the pending action or proceeding or in connection with the administration and enforcement by the SEC of the federal securities laws or the SEC's Rules of Practice.
14. To disclose to any person during the course of any inquiry or investigation conducted by the SEC staff, or in connection with civil litigation, if the staff has reason to believe that the person to whom the record is disclosed may have further information about the matters related therein, and those matters appeared to be relevant at the time to the subject matter of the inquiry.
15. To disclose to any person with whom the SEC contracts to reproduce, by typing, photocopy or other means, any record within this system for use by the SEC and its staff in connection with their official duties or to any person who is utilized by the

SEC to perform clerical, stenographic or data analysis functions relating to the official business of the SEC.

16. To disclose in reports published by the SEC pursuant to authority granted in the federal securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47)).
17. To disclose to members of advisory committees that are created by the SEC or by Congress to render advice and recommendations to the SEC or to Congress, to be used solely in connection with their official, designated functions.
18. To disclose as a routine use to any person who is or has agreed to be subject to the SEC's Rules of Conduct, 17 CFR 200.735-1 to 200.735-18, and who assists in the investigation by the SEC of possible violations of federal securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47)), in the preparation or conduct of enforcement actions brought by the SEC for such violations, or otherwise in connection with the SEC's enforcement or regulatory functions under the federal securities laws.
19. To disclose to a Congressional office from the record of an individual in response to an inquiry from the Congressional office made at the request of that individual.
20. To aid in responding to requests from Members of Congress and the public relating to particular Registrants and their activities.
21. To disclose to interns, grantees, experts and contractors who have been engaged by the Commission to assist in the performance of a service related to this system of records and who need access to the records for the purpose of assisting the Commission in the efficient administration of its programs. Recipients of these

records shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

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

**STORAGE:**

Records are maintained in electronic format, paper form, magnetic disk and tape.

Electronic records are stored in computerized databases. Paper, magnetic disk or tape records are stored in locked file rooms or metal file cabinets.

**RETRIEVABILITY:**

Information is indexed by name of the Registrant or by certain SEC identification numbers. Information regarding individuals may be obtained through the use of cross-reference methodology or some form of personal identifier. Access for inquiry purposes is via a computer terminal.

**SAFEGUARDS:**

Records are safeguarded in a secured environment. Buildings where records are stored have security cameras and 24 hour security guard service. Access is limited to those personnel whose official duties require access. Computerized records are safeguarded through use of access codes and information technology security.

**RETENTION AND DISPOSAL:**

These records will be maintained until they become inactive, at which time they will be retired or destroyed in accordance with records schedules of the United States Securities and Exchange Commission and as approved by the National Archives and Records Administration.

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

Chief Information Officer, Office of Information Technology, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, VA 22312-2413.

**NOTIFICATION PROCEDURE:**

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

**RECORD ACCESS PROCEDURES:**

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of these records may contact the FOIA/PA Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**CONTESTING RECORD PROCEDURES:**

See Record Access Procedures above.

**RECORD SOURCE CATEGORIES:**

Record sources include filings made by Registrants; information obtained through examinations or investigations of Registrants and their activities; information contained in SEC correspondence with Registrants; information received from other federal, state, local, foreign or other regulatory organizations or law enforcement agencies; complaint information received by the SEC via letters, telephone calls, emails or any other form of communication; and data obtained from third-party sources.

**EXEMPTIONS CLAIMED FOR THE SYSTEM:**

None.

**SEC-56**

**SYSTEM NAME:**

Mailing, Contact and Other Lists.

**SYSTEM LOCATION:**

Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

Records are also maintained in the SEC Regional Offices.

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

Records contain information related to individuals and employees who submit requests for information, subscriptions, inquiries, guidance, informal advice and other assistance to the SEC in any format, including but not limited to paper, telephone, and electronic submissions; SEC personnel assigned to handle such correspondence; individuals who have registered for SEC events and responded to questionnaires, request forms and feedback forms.

**CATEGORIES OF RECORDS IN THE SYSTEM:**

Records may contain information relating to but not limited to name, title, affiliation, mailing address, telephone number, cell phone number, fax number, email address, business affiliation, other contact and related supporting information provided to the Commission by individuals or derived from other sources covered by this system of records and not currently covered under an existing SORN.

**AUTHORITY FOR MAINTENANCE OF THE SYSTEM:**

15 U.S.C. 77a et seq., 78a et seq., 80a-1 et seq., and 80b-1 et seq.

**PURPOSE(S):**

1. To track and process complaints/inquiries/requests/comments and communications from members of the public, including industry representatives, counsel, and others.
2. To handle subscription requests for informational literature, reports, and other SEC materials, via individual, mass, and targeted mailing in the furtherance of SEC activities.
3. To process registration to SEC-related activities and events.

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

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the Commission as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

1. When (1) it is suspected or confirmed that the security or confidentiality of information in the system of records has been compromised; (2) the SEC has determined that as a result of the suspected or confirmed compromise there is a risk of harm to economic or property interests, identity theft or fraud, or harm to the security or integrity of this system or other systems or programs (whether maintained by the SEC or another agency or entity) that rely upon the compromised information; and (3) the disclosure is made to such agencies, entities, and persons who are reasonably necessary to assist in connection with the SEC's efforts to respond to the suspected or confirmed compromise and prevent, minimize, or remedy such harm.
2. Where there is an indication of a violation or potential violation of law, whether civil, criminal or regulatory in nature, and whether arising by general statute or particular program statute, or by regulation, rule or order issued pursuant thereto, the

relevant records in the system of records may be referred, as a routine use, to the appropriate agency, whether federal, state, local, foreign or a securities self-regulatory organization charged with the responsibility of investigating or prosecuting such violation or charged with enforcing or implementing the statute, or rule, regulation or order issued pursuant thereto.

3. Records in this system may, in the discretion of the Commission's staff, be disclosed to any person during the course of any inquiry or investigation conducted by the Commission staff, or in connection with civil litigation, if the staff has reason to believe that the person to whom the record is disclosed may have further information about the matters related therein, and those matters appeared to be relevant at the time to the subject matter of the inquiry.
4. A record or information in this system may be disclosed to any person with whom the Commission contracts to reproduce, by typing, photocopy or other means, any record within this system for use by the Commission and its staff in connection with their official duties or to any person who is utilized by the Commission to perform clerical or stenographic functions relating to the official business of the Commission.
5. Records or information in records contained in this system may be disclosed to members of advisory committees that are created by the Commission or by Congress to render advice and recommendations to the Commission or to Congress, to be used solely in connection with their official, designated functions.
6. Disclosure may be made to a Congressional office from the record of an individual in response to an inquiry from the Congressional office made at the request of that individual.

7. To interns, grantees, experts and contractors who have been engaged by the Commission to assist in the performance of a service related to this system of records and who need access to the records for the purpose of assisting the Commission in the efficient administration of its programs. Recipients of these records shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

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

**STORAGE:**

Records are maintained in electronic format, paper form, magnetic disk and tape.

Electronic records are stored in computerized databases. Paper, magnetic disk or tape records are stored in locked file rooms or metal file cabinets.

**RETRIEVABILITY:**

Records may be retrieved by any of the following: email address, name, or an assigned file number for the purpose of responding to the requestor. Information may additionally be retrieved by other personal identifiers.

**SAFEGUARDS:**

Records are safeguarded in a secured environment. Buildings where records are stored have security cameras and 24 hour security guard service. Access is limited to those personnel whose official duties require access. Computerized records are safeguarded through use of access codes and information technology security.

**RETENTION AND DISPOSAL:**

These records will be maintained until they become inactive, at which time they will be

retired or destroyed in accordance with records schedules of the United States Securities and Exchange Commission and as approved by the National Archives and Records Administration.

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

**For SEC Headquarters**

U. S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

Components: Office of the Chairman and Commissioners, Division of Corporation Finance, Division of Trading and Markets, Division of Investment Management, Division of Enforcement, Office of the General Counsel, Office of the Chief Accountant, Office of Economic Analysis, Office of Compliance Inspections and Examinations, Office of International Affairs, Office of Investor Education and Advocacy, Office of Information Technology, Office of the Executive Director, Office of Human Resources, Office of Financial Management, Office of Administrative Services, Office of Risk Assessment, Office of the Inspector General, Office of Legislative and Intergovernmental Affairs, Office of Public Affairs, Office of the Secretary, Office of Equal Employment Opportunity, and Office of Administrative Law Judges.

**For Regional Offices**

New York Regional Office, Regional Director, 3 World Financial Center, Suite 400, New York, NY 10281-1022; Boston Regional Office, Regional Director, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424; Philadelphia Regional Office, Regional Director, The Mellon Independence Center, 701 Market Street, Suite 2000, Philadelphia, PA 19106-1532; Miami Regional Office, Regional Director, 801 Brickell Avenue, Suite 1800, Miami, FL 33131-4901, Atlanta Regional Office, Regional Director, 3475 Lenox Road,

NE, Suite 1000, Atlanta, GA 30326-1232; Chicago Regional Office, Regional Director, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604-2908; Denver Regional Office, Regional Director, 1801 California Street, Suite 1500, Denver, CO 80202-2656; Fort Worth Regional Office, Regional Director, Burnett Plaza, Suite 1900, 801 Cherry Street, Unit #18, Fort Worth, TX 76102-6882; Salt Lake Regional Office, Regional Director, 15 West South Temple Street, Suite 1800, Salt Lake City, UT 84101-1573; Los Angeles Regional Office, Regional Director, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, CA 90036-3648; San Francisco Regional Office, Regional Director, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104-4716.

**NOTIFICATION PROCEDURE:**

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

**RECORD ACCESS PROCEDURES:**

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of these records may contact the FOIA/PA Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**CONTESTING RECORD PROCEDURES:**

See Record Access Procedures above.

**RECORD SOURCE CATEGORIES:**

The information is supplied by the individual and/or company making the request. Data may also be added pertaining to the fulfillment of the request. Information may also be obtained from other SEC records systems.

**EXEMPTIONS CLAIMED FOR THE SYSTEM:**

None.

**SEC-57**

**SYSTEM NAME:**

International Program Oversight Database (International – POD)

**SYSTEM LOCATION:**

Office of International Affairs, Securities and Exchange Commission, 100 F Street, NE,  
Washington, DC 20549.

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

Foreign and domestic contacts for Enforcement workload/Commission and foreign requests; foreign and domestic contacts for policy requests; Foreign officials trained in SEC Headquarters; Chairmen, CEOs, and Presidents of foreign regulators and stock exchanges; SEC staff traveling overseas; and information on vendors providing support for SEC's technical assistance program and individuals entitled to USAID reimbursements.

**CATEGORIES OF RECORDS IN THE SYSTEM:**

Contact information of individuals related to Enforcement cases and policy requests.  
Contact information of international institute foreign officials trained in SEC Headquarters; Contact information for Chairmen, CEOs, and Presidents of foreign regulators and stock exchanges; SEC staff traveling overseas; and information on vendors providing support for SEC's technical assistance program and individuals entitled to USAID reimbursements.

Correspondence relevant to the matter, internal staff memoranda, Commission Minutes and Commission Orders, working papers of the staff and other documents and records relating to the matter, opening reports, progress reports and closing reports, miscellaneous records relating to cross-border investigations or litigation and other international enforcement and regulatory matters.

**AUTHORITY FOR MAINTENANCE OF THE SYSTEM:**

15 U.S.C. 77s, 77t, 78u, 77uuu, 80a-41, 80b-9, and 17 CFR 202.5.

**PURPOSE(S):**

Tracks data gathered by the Office of International Affairs with respect to processing (1) requests for enforcement cooperation with foreign regulators and law enforcement agencies; (2) international regulatory policy matters designed to protect investors, improve market efficiency, and eliminate opportunities for "regulatory arbitrage"; (3) technical assistance and international training programs for emerging securities markets; (4) directory of contacts for foreign regulators and stock exchanges; (5) SEC staff foreign travel; and (6) USAID Reimbursement.

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

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the Commission as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

1. When (1) it is suspected or confirmed that the security or confidentiality of information in the system of records has been compromised; (2) the SEC has determined that as a result of the suspected or confirmed compromise there is a risk

of harm to economic or property interests, identity theft or fraud, or harm to the security or integrity of this system or other systems or programs (whether maintained by the SEC or another agency or entity) that rely upon the compromised information; and (3) the disclosure is made to such agencies, entities, and persons who are reasonably necessary to assist in connection with the SEC's efforts to respond to the suspected or confirmed compromise and prevent, minimize, or remedy such harm.

2. To coordinate law enforcement activities between the SEC and other federal, state, local or foreign law enforcement agencies, securities self-regulatory organizations, and foreign securities authorities.
3. Where there is an indication of a violation or potential violation of law, whether civil, criminal or regulatory in nature, and whether arising by general statute or particular program statute, or by regulation, rule or order issued pursuant thereto, the relevant records in the system of records may be referred to the appropriate agency, whether federal, state, or local, a foreign governmental authority or foreign securities authority, or a securities self-regulatory organization charged with the responsibility of investigating or prosecuting such violation or charged with enforcing or implementing the statute or rule, regulation or order issued pursuant thereto.
4. In any proceeding where the federal securities laws are in issue or in which the Commission, or past or present members of its staff, is a party or otherwise involved in an official capacity.
5. To respond to inquiries from Members of Congress, the press and the public which relate to specific matters that the Commission has investigated and to matters under the Commission's jurisdiction.

6. To interns, grantees, experts and contractors who have been engaged by the Commission to assist in the performance of a service related to this system of records and who need access to the records for the purpose of assisting the Commission in the efficient administration of its programs. Recipients of these records shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

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

**STORAGE:**

Records are maintained in electronic format and paper form. Electronic records are stored in computerized databases. Paper records are stored in locked file rooms or metal file cabinets.

**RETRIEVABILITY:**

Data are retrievable by the individual's name or other identifier, such as case number, name, as well as non-identifying information.

**SAFEGUARDS:**

Records are safeguarded in a secured environment. Buildings where records are stored have security cameras and 24 hour security guard service. Access is limited to those personnel whose official duties require access. Computerized records are safeguarded through use of access codes and information technology security.

**RETENTION AND DISPOSAL:**

These records will be maintained until they become inactive, at which time they will be

retired or destroyed in accordance with records schedules of the United States Securities and Exchange Commission and as approved by the National Archives and Records Administration.

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

Deputy Director, Office of International Affairs, Securities and Exchange Commission,  
100 F Street, NE, Washington, DC 20549-1004.

**NOTIFICATION PROCEDURE:**

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

**RECORD ACCESS PROCEDURES:**

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of these records may contact the FOIA/PA Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**CONTESTING RECORD PROCEDURES:**

See Record Access Procedures above.

**RECORD SOURCE CATEGORIES:**

Information contained in this system is obtained from enforcement requests related to an SEC investigation; international institute training programs; foreign regulators and stock exchanges; SEC travel records; and USAID reimbursable programs.

**EXEMPTIONS CLAIMED FOR THE SYSTEM:**

None.

**SEC-58**

**SYSTEM NAME:**

System for Enforcement Case Tracking and Routing (SECTR).

**SYSTEM LOCATION:**

Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Files may also be maintained in the Commission's Regional Offices that conducted an investigation or litigation, or at a records management company under contract with the Commission. Closed investigatory files are stored at a federal records center.

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

Records are maintained on persons who have been involved in Commission investigations or litigation, or in activities which violated or may have violated federal, state or foreign laws relating to transactions in securities, the conduct of securities business or investment advisory activities, and banking or other financial activities.

**CATEGORIES OF RECORDS IN THE SYSTEM:**

Correspondence relevant to the matter, internal staff memoranda, Commission Orders, settlement offers, Wells submissions, sworn financial statements, affidavits, transcripts of testimony, copies of pleadings, documents and other evidence obtained in the course of the matter, computerized records, working papers of the staff, and other documents and records relating to the matter.

**AUTHORITY FOR MAINTENANCE OF THE SYSTEM:**

15 U.S.C. 77s, 77t, 78u, 77uuu, 80a-41, 80b-9, and 17 CFR 202.5.

**PURPOSE(S):**

The purpose of this system of records is to create and maintain an electronic database of enforcement matters reviewed and comments provided by staff of the Division of Trading

and Markets to the Division of Enforcement; and to maintain a record of communications within the Division of Trading and Markets relating to the enforcement matters reviewed.

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

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the Commission as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

1. When (1) it is suspected or confirmed that the security or confidentiality of information in the system of records has been compromised; (2) the SEC has determined that as a result of the suspected or confirmed compromise there is a risk of harm to economic or property interests, identity theft or fraud, or harm to the security or integrity of this system or other systems or programs (whether maintained by the SEC or another agency or entity) that rely upon the compromised information; and (3) the disclosure is made to such agencies, entities, and persons who are reasonably necessary to assist in connection with the SEC's efforts to respond to the suspected or confirmed compromise and prevent, minimize, or remedy such harm.
2. As a data source for management information for production of summary descriptive statistics and analytical studies in support of the function for which the records are collected and maintained or for related personnel management functions or manpower studies, and to respond to general requests for statistical information (without personal identification of individuals) under the Freedom of Information Act or to locate specific individuals for personnel research or other personnel management functions.

3. In connection with their regulatory and enforcement responsibilities mandated by the federal securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47)), or state or foreign laws regulating securities or other related matters, records may be disclosed to national securities associations that are registered with the Commission, the Municipal Securities Rulemaking Board, the Securities Investor Protection Corporation, the federal banking authorities, including but not limited to, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, state securities regulatory or law enforcement agencies or organizations, or regulatory law enforcement agencies of a foreign government, or foreign securities authority.
4. To any person with whom the Commission contracts to reproduce, by typing, photocopy or other means, any record within this system for use by the Commission and its staff in connection with their official duties or to any person who is utilized by the Commission to perform clerical or stenographic functions relating to the official business of the Commission.
5. Inclusion in reports published by the Commission pursuant to authority granted in the federal securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47)).
6. To members of advisory committees that are created by the Commission or by Congress to render advice and recommendations to the Commission or to Congress, to be used solely in connection with their official designated functions.
7. To any person who is or has agreed to be subject to the Commission's Rules of Conduct, 17 CFR 200.735-1 to 200.735-18, and who assists in the investigation by

the Commission of possible violations of federal securities laws (as defined in Section 3(a)(47) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(47)), in the preparation or conduct of enforcement actions brought by the Commission for such violations, or otherwise in connection with the Commission's enforcement or regulatory functions under the federal securities laws.

8. Disclosure may be made to a Congressional office from the record of an individual in response to an inquiry from the Congressional office made at the request of that individual.
9. To respond to inquiries from Members of Congress, the press and the public which relate to specific matters that the Commission has investigated and to matters under the Commission's jurisdiction.
10. To prepare and publish information relating to violations of the federal securities laws as provided in 15 U.S.C. 78c(a)(47).
11. To respond to subpoenas in any litigation or other proceeding.
12. To interns, grantees, experts and contractors who have been engaged by the Commission to assist in the performance of a service related to this system of records and who need access to the records for the purpose of assisting the Commission in the efficient administration of its programs. Recipients of these records shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

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

Records are maintained in electronic format, paper form and other media. Electronic records are stored in computerized databases. Paper and other media records are stored in locked file rooms or metal file cabinets.

**RETRIEVABILITY:**

The records can be retrieved by the case number or case name (as designated by the Division of Enforcement), or by the name of an involved party related to the investigation being conducted or the administrative proceeding or civil action filed.

**SAFEGUARDS:**

Records are safeguarded in a secured environment. Buildings where records are stored have security cameras and 24 hour security guard service. Access is limited to those personnel whose official duties require access. Computerized records are safeguarded through use of access codes and information technology security.

**RETENTION AND DISPOSAL:**

These records will be maintained until they become inactive, at which time they will be retired or destroyed in accordance with records schedules of the United States Securities and Exchange Commission and as approved by the National Archives and Records Administration.

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

Assistant Director, Office of Enforcement Liaison and Institutional Trading, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-6628.

**NOTIFICATION PROCEDURE:**

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

**RECORD ACCESS PROCEDURES:**

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of these records may contact the FOIA/PA Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**CONTESTING RECORD PROCEDURES:**

See Record Access Procedures above.

**RECORD SOURCE CATEGORIES:**

Information in these records is supplied by other offices within the Commission; correspondence relating to litigation; pleadings in administrative proceedings; and other documents, including evidence entered in such proceedings.

**EXEMPTIONS CLAIMED FOR THE SYSTEM:**

None.

**SEC-59**

**SYSTEM NAMES:**

Office of Interpretation and Guidance Log; Office of Broker-Dealer Finances NRSRO Log; and Office of Financial Responsibility Log.

**SYSTEM LOCATION:**

Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

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

Representatives of regulated entities and their counsel, members of the public, representatives of other governmental agencies or Congress, and others who submit inquiries, information, comments, or other forms of communication to the Commission's Division of Trading and Markets' Office of Interpretation and Guidance, Office of Broker-Dealer Finances, or Office of Financial Responsibility, respectively, or who address their communications to other Division or Commission staff or offices that make a referral to, or consult with, the Division of Trading and Markets' Office of Interpretation and Guidance, Office of Broker-Dealer Finances, or Office of Financial Responsibility, respectively, or related staff.

**CATEGORIES OF RECORDS IN THE SYSTEM:**

Both electronic and paper records in this system may include the name of the inquirer/requester/commenter/communicant or their representative, the name of the entity if available, the subject of the inquiry/request/comment or communication, the date of the inquiry/request/comment or communication, and the staff response provided or other disposition. Paper records may include, but are not limited to letters of inquiry/request/comment or communications, responses, and related documentation.

**AUTHORITY FOR MAINTENANCE OF THE SYSTEM:**

15 U.S.C. 78a et seq. and 17 CFR 202.1 to 202.10.

**PURPOSE(S):**

The records are used by the staff to track and process inquiries/requests/comments and communications from members of the public, industry representatives, counsel, and others.

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

In addition to those disclosures generally permitted under 5 U.S.C. 552a(b) of the Privacy Act, these records or information contained therein may specifically be disclosed outside the Commission as a routine use pursuant to 5 U.S.C. 552a(b)(3) as follows:

1. When (1) it is suspected or confirmed that the security or confidentiality of information in the system of records has been compromised; (2) the SEC has determined that as a result of the suspected or confirmed compromise there is a risk of harm to economic or property interests, identity theft or fraud, or harm to the security or integrity of this system or other systems or programs (whether maintained by the SEC or another agency or entity) that rely upon the compromised information; and (3) the disclosure is made to such agencies, entities, and persons who are reasonably necessary to assist in connection with the SEC's efforts to respond to the suspected or confirmed compromise and prevent, minimize, or remedy such harm.
2. To respond to inquiries from the White House, Congressional committees or offices, the General Accountability Office, General Services Administration or the National Archives and Records Administration, or others charged with monitoring the work of the Commission or conducting records management inspections.
3. To provide information to other federal or state government agencies, or securities self-regulatory organizations which have direct jurisdiction over the subject matter of the inquiry/request/comment or communication.
4. As a data source for the production of summary statistics and analytical studies in support of the function for which the records are collected and maintained or for

statistics relating to personnel management functions or manpower studies; may also be utilized to respond to general requests for statistical information (without personal identification of individuals) under the Freedom of Information Act.

5. To coordinate with or assist in law enforcement and regulatory activities of the Commission and other federal, state, local, or foreign law enforcement or regulatory agencies, securities self-regulatory organizations, and foreign securities authorities.
6. To respond to a subpoena, court order, or request for discovery, in connection with any relevant litigation or proceeding where the federal securities laws are at issue or in which the Commission, or past or present members of its staff, is a party or otherwise involved in an official capacity.
7. To provide information to a federal, state, local, or foreign government or foreign securities authority, in response to its request, in connection with civil, criminal, or other enforcement information, the hiring or retention of an employee, the issuance of a security clearance, the reporting of an investigation of an employee, the letting of a contract, or the issuance of a license, grant, or other benefit by the requesting agency, to the extent that the information is relevant and necessary to the requesting agency's decision on the matter.
8. A record or information in this system may be disclosed to any person with whom the Commission contracts to reproduce, by typing, photocopy or other means, any record within this system for use by the Commission and its staff in connection with their official duties or to any person who is utilized by the Commission to perform clerical or stenographic functions relating to the official business of the Commission.

9. To interns, grantees, experts and contractors who have been engaged by the Commission to assist in the performance of a service related to this system of records and who need access to the records for the purpose of assisting the Commission in the efficient administration of its programs. Recipients of these records shall be required to comply with the requirements of the Privacy Act of 1974, as amended, 5 U.S.C. 552a.

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

**STORAGE:**

Records are maintained in electronic format, and paper form. Electronic records are stored in computerized databases. Paper records are stored in locked file rooms or file cabinets.

**RETRIEVABILITY:**

Records may be retrieved by any of the following: individual name, receipt date, entity name if provided, telephone number or email address if provided, the subject matter, or other indexed information.

**SAFEGUARDS:**

Records are safeguarded in a secured environment. Buildings where records are stored have security cameras and 24 hour security guard service. Access is limited to those personnel whose official duties require access. Computerized records are safeguarded through use of access codes and information technology security.

**RETENTION AND DISPOSAL:**

These records will be maintained until they become inactive, at which time they will be retired or destroyed in accordance with records schedules of the United States Securities and Exchange Commission and as approved by the National Archives and Records Administration.

**SYSTEM MANAGERS AND ADDRESSES:**

Deputy Associate Director, Office of Broker-Dealer Finances, and Senior Special Counsel, Office of Interpretation and Guidance, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7561.

**NOTIFICATION PROCEDURE:**

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

**RECORD ACCESS PROCEDURES:**

Persons wishing to obtain information on the procedures for gaining access to or contesting the contents of these records may contact the FOIA/PA Officer, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5100.

**CONTESTING RECORD PROCEDURES:**

See Record Access Procedures above.

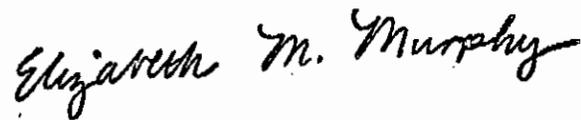
**RECORD SOURCE CATEGORIES:**

Information collected is received from individuals primarily through telephone calls, emails, facsimiles, or letters to the Division of Trading and Markets or other Commission offices.

**EXEMPTIONS CLAIMED FOR THE SYSTEM:**

None.

By the Commission.

A handwritten signature in cursive script that reads "Elizabeth M. Murphy".

Elizabeth M. Murphy  
Secretary

Date: July 16, 2009

*Commissioner Aguilar and  
Commissioner Paredes  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 17, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13550

In the Matter of

J.P. TURNER & COMPANY,  
LLC,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO SECTIONS 15(b) AND 21C  
OF THE SECURITIES EXCHANGE ACT OF  
1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against J.P. Turner & Company, L.L.C. ("Respondent" or "J.P. Turner").

II.

After an investigation, the Division of Enforcement alleges that:

1. J.P. Turner is an Atlanta, Georgia-based limited liability company that has been registered with the Commission as a broker-dealer since 1997. As of mid-September 2006, J.P. Turner had approximately 488 independent contractor registered representatives, working out of over 150 branch offices, including 48 offices of supervisory jurisdiction, located throughout the United States.

Summary

2. Between July 1, 2001 and approximately mid-September 2006, J.P. Turner failed to adopt and implement policies and procedures designed reasonably to safeguard customer records and information as required by Rule 30(a) of Regulation S-P (the "Safeguard Rule") (17 CFR § 248.30(a)). During the relevant period, J.P. Turner employed hundreds of independent contractor registered representatives who worked from multiple branch offices located throughout the United States. Because it never complied with the Safeguard Rule, J.P. Turner, among other things, never

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gave its numerous branch managers or registered representatives guidance on how to protect customer records or how to dispose properly of such records when they were no longer needed. This lack of guidance became apparent in September 2006 when the account records of over 5,000 brokerage customers of J.P. Turner were left abandoned for several weeks at curbside outside of the former home of a J.P. Turner registered representative in Alpharetta, Georgia.

### The Safeguard Rule

3. Regulation S-P became effective on July 1, 2001 and required, among other things, that every broker, dealer, and investment company, and every investment adviser registered with the Commission to have policies and procedures reasonably designed, among other things, to insure the security and confidentiality of customer records and information and protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer. These policies and procedures did not have to be in writing when Regulation S-P originally went into effect. However, the Commission later amended Regulation S-P to require that such policies and procedures be written. This amendment to the Safeguard Rule went into effect on January 11, 2005 and required compliance by July 1, 2005.

4. In September 2000, the NASD provided a Notice to Members which informed members of, among other things, the requirements of the Safeguard Rule under Regulation S-P. This Notice to Members stated, in pertinent part, that "in the first year a broker/dealer becomes subject to the rule, a broker/dealer must comply with the following requirements: . . . adopt policies and procedures that address the protection of customer information and records." J.P. Turner's chief compliance officer acknowledged receiving this Notice to Members. On July 1, 2005, Regulation S-P was amended to require that those policies and procedures be in writing. J.P. Turner received a Notice to Members setting out the new requirement that Regulation S-P policies and procedures must be in writing.

5. From July 1, 2001 to June 30, 2005, J.P. Turner had no policies and procedures reasonably designed to protect customer information, as required by the Safeguard Rule, as effective on July 1, 2001. Additionally, between July 1, 2005 and September 2006, J.P. Turner failed to comply with the amended Safeguard Rule, as effective on July 1, 2005.

6. Specifically, following the effective date of Regulation S-P, J.P. Turner issued a number of successive editions of both its registered representative's manual and its branch manager's manual. None of these editions made mention of the Safeguard Rule nor provided policies or procedures concerning how to protect customer records and customer information as required by the Safeguard Rule.

7. The only written mention of the Safeguard Rule in J.P. Turner's manuals was contained in six successive editions of its main office manual issued between July 2005 and September 2006. However, these manuals simply restated the objectives of the Safeguard Rule and delegated to J.P. Turner's assistant chief compliance officer the responsibility to ensure compliance with it. Although these main office manuals mandated that firm records be kept in locked file cabinets which were to be subjected to random spot-checks, there were no other policies

or procedures in the manuals addressing any administrative, technical, or physical safeguards associated with customer records or information, including how to dispose properly of such records when they were no longer needed.

### **The Abandoned Customer Records**

8. J.P. Turner's failure to comply with the requirements of the Safeguard Rule became apparent in September 2006. Specifically, on September 1, 2006, in connection with a residence change a then-registered representative of J.P. Turner placed records of more than 5,000 current or former J.P. Turner customers curbside at his residence in suburban Atlanta, Georgia, for pick up by a trash hauler with whom he had contracted to retrieve and destroy the records. The customer records contained variously the names, addresses, dates of birth, social security numbers, bank account numbers, and account statements of the customers. However, the hauler never collected the records which remained abandoned until J.P. Turner retrieved them on September 14. J.P. Turner has been unable to confirm that all of the customer records have been retrieved.

9. As a result of the conduct described above, J.P. Turner willfully violated Section 30(a) of Regulation S-P by failing to have written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information and that were reasonably designed to: (1) insure the security and confidentiality of customer records and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

### **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 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing any violations of and any future violations of Section 30(a) of Regulation S-P (17 C.F.R. . § 248.30(a)) and whether Respondent should be ordered to pay disgorgement pursuant to Section 21C 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 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.

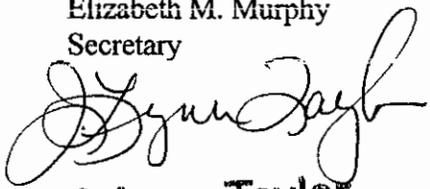
This Order shall be served forthwith upon Respondent personally or by certified mail.

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



By: J. Lynn Taylor  
Assistant Secretary

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

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 60331 / July 17, 2009

**ACCOUNTING AND AUDITING ENFORCEMENT**  
Release No. 3014 / July 17, 2009

**ADMINISTRATIVE PROCEEDING**  
File No. 3-13552

**In the Matter of**

**THOMAS STINER, 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 Thomas Stiner ("Stiner" or "Respondent") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

**II.**

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<sup>1</sup>Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

### III.

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

1. Stiner, age 53, is a certified public accountant who was previously licensed to practice in the Commonwealth of Pennsylvania. He served as Chief Financial Officer of AstroPower, Inc. ("AstroPower") from December 1997 until his resignation on May 23, 2003. He had previously served as AstroPower's controller from May 1993 through November 1997.

2. AstroPower was, at all relevant times, a Delaware corporation with its principal place of business in Newark, Delaware. AstroPower was engaged in the business of manufacturing solar electric power products including solar cells, modules and panels worldwide. At all relevant times, AstroPower's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the NASDAQ National Market.

3. On March 10, 2009, the Commission filed a complaint against Stiner in SEC v. Allen Barnett, et al. (Civil Action No. 1:09-cv-00457-EGS). On July 10, 2009, the court entered a final judgment permanently enjoining Stiner, by consent, from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Exchange Act Rules 10b-5, 13a-14, 13b2-1 and 13b2-2, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, and 13a-13. Stiner was also ordered to pay a \$40,000 civil money penalty and prohibited from serving as an officer or director of a public company.

4. In its complaint, the Commission alleged that during 2002, Stiner, and AstroPower's former Chief Executive Officer, Allen Barnett, made material misstatements, engaged in fraudulent accounting practices, and signed filings made with the Commission that they knew, or were reckless in not knowing, contained materially false and misleading financial statements. As alleged in the complaint, at the direction of Barnett and Stiner, and in contravention of Generally Accepted Accounting Principles, AstroPower improperly recognized approximately \$4 million in revenues from four transactions executed over the course of the second and third quarters of 2002. These improper accounting practices included: 1) revenue recognition from sales where payment of the sales price was contingent and collectibility was not assured; 2) recognizing

revenue from a fictitious sale; and 3) initiating and recognizing revenue from improper seller-initiated bill-and-hold transactions in which AstroPower bore the risks of ownership and the costs of storage. In its complaint, the Commission alleged that as a result of fraudulently recognizing revenue from these transactions, AstroPower's reported revenues were overstated by \$2.1 million or 12% in the second quarter of 2002, and by \$1.9 million or 9% in the third quarter of 2002. AstroPower's net income was also overstated by approximately \$160,000 or 80% for the second quarter of 2002, and approximately \$440,000 or 113% for the third quarter of 2002. In its complaint, the Commission also alleged that, in connection with a single improper transaction, Stiner made materially false statements to AstroPower's external auditors during the 2002 financial statement audit.

#### IV.

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

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

Chairman Schapiro  
not participating

SECURITIES AND EXCHANGE COMMISSION  
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934  
Rel. No.60328 / July 17, 2009

Admin. Proc. File No. 3-13334

In the Matter of  
TIMOTHY H. EMERSON, JR.  
c/o Brian P. Sweeney, Esq.  
520 S. Florida  
Lakeland, FL 33801  
For Review of Action Taken by  
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DENIAL OF  
MEMBERSHIP CONTINUANCE APPLICATION

Registered securities association denied member's application to permit continued employment of individual subject to a statutory disqualification. *Held*, the application for review is *dismissed*.

APPEARANCES:

*Brian P. Sweeney*, for Timothy H. Emerson, Jr.

*Marc Menchel, Alan Lawhead, and Deborah F. McIlroy*, for the Financial Industry Regulation Authority, Inc.

Appeal filed: January 14, 2009  
Last brief received: April 21, 2009

I.

Timothy H. Emerson, Jr., a general securities representative, appeals from the denial by Financial Industry Regulation Authority, Inc. ("FINRA") of an application (the "Application") by Brookstone Securities, Inc. ("Brookstone" or the "Firm"), a FINRA member firm, requesting permission for Emerson to continue associating with the Firm despite Emerson's statutory disqualification.<sup>1</sup> We base our findings on an independent review of the record.

<sup>1</sup> On July 26, 2007, the Commission approved a proposed rule change filed by  
(continued...)

**II.**

The parties do not dispute the relevant facts on appeal. In June 2005, Emerson was arrested for driving under the influence of alcohol ("DUI") in the state of Kansas and was initially charged with a misdemeanor. However, because Emerson had three previous DUI convictions, the charge was upgraded to a felony in August 2005.<sup>2</sup> Emerson pleaded guilty on September 6, 2006, and a state court sentenced Emerson to ninety days in jail and twelve months of post-release treatment, along with a \$2,500 fine. Emerson served his jail sentence, paid his fine, and completed the required treatment. Emerson testified at his statutory disqualification hearing that he continues to be active in Alcoholics Anonymous, has a sponsor in the program, and has maintained his sobriety since April 2006.

Because of the felony conviction, Emerson became subject to a ten-year statutory disqualification under Section 3(a)(39)(F) of the Securities Exchange Act of 1934 and FINRA's By-Laws.<sup>3</sup> As a statutorily disqualified person, Emerson is not eligible to associate with a FINRA member firm without FINRA's consent.<sup>4</sup>

**A. Emerson's Employment History****1. Dean Witter**

After becoming qualified as a general securities representative in September 1989, Emerson joined Dean Witter Reynolds, Inc. ("Dean Witter"). Emerson worked at Dean Witter for approximately nine and one-half years before Dean Witter terminated him in March 1999. The record does not contain a copy of the Uniform Termination Notice for Securities Industry Registration ("Form U5") that Dean Witter filed when it discharged Emerson. The record does

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<sup>1</sup> (...continued)

National Association of Securities Dealers, Inc. ("NASD") to amend NASD's Restated Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of NASD and the member-regulation, enforcement, and arbitration functions of the New York Stock Exchange. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517 (SR-NASD-2007-053). Because FINRA denied Brookstone's application after the consolidation, references to FINRA will include references to NASD.

<sup>2</sup> Emerson's prior three DUI convictions, which were misdemeanors, occurred in 1995, 1987 and 1985 – all in Kansas.

<sup>3</sup> 15 U.S.C. § 78c(a)(39)(F); FINRA By-Laws, Art. 3, § 4 (2009).

<sup>4</sup> FINRA By-Laws, Art. 3, § 3 (b), (d).

show, however, that, before Dean Witter discharged him, the firm had questioned Emerson about accounts involving retired persons purchasing initial public offerings.

The record also includes Emerson's Uniform Application for Securities Industry Registration ("Form U4"), dated June 27, 2006, which indicates that two customers filed complaints against Emerson for unsuitable recommendations. The first complaint, filed the same month Emerson was terminated (March 1999), alleged that Emerson had made unsuitable investment recommendations resulting in purported losses to the client of \$52,000. Dean Witter settled that complaint in April 1999 for \$35,433. The next complaint, filed in July 1999, alleged that Emerson had engaged in an unsuitable strategy of investing in initial public offerings, which purportedly cost the customer \$59,000. Dean Witter settled that complaint for \$20,000 in August 1999.<sup>5</sup>

Emerson testified at the statutory disqualification hearing that these customer complaints were due to the aggressive business "culture" at Dean Witter, which encouraged him to "raise assets under management [and] grow [his] accounts." Emerson claimed that he has "drastically changed [his] business" since then by decreasing the number of households he serves and focusing "only on high net worth individuals that had excellent investor experience."

## 2. Wachovia Securities

Approximately a month after being dismissed from Dean Witter, Emerson became associated with Wachovia Securities, Inc. ("Wachovia").<sup>6</sup> After working for Wachovia for approximately seven years, the firm terminated Emerson on May 15, 2006. The Form U5 filed by Wachovia states that Emerson was terminated for "violating firm policy" and adds that Emerson "took discretion in client accounts."

The questionable trades were apparently done for a deceased account holder's widow, at the request of the widow's attorney. NYSE Regulation Inc. ("NYSE Regulation") investigated the matter and concluded that Emerson had allowed the widow to withdraw funds from her deceased husband's account without the necessary written authorization. NYSE Regulation decided not to take any formal disciplinary action, however, because Emerson had no previous

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<sup>5</sup> In January 2000, two other customers filed complaints, alleging that Emerson had mismanaged their accounts while at Dean Witter. Dean Witter denied those complaints.

<sup>6</sup> According to Emerson's Form U4, Emerson joined Everen Securities, Inc. ("Everen") after leaving Dean Witter. Everen, however, later apparently merged with First Union Securities, Inc., which, in turn, merged with Wachovia. For simplicity's sake, this opinion refers to these entities collectively as Wachovia.

disciplinary history, he had cooperated with the investigation and admitted wrongdoing, the customer had not suffered harm, and Wachovia had terminated Emerson's employment.<sup>7</sup>

It was during his time at Wachovia that Emerson was arrested for his fourth DUI. Although Emerson notified Wachovia of the initial arrest, he apparently failed to notify Wachovia when the DUI was upgraded to a felony – a point he does not dispute on appeal. In fact, Emerson submitted a deposition transcript to FINRA in which a former Wachovia compliance officer testified that Emerson had notified him of the misdemeanor arrest, but that he could not remember Emerson ever telling him that the misdemeanor DUI charge had been upgraded to a felony. Emerson's Form U4 was also not amended to reflect the upgrade to a felony DUI, as FINRA rules require.<sup>8</sup>

### 3. Brookstone

Emerson joined Brookstone on June 30, 2006, approximately one month after being discharged from Wachovia and two months before he pleaded guilty to the felony DUI. Brookstone has twenty-nine branch offices, twenty offices of supervisory jurisdiction ("OSJs"), fourteen registered principals, and eighty-five registered representatives.

#### B. Brookstone's Membership Continuation Application

On November 11, 2006, approximately two months after Emerson pleaded guilty to felony DUI, Brookstone applied to the FINRA Department of Registration and Disclosure to

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<sup>7</sup> In November 2006, several months after Emerson left Wachovia, two joint account holders filed a complaint against Emerson, alleging that he had engaged in unauthorized trading from 2002 until 2005 and claiming \$8,000 in losses. The same customers filed what appears to be a nearly identical complaint in January 2007. In both cases, Wachovia denied the complaint "in its entirety," stating that Wachovia's "review of the matter revealed no evidence of wrongdoing." Emerson testified that his ex-wife and her mother instituted these complaints and that they had no substance.

<sup>8</sup> Form U4 asks members, in part, to disclose whether they have been charged or convicted of a felony. FINRA and other self-regulatory organizations use Forms U4 as one of the bases to determine the fitness of applicants for registration as securities professionals. FINRA Membership Rule IM-1000-1 requires members to correct information in connection with membership or registration as a registered representative that is so "incomplete or inaccurate so as to be misleading." FINRA Manual at 16,111 (2009); *see also* Jason A. Craig, Exchange Act Rel. No. 59137 (Dec. 22, 2008), 95 SEC Docket 12694, 12694 (affirming a bar where applicant failed to disclose on his Form U4 that he had been charged with four felonies and had been convicted of a misdemeanor); *Thomas A. Alton*, 52 S.E.C. 380, 382 (1995) (affirming a bar where applicant's Form U4 contained misrepresentations about a perjury conviction), *aff'd*, 105 F. 3d 664 (9th Cir. 1996) (table).

permit Emerson to continue to associate with the Firm as a general securities representative. As part of its application, Brookstone submitted a heightened supervisory plan in which Brookstone proposed, in part, that Emerson would move from his current workplace in his home to Brookstone's OSJ in Overland Park, Kansas, where Russell Fieger, a principal and active producer at the Firm, would be Emerson's primary supervisor. Brookstone also proposed that Emerson's daily trades would be reviewed and approved by David Locy, the Firm's chief compliance officer. Because Locy would not be in the same OSJ as Emerson, Brookstone proposed that Locy would review the trades through the Firm's electronic surveillance software.

On March 6, 2008, a two-person Hearing Panel of FINRA's Statutory Disqualification Committee held a hearing to consider the Application. During the hearing, Locy testified that the Firm currently employs eight representatives, including Emerson, who, due to certain disclosures on their Forms U4, are subject to Brookstone's own heightened supervisory procedures. When asked about representatives who work from home – which Emerson has apparently been doing since he started at the Firm in June 2006 – Locy explained that only persons with a "clean" Form U4 are allowed to work from their home. When asked to explain why Emerson had been allowed to work from home given his statutory disqualification, Locy responded "I guess I can't answer that."<sup>9</sup>

The Hearing Panel also heard from Fieger about his proposed role supervising Emerson. Fieger stated that he currently supervises nine registered representatives but has not supervised a statutorily disqualified person before. He also explained that he had given only a "cursory review" to Emerson's business and that he had known Emerson for only twenty-four hours before his testimony.

On December 17, 2008, the National Adjudicatory Council ("NAC") denied Brookstone's application for Emerson to continue to be associated with Brookstone. The NAC found that allowing Emerson to continue to be associated with Brookstone was "not in the public interest, and would create an unreasonable risk of harm to the market or investors." The NAC expressed concern (i) that insufficient time had elapsed since Emerson's felony conviction, (ii) that Emerson had failed in his obligation to notify Wachovia promptly that the DUI charge had been upgraded to a felony, (iii) that Emerson's regulatory history of prior customer complaints demonstrated "a lack of respect for authority and an inability to conform to the regulatory atmosphere of the securities industry," (iv) that Brookstone's proposed supervisory plan was inadequate, and (v) that Brookstone had failed to establish its ability to comply with that plan. This appeal followed.

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<sup>9</sup> Locy testified that, under the Firm's then-current supervision of Emerson, Locy would visit Emerson at home and review Emerson's files and correspondence. Locy also testified that, while Locy's headquarters was in Lakeland, Florida, his "time is split between Kansas City and Lakeland."

## III.

Section 19(f) of the Exchange Act sets forth the standards that govern our review of FINRA's denial of the Application.<sup>10</sup> We must dismiss Emerson's appeal if we find (i) that the specific grounds on which FINRA based its action exist in fact, (ii) that the denial is in accordance with FINRA rules, and (iii) that those rules were applied in a manner consistent with the purposes of the Exchange Act, unless we determine that FINRA's action imposes an unnecessary burden on competition.<sup>11</sup> In a FINRA proceeding such as this, "the burden rests on the applicant to show that, despite the disqualification, it is in the public interest to permit the requested employment."<sup>12</sup>

We find, and Emerson does not dispute on appeal, that the grounds on which FINRA based its decision exist in fact, including (i) that Emerson was convicted of a felony DUI in 2006, (ii) that Emerson's felony conviction was a statutorily disqualifying event,<sup>13</sup> (iii) that Emerson has three previous DUI convictions, (iv) that Emerson failed to notify Wachovia that the DUI had been upgraded to a felony, (v) that Emerson was the subject of several customer complaints, (vi) that Emerson's two previous employers discharged him, (vii) that Brookstone allowed Emerson to work from home in contravention of its own internal procedures, and (viii) that the NAC opinion correctly stated the facts and circumstances surrounding Brookstone's proposed supervision of Emerson.

We also find that FINRA's denial of the Application was in accordance with FINRA's rules. For example, we find, and Emerson does not dispute, that FINRA may deny a statutorily disqualified person's association with a member firm and that FINRA conducted an eligibility hearing during which FINRA afforded Emerson an opportunity to be heard.<sup>14</sup>

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<sup>10</sup> 15 U.S.C. § 78s(f).

<sup>11</sup> *Id.*

<sup>12</sup> *Gershon Tannenbaum*, 50 S.E.C. 1138, 1140 (1992).

<sup>13</sup> Section 3(a)(39)(F) of the Exchange Act provides that "[a] person is subject to a 'statutory disqualification' . . . if such person . . . has been convicted of any . . . felony within ten years of the date of the filing of an application . . ." 15 U.S.C. § 78c(a)(39)(F).

<sup>14</sup> See FINRA By-Laws, Art. 3, § 4 (stating that a person is "subject to a 'disqualification' with respect . . . to association with a member, if such person is subject to any 'statutory disqualification'" & § 3(d) (stating that a person may file an application requesting relief from ineligibility from association with a member and that FINRA "may conduct such inquiry or investigation into the relevant facts and circumstances as it, in its discretion, considers necessary to its determination" of whether to approve such an application); see also FINRA Code (continued...)

We further find that FINRA applied its rules in a manner consistent with the Exchange Act when it denied the Application. Under the Exchange Act, FINRA may deny a firm's application for associating with a statutorily disqualified person if FINRA determines that a person's association with a member firm would be inconsistent with the public interest and the protection of investors.<sup>15</sup> We have accordingly held that, for FINRA's denial of an application to be consistent with the Exchange Act, FINRA "must explain how the particular felony at issue, examined in light of circumstances relating to the felony, creates an unreasonable risk of harm to the market or investors."<sup>16</sup> Here, FINRA provided such an explanation by appropriately weighing all the facts and circumstances surrounding Emerson's felony conviction and Brookstone's proposed supervisory plan.

FINRA first considered the time between Emerson's felony conviction and Brookstone's application. FINRA "appreciated that Emerson has taken steps to deal with his addiction," but concluded that insufficient time had elapsed "to demonstrate that the change in his behavioral pattern is fundamental and long-lasting and that he can conduct himself in a responsible and compliant fashion in the securities industry." We agree. Emerson's felony conviction was less than three years ago, and we have upheld the denial of applications where the time elapsed since the applicant's conviction was more than twice as long.<sup>17</sup>

FINRA also concluded that Emerson failed to notify Wachovia promptly that his DUI had been upgraded to a felony. As explained earlier, Emerson's Form U4 did not reflect the upgraded DUI charge, and Emerson's compliance officer at Wachovia could not corroborate Emerson's claim that he had notified Wachovia of the upgrade. FINRA noted that the upgrade of Emerson's DUI was "a particularly important fact to have disclosed to [Wachovia] because a felony

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<sup>14</sup> (...continued)  
of Procedure, Rules 9520-25 (setting forth parameters of eligibility proceedings).

<sup>15</sup> Section 15A(g)(2) of the Exchange Act, 15 U.S.C. § 78o-3(g)(2); *see also Frank Kufrovich*, 55 S.E.C. 616, 624 (2002) (describing steps NASD must take when denying an application to be consistent with the purposes of the Exchange Act); FINRA By-Laws Art. 3, § 3(d) ("The Board may, in its discretion, approve the continuance in membership, and may also approve the association or continuance of association of any person, if the Board determines that such approval is consistent with the public interest and the protection of investors.").

<sup>16</sup> *Stephen L. Keidaish*, 54 S.E.C. 983, 987 (2000); *see also Kufrovich*, 55 S.E.C. at 625-26 (concluding that "NASD had properly discharged its Exchange Act obligation" by weighing facts such as the nature and recency of the applicant's conviction, his previous disciplinary history and the proposed supervision plan).

<sup>17</sup> *See, e.g., William J. Haberman*, 53 S.E.C. 1024, 1030 (1998) (finding representative's association with member firm to be "not in the public interest" where representative's felony conviction was "only six years ago").

conviction results in a person being subject to statutory disqualification." FINRA and other self-regulatory agencies rely on Form U4 "to monitor and determine the fitness of securities professionals."<sup>18</sup> We have thus repeatedly stated, "[t]he candor and forthrightness of [individuals making these filings] is critical to the effectiveness of this screening process."<sup>19</sup> Here, we find, and Emerson does not dispute on appeal, that Emerson failed in his duty to notify Wachovia promptly of the felony charge or to ensure that his Form U4 was accurate. Emerson's failure to fulfil these obligations raises questions about his ability to maintain his obligations under the securities laws.

FINRA next considered Emerson's personal history, which, as discussed earlier, includes several customer complaints (two of which Dean Witter settled), discharges from his two previous employers, and repeated DUI convictions. FINRA reasonably concluded that this history demonstrated "a lack of respect for authority and an inability to conform to the regulatory atmosphere of the securities industry." Even where prior misconduct is not recent, it still "reflects poorly on [an applicant's] judgment and trustworthiness."<sup>20</sup>

FINRA also reviewed Brookstone's proposed supervisory plan. In assessing a supervisory plan, "we require . . . stringent supervision for a person subject to a statutory disqualification."<sup>21</sup> Here, FINRA concluded that the proposed plan lacked such stringent supervision, and we agree. For example, Brookstone proposed that Emerson's primary supervisor would be Fieger, who has never supervised a statutorily disqualified person before. We are concerned with the adequacy of this plan, because of both Fieger's lack of experience supervising statutorily disqualified persons and Fieger's lack of familiarity with Emerson and his business. FINRA also reasonably "question[ed] whether Fieger has sufficient time to devote to the heightened supervision of a statutorily disqualified individual" given that Fieger supervised nine other people. FINRA also noted that Locy, rather than Fieger, would be responsible for the review and approval of

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<sup>18</sup> *Alton*, 52 S.E.C. at 382.

<sup>19</sup> *Rosario R. Ruggiero*, 52 S.E.C. 725, 728 (1996) (quoting *Alton*, 52 S.E.C. at 382) (alteration in original) (dismissing appeal where statutorily disqualified person had failed to amend his Form U4 within ten days of statutorily disqualifying event). Moreover, NASD issued a Notice to Members in 1987 making clear that the Form U4 must be amended within ten days after an event creating a statutory disqualification. NASD Notice to Members 87-65. NASD further warned that the late amendment of a Form U4 may be grounds for denying an application to permit a statutorily disqualified person to remain associated with a member. *Id.*

<sup>20</sup> *Kufrovich*, 55 S.E.C. at 628 (concluding that prior misconduct, even if not recent, still reflects poorly on a statutorily disqualified person).

<sup>21</sup> *Haberman*, 53 S.E.C. at 1032 (finding fault with a supervisory plan where sole compliance officer would have insufficient contact with statutorily disqualified person).

Emerson's daily trades. Lucy, however, does not work in the same location as Emerson. As we have previously concluded, a supervisory plan lacks the necessary intensive scrutiny when the supervisor will not be in close, physical proximity to the statutorily disqualified person.<sup>22</sup>

Emerson, for his part, does not challenge FINRA's conclusion that Brookstone's heightened supervisory procedures are inadequate as presently drafted. He instead asks the Commission to "act as a mediator, perhaps finding those terms to which FINRA will agree." He contends that "Applicants have remained willing to accept a supervisory agreement that would satisfy FINRA's concerns, and yet do so to this day, but FINRA has offered no suggestions, seeking only to reject Brookstone's drafts, without offering any additions." Drafting a supervisory plan, however, is neither the Commission's nor FINRA's role. The burden is instead on Emerson to show that his continued employment in the securities industry would be in the public interest.<sup>23</sup> Brookstone is nevertheless free to revise its proposed supervisory plan in any subsequent application that Brookstone may decide to make.

In addition to citing the plan's shortcomings, FINRA also expressed concern with whether Brookstone would comply with the proposed supervisory plan. As noted earlier, Brookstone allowed Emerson to work from home despite Brookstone's own internal rules for individuals subject to heightened supervision. FINRA concluded, and we agree, that "[s]uch inattention to the requirements of heightened supervision is not acceptable in statutory disqualification matters."<sup>24</sup>

We accordingly find that FINRA's basis for denying Brookstone's application to continue associating with Emerson exists in fact, that FINRA acted fairly and in accordance with its rules, which are and were applied in a manner consistent with the purposes of the Exchange Act, and that FINRA's action imposed no undue burden on competition.

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<sup>22</sup> See, e.g., *Kufrovich*, 55 S.E.C. at 629 (finding supervisory plan to be inadequate, in part, because the supervisor would "not be physically present in close proximity . . . during all working days"); *Haberman*, 53 S.E.C. at 1031-32 (finding supervisory plan to be inadequate where supervisor's travel schedule would cause him and the disqualified representative to "have insufficient contact with each other").

<sup>23</sup> See *supra* note 12 and accompanying text.

<sup>24</sup> Although Brookstone and its predecessor were the subject of several letters of caution, FINRA did not rely on Brookstone's disciplinary history when denying the Application and, in fact, "note[d] the lack of formal disciplinary history for the Firm."

## IV.

Emerson presents a variety of arguments about why we should reverse FINRA's denial of the Application. Most of these arguments center on Emerson's assertion that his DUI conviction is not related to the securities industry. Emerson argues, for instance, that, while he "may have had the poor judgment to drive while drunk," such behavior, he contends, "has no logical correlation with the integrity or probity required to manage client accounts." In making this claim, Emerson asks that the Commission "be cognizant of the fact that drunks have long served in the [securities] industry."

The Exchange Act, however, makes no distinction between felonies that are securities related and those that are not. Instead, a person becomes subject to a statutory disqualification for "any" felony committed within ten years of an application.<sup>25</sup> As we have noted before, "[t]he fact that [applicant's] misconduct did not occur in the securities industry does not weigh in his favor."<sup>26</sup> Moreover, FINRA's decision is not, as Emerson seems to contend, solely about Emerson's DUI conviction. Rather, FINRA considered all of the circumstances around Emerson's conviction, including the time elapsed since Emerson's conviction, Emerson's other disciplinary incidents, and the shortcomings in Brookstone's then-current supervision of Emerson and its proposed supervisory plan. FINRA's consideration of these various circumstances is, as discussed above, consistent with the Exchange Act and long-standing precedent.

Emerson alternatively argues that "[i]t is unconstitutionally overbroad for Emerson to be denied a right to work based solely on a felony that is unrelated to the occupation to which he is applying." In support, Emerson quotes various Supreme Court cases for the proposition that the right to work is a fundamental liberty guaranteed by the Fourteenth Amendment of the U.S. Constitution.<sup>27</sup> Emerson's constitutional arguments are wrong for multiple reasons.

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<sup>25</sup> See *supra* note 13.

<sup>26</sup> *Halpert*, 50 SEC at 422 (dismissing appeal where appellant was statutorily disqualified because of a conviction for credit card fraud); see also *Kufrovich*, 55 S.E.C. at 617, 630 (dismissing appeal where appellant was statutorily disqualified because of a conviction for "enticing and attempting to entice a minor to engage in an unlawful sexual act" and "traveling interstate with intent to engage in a sexual act with a minor").

<sup>27</sup> Quoting *Mass. Bd. of Ret. v. Murgia*, 427 U.S. 307, 322 (1976) (Marshall, J., dissenting) (quoting *Bd. of Regents v. Roth*, 408 U.S. 564, 572 (1972) (stating that the liberty guaranteed by the Fourteenth Amendment includes "the right of the individual to contract [and] to engage in any of the common occupations of life" (quoting *Meyer v. Nebraska*, 262 U.S. 390, 399 (1923)))); *Smith v. Texas*, 233 U.S. 630, 636 (1914) ("Liberty means more than freedom from servitude, and the constitutional guaranty is an assurance that the citizen shall be protected in the right to use his power of mind and body in any lawful calling."); *Butcher's Union*

(continued...)

We have repeatedly noted that, as a general matter, self-regulatory organizations ("SROs") are not state actors and thus are not subject to the Constitution's due process requirements.<sup>28</sup> Furthermore, even if SROs such as FINRA were subject to due process requirements, "[t]he Supreme Court characterizes the ability to pursue a particular line of employment as a fundamental right only in the limited context of the [U.S. Constitution's] privileges and immunities clause . . . where a state government attempts to limit employment opportunities to state or municipal residents."<sup>29</sup> FINRA's action here does not involve such an attempt to limit employment opportunities to particular residents, nor does Emerson make such a claim. Emerson notes in his brief that, even with the statutory bar in place, he is presently "practicing as a financial advisor at Cornerstone Securities, LLC."<sup>30</sup>

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<sup>27</sup> (...continued)

*Slaughter-House & Live-Stock Landing Co. v. Crescent City Co.*, 111 U.S. 746, 762 (1884) (Bradley, J., concurring) ("The right to follow any of the common occupations of life is an inalienable right, it was formulated as such under the phrase 'pursuit of happiness' in the declaration of independence."); *Truax v. Raich*, 239 U.S. 33, 41 (1915) ("It requires no argument to show that the right to work for a living in the common occupations of the community is of the very essence of the personal freedom and opportunity that it was the purpose of the Amendment to secure.").

<sup>28</sup> See, e.g., *Scott Epstein*, Exchange Act Rel. No. 59328 (Jan. 30, 2009), 95 SEC Docket 13833, 13855 ("[I]t is well-established that self-regulatory organizations ("SROs") are not subject to the Constitution's due process requirements."); *Mark H. Love*, 57 S.E.C. 315, 322 n.13 (2004) ("We have held that NASD proceedings are not state actions and thus not subject to constitutional requirements."); *William J. Gallagher*, 56 S.E.C. 163, 168 n.10 (2003) ("[W]e note that many courts and this Commission have determined that self-regulatory organizations such as the NASD are not subject to . . . constitutional limitations applicable to government agencies."); see also *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 162 (2d Cir. 2002) (stating that it is a well-settled principle that NASD is not a governmental actor).

<sup>29</sup> *Okia. Educ. Ass'n v. Alcoholic Beverage Laws Enforcement Comm'n*, 889 F.2d 929, 932 (10th Cir. 1989); see also *Edelstein v. Wilentz*, 812 F.2d 128, 132 (3d Cir. 1987) ("The Constitution does not create fundamental interests in particular types of employment." (citing *Murgia*, 427 U.S. at 313)).

<sup>30</sup> The record is unclear about what Emerson's duties are at Cornerstone as a financial advisor. According to Emerson, Cornerstone is an advisory firm registered in Kansas, Missouri, and Texas. The record indicates that Fieger is also associated with Cornerstone. Fieger explained during the hearing that Cornerstone is a registered investment advisory firm, while Brookstone is the broker-dealer. Investment advisors are not subject to FINRA jurisdiction.

Moreover, FINRA's action is not, as Emerson describes it, "a life sentence." FINRA has not expelled Emerson from the securities industry, nor has FINRA imposed a penalty or remedial sanction.<sup>31</sup> FINRA's action "merely denies [Emerson] relief from a previously existing disqualification."<sup>32</sup> Emerson's DUI felony will no longer be a statutorily disqualifying event once ten years have elapsed from the date of Emerson's conviction. In the intervening time, Emerson and Brookstone are free to submit a revised application. Emerson can also seek to associate with a different firm, under a different supervisory arrangement.

In addition to Emerson's constitutional arguments, Emerson also argues that FINRA lacked subject matter jurisdiction to deny the Application. Emerson contends that he has been unable to procure a copy of the application NASD submitted "during 1938-1939" to become a registered securities association and that, if no application exists, "NASD was not validly formed as a national securities association." However, as we found in 1939 when approving NASD's application to become registered as a national securities association, "NASD filed an application, pursuant to Rule X-15AA-1 and the provisions of Form X-15AA-1, for registration as a national securities association under Section 15A of the Securities Exchange Act of 1934, as amended."<sup>33</sup> Emerson's apparent inability to obtain a copy of an approximately seventy-year-old application does not alter our finding that NASD filed an application, which we approved. Moreover, NASD became FINRA when NASD's member firm regulatory functions were consolidated with NYSE Regulation, Inc. We approved the proposed rule change effecting this consolidation on July 26, 2007.<sup>34</sup> As a result, Brookstone's application is not governed by NASD, but by FINRA. We accordingly see no merit in Emerson's contention that FINRA lacked subject matter jurisdiction to consider the Application.

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<sup>31</sup> See *Dennis Milewitz*, 53 S.E.C. 701, 707 (1998) ("NASD's consideration of the applicant's disciplinary history prior to the statutory disqualification, including misconduct for which sanctions were imposed previously, does not amount to a further penalty for that prior misconduct."); *Halpert & Co.*, 50 SEC 420, 422 (1990) (noting that NASD's denial of membership was not "imposing a penalty on applicants in this matter or even a remedial sanction").

<sup>32</sup> *Milewitz*, 53 S.E.C. at 706; see also *Halpert*, 50 SEC at 422 (stating that the denial of an application is a denial only of the "request *at this time* for relief from [his] previously incurred disqualification" (emphasis added)).

<sup>33</sup> *Application by NASD for Registration as a Nat'l Sec. Assoc.*, 5 S.E.C. 627, 627 (1939).

<sup>34</sup> See Exchange Act Rel. No. 56146 (July 26, 2007), 72 Fed. Reg. 42,190 (Aug. 1, 2007) (SR-NASD-2007-053) (approving proposed rule change that "NASD filed" and that "amend the NASD By-Laws to implement the governance and related changes to accommodate the consolidation of the member regulatory functions of NASD and NYSE Regulation, Inc.").

Emerson also argues that FINRA was biased against him in reaching its decision. According to Emerson, Brookstone ran a candidate in FINRA's Board of Governors election against a FINRA-nominated candidate. Emerson asserts that, while campaigning, "Brookstone's candidate argued loudly and strongly in stinging oratory against FINRA's culture and practices." Emerson additionally alleges that his counsel in the present appeal "sent a critical letter to Marcia Asquith [FINRA's corporate secretary] condemning FINRA's management of the election." Asquith, in her role as secretary, later signed NAC's decision denying Emerson's application. Emerson now claims that Asquith's signature on NAC's decision, combined with comments made during the Board of Governors campaign, gives FINRA "ample justification to be biased against Appellants."

The only connection between Asquith and NAC's denial of Emerson's application is that Asquith signed the NAC decision in her role as corporate secretary, "On Behalf of the National Adjudicatory Council." As we have stated in the past, the secretary's role is purely administrative,<sup>35</sup> and the record contains no evidence that Asquith was in any way influenced by Emerson's counsel's letter or that she, in turn, influenced FINRA's decision. Similarly, the record does not indicate that any actions were taken, or comments made, during the Board of Governors election that influenced FINRA's decision.

Emerson finally makes a variety of other, vague arguments about FINRA's "forced membership," which he broadly claims is "a violation of Appellants' right to freedom of contract, a restraint of free trade under federal Anti-Trust Acts and a violation of Appellants' rights to freedom of speech and association under the United States and Florida Constitutions." Emerson also argues that FINRA's decision unconstitutionally addresses "questions for each state under the Tenth Amendment that should not be cut off by federal paternalism." As we noted above, however, FINRA is not a state actor and is thus subject to the Constitutional requirements Emerson cites.<sup>36</sup> The Supreme Court has also deemed the antitrust laws to be repealed to the extent necessary for the securities laws to function in the manner Congress envisioned, and courts have noted that a nationwide federal rule is preferable to a state-by-state approach when it comes to the securities laws.<sup>37</sup> More problematic for Emerson's arguments, however, is that he

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<sup>35</sup> See, e.g., *Perpetual Sec., Inc.*, Exchange Act Rel. No. 56613 (Oct. 4, 2007), 91 SEC Docket 2489, 2497 n.21 ("NASD's Secretary signs the NAC decision 'on behalf of the [NAC], not in her personal capacity. Her role is purely administrative. The decision was issued by the NAC."); *Conrad C. Lysiak*, 51 S.E.C. 841, 847 (1993) ("The NASD's Secretary's signing of the decision is a purely ministerial act.").

<sup>36</sup> See *supra* note 28 and accompanying text; see also *Martin Lee Eng*, 55 S.E.C. 91, 95 (2001) (holding that the First Amendment is not applicable to the NASD).

<sup>37</sup> See *Gordon v. N.Y. Stock Exch.*, 422 U.S. 659, 688-691 (1975) (stating that the "[i]mplied repeal of the antitrust laws is, in fact, necessary to make the Exchange Act work as it

(continued...)

does not cite any authority or provide any basis or rationale for his assertions. He does not explain, for instance, what speech is being infringed or in what way FINRA's decision implicates the Florida constitution. As other courts have admonished, "we cannot 'manufacture arguments for an appellant.'"<sup>38</sup> We accordingly decline to address Emerson's arguments not addressed by legal argument or citation.

## V.

For these reasons, we dismiss this review proceeding.

An appropriate order will issue.<sup>39</sup>

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

Elizabeth M. Murphy  
Secretary



By: Florence E. Harmon  
Deputy Secretary

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<sup>37</sup> (...continued)

was intended"); *Eichenholtz v. Brennan*, 52 F.3d 478, 486 (3d Cir. 1995) ("In cases involving the federal securities laws, we believe that a nationwide federal rule is preferable"); *Bluebird Partners, L.P. v. First Fid. Bank*, 896 F. Supp. 152, 156 (S.D.N.Y. 1995) (noting "that the policy of protecting investors that underlies federal securities laws . . . is best served by applying a uniform federal rule").

<sup>38</sup> *Indep. Towers of Wash. v. Washington*, 350 F.3d 925, 929 (9th Cir. 2003) (citing *Greenwood v. FAA*, 28 F.3d 971, 977 (9th Cir. 1994)) (declining to address arguments not accompanied by legal argument).

<sup>39</sup> 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. 60328 / July 17, 2009

Admin. Proc. File No. 3-13334

In the Matter of  
TIMOTHY H. EMERSON, JR.  
c/o Brian P. Sweeney, Esq.  
520 S. Florida  
Lakeland, FL 33801  
For Review of Action Taken By  
FINRA

ORDER AFFIRMING ACTION OF NATIONAL SECURITIES EXCHANGE

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

ORDERED that the review proceeding of the application by Brookstone Securities, Inc. to continue to employ Timothy H. Emerson, Jr., as a registered representative is hereby dismissed.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Florence E. Harmon  
Deputy Secretary

*Commissioner Aguilar and  
Commissioner Faredes  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60326 / July 17, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13551

In the Matter of

Stephen Cheryl Bauman

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 Stephen Cheryl Bauman ("Bauman" or "Respondent").

**II.**

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

*29 of 64*

### III.

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

1. Between July 1, 2001 and approximately mid-September 2006, J.P. Turner & Company, LLC ("J.P. Turner"), an Atlanta-headquartered broker-dealer registered with the Commission, failed to adopt and implement policies and procedures reasonably designed to safeguard customer records and information as required by Rule 30(a) of Regulation S-P (the "Safeguards Rule") (17 CFR § 248.30(a)). During the relevant period, Bauman served as either J.P. Turner's chief compliance officer ("CCO") or assistant chief compliance officer ("ACCO"). As J.P. Turner's CCO from July 2001 to July 2004, Bauman failed to adopt and implement policies and procedures to make J.P. Turner compliant with the Safeguards Rule. Later, when she was ACCO from July 2004 to the end of the relevant period, Bauman failed, despite specifically being delegated the responsibility to do so, to adopt and implement policies and procedures to make J.P. Turner compliant with the Safeguards Rule.

J.P. Turner employed hundreds of independent contractor registered representatives who worked from multiple branch offices located throughout the United States. Because it never complied with the Safeguards Rule, J.P. Turner, among other things, never gave its numerous branch managers or registered representatives guidance on how to protect customer records or how to dispose properly of such records when they were no longer needed. This lack of guidance became apparent in September 2006 when the account records of over 5,000 brokerage customers of J.P. Turner were left abandoned for several weeks at curbside outside of the former home of a J.P. Turner registered representative in Alpharetta, Georgia.

#### Respondent

2. Bauman, 57 and is a resident of Atlanta, Georgia. Bauman served as J.P. Turner's CCO from July 1999 to July 2004 and served as the firm's ACCO from July 2004 to March 2008. She holds Series 7, 24, 55, and 63 licenses.

#### The Safeguards Rule

3. Regulation S-P became effective on July 1, 2001 and required, among other things, that every broker, dealer, and investment company, and every investment adviser registered with the Commission have policies and procedures reasonably designed, among other things, to insure the security and confidentiality of customer records and information and protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer. These policies and procedures did not have to be in

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

writing when Regulation S-P originally went into effect. However, the Commission later amended Regulation S-P to require that such policies and procedures be written. This amendment to the Safeguards Rule went into effect on January 11, 2005 and required compliance by July 1, 2005.

4. From July 1, 2001 to June 30, 2005, J.P. Turner had no policies and procedures reasonably designed to protect customer information, as required by the Safeguards Rule, as effective on July 1, 2001. Bauman was J.P. Turner's CCO during this period until July 2004. Additionally, between July 1, 2005 and September 2006, when Bauman served as J.P. Turner's ACCO, J.P. Turner failed to comply with the amended Safeguards Rule.

5. Specifically, following the effective date of Regulation S-P, J.P. Turner issued a number of successive editions of both its registered representative's manual and its branch manager's manual. None of these editions made mention of the Safeguards Rule or provided policies or procedures concerning how to protect customer records and customer information as required by the Safeguards Rule.

6. The only written mention of the Safeguards Rule in J.P. Turner's manuals was contained in six successive editions of its main office manual issued between July 2005 and September 2006. However, these manuals simply restated the objectives of the Safeguards Rule and delegated to Bauman the responsibility to ensure compliance with it. Although these main office manuals mandated that firm records be kept in locked file cabinets which were to be subjected to random spot-checks, there were no other policies or procedures in the manuals addressing any administrative, technical, or physical safeguards associated with customer records or information, including how to dispose properly of such records when they were no longer needed.

### The Abandoned Customer Records

7. J.P. Turner's failure to comply with the requirements of the Safeguards Rule became apparent in September 2006. Specifically, on September 1, 2006, in connection with a residence change a then-registered representative of J.P. Turner placed records of more than 5,000 current or former J.P. Turner customers curbside at his residence in suburban Atlanta, Georgia, for pick up by a trash hauler with whom he had contracted to retrieve and destroy the records. The customer records contained variously the names, addresses, dates of birth, social security numbers, bank account numbers, and account statements of the customers. However, the hauler never collected the records which remained abandoned until J.P. Turner retrieved them on September 14. J.P. Turner has been unable to confirm that all of the customer records have been retrieved. To date, there has been no indication that any customer whose records were improperly maintained has become the victim of identify theft or other financial crime.

8. As a result of the conduct described above, Bauman caused J.P. Turner's violations of Rule 30(a) of Regulation S-P, which requires written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information and that were reasonably designed to: (1) insure the security and confidentiality of customer records and information; (2) protect

against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.

#### Undertakings

9. Respondent shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, Respondent has undertaken:

a. To produce, without service of a notice or subpoena, any and all documents and other information requested by the Commission's staff;

b. To be interviewed by the Commission's staff at such times as the staff reasonably may direct;

c. To appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and

d. That in connection with any testimony of Respondent to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Respondent:

(i) Agrees that any such notice or subpoena for Respondent's appearance and testimony may be served by regular mail on her attorney, Joel R. Beck, Esq., at The Beck Law Firm, LLC, PO Box 958 Snellville, GA 30078; and

(ii.) Agrees that any such notice or subpoena for Respondent's appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

In determining whether to accept the Offer, the Commission has considered these undertakings.

#### IV.

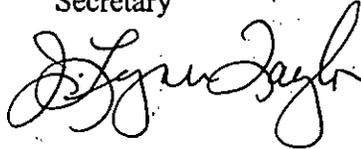
In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Bauman's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Section 21C of the Exchange Act, Respondent Bauman cease and desist from causing any violations and any future violations of Rule 30(a) of Regulation S-P.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

By: J. Lynn Taylor  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60329 / July 17, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3013 / July 17, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-12227

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

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On March 3, 2006, Andrew J. McAdams, CPA ("McAdams") 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 McAdams pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.<sup>1</sup> This order is issued in response to McAdams' 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.

As the engagement partner for PricewaterhouseCoopers LLP's ("PwC") audits of Aerosonic Corporation's ("Aerosonic") financial statements for fiscal years 1999 through 2002, McAdams supervised the audit services performed by PwC. During this time, Aerosonic recorded fictitious revenue through a number of accounting schemes in violation of Generally Accepted Accounting Principles while McAdams failed to perform his work in accordance with Generally Accepted Auditing Standards. With regard to some significant audit items in those years, McAdams did not adequately plan and supervise the audits, did not obtain sufficient competent evidential matter, did not maintain an attitude of professional skepticism, and placed undue reliance upon former senior management's representations. McAdams thereby engaged in improper professional conduct.

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<sup>1</sup> See Accounting and Auditing Enforcement Release No. 2392 dated March 3, 2006. McAdams was permitted, pursuant to the order, to apply for reinstatement after two years upon making certain showings.

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

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."<sup>2</sup> This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by McAdams, it appears that he has complied with the terms of the March 3, 2006 order denying him the privilege of appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that McAdams, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Andrew J. McAdams, 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

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

<sup>2</sup> Rule 102(e)(5)(i) provides:

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

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

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 2903 / July 17, 2009

**ADMINISTRATIVE PROCEEDING**  
File No. 3-13554

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<b>In the Matter of</b>	:	<b>ORDER INSTITUTING ADMINISTRATIVE</b>
	:	<b>AND CEASE-AND-DESIST PROCEEDINGS</b>
<b>PAUL W. OLIVER, JR.,</b>	:	<b>PURSUANT TO SECTIONS 203(f) AND 203(k)</b>
	:	<b>OF THE INVESTMENT ADVISERS ACT OF</b>
<b>Respondent.</b>	:	<b>1940, MAKING FINDINGS, AND IMPOSING</b>
	:	<b>REMEDIAL SANCTIONS AND A CEASE-</b>
	:	<b>AND-DESIST ORDER</b>

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**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 Paul W. Oliver, Jr. ("Oliver" or "Respondent").

**II.**

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

**III.**

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

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

### Summary

1. This matter arises from the misappropriation of more than \$23 million in client funds by AA Capital Partners, Inc. ("AA Capital"), a registered investment adviser that managed several affiliated private equity funds; and its former president, John Orecchio ("Orecchio"). From 2004 to 2006, Oliver, AA Capital's former chairman, aided and abetted the misappropriations by failing to disclose the misappropriations by Orecchio and AA Capital to AA Capital's clients and by failing to take appropriate action to halt the misappropriations after he learned of them. As a result of his inaction, Oliver aided and abetted Orecchio's and AA Capital's violations of Sections 206(2) and 206(4) of the Advisers Act.

### Respondent

2. Oliver, age 67, is currently a resident of Wellington, Florida. He formed AA Capital with Orecchio in February 2002 and served as its chairman until his resignation in September 2006.

### Other Relevant Parties

3. Orecchio, age 41, is a resident of Arlington Heights, Illinois. Orecchio co-founded AA Capital in February 2002 and acted as its president and managing director from at least April 2002 until August 30, 2006 when his employment was terminated. On September 8, 2006, the Commission filed an emergency action against Orecchio and AA Capital, SEC v. AA Capital Partners, Inc. and John A. Orecchio, Case No. 06-C-4859 (N.D. Ill.), seeking temporary, preliminary and permanent injunctive relief against Orecchio based on his aiding and abetting of AA Capital's violations of Sections 206(1) and 206(2) of the Advisers Act. This case is still pending. Oliver was not named as a defendant in that case.

4. Mary Beth Stevens, age 39, is a resident of Lincoln, Illinois. Stevens joined AA Capital as an accountant shortly after it began operating in 2002. Shortly thereafter, Stevens became AA Capital's chief financial officer. In 2004, Stevens also became AA Capital's chief compliance officer. She continued in these roles until her employment was terminated in September 2006. During her employment at AA Capital, Stevens reported to Orecchio.

5. AA Capital Partners, Inc. is a Delaware corporation headquartered in Chicago, Illinois. AA Capital manages approximately \$200 million in assets for six union clients, five of which are union pension funds, and advises several private equity funds through its affiliated entities. Since 2002, AA Capital has been registered with the Commission as an investment adviser. AA Capital is a defendant in SEC v. AA Capital Partners, Inc. and John A. Orecchio. On September 12, 2006, the U.S. District Court for the Northern District of Illinois appointed W. Scott Porterfield of the law firm Barack Ferrazzano Kirschbaum & Nagelberg LLP as the receiver over AA Capital.

## Background

6. When Oliver and Orecchio formed AA Capital in 2002, they divided the responsibilities for managing the assets of AA Capital's clients. Between 2002 and 2006, Oliver managed AA Capital's "fund of funds" investments, which consisted of investments in private equity funds. Orecchio managed AA Capital's direct investments, which mainly concerned real estate development deals. Orecchio also managed AA Capital's day-to-day operations.

7. While building up AA Capital's advisory business, Orecchio spent lavishly on travel and entertainment, regularly entertaining clients in Detroit, Michigan and Las Vegas, Nevada.

8. In August 2003, Orecchio began a relationship with a woman who performed at a Detroit strip club. Orecchio spent extravagant amounts of money on his mistress and her family. Between 2003 and 2006, Orecchio purchased five parcels of real estate in Michigan for his mistress and her mother, including a horse farm. He also bought a boat, several luxury automobiles and approximately \$1.4 million of jewelry for his mistress. On two separate occasions, Orecchio also rented a private Caribbean island to throw parties for his mistress and her friends. Orecchio also expended a considerable amount of money refurbishing the horse farm and paying for the renovation of a Detroit strip club that he intended to purchase, and which his mistress would manage.

9. In May 2004, Orecchio told Stevens that he owed a significant amount of money to the Internal Revenue Service based on his ownership interest in one of AA Capital's affiliated private equity funds and a failure by AA Capital's auditors to timely file certain tax returns. At Orecchio's direction, Stevens withdrew over \$600,000 from AA Capital's client trust accounts, deposited the funds into AA Capital's operating account and then wired the money to Orecchio's personal bank account.

10. On numerous subsequent occasions, Orecchio requested additional funds from Stevens to pay his purported tax liability. Between May 2004 and October 2005, Stevens made at least 20 separate disbursements to Orecchio totaling over \$5.7 million for the purported tax liability. These disbursements consisted of funds withdrawn originally from AA Capital's client trust accounts. In several instances, Stevens wired funds from AA Capital directly to bank accounts associated with Orecchio's horse farm and the Detroit strip club Orecchio was renovating.

11. Orecchio also misappropriated client funds in other ways. Between August 2005 and July 2006, Orecchio misrepresented to Stevens the amount of money required for one of AA Capital's affiliated private equity funds' investments in a real estate development. Orecchio obtained \$8.7 million in client funds for this investment, but invested only \$1.3 million in the real estate development. At Orecchio's direction, \$6.9 million of the misappropriated funds was paid to the contractors renovating his horse farm and the Detroit strip club and \$500,000 was used for a down payment on a Las Vegas, Nevada condominium.

12. Between 2004 and 2006, Orecchio also requested and received reimbursement for numerous expenses that AA Capital was not entitled to charge back to its clients. These included

more than \$1 million in non-existent political contributions, numerous visits to various casinos and strip clubs, and more than \$1.5 million in tickets to sporting events and concerts for Orecchio, his mistress, her friends and other individuals.

13. AA Capital's expenses far exceeded its revenues in 2005 and 2006, largely due to Orecchio's lavish spending.

14. In order to keep AA Capital afloat, Stevens periodically withdrew funds from AA Capital's client trust accounts to pay the firm's expenses. AA Capital ultimately misappropriated more than \$10 million in client funds to cover the shortfalls between the firm's revenues and expenses.

15. In early 2006, Oliver intended to retire, and as a result, he began negotiating with Orecchio regarding the sale of Oliver's interest in AA Capital. In approximately May 2006, Oliver and Orecchio finalized and executed a letter of intent, pursuant to which Orecchio would purchase Oliver's 50 percent interest in the business and thereby terminate Oliver's employment with AA Capital.

16. The Commission's examination staff discovered Orecchio's and AA Capital's misappropriation of client funds during a compliance inspection conducted between August 21 and 31, 2006.

17. Oliver and AA Capital's three other managing directors terminated Orecchio's association with AA Capital on August 30, 2006, just days before the Commission filed its emergency injunctive action. Orecchio was provided with a notice that suspended him from association with AA Capital based on "a written determination by the Compliance Officer of a violation of the Code of Ethics." The "written determination" consisted of a one-paragraph report that stated that Orecchio had violated AA Capital's Code of Ethics "in connection with his borrowing of approximately \$5.7 million from a fund managed by [AA Capital]."

#### Oliver's Conduct

18. In the summer of 2004, Oliver learned that Orecchio had borrowed approximately \$1 million for a tax "loan" due to an accountant's miscalculation of Orecchio's personal liability for a gain in an affiliated private equity fund. As a 50% owner of AA Capital, Oliver knew that his own tax liability for the same miscalculation amounted to only \$18,228. Shortly after learning about Orecchio's million-dollar loan, Oliver asked Orecchio why Orecchio's tax liability was so much greater than his own, and Orecchio represented that it was a mistake by the IRS that his advisors were actively working to correct.

19. Oliver received additional information about Orecchio's tax loan in March of 2006. At that time, Oliver met with Stevens and Orecchio to discuss the significant amount of expenses that Orecchio had charged to AA Capital. Oliver was advised that Stevens had prepared numerous financial schedules showing these expenses for use at the meeting, including AA Capital's general ledger, a schedule of accounts receivable and accounts payable and large dollar expense items.

20. During the meeting with Stevens and Orecchio, Oliver was informed that Orecchio's "tax loan" from client funds now totaled over \$5 million and also that AA Capital had "borrowed" more than \$5 million in client funds to pay its operating expenses in 2005.

21. These purported "loans" to Orecchio and AA Capital were in fact misappropriations of client funds, as AA Capital was not permitted to use client funds for such purposes. Nonetheless, Oliver did not inform AA Capital's clients that Orecchio and the firm had misappropriated their funds until September 6, 2006.

22. Oliver and the other managing directors terminated Orecchio's employment at AA Capital on August 30, 2006. However, Oliver failed to take timely and appropriate action to protect the interests of AA Capital's clients prior to that time.

#### Violations

23. As a result of the conduct described above, Oliver willfully aided and abetted and caused AA Capital's violations of Section 206(2) of the Advisers Act, which prohibits an investment advisor from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

24. As a result of the conduct described above, Oliver also willfully aided and abetted and caused AA Capital's violations of Section 206(4) of the Advisers Act and Rule 206(4)-4 thereunder, which prohibit an investment advisor from engaging in any act, practice, or course of business that is fraudulent, deceptive or manipulative. Because AA Capital failed to disclose to its clients its precarious financial condition and its need to misappropriate client funds to stay afloat, AA Capital violated Section 206(4) and Rule 206(4)-4 thereunder.

#### IV.

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

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

A. Respondent Oliver cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-4 promulgated thereunder; and

B. Respondent Oliver be, and hereby is, suspended from association with any investment adviser for a period of 12 months, effective on the second Monday following the entry of this Order.

C. Respondent Oliver shall pay disgorgement of \$49,786.44, prejudgment interest of \$7,979.71 and a civil penalty of \$75,000 to the Securities and Exchange Commission. Payment shall be made in the following five installments: Oliver's first payment of \$26,553.23 shall be due within 10 days of the entry of this Order. Oliver's remaining four payments of \$26,553.23

each shall be due no later than 85 days after the immediately preceding payment. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payments shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Oliver 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 Timothy L. Warren, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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



## Respondent

2. Mary Beth Stevens, age 39, is a resident of Lincoln, Illinois. Stevens graduated from college with an accounting degree. She has never been licensed as a CPA. Stevens joined AA Capital as an accountant shortly after it began operating in 2002. Shortly thereafter, Stevens became AA Capital's chief financial officer. In 2004, Stevens also became AA Capital's chief compliance officer. She continued in these roles until her employment was terminated in September 2006. Stevens has never been registered with the Commission in any capacity.

## Other Relevant Person and Entity

3. John Orecchio, age 41, is a resident of Arlington Heights, Illinois. Orecchio co-founded AA Capital in February 2002 and acted as its president and managing director from at least April 2002 until August 30, 2006. On September 8, 2006, the Commission filed an emergency action against Orecchio, SEC v. AA Capital Partners, Inc. and John A. Orecchio, Case No. 06-C-4859 (N.D. Ill.), seeking temporary, preliminary and permanent injunctive relief against him based on his aiding and abetting of AA Capital's violations of Sections 206(1) and 206(2) of the Advisers Act.

4. AA Capital Partners, Inc. is a Delaware corporation headquartered in Chicago, Illinois. AA Capital manages approximately \$200 million in assets for six union clients, five of which are union pension funds, and advises several private equity funds through its affiliated entities. AA Capital is registered with the Commission as an investment adviser. On September 12, 2006, as part of the Commission's emergency action against Orecchio and AA Capital, the U.S. District Court for the Northern District of Illinois appointed W. Scott Porterfield of the law firm Barack Ferrazzano Kirschbaum & Nagelberg LLP as the receiver over AA Capital.

## Background

5. Between May 2004 and September 2006, Stevens facilitated Orecchio's and AA Capital's misappropriation of more than \$23 million belonging to AA Capital's clients. By improperly withdrawing funds from AA Capital's client trust accounts and transferring those funds to personal bank accounts at Orecchio's direction and to AA Capital's main bank account to pay the firm's operating expenses, Stevens aided and abetted and caused the misappropriations.

6. In May 2004, Orecchio approached Stevens and told her that he owed a significant amount of money to the Internal Revenue Service based on his ownership interest in one of AA Capital's affiliated private equity funds and a failure by AA Capital's auditors to timely file certain tax returns.

7. Shortly thereafter, at Orecchio's direction, Stevens withdrew over \$600,000 from AA Capital's client trust accounts, deposited the funds into AA Capital's main operating bank account and then wired the money to Orecchio's personal bank account.

8. In the monthly account statements Stevens prepared and sent to AA Capital's clients, Stevens falsely described this withdrawal of funds as a capital call for the AA Capital Equity Fund.

9. Subsequently, Orecchio requested additional funds from Stevens to pay his purported tax liability. Between May 2004 and October 2005, Stevens made at least 20 separate disbursements to Orecchio, totaling over \$5.7 million, for the purported tax liability. In several instances, Orecchio directed Stevens to wire funds directly to the bank accounts of two entities in which he had a personal interest: M & J Animal Rescue, a Michigan horse farm, and Lonyo, LLC, which managed a Detroit strip club.

10. Stevens never obtained any loan documentation from Orecchio regarding these transfers, and never recorded any interest on the funds "borrowed" from the client trust accounts.

11. Between August 2005 and July 2006, Orecchio also requested that Stevens pay \$6.9 million in client funds, which were intended for a private equity real estate investment, to a general contractor employed by M & J Animal Rescue and Lonyo, LLC.

12. In February 2006, Orecchio requested that Stevens provide him with \$505,000 to invest in the same real estate investment, but instead used the money as a deposit on a condominium in Las Vegas, Nevada for his own personal benefit.

13. Between 2004 and 2006, Orecchio also requested reimbursement from AA Capital for numerous items that AA Capital was not entitled to charge back to its clients. These items included more than \$1 million in bogus political contributions, numerous visits to strip clubs and more than \$1.5 million in tickets to sporting events and concerts. These reimbursement requests were submitted to Stevens, and she granted them.

14. In addition, AA Capital's operating expenses far exceeded its revenues during 2005 and 2006. In 2005, AA Capital had revenues of \$2 million and expenses of \$7.15 million. AA Capital spent more than \$4.4 million in salaries and benefits alone in 2005, including more than \$2 million in bonuses. In 2006, AA Capital had a \$5 million operating deficit. In the first nine months of 2006, Orecchio requested reimbursement for more than \$4.3 million in travel and entertainment expenses.

15. In order to pay these expenses, Stevens repeatedly withdrew funds from AA Capital's client trust accounts. AA Capital never advised its clients that it had used their funds in this manner. Rather, in the monthly client account statements, Stevens falsely characterized the withdrawals from client accounts to cover AA Capital's expenses as capital calls for legitimate investments. Stevens' efforts were instrumental in allowing AA Capital to misappropriate more than \$10 million in client funds to cover the shortfalls between the firm's revenues and expenses.

## Stevens' Conduct

16. Stevens was AA Capital's chief financial officer and the sole employee with accounting responsibilities. Accordingly, Stevens was responsible for conducting all of the firm's day-to-day financial operations, which included managing client funds, paying AA Capital's expenses, and maintaining AA Capital's books and records. Stevens also prepared the monthly account statements that AA Capital sent to its clients.

17. In May of 2004, Stevens approved Orecchio's request for a "loan" of \$602,150 from client funds to pay a purported tax liability. Around this same time, Stevens also approved a loan of client funds to AA Capital's co-founder, who also co-owned the firm with Orecchio, for his own tax liability of \$18,228. Even though Stevens was aware that Orecchio and the co-founder each owned 50% of AA Capital, she did not question Orecchio about the difference between the two tax liabilities. In addition, Stevens did not review AA Capital's investment management agreements, which did not permit AA Capital to borrow client funds to pay a principal's personal tax liability, to determine whether Orecchio's requests for "loans" from client funds were proper.

18. In fact, Orecchio's loan request was fraudulent, and Stevens had no authority to grant Orecchio's request for a loan from client funds.

19. Stevens continued to grant Orecchio's requests for additional client funds to pay his purported tax liability. However, Stevens never created any documentation for Orecchio to sign regarding this "loan." Nor did she demand that Orecchio repay this loan or accrue interest on the amounts he "borrowed."

20. Between 2004 and 2006, Stevens played an active role in misappropriating funds from AA Capital's clients. She concealed the misappropriations from AA Capital's clients by characterizing the withdrawals for Orecchio's supposed tax loan as "capital calls" in the monthly account statements she prepared and sent to AA Capital's clients. On her own initiative, Stevens also created a system for withdrawing from each client's trust account a *pro rata* share of any money required to meet Orecchio's requests for funds. For example:

- (a) On August 1, 2004, Orecchio requested \$190,154 from Stevens. On August 2, Stevens directed a transfer of \$104,992.25 from one client's trust account ("Client A"), \$84,867.15 from a second client's trust account ("Client B"), and \$140.60 from a third client's trust account ("Client C"), for a total transfer of \$190,000 to AA Capital's main bank account. Later that same day, Stevens wired \$190,154 from AA Capital's main bank account to Orecchio's personal bank account.
- (b) On September 19, 2004, Orecchio requested \$579,000 from Stevens. On September 20, Stevens directed a transfer of \$331,554.47 from Client A's account, \$268,001.53 from Client B's account, and \$440 from Client C's account, for a total transfer of \$600,000 to AA Capital's main bank account. Later that same day, Stevens wired \$579,000 from AA Capital's main bank account to Orecchio's personal bank account.

- (c) On November 3, 2004, Orecchio requested \$550,000 from Stevens. On November 4, Stevens directed a transfer of \$303,924.93 from Client A's account, \$245,668.07 from Client B's account, and \$407 from Client C's account, for a total transfer of \$550,000 to the AA Capital Equity Fund bank account. On November 5, Stevens wired \$550,000 from the Equity Fund bank account to Orecchio's personal bank account.
- (d) On January 10, 2005, Orecchio requested \$150,000 from Stevens. He asked that Stevens send half of the money to his personal bank account and half to the bank account for M & J Animal Rescue. That same day, Stevens directed a transfer of \$82,888.62 from Client A's account, \$67,000.38 from Client B's account, and \$111 from Client C's account, for a total transfer of \$150,000 to the AA Capital Equity Fund bank account. Also that same day, Stevens wired \$75,000 from the Equity Fund bank account to Orecchio's personal bank account, and \$75,000 from the Equity Fund bank account to M & J Animal Rescue's bank account.
- (e) On January 24, 2005, Orecchio requested \$45,000 from Stevens. That same day, Stevens directed a transfer of \$24,856.59 from Client A's account, \$20,100.11 from Client B's account, and \$33.30 from Client C's account, for a total transfer of \$45,000 to AA Capital's main bank account. One minute after making the transfer request, Stevens wired \$45,000 from AA Capital's main bank account to Orecchio's personal bank account.
- (f) On August 24, 2005, Orecchio requested \$300,000 from Stevens. On August 25, Stevens directed a transfer of \$221,036.31 from Client A's account, \$178,667.69 from Client B's account, and \$296 from Client C's account, for a total transfer of \$400,000 to AA Capital's main bank account. That same day, Stevens wired \$300,000 from AA Capital's main bank account to Orecchio's personal bank account. In the same August 24, 2005 e-mail request, Orecchio advised Stevens that he would need another \$850,000 by November 1 and another undetermined amount on December 31.
- (g) On September 15, 2005, Stevens directed a transfer of \$745,997.55 from Client A's account, \$603,003.45 from Client B's account, and \$999 from Client C's account for a total transfer of \$1.35 million to AA Capital's main bank account. In an e-mail dated September 15, 2005, Stevens advised Orecchio that she had "called \$1.35 million for [his] tax reimbursement" and asked Orecchio where he would like her to send the money. In a September 15, 2005 reply e-mail, Orecchio advised her to transfer the money to his personal bank account. That same day, Stevens transferred \$1.35 million from AA Capital's main bank account to Orecchio's personal bank account.
- (h) On September 26, 2005, Orecchio requested that Stevens transfer \$75,000 to the bank account for Lonyo, LLC. That same day, Stevens directed a transfer of

\$138,147.70 from Client A's account, \$111,667.31 from Client B's account, and \$185 from Client C's account, for a total transfer of \$245,000 to AA Capital's main bank account. Also on September 26, Stevens transferred \$75,000 from AA Capital's main bank account to Lonyo's bank account, and transferred another \$30,000 to M & J Animal Rescue's bank account.

21. From 2005 to 2006, Stevens also was instrumental in AA Capital's misappropriation of more than \$10 million in client funds to cover the vast shortfalls between its revenues and expenses. AA Capital incurred an operational deficit of at least \$5 million in 2005 and another \$5 million during the first eight months of 2006.

22. Stevens regularly agreed to Orecchio's requests for reimbursement of his purported expenses and regularly and improperly withdrew funds from AA Capital's client trust accounts in order to pay for those expenses. In doing so, Stevens reimbursed Orecchio for expenses that were plainly ineligible for payment by AA Capital's clients. Stevens again, on her own initiative, used a system through which she withdrew from the accounts of each of AA Capital's clients a *pro rata* share of any money she needed to cover the firm's expenses. For example:

- (a) Orecchio submitted a December 14, 2005 expense report seeking reimbursement for \$492,566 in expenses. On December 15, 2005, Stevens made a purported "capital call" and withdrew \$240,377 from Client A's account, \$194,301 from Client B's account, and \$322 from Client C's account. Stevens deposited this money into AA Capital's main bank account and used it to cover AA Capital's expenses.
- (b) Orecchio submitted a January 1, 2006 expense report seeking reimbursement for more than \$1.2 million in expenses. Between January 3 and January 12, 2006, Stevens made four purported "capital calls" totaling more than \$560,000 from Client A's account, more than \$450,000 from Client B's account, and more than \$600 from Client C's account. Stevens deposited this money into AA Capital's main bank account and used it to cover AA Capital's expenses.
- (c) Orecchio submitted a February 13, 2006 expense report seeking reimbursement for \$627,551 in expenses. On February 22, 2006, Stevens made a purported "capital call" of \$331,554 from Client A's account, \$268,002 from Client B's account, and \$444 from Client C's account. Stevens deposited this money into AA Capital's main bank account and used it to cover AA Capital's expenses.

23. During the first nine months of 2006, Stevens approved Orecchio's requests for reimbursement of at least \$4.3 million in travel and entertainment expenses. These expenses included \$1 million for purported political contributions, hundreds of thousands of dollars for private plane rentals, nearly \$1 million for concert and sporting event tickets and more than \$1 million for expenses incurred in Las Vegas, Nevada, including more than \$300,000 for visits to night clubs. Stevens paid these expenses by withdrawing funds from the trust accounts of AA

Capital's clients, and falsely characterized these withdrawals as "capital calls" in the monthly statements she prepared and sent to AA Capital's clients.

24. In addition to her role in these misappropriations, Stevens did not fulfill her responsibility as AA Capital's chief financial officer to properly maintain the firm's books and records. Stevens failed to make and keep true, accurate and current the firm's trial balances, cash receipt journals, disbursement records and ledgers.

25. Instead of keeping the firm's records up-to-date, Stevens relied upon a year-end reconciliation of AA Capital's revenue and expenses conducted in conjunction with the firm's annual audit. Stevens' failure to keep up-to-date books and records helped conceal Orecchio's and AA Capital's misappropriations from the firm's clients.

### Violations

26. As a result of the conduct described above, Stevens willfully aided and abetted and caused AA Capital's violations of Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct upon any client or prospective client of an investment adviser.

27. As a result of the conduct described above, Stevens willfully aided and abetted and caused AA Capital's violations of Section 206(4) of the Advisers Act and Rule 206(4)-4 thereunder, which prohibit an investment adviser from engaging in any act, practice, or course of business that is fraudulent, deceptive or manipulative. Because AA Capital failed to disclose to its clients its precarious financial condition and its need to misappropriate client funds to stay afloat, AA Capital violated Section 206(4) and Rule 206(4)-4 thereunder.

28. As a result of the conduct described above, Stevens also willfully aided and abetted and caused AA Capital's violations of Section 204 of the Advisers Act and Rules 204-2(a)(1), Rule 204-2(a)(2), and Rule 204-2(a)(6) thereunder, which require investment advisers to make and keep certain records.

### **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 Stevens an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent Stevens pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement plus prejudgment interest and civil penalties pursuant to Sections 203(j) and 203(i) of the Advisers Act;

C. Whether, pursuant to Section 203(k) of the Advisers Act, Respondent Stevens should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(1), 206(2), 206(4) of the Advisers Act, and Rule 206(4)-4 thereunder; and

D. Whether, pursuant to Section 203(k) of the Advisers Act, Respondent Stevens should be ordered to cease and desist from committing or causing violations of and any future violations of Section 204 of the Advisers Act and Rules 204-2(a)(1), 204-2(a)(2), and 204-2(a)(6) thereunder.

#### 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 Stevens 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 Stevens fails to file the directed answer, or fails to appear at a hearing after being duly notified, she 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 Stevens 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

*Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60336 / July 17, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3015 / July 17, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13555

In the Matter of

LSB INDUSTRIES, INC. and  
JIMMIE DEAN JONES,  
CPA,

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against LSB Industries, Inc. ("LSB"), and pursuant to Sections 4C<sup>1</sup> and 21C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice<sup>2</sup> against Jimmie Dean Jones, CPA ("Jones") (collectively, "Respondents").

<sup>1</sup> Section 4C provides, in relevant part, that: "The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

<sup>2</sup> Rule 102(e)(1)(iii) provides, in pertinent part, that: "The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder."

## II.

In anticipation of the institution of these proceedings, each Respondent has 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 them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

## III.

On the basis of this Order and Respondents' Offers, the Commission finds<sup>3</sup> that:

### Summary

These proceedings arise out of LSB's and Jones' failures to comply with Generally Accepted Accounting Principles ("GAAP") in connection with LSB's change in inventory pricing methodology from LIFO to FIFO. When LSB changed from LIFO to FIFO during the first quarter of fiscal year 2004, the value of its LIFO reserve was material to its net income.<sup>4</sup> LSB, however, failed to comply with GAAP by disclosing its change from LIFO to FIFO and by restating its prior financial results. Instead, to avoid a restatement, Jones (LSB's then Chief Accounting Officer and Controller) directed his subordinates to eliminate the LIFO reserve by improperly "bleeding it down" over four quarters in 2004. Consequently, Jones caused LSB to issue three quarterly reports and one annual report for fiscal year 2004 that failed to comply with GAAP. In addition, Jones caused two of the quarterly reports issued in fiscal year 2004 to falsely represent that LSB still maintained LIFO inventory. In December 2005, after the Commission's Division of Corporation Finance questioned how LSB's change from LIFO to FIFO was in compliance with GAAP, LSB disclosed the change and restated its financial results.

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<sup>3</sup> The findings herein are made pursuant to Respondents' offers of settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>4</sup> LIFO is an inventory pricing method whereby a company values the cost of the products it sells at the price paid for its most recently purchased inventory. Under FIFO, a company values the cost of the products it sells at the price paid for its oldest purchased inventory. GAAP requires issuers with LIFO inventory to maintain a reserve that represents the difference between the carrying value of their inventory using LIFO and what the carrying value of that inventory would be if they used FIFO instead. GAAP requires companies to track their inventory costs in order to maintain a LIFO reserve.

## Respondents

1. LSB Industries, Inc. is a Delaware corporation, based in Oklahoma City, Oklahoma. It is a diversified holding company with two primary subsidiaries. Its Climate Control Business manufactures and sells products used in commercial and residential air conditioning systems. LSB's Chemical Business manufactures and sells chemical products for agricultural, varied industrial, and mining markets. LSB's securities are registered with the Commission pursuant to Section 12(b) of the Exchange Act and are listed on the New York Stock Exchange.

2. Jimmie Dean Jones, age 66, is a Certified Public Accountant licensed to practice in Oklahoma. Jones served as the Chief Accounting Officer, Corporate Controller, Treasurer and a Senior Vice President of LSB, from the early 1980s until he resigned from these positions in 2008. He is currently a Senior Vice President and Treasurer at LSB. Prior to joining LSB, Jones worked in public accounting for seven years at Arthur Young & Co.

## Facts

1. Prior to and during its fiscal year 2003, LSB valued the inventory of its Climate Master subsidiary using the LIFO (last in, first out) inventory pricing method. LSB also tracked its inventory costs to maintain a LIFO reserve which, under GAAP, is required to reflect the difference between the carrying value of a company's inventory under LIFO and what the carrying value would be if the company instead used the FIFO (first in, first out) inventory pricing method.

2. In May 2003, LSB's independent auditor, Ernst & Young ("E&Y"), suggested to LSB that it change the inventory pricing method for its Climate Master subsidiary from LIFO to FIFO for tax purposes. E&Y suggested this change because LSB was no longer deriving any tax benefit from maintaining this pricing methodology, yet was incurring the cost of tracking its LIFO inventory as required by GAAP. LSB agreed and, at Jones' direction, changed from LIFO to FIFO for tax purposes in October 2003.

3. For financial reporting purposes, however, LSB did not change from LIFO to FIFO at that time to avoid having to restate its financial results. Under GAAP, if the value of an issuer's LIFO reserve is material to its net income when it changes from LIFO to FIFO, then the issuer must disclose the change and eliminate its LIFO reserve by restating its financial statements to reflect what the company's results would have been in prior periods had it not maintained a LIFO reserve.<sup>5</sup> Accounting Principles Board Opinion No. 20, "Accounting Changes" ("APB 20"). At the end of fiscal year 2003, LSB's LIFO reserve was \$503,000, which represented 16 percent of its 2003 reported net income of \$3,111,000. However, the LIFO reserve was forecast to decline to \$250,000 by the end of fiscal year 2004 in the ordinary course of business. In December 2003, an E&Y senior manager advised Jones that if LSB were to delay the change from LIFO to FIFO for financial reporting purposes until its LIFO reserve became immaterial, the company could write the reserve off without having to restate.

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<sup>5</sup> Alternatively, if an issuer's LIFO reserve is not material to its net income in the period of the change, an issuer changing from LIFO to FIFO may eliminate its LIFO reserve by releasing the value of the reserve into current net income and disclosing the change in the notes to its financial statements.

4. To avoid filing a restatement, Jones told an E&Y audit principal on January 5, 2004, that LSB would delay the change from LIFO to FIFO for financial reporting purposes until the end of 2004 to ensure that E&Y would not consider the impact of the change on LSB's net income to be material. The E&Y audit principal agreed with this plan and confirmed to Jones that he would not consider a restatement to be necessary if LSB were to change from LIFO to FIFO when the LIFO reserve fell to \$250,000, assuming that LSB's financial condition did not change materially.

5. LSB ceased tracking inventory costs in January 2004. By not tracking its LIFO inventory costs, which GAAP requires for purposes of maintaining an accurate LIFO reserve, LSB effectively switched to FIFO for financial reporting purposes in January 2004. LSB did not disclose its change from LIFO to FIFO for financial reporting purposes at that time. Jones understood in the first quarter of fiscal year 2004 that LSB had ceased tracking inventory costs. Jones also understood at that time that LSB was required to track its inventory costs in order to remain on LIFO.

6. In April 2004, Jones learned that, due to rising costs, the value of LSB's LIFO reserve was not declining in the normal course of business as expected. Whereas LSB had previously forecast that the LIFO reserve would decline to \$250,000 in the normal course of business by the end of 2004, Jones learned in April 2004 that the reserve remained at \$503,000 as of March 31, 2004, and was expected to decline by only \$40,000 in fiscal year 2004 and was therefore still expected to be material to LSB's net income.

7. To avoid having to file a restatement, Jones improperly directed his subordinates to make journal entries that artificially reduced LSB's LIFO reserve by \$125,000 in each quarter of 2004, so that the LIFO reserve account's year-end balance was zero by December 31, 2004. These entries resulted in corresponding increases in LSB's operating income by \$125,000 in each quarter. The only justification for these entries was the elimination of the LIFO reserve to avoid restatement. Jones did not inform LSB's chief financial officer of his decision to bleed down the LIFO reserve, even though LSB's internal controls policies required Jones to note any item with a potential financial statement impact of at least \$100,000 on a quarterly "Issues List" for the CFO to review. In fact, Jones did not inform LSB's CFO of the bleed down at any point in 2004, even though LSB's internal controls required him to do so.

8. By the time LSB filed its Form 10-Q for the first quarter of 2004 on May 14, 2004, it had effectively changed from LIFO to FIFO for financial reporting purposes. The change was material: the value of LSB's LIFO reserve was \$503,000 while its first quarter operating results were a \$243,000 net loss. Had LSB instead released the entire amount of the LIFO reserve in that quarter, it would have reported \$260,000 net income. Nevertheless, LSB failed to comply with APB 20's restatement and disclosure requirements in its Form 10-Q for the quarter ended March 31, 2004. Not only did LSB fail to disclose its change from LIFO to FIFO in this filing, but it falsely disclosed in this Form 10-Q that it was continuing to price inventory using the LIFO methodology.

9. As a result of the decision to bleed down the LIFO reserve by \$125,000 each quarter, LSB understated its net loss for the quarter ended March 31, 2004 by \$125,000, a 51 percent understatement. LSB reported a net loss of \$118,000; its actual (restated) net loss was \$243,000. LSB also reported a loss per share of 1 cent instead of 2 cents for the quarter, a 50 percent understatement.

10. LSB continued to reduce its LIFO reserve by \$125,000 each quarter throughout the remainder of 2004. This led LSB to overstate its income in its Form 10-Q for the quarter ended June 30, 2004 by \$125,000, or 7.8 percent, and to overstate its income for the six-month period ended June 30, 2004 by \$250,000, or 18.4 percent. LSB reported earnings per share of 8 cents instead of 7 cents for that quarter, a 12.5 percent overstatement, and earnings per share of 6 cents instead of 5 cents for the six-month period ended June 30, 2004, a 16.7 percent overstatement. Again, LSB disclosed that it was continuing to value inventory using the LIFO methodology in its Form 10-Q for the quarter ended June 30, 2004.

11. As a result of LSB's decision to bleed down the LIFO reserve by \$125,000 each quarter, LSB overstated its income in its Form 10-Q for the quarter ended September 30, 2004 by \$125,000, or 3.7 percent, and by \$375,000, or 7.9 percent, for the nine-month period ended September 30, 2004. LSB also reported earnings per share of 19 cents instead of 18 cents for the quarter, a 5.6 percent overstatement, and 26 cents instead of 24 cents for the 9-month period ended September 30, 2004, an 8 percent overstatement.

12. The bleed-down plan also led LSB to overstate its net income for the annual period by \$503,000, or 36.7 percent, in its Form 10-K for the year ended December 31, 2004. LSB reported net income of \$1.873 million for the year; its actual (restated) net income was \$1.370 million. LSB also reported earnings per share for this annual period of 1 cent instead of a loss per share of 3 cents.

13. As principal accounting officer for LSB, Jones was responsible for the preparation of its financial statements. He reviewed and signed the Forms 10-Q for the quarters ended March 31, 2004, June 30, 2004, and September 30, 2004, and the Form 10-K for the year ended December 31, 2004.

14. Following a series of comment letters to LSB from the Commission's Division of Corporation Finance that questioned how LSB's change from LIFO to FIFO complied with APB 20, on December 30, 2005, LSB disclosed the change and filed an amended Form 10-K in which it restated its financials for the year ended December 31, 2004. The amended Form 10-K restated the financial statements and corrected the disclosure issues described in paragraphs 8-12 above.

## Violations

1. Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13 require issuers with securities registered under Section 12 of the Exchange Act to file quarterly and annual reports with the Commission and to keep this information current. The obligation to file such reports also embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978). Rules 13a-1 and 13a-13 also require issuers to file annual and quarterly financial statements that comply with Regulation S-X. Regulation S-X, Section 4-01(a) mandates that financial statements and the accompanying notes be presented in conformity with GAAP.

2. Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets.

3. Section 13(b)(5) of the Exchange Act provides that no person shall knowingly falsify any such book, record, or account or circumvent internal controls. Exchange Act Rule 13b2-1 also prohibits the falsification of any book, record, or account subject to Section 13(b)(2)(A).

4. By failing to comply with APB 20's restatement and disclosure requirements, misstating its financial results during the first three quarters of fiscal year 2004 and the full fiscal year 2004 by bleeding down its LIFO reserve quarterly by \$125,000, and falsely stating in its Forms 10-Q for the first and second quarters of 2004 that it maintained LIFO inventory, LSB violated Exchange Act Sections 13(a) and 13(b)(2)(A) and Rules 13a-1 and 13a-13.

5. Rather than comply with APB 20's restatement and disclosure requirements, Jones directed his subordinates to bleed down LSB's LIFO reserve during 2004. Jones also failed to comply with LSB's requirement that he alert the company's CFO to items with a financial statement impact exceeding \$100,000. Moreover, Jones, as LSB's Chief Accounting Officer, was responsible for LSB's false disclosures in its Forms 10-Q for the first and second quarters of 2004 that it maintained LIFO inventory. Jones knew that LSB's Forms 10-Q for the first three quarters of fiscal year 2004 and Form 10-K for the year ended December 31, 2004 materially overstated LSB's reported net income. Jones also knew that LSB's Form 10-Q for the quarter ended March 31, 2004 failed to comply with APB 20. Finally, Jones knew or should have known that LSB's Forms 10-Q for the quarters ended March 31, 2004 and June 30, 2004 contained false disclosures that LSB maintained inventory using the LIFO pricing methodology. As a result of this conduct, Jones willfully violated Exchange Act Section 13(b)(5) and Rule 13b2-1 and caused and willfully aided and abetted LSB's violations of Exchange Act Sections 13(a) and 13(b)(2)(A), and Rules 13a-1 and 13a-13.

### Findings

1. Based on the foregoing, the Commission finds that LSB violated Exchange Act Sections 13(a) and 13(b)(2)(A), and Rules 13a-1 and 13a-13.
2. Based on the foregoing, the Commission finds that Jones willfully violated Exchange Act Section 13(b)(5) and Rule 13b2-1, and caused and willfully aided and abetted LSB's violations of Exchange Act Sections 13(a) and 13(b)(2)(A), and Rules 13a-1 and 13a-13.
3. Based on the foregoing, the Commission finds that Jones willfully violated and willfully aided and abetted the violation of provisions of the federal securities laws and rules thereunder within the meaning of Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

### IV.

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

Accordingly, it is hereby ORDERED that:

- A. LSB Industries, Inc. shall cease and desist from committing or causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Exchange Act Rules 13a-1 and 13a-13;
- B. Jimmie Dean Jones shall cease and desist from committing or causing any violations and any future violations of Section 13(b)(5) of the Exchange Act and Exchange Act Rule 13b2-1, and from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) and Rules 13a-1 and 13a-13;
- C. Respondent Jimmie Dean Jones is denied the privilege of appearing or practicing before the Commission as an accountant.
- D. After two years from the date of this order, Respondent Jimmie Dean Jones may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:
  1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Parts 240 and 241**

**[Release No. 34-60332; File No. S7-15-09]**

**RIN 3235-AJ66**

**Proposed Amendment to Municipal Securities Disclosure**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule and interpretation.

**SUMMARY:** The Securities and Exchange Commission ("Commission" or "SEC") is publishing for comment proposed amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 ("Exchange Act") relating to municipal securities disclosure. The proposal would amend certain requirements regarding the information that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities must reasonably determine that an issuer of municipal securities or an obligated person has undertaken, in a written agreement or contract for the benefit of holders of the issuer's municipal securities, to provide to the Municipal Securities Rulemaking Board ("MSRB"). Specifically, the proposed amendments would require a broker, dealer, or municipal securities dealer to reasonably determine that the issuer or obligated person has agreed to provide notice of specified events in a timely manner not in excess of ten business days after the event's occurrence, would amend the list of events for which a notice is to be provided, and would modify the events that are subject to a materiality determination before triggering a notice to the MSRB. In addition, the amendments would revise an exemption from the rule for certain offerings of municipal securities with put features. The Commission also is providing interpretive guidance intended to

assist municipal securities issuers, brokers, dealers and municipal securities dealers in meeting their obligations under the antifraud provisions.

**DATES:** Comments should be received on or before [insert date 45 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/proposed.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. S7-15-09 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. S7-15-09. 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/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying

information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Martha Mahan Haines, Assistant Director and Chief, Office of Municipal Securities, at (202) 551-5681; Nancy J. Burke-Sanow, Assistant Director, Office of Market Supervision, at (202) 551-5620; Mary N. Simpkins, Senior Special Counsel, Office of Municipal Securities, at (202) 551-5683; Cyndi N. Rodriguez, Special Counsel, Office of Market Supervision, at (202) 551-5636; Rahman J. Harrison, Special Counsel, Office of Market Supervision, at (202) 551-5663; David J. Michehl, Special Counsel, Office of Market Supervision, at (202) 551-5627; and Steven Varholik, Special Counsel, Office of Market Supervision, at (202) 551-5615, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

**SUPPLEMENTARY INFORMATION:** The Commission is requesting public comment on a proposed amendment to Rule 15c2-12 under the Exchange Act.<sup>1</sup>

**I. Background**

**A. History of Rule 15c2-12**

The Commission has long been concerned with improving the quality, timing, and dissemination of disclosure in the municipal securities market. In an effort to improve the transparency of the municipal securities market, in 1989, the Commission adopted Rule 15c2-12<sup>2</sup> (“Rule” or “Rule 15c2-12”) and an accompanying interpretation modifying a previously published interpretation of the legal obligations of underwriters of municipal securities.<sup>3</sup> As

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<sup>1</sup> 17 CFR 240.15c2-12.

<sup>2</sup> Id.

<sup>3</sup> See Securities Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799 (July 10, 1989) (“1989 Adopting Release”).

adopted in 1989, Rule 15c2-12 required, and still requires, underwriters participating in primary offerings of municipal securities of \$1,000,000 or more to obtain, review, and distribute to potential customers copies of the issuer's official statement. Specifically, Rule 15c2-12 required, and still requires, an underwriter acting in a primary offering of municipal securities: (1) to obtain and review an official statement "deemed final" by an issuer of the securities, except for the omission of specified information, prior to making a bid, purchase, offer, or sale of municipal securities; (2) in non-competitive bid offerings, to send, upon request, a copy of the most recent preliminary official statement (if one exists) to potential customers; (3) to send, upon request, a copy of the final official statement to potential customers for a specified period of time; and (4) to contract with the issuer to receive, within a specified time, sufficient copies of the final official statement to comply with the Rule's delivery requirement, and the requirements of the rules of the MSRB.

While the availability of primary offering disclosure significantly improved following the adoption of Rule 15c2-12, there was a continuing concern about the adequacy of disclosure in the secondary market.<sup>4</sup> To enhance the quality, timing, and dissemination of disclosure in the secondary municipal securities market, the Commission in 1994 adopted amendments to Rule

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<sup>4</sup> In 1993, the Commission's Division of Market Regulation (n/k/a the Division of Trading and Markets) ("Division") conducted a comprehensive review of many aspects of the municipal securities market, including secondary market disclosure ("1993 Staff Report"). Findings in the 1993 Staff Report highlighted the need for improved disclosure practices in both the primary and secondary municipal securities markets. The 1993 Staff Report found that investors need sufficient current information about issuers and significant obligors to better protect themselves from fraud and manipulation, to better evaluate offering prices, to decide which municipal securities to buy, and to decide when to sell. Moreover, the 1993 Staff Report found that the growing participation of individuals as both direct and indirect purchasers of municipal securities underscored the need for sound recommendations by brokers, dealers, and municipal securities dealers. See Commission, Division of Market Regulation, Staff Report on the Municipal Securities Market (September 1993) (available at <http://www.sec.gov/info/municipal.shtml>).

15c2-12 (“1994 Amendments”).<sup>5</sup> Among other things, the 1994 Amendments placed certain requirements on brokers, dealers, and municipal securities dealers (“Dealers” or, when used in connection with primary offerings, “Participating Underwriters”).

Specifically, Rule 15c2-12, as amended by the 1994 Amendments, prohibits Participating Underwriters from purchasing or selling municipal securities covered by the Rule in a primary offering, unless the Participating Underwriter has reasonably determined that an issuer of municipal securities or an obligated person<sup>6</sup> has undertaken in a written agreement or contract for the benefit of holders of such securities (“continuing disclosure agreement”) to provide specified annual information and event notices to certain information repositories.<sup>7</sup> The information to be provided consists of: (1) certain annual financial and operating information and audited financial statements (“annual filings”);<sup>8</sup> (2) notices of the occurrence of any of eleven specific events

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<sup>5</sup> See Securities Exchange Act Release No. 34961 (November 10, 1994), 59 FR 59590 (November 17, 1994) (“1994 Amendments Adopting Release”). In light of the growing volume of municipal securities offerings, as well as the growing ownership of municipal securities by individual investors, in March 1994, the Commission published the Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others. See Securities Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748 (March 17, 1994) (“1994 Interpretive Release”). The Commission intended that its statement of views with respect to disclosures under the federal securities laws in the municipal market would encourage and expedite the ongoing efforts by market participants to improve disclosure practices, particularly in the secondary market, and to assist market participants in meeting their obligations under the antifraud provisions. *Id.*

<sup>6</sup> The term “obligated persons” means persons, including the issuer of municipal securities, committed by contract or other arrangement to support payment of all or part of the obligations on the municipal securities to be sold in an offering. See 17 CFR 240.15c2-12(f)(10).

<sup>7</sup> See 17 CFR 240.15c2-12(b)(5)(i)(C). This provision now provides that the annual information and event notices are to be submitted to a single repository, the MSRB. See infra note 11 and accompanying text.

<sup>8</sup> 17 CFR 240.15c2-12(b)(5)(i)(A) and (B).

“event notices”);<sup>9</sup> and (3) notices of the failure of an issuer or other obligated person to make a submission required by a continuing disclosure agreement (“failure to file notices”).<sup>10</sup> The 1994 Amendments also amended Rule 15c2-12 to require the Participating Underwriter to reasonably determine that an issuer of municipal securities or an obligated person has undertaken in the continuing disclosure agreement to provide: (1) annual filings to each nationally recognized municipal securities information repository (“NRMSIR”); (2) event notices and failure to file notices either to each NRMSIR or to the MSRB; and (3) in the case of states that established state information depositories (“SIDs”), all continuing disclosure documents to the appropriate SID. Finally, the 1994 Amendments amended Rule 15c2-12 to revise the definition of “final official statement” to include a description of the issuer’s or obligated person’s continuing disclosure undertakings for the securities being offered, and of any instances in the previous five years in which the issuer or obligated person failed to comply, in all material respects, with undertakings in previous continuing disclosure agreements.

Furthermore, to promote more efficient, effective, and wider availability of municipal securities information to investors and market participants, on December 5, 2008, the

<sup>9</sup> 17 CFR 240.15c2-12(b)(5)(i)(C). Currently, the following events, if material, require notice: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the tax-exempt status of the security; (7) modifications to rights of security holders; (8) bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the securities; and (11) rating changes. In addition, Rule 15c2-12(d)(2) provides an exemption from the application of paragraph (b)(5) of the Rule with respect to certain primary offerings if, among other things, the issuer or obligated person has agreed to a limited disclosure obligation. See 17 CFR 240.15c2-12(d)(2). As discussed in detail in Section II.C., below, the Commission is proposing to eliminate the materiality determination for certain of these events.

<sup>10</sup> 17 CFR 240.15c2-12(b)(5)(i)(D). Annual filings, event notices, and failure to file notices are referred to collectively herein as “continuing disclosure documents.”

Commission adopted amendments to Rule 15c2-12 (“2008 Amendments”) to provide for a single centralized repository, the MSRB, for the electronic collection and availability of information about outstanding municipal securities in the secondary market.<sup>11</sup> In the 2008 Amendments Adopting Release, the Commission stated that the establishment of a single centralized repository will help provide ready and prompt access to continuing disclosure documents to investors and other municipal market participants and will help fulfill the regulatory and information needs of municipal market participants, including Dealers, Participating Underwriters, mutual funds and others.<sup>12</sup> Specifically, the 2008 Amendments require the Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in its continuing disclosure agreement to provide the continuing disclosure documents: (1) solely to the MSRB; and (2) in an electronic format and accompanied by identifying information, as prescribed by the MSRB.<sup>13</sup>

B. Need for Further Amendments to Rule 15c2-12

As discussed below, experience with the operation of the Rule, changes in the municipal market since the adoption of the 1994 Amendments, and recent market events have suggested the need for the Commission to reconsider certain aspects of the Rule, including the exemption for

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<sup>11</sup> See Securities Exchange Act Release No. 59062 (December 5, 2008), 73 FR 76104 (December 15, 2008) (“2008 Amendments Adopting Release”). See also Securities Exchange Act Release No. 58255 (July 30, 2008), 73 FR 46138 (August 7, 2008) (“2008 Proposing Release”). The 2008 Amendments became effective on July 1, 2009. The Commission proposes that the effective date of the proposed amendments discussed herein would be no earlier than three months after any final approval of the proposed amendments, should the Commission adopt these proposed rule amendments.

<sup>12</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR at 76106.

<sup>13</sup> *Id.* See also Securities Exchange Act Release No. 59061 (December 5, 2008), 73 FR 75778 (December 12, 2008) (order approving the MSRB’s proposed rule change to establish as a component of its central municipal securities document repository, the Electronic Municipal Market Access (“EMMA”) system, the collection and availability of continuing disclosure documents over the Internet for free).

primary offerings of municipal securities in authorized denominations of \$100,000 or more which, at the option of the holder thereof, may be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent (“demand securities”).<sup>14</sup> Furthermore, since the adoption of the 1994 Amendments, municipal securities industry participants have raised a number of areas in which the Rule’s provisions could be clarified or enhanced and have expressed a desire for additional information about these securities.<sup>15</sup>

Since the adoption of the 1994 Amendments, the amount of outstanding municipal securities has more than doubled - to almost \$2.7 trillion.<sup>16</sup> Notably, despite this large increase

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<sup>14</sup> 17 CFR 240.15c2-12(d)(1)(iii).

<sup>15</sup> See, e.g., Letter from Karrie McMillan, General Counsel, Investment Company Institute (“ICI”), to Florence E. Harmon, Secretary, Commission (July 25, 2008) (available at <http://www.sec.gov/comments/s7-13-08/s71308-44.pdf>); comments of participants in the 2001 SEC Municipal Market Roundtable – “Secondary Market Disclosure for the 21st Century,” (available at <http://www.sec.gov/info/municipal/roundtables/thirdmuniround.htm>) (Leslie Richards-Yellen, Principal, The Vanguard Group: “. . . what I’d like to see change the most is the inclusion of securities that have been carved out of Rule 15c2-12. I would like securities such as money market securities to be within the ambit of Rule 15c2-12. In addition, I’d like to see the eleven material events be expanded. The first eleven were very helpful. The ICI drafted a letter and we’ve added another twelve for the industry to think about and cogitate on . . .,” and Dianne McNabb, Managing Director, A.G. Edwards & Sons, Inc: “I think that in summary, we could use more specificity as far as what needs to be disclosed, the timeliness of that disclosure, such as the financial statements, more events, I think that we would agree that there are more events . . .”); and National Federation of Municipal Analysts, Recommended Best Practices in Disclosure for Variable Rate and Short-Term Securities, February, 2003 (recommendations for continuing disclosures of specified information) (available at [http://www.nfma.org/publications/short\\_term\\_030207.pdf](http://www.nfma.org/publications/short_term_030207.pdf)).

<sup>16</sup> According to statistics assembled by the Securities Industry and Financial Markets Association (“SIFMA”), the amount of outstanding municipal securities grew from approximately \$1.26 trillion in 1996 to \$2.69 trillion at the end of 2008. See SIFMA Outstanding U.S. Bond Market Debt (available at [http://www.sifma.org/research/pdf/Overall\\_Outstanding.pdf](http://www.sifma.org/research/pdf/Overall_Outstanding.pdf)).

in the amount of outstanding municipal securities, direct investment in municipal securities by individuals remained relatively steady from 1996 to 2008, ranging from approximately 35% to 39% of outstanding municipal securities.<sup>17</sup> At the end of 2008, individual investors held approximately 36% of outstanding municipal securities directly and up to another 36% indirectly through money market funds, mutual funds, and closed end funds.<sup>18</sup> There is also substantial trading volume in the municipal securities market. According to the MSRB, almost \$5.5 trillion of long and short term municipal securities were traded in 2008 in nearly 11 million transactions.<sup>19</sup> Further, the municipal securities market is extremely diverse, with approximately 50,000 state and local issuers of these securities. In addition, municipal bonds can and do default. In fact, at least 917 municipal bond issues went into monetary default during the 1990's with a defaulted principal amount of over \$9.8 billion.<sup>20</sup> Bonds for healthcare, multifamily housing, and industrial development, together with land-backed debt, accounted for more than 80% of defaulted dollar amounts.<sup>21</sup> In 2007, a total of \$226 million in municipal bonds defaulted

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<sup>17</sup> See SIFMA,  Holders of U.S. Municipal Securities  (available at [http://www.sifma.org/research/pdf/Holders\\_Municipal\\_Securities.pdf](http://www.sifma.org/research/pdf/Holders_Municipal_Securities.pdf)) ("SIFMA Report").

<sup>18</sup>  Id.

<sup>19</sup> See MSRB,  Real-Time Transaction Reporting, Statistical Patterns in the Municipal Market, Monthly Summaries 2008  (available at [http://www.msrb.org/msrb1/TRSweb/MarketStats/statistical\\_patterns\\_in\\_the\\_muni.htm](http://www.msrb.org/msrb1/TRSweb/MarketStats/statistical_patterns_in_the_muni.htm)).

<sup>20</sup> See Standard and Poor's,  A Complete Look at Monetary Defaults in the 1990s  (June, 2000) (available at <http://www.kennyweb.com/kwnext/mip/paydefault.pdf>) ("Standard and Poor's Report"). See also Moody's Investors Service,  The U.S. Municipal Bond Rating Scale: Mapping to the Global Rating Scale And Assigning Global Scale Ratings to Municipal Obligations  (March, 2008) (available at [http://www.moody.com/cust/content/content.ashx?source=StaticContent/Free%20pages/Credit%20Policy%20Research/documents/current/102249\\_RM.pdf](http://www.moody.com/cust/content/content.ashx?source=StaticContent/Free%20pages/Credit%20Policy%20Research/documents/current/102249_RM.pdf)) (regarding municipal defaults of Moody's rated municipal securities).

<sup>21</sup> See Standard and Poor's Report,  supra  note 20.

(including both monetary and covenant defaults).<sup>22</sup> In 2008, 140 issuers defaulted on \$7.6 billion in municipal bonds.<sup>23</sup>

At the time the Rule was adopted in 1989, municipal securities with put or demand features were relatively new. Approximately \$13 billion of variable rate demand obligations (“VRDOs”)<sup>24</sup> were issued in 1989.<sup>25</sup> However, by 2008, new issuances of VRDOs had grown to approximately \$115 billion,<sup>26</sup> with trading in VRDOs representing approximately 38% of trading volume of all municipal securities.<sup>27</sup> Many issuers and other obligated persons are reported to have converted their municipal auction rate securities (“ARS”)<sup>28</sup> to securities with other interest rate modes (as provided in related trust indentures),<sup>29</sup> such as VRDOs, or refunded or otherwise refinanced their ARS in order to reduce the unusually high interest rates on ARS caused by

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<sup>22</sup> See Joe Mysak, Subprime Finds New Victim as Muni Defaults Triple, Bloomberg News, May 30, 2008.

<sup>23</sup> See Joe Mysak, Municipal Defaults Don’t Reflect Tough Times: Chart of Day, Bloomberg News, May 28, 2009 (also noting that since 1999, issuers have defaulted on \$24.13 billion in municipal bonds).

<sup>24</sup> VRDOs principally are demand securities.

<sup>25</sup> See Two Decades of Bond Finance: 1989-2008, The Bond Buyer/Thomson Reuters 2009 Yearbook 4 (Matthew Kreps ed., Source Media, Inc.) (2009).

<sup>26</sup> Id.

<sup>27</sup> According to the MSRB, trading volume in VRDOs in 2008 was approximately \$2.1 trillion. Total trading volume in 2008 for all municipal securities was approximately \$5.5 trillion. See e-mail between Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, and Harold Johnson, Deputy General Counsel, MSRB, May 28, 2009 (confirming 2008 trading volume in VRDOs and trading volume for municipal securities).

<sup>28</sup> Auction rate securities are not demand securities.

<sup>29</sup> “Interest rate modes” is the term used to refer collectively to the various forms in which offerings that include variable rate demand obligations may typically be issued or converted. Such “multi-modal” bonds typically include a variety of optional forms (modes), such as fixed interest rate, variable interest rates of different lengths (e.g., daily, weekly or monthly interest rate resets), auction rate, and commercial paper.

turmoil in the ARS market.<sup>30</sup> This conversion or refinancing appears to have contributed to the increased volume of new issues of VRDOs in 2008<sup>31</sup> and was accompanied by an increased number of investors in VRDOs, with some investors holding these securities for long periods of time.<sup>32</sup> There has also been an increase in the trading volume of VRDOs. As the size and complexity of the VRDO market and the number of investors has grown, so have the risks associated with less complete disclosure. In addition, during the fall of 2008, the VRDO market experienced significant volatility.<sup>33</sup> Moreover, there have been concerns expressed by representatives of the primary purchasers of VRDOs – money market funds – that suggest that the exemption in Rule 15c2-12 for these securities may no longer be justified.<sup>34</sup> All of these

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<sup>30</sup> See, e.g., Press Release, Dormitory Authority State of New York, DASNY Moving Clients Out of Auction Rate Securities (March 26, 2008) (available at <http://www.dasny.org/dasny/news/2008/080326moving.php>); Press Release, Office of Chief Financial Officer, District of Columbia, Over \$100 Million Saved: \$10 Million This Fiscal Year by CFO Debt Management Strategy (May 27, 2008) (available at <http://newsroom.dc.gov/show.aspx/agency/cfo/section/2/release/13845>); Henry J. Gomez, Bond Failures Could Mean Millions In Lost Interest, Cleveland Plain Dealer, March 4, 2008, at B3; Laura Brost, Citizens to Cut its Borrowing Cost, Orlando Sentinel, March 14, 2008, at C3; and Matt Krantz, Credit Crisis Forces Museums to be Creative; Skittish Bond Investors Meant Their Interest Costs Were Getting Out of Hand, USA TODAY, April 17, 2008, at 4B.

<sup>31</sup> According to Thomson Reuters, VRDO issuances in 2008 were much higher than in 2007 – approximately \$115 billion in 2008 vs. \$50 billion in 2007. No ARS were reported to have been issued during the same period in 2008. See Two Decades of Bond Finance: 1989-2008, The Bond Buyer/Thomson Reuters 2009 Yearbook 7 (Matthew Kreps ed., Source Media, Inc.) (2009).

<sup>32</sup> See infra note 45 and accompanying text.

<sup>33</sup> See Diya Gullapalli, Crisis On Wall Street: Muni Money-Fund Yields Surge – Departing Investors Send 7-Day Returns Over 5%, Wall Street Journal, September 27, 2008; Andrew Ackerman, Short-Term Market Dries Up: Illiquidity Leads to Lack of Bank LOCs, The Bond Buyer, October 7, 2008. (“The reluctance of financial firms to carry VRDOs is evident in the spike in the weekly [SIFMA] municipal swap index, which is based on VRDO yields and spiked from 1.79% on Sept. 10 to 7.96% during the last week of the month. It has since declined somewhat to 5.74%.”).

<sup>34</sup> See supra note 15 and accompanying text.

developments highlight the need for the Commission to consider whether improvements should be made regarding the availability to investors of important information regarding demand securities.

As a result of the changes in the VRDO market, the Commission believes that investors and other municipal market participants today should be able to obtain ongoing continuing disclosure information regarding demand securities in order to make more knowledgeable investment decisions, to effectively manage and monitor their investments, and thereby be better able to protect themselves from misrepresentations and fraudulent activities. Accordingly, the Commission proposes to modify the exemption in the Rule, as discussed below, for demand securities<sup>35</sup> by requiring Participating Underwriters to reasonably determine that the issuer or obligated person of demand securities has undertaken in a written agreement to provide continuing disclosure documents to the MSRB.

In addition, the Commission proposes to require Participating Underwriters to reasonably determine that the issuer or obligated person has contractually agreed to provide notice of specified events within a certain time frame, amend the list of events that would trigger an

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<sup>35</sup> See 17 CFR 240.15c2-12(d)(1)(iii). Specifically, the Commission proposes to eliminate the exemption for primary offerings of demand securities contained in paragraph (d)(1)(iii) of the Rule and to add new paragraph (d)(5) to the Rule. Paragraph (d)(5) of the Rule, as proposed, would exempt primary offerings of demand securities from all of the provisions of the Rule except those relating to a Participating Underwriter's obligations pursuant to paragraph (b)(5) of the Rule and relating to recommendations by brokers, dealers, and municipal securities dealers pursuant to paragraph (c) of the Rule. As a result of these proposed changes, Participating Underwriters, in connection with a primary offering of demand securities, would need to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement with respect to the submission of continuing disclosure documents to the MSRB. In addition, brokers, dealers and municipal securities dealers recommending the purchase or sale of demand securities would need to have procedures in place that provide reasonable assurance that they would receive prompt notice of event notices and failure to file notices. See 17 CFR 240.15c2-12(c).

issuer's or other obligated person's obligation under its continuing disclosure agreement to submit an event notice to the MSRB, and amend the Rule to modify those events that would be subject to a materiality determination before triggering a notice to the MSRB.<sup>36</sup> As discussed below, the Commission believes that these proposed changes would, among other things, help Participating Underwriters satisfy their obligations and help improve the availability of timely and important information to investors of municipal securities. In addition, in line with the objectives behind the Commission's prior revisions to Rule 15c2-12 and the 2008 Amendments, these proposed amendments are designed to help deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and recommendation of transactions in municipal securities for which adequate information is not available on an ongoing basis.

## **II. Description of the Proposed Amendments to Rule 15c2-12**

### **A. Modification of the Exemption for Demand Securities**

Rule 15c2-12(d) provides an exemption for a primary offering<sup>37</sup> of municipal securities in authorized denominations of \$100,000 or more, if such securities, at the option of the holder thereof, may be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent.<sup>38</sup> Demand securities qualify for this exemption. The Commission now proposes to delete the current exemption for demand

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<sup>36</sup> As discussed below in Section II.F., the Commission is aware that undertakings by issuers and obligated persons that were entered into prior to the effective date of any final amendments would be different from those entered into on or after the effective date of any final amendments.

<sup>37</sup> See Rule 15c2-12(f)(7) for a definition of primary offering. 17 CFR 240.15c2-12(f)(7).

<sup>38</sup> 17 CFR 240.15c2-12(d)(1)(iii).

securities in paragraph (d)(1)(iii) and add language in new paragraph (d)(5) so that paragraphs (b)(5)<sup>39</sup> and (c)<sup>40</sup> of the Rule also would apply to a primary offering of demand securities.

The Commission believes that its experience with the operation of the Rule and market changes since the adoption of the 1994 Amendments have suggested a need to modify the exemption relating to demand securities as described. The effect of this proposed amendment would be to eliminate the current exemption of demand securities from the requirement that a Participating Underwriter reasonably determine that the issuer or obligated person has undertaken, in a continuing disclosure agreement, to provide continuing disclosure documents to the MSRB. As noted above, when this exemption was adopted VRDOs were relatively new and did not represent a large proportion of the market.<sup>41</sup> However, by 2008, the amount of issuances of VRDOs was approximately \$115 billion<sup>42</sup> and trading volume of VRDOs exceeded 38% of all municipal securities.<sup>43</sup> The Commission observes that an unusually high volume of VRDOs were issued in 2008.<sup>44</sup> The increase in the amount of issuances and trading volume of VRDOs seem to indicate that more investors own such securities. Furthermore, despite their periodic

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<sup>39</sup> As noted above, Rule 15c2-12(b)(5) requires a Participating Underwriter, before purchasing or selling municipal securities in connection with an offering of municipal securities, to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of the holders of municipal securities, to provide annual filings, material event notices, and failure to file notices (i.e., continuing disclosure documents) to the MSRB. See 17 CFR 240.15c2-12(b)(5). See also supra note 11.

<sup>40</sup> Rule 15c2-12(c) requires a broker, dealer, or municipal securities dealer that recommends the purchase or sale of a municipal security to have procedures in place that provide reasonable assurance that it will receive prompt notice of any material event and any failure to file annual financial information regarding the municipal security. See 17 CFR 240.15c2-12(c).

<sup>41</sup> See supra note 25 and accompanying text.

<sup>42</sup> See supra note 25 and accompanying text.

<sup>43</sup> See supra note 27 and accompanying text.

<sup>44</sup> See supra notes 30 and 31 and accompanying text.

ability to tender VRDOs to the respective issuer for repurchase, some investors in VRDOs appear to hold these securities for long periods of time<sup>45</sup> and would be better able to protect themselves against manipulation and fraud if they were able more easily to access information about important events, such as those listed in paragraphs (b)(5) and (c) of the Rule.

Accordingly, the increased amount of VRDO issuances, high VRDO trading volume, increased number of investors in VRDOs,<sup>46</sup> and some investors' tendency to hold these securities for long periods of time highlight the risks associated with less information being available and suggest a need to take measures designed to help improve the availability of important information to investors in this considerable segment of the municipal market. Representatives

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<sup>45</sup> Telephone call between Heather Traeger, Associate Counsel, Securities Regulation, Capital Markets, ICI, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on July 14, 2009.

<sup>46</sup> The recent increased investment interest and activity in VRDOs may be attributable, in part, to the recent turmoil in the market for ARS, which began in February 2008. See MSRIB Notice 2008-09 (February 19, 2008) ("Recent downgrades of municipal bond insurers and other short-term liquidity concerns have created extreme volatility in the market for municipal Auction Rate Securities. There also have been an unprecedented number of 'failed auctions,' meaning that investors who chose to liquidate their positions through the auction process were not able to do so.") (available at <http://www.msrb.org/msrb1/whatsnew/2008-09.asp>). See also Anthony P. Inverso, 2008 First-Half Municipal Market Review: The End of Securities and Bond Insurance As We Know It? Building Futures, New Jersey Educational Facilities Authority (June, 2008) (stating that as downgrades to bond insurer ratings grew, so did the rates on ARS. Further stating that by the end of the first half of 2008, nearly half of all auction rate securities will have been converted or redeemed, mainly in the form of more predictable fixed rate debt or variable rate secured by a bank letter of credit.) (available at <http://www.njefa.com/njefa/pdf/newsletter/NJEFA%20Building%20futures%20newsletter%20June%202008%20Vol.%207,%20No.%201.pdf>); and Adrian D'Silva, Haley Gregg, and David Marshall, Explaining the Decline in the Auction Rate Securities Market, Chicago Fed Letter, The Federal Reserve Bank of Chicago (November, 2008) (stating that the rash of failed auctions in the ARS markets starting in February 2008 has prompted issuers to consider a variety of potential solutions, including: finding buyers for ARSs in the secondary market; converting ARSs to variable-rate demand notes; and replacing ARSs with short term debt funding.) (available at [http://www.chicagofed.org/publications/fedletter/cflnovember2008\\_256.pdf](http://www.chicagofed.org/publications/fedletter/cflnovember2008_256.pdf)). See also supra note 30.

of money market funds have discussed their difficulty or, on some occasions, their inability to obtain the information that they believe is necessary to oversee their investments in demand securities.<sup>47</sup> Modification of the exemption for demand securities, as further discussed below, would help improve the availability of continuing disclosures about these securities, not only to institutional investors, such as mutual funds, that acquire demand securities for their portfolios, but also to individual investors who own, or who may be interested in owning, demand securities, and would help them make better informed investment decisions, and thereby better protect themselves.

Further, the Commission notes that the exemption for demand securities, which was included in the Rule when Rule 15c2-12 was adopted in 1989, was intended to respond to concerns expressed by commenters “that applying the provisions of the [Proposed] Rule to variable rate demand notes, or similar securities, might unnecessarily hinder the operation of this market, if underwriters were required to comply with the provisions of the Proposed Rule on each tender or reset date.”<sup>48</sup> The exemption in the original Rule was intended to ensure that the remarketings would not be affected by application of paragraphs (a) and (b)(1) – (4) of the Rule, which require Participating Underwriters to review an official statement that the issuer “deems

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<sup>47</sup> See, e.g., comments of Leslie Richards -Yellen, Principal, The Vanguard Group, transcript of the 2001 Municipal Market Roundtable – “Secondary Market Disclosure for the 21st Century” (available at <http://www.sec.gov/info/municipal/roundtables/thirdmuniround.htm>) (“ . . . what I hope more than anything is that variable rate demand obligations become within the Rule 15c2-12 disclosure regime . . . put yourself in the position of a fund, we have on one hand Rule 15c2-12, which is very helpful and it sets the floor of what kind of information must be delivered for a secondary market, . . . . But on the other hand, mutual funds are bound by Rule 2a-7 and that says for short-term obligations what we must find for every security, and Rule 2a-7 has legal requirements that we must fulfill in order to buy the securities, and . . . to make these findings we have to make our own determination, we can’t rely on rating agencies, we do this all in house.”). See also supra note 15.

<sup>48</sup> See 1989 Adopting Release, supra note 3, 54 FR at 28808, n. 68.

final” before it may bid for, purchase, offer or sell an offering; to deliver a preliminary official statement or final official statement to any potential customer, upon request; and to contract with the issuer to receive an adequate number of the final official statement to accompany confirmation statements and otherwise fulfill its regulatory responsibilities. Although remarketings of VRDOs may be primary offerings,<sup>49</sup> the Commission did not impose paragraphs (a) and (b)(1) – (4) of the Rule on Participating Underwriters of each remarketing – of which hundreds could occur on the same day – because it potentially would have made it impractical and unduly burdensome for Participating Underwriters to comply with these Rule provisions.<sup>50</sup>

Generally, there are no continuing disclosure agreements in place with respect to VRDOs, because primary offerings of these securities are exempt from the Rule.<sup>51</sup> Under the proposed amendments, the Participating Underwriter of a primary offering of VRDOs would need to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement with respect to the submission to the MSRB of continuing disclosure documents. The proposed amendment modifying the exemption for VRDOs would apply to any initial offering of VRDOs occurring on or after the effective date of any final amendments that the Commission may adopt. In addition, the proposed amendment also would apply to any

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<sup>49</sup> See supra note 37.

<sup>50</sup> See 1994 Amendments Adopting Release, supra note 5. The Commission notes that, in the 1994 Amendments Adopting Release, it did not address the application of paragraph (b)(5) of the Rule to remarketing of VRDOs, including the practicality and burdens for Participating Underwriters to comply with this provision. The 1994 Amendments did not reconsider any of the exemptions contained in the Rule. As discussed above, since that time, there have been significant developments in the market related to demand securities.

<sup>51</sup> There may, however, be continuing disclosure agreements for VRDOs that were initially issued in an interest rate mode, such as a fixed rate mode, subject to the Rule that were subsequently converted to VRDOs in accordance with the provisions of the related indenture.

remarketing of VRDOs that are primary offerings<sup>52</sup> occurring on or after the effective date of any final amendments that the Commission may adopt, including any such remarketing of VRDOs that initially were issued prior to any such effective date. Consequently, the initial issuance of VRDOs, and any remarketing that is a primary offering of VRDOs, following the effective date of any final amendments would require the Participating Underwriter to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement reflecting the proposed new provisions of the Rule.

The Commission, however, preliminarily believes that the effect of the application of paragraphs (b)(5) and (c) of the Rule to VRDOs would not be significantly burdensome for Participating Underwriters in connection with the initial issuance and remarketing of VRDOs following the effective date of any final amendments. If the amendments are adopted, any primary offering (including a remarketing) that occurs on or after the effective date of the Rule would require a Participating Underwriter or a Participating Underwriter serving as a remarketing agent<sup>53</sup> for a particular VRDO issue to make a determination that an issuer or obligated person has entered into a continuing disclosure agreement for that issue reflecting the new provisions of the Rule. The Participating Underwriter or the remarketing agent (who often served as the underwriter in the initial issuance of the VRDOs) would need to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement in which it undertakes to provide continuing disclosure documents to the MSRB. However, once

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<sup>52</sup> 17 CFR 240.15c2-12(f)(7).

<sup>53</sup> A remarketing agent is a broker-dealer responsible for reselling to new investors securities (such as VRDOs) that have been tendered for purchase by their owner. The remarketing agent also typically is responsible for resetting the interest rate for a variable rate issue and also may act as tender agent. See MSRB, Municipal Securities Rulemaking Board Glossary, Second Edition (January 2004) (defining "remarketing agent") (available at <http://www.msrb.org/msrb1/glossary>).

the Participating Underwriter has made such a determination for a particular VRDO issue, it would be aware of the existence of the continuing disclosure agreement reflecting the proposed amendment, and thus would easily be able to make the necessary determination for remarketings of that issue occurring thereafter.<sup>54</sup> Furthermore, remarketing agents who did not previously participate in a remarketing could confirm that the issuer has entered into an undertaking in conformity with the proposed amendment by obtaining an official statement from the issuer (which by definition must include a description of the issuer's undertakings),<sup>55</sup> from the MSRB (under its program that makes official statements for nearly every offering of municipal securities available on the Internet from the MSRB's EMMA system),<sup>56</sup> or from a variety of vendors. In addition, a remarketing agent could obtain a copy of the continuing disclosure agreement from the issuer or obligated person at the time that it enters into a contract to act as a remarketing agent.

According to an industry commentator, some rating agencies recommend that variable-rate debt not exceed 20 percent of the total debt outstanding of governmental issuers.<sup>57</sup> If governmental issuers follow this recommendation, it would be likely that state and local government issuers with VRDOs would have some fixed rate securities outstanding, at least some of which likely would be subject to continuing disclosure agreements under Rule 15c2-12.

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<sup>54</sup> See *infra* Section III. for a reaffirmation of the Commission's interpretations regarding Participating Underwriters' obligations under Rule 15c2-12.

<sup>55</sup> 17 CFR 240.15c2-12(f)(3).

<sup>56</sup> See Securities Exchange Act Release No. 59061 (December 5, 2008), 73 FR 75778 (December 12, 2008) (File No. SR-MSRB-2008-05) (order approving the MSRB's proposed rule change to make permanent a pilot program for an Internet-based public access portal for the consolidated availability of primary offering information about municipal securities).

<sup>57</sup> See Douglas Skarr, Auction Rate Securities: A Primer For Finance Officers, Government Finance Review, August 2005.

Because any existing continuing disclosure agreements for those other outstanding securities would obligate such issuers and obligated persons to provide annual filings, event notices and failure to file notices with respect to their outstanding securities, the Commission does not anticipate that the modification of the exemption for demand securities in the proposed amendments would increase significantly the obligation that they would incur to provide continuing disclosure documents to the MSRB.<sup>58</sup> Furthermore, the Commission notes that some annual filings, such as audited financial statements, are often prepared by issuers and obligated persons in the ordinary course of their business. In such cases, the obligation incurred by an issuer or obligated person to provide to the MSRB information that it has already prepared should be small.<sup>59</sup> Issuers and obligated persons of demand obligations that have not previously issued such securities, however, would be entering into a continuing disclosure agreement for the first time and would incur some costs to provide continuing disclosure documents electronically to the MSRB.<sup>60</sup>

For the reasons stated above, the Commission believes that application of paragraphs (b)(5) and (c) of the Rule would be appropriate in the case of demand securities. The Commission preliminarily believes that any additional burden on Participating Underwriters, issuers or obligated persons, the MSRB or others would be justified by the improved availability of information to investors in demand securities, so that investors in these securities could make better informed investment decisions and thereby better protect themselves from misrepresentations and fraudulent activities. Investors now would have better access to baseline

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<sup>58</sup> See *infra* Section V. for a discussion of the collection of information burdens and costs as they relate to the proposed amendment regarding demand securities.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

information and material events regarding VRDOs. The availability of such information also would assist brokers, dealers and municipal securities dealers in fulfilling their responsibilities to their customers,<sup>61</sup> such as disclosing material facts about transactions and securities; making suitable recommendations in transactions for municipal securities; and complying with other sales practice obligations.<sup>62</sup>

The Commission requests comment on whether it is appropriate to revise the Rule's exemption for demand securities by proposing to apply paragraphs (b)(5) and (c) of the Rule to the offering of demand securities.<sup>63</sup> Further, the Commission requests comment regarding investors' and other municipal market participants' need for continuing disclosure information relating to demand securities. In addition, the Commission requests comment on the extent to which the proposed amendment would provide benefits to investors and other municipal market participants. The Commission also requests comment regarding the effect of the proposed amendment on Participating Underwriters, issuers and obligated persons, and others.

B. Time Frame for Submitting Event Notices under a Continuing Disclosure Agreement

The Commission proposes to modify paragraph (b)(5)(i)(C) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB<sup>64</sup> "in a timely

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<sup>61</sup> For example, brokers, dealers and municipal securities dealers with access to current information contained in event notices submitted to the MSRB would be able to use such information when deciding whether or not to recommend the purchase or sale of a particular demand security.

<sup>62</sup> See MSRB, Reminder of Customer Protection Obligations in Connection with Sales of Municipal Securities, Interpretative Notice of Rule G-17, dated May 30, 2007 (available at <http://www.msrb.org/msrb1/rules/notg17.htm>).

<sup>63</sup> See supra note 35.

<sup>64</sup> See supra note 11 and accompanying text.

manner not in excess of ten business days after the occurrence of the event,” instead of “in a timely manner” as the Rule currently provides. The Commission proposes a similar revision to the limited undertaking in paragraph (d)(2)(ii)(B) of the Rule<sup>65</sup> to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB<sup>66</sup> “in a timely manner not in excess of ten business days after the occurrence of the event,” instead of “in a timely manner” as the Rule currently provides. Therefore, under the proposed amendments, a Participating Underwriter would need to reasonably determine that the continuing disclosure agreement provides for the submission of notices to the MSRB within a period up to and including ten business days after the occurrence of the event. In the 1994 Amendments, the Commission noted that it had not established a specific time frame with respect to “timely” because of the wide variety of events and issuer circumstances.<sup>67</sup> The Commission stated that, in general, this determination must take into consideration the time needed to discover the occurrence of the event, assess its materiality, and prepare and disseminate the notice.<sup>68</sup> It has been reported that some event notices have not been submitted until months after the events occurred.<sup>69</sup> The

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<sup>65</sup> 17 CFR 240.15c2-12(d)(2)(ii)(B).

<sup>66</sup> See supra note 11 and accompanying text.

<sup>67</sup> See 1994 Amendments, supra note 5, 59 FR at 59601.

<sup>68</sup> Id.

<sup>69</sup> See, e.g., Elizabeth Carvlin, Trustee for Vigo County, Ind., Agency Taps Reserve Fund for Debt Service, The Bond Buyer, April 2, 2004, page 3 (reporting the filing of a material event notice regarding a draw on debt service reserve fund that occurred in February); Alison L. McConnell, Two More Deals Under Audit By TEB Office, The Bond Buyer, April 5, 2006 (event notice of tax audit filed nine months after audit was opened); Susanna Duff Barnett, IRS Answers Toxic Query; Post 1986 Radioactive Waste Debt Not Exempt, The Bond Buyer, November 2, 2004 (material event notice filed October 29, 2004 regarding IRS technical advice memorandum dated August 27, 2004 that bonds issued to finance certain radioactive solid waste facilities were taxable; related preliminary adverse determination letter was issued in January, 2002); and Michael

Commission believes that these delays can, among other things, deny investors important information that they need in order to make informed decisions regarding whether to buy or sell municipal securities. More timely information would aid brokers, dealers and municipal securities dealers to be better able to satisfy their obligations to have a reasonable basis to recommend the purchase or sale of municipal securities and aid investors in determining whether the price they pay or receive for their transactions is appropriate, and thereby better protect themselves from misrepresentations and other fraudulent activities.

The Commission believes that longer delays in providing notice of the events set forth in paragraph (b)(5)(i)(C) of the Rule undermine the effectiveness of the Rule. Indeed, market participants have emphasized the importance of the prompt availability of such information.<sup>70</sup> In addition to helping to reduce opportunities for fraudulent activities, the Commission anticipates that, in providing for a maximum time frame within which event notices should be disclosed under a continuing a disclosure agreement, the proposed amendment should foster the availability of up-to-date information about municipal securities, thereby promoting greater transparency and investor confidence in the municipal securities market as a whole.

The Commission notes that, with respect to Participating Underwriters, the proposed amendment simply would require them to reasonably determine that issuers and obligated

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Stanton, IRS: Utah Pool Bonds Taxable; Issuer Disputes Facts of Case, The Bond Buyer, December 8, 1997 (issuer's receipt of August, 1997 IRS technical advice memorandum concluding certain bonds were taxable was disclosed on December 5, 1997).

<sup>70</sup> See, e.g., National Federation of Municipal Analysts, Recommended Best Practices in Disclosure for General Obligation and Tax-Supported Debt (December 2001) ("Any material event notices, including those required under SEC Rule 15c2-12, should be released as soon as practicable after the information becomes available.") (available at <http://www.nfma.org/disclosure.php>); Peter J. Schmitt, Letter to the Editor, To the Editor: MuniFilings.com: The Once and Future Edgar?, The Bond Buyer, October 9, 2007, Commentary, Vol. 362 No. 32732, at 36 ("We suggest . . . that the true problem is issuer compliance . . . filing issues are the sole cause of lack of transparency and disclosure availability in the industry. These filing issues include . . . late filing, . . .").

persons have contractually agreed to submit event notices “in a timely manner not in excess of ten business days after the occurrence of the event,” rather than in a “timely manner.” On the other hand, there would be a significant benefit to investors and municipal market participants, who would be able to obtain information about municipal securities within a specific time frame of an event’s occurrence. Indeed, while issuers and obligated persons under continuing disclosure agreements entered into prior to the effective date of any final amendments that the Commission may adopt already would have committed to submit event notices in a timely manner, the proposed amendment would help to make the timing of such submissions more certain in the case of issuers and obligated persons that enter into continuing disclosure agreements on or after the effective date of any final amendments that the Commission may adopt.<sup>71</sup>

The Commission believes that the proposed change regarding the time frame for submission of event notices would continue to provide an issuer or obligated person with adequate time to become aware of the event and, pursuant to its undertaking, submit notice of the event’s occurrence to the MSRB. In proposing that event filings be provided “in a timely manner not in excess of ten business days after the occurrence of the event,” the Commission intends to strike a balance between the need for such information to be disseminated promptly and the need to allow adequate time for an issuer or other obligated person to become aware of the event and to prepare and file such a notice. The Commission preliminarily believes that the proposed ten business day time frame would provide a reasonable amount of time for issuers to comply with their obligations under their continuing disclosure agreements, while also allowing

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<sup>71</sup> The Commission notes that the proposed ten business day time frame would not apply to continuing disclosure agreements entered into with respect to primary offerings that occurred prior to the effective date of any final amendments that the Commission may adopt.

event notices to be made available to investors, underwriters, and other market participants in a timely manner.

By their nature, the events currently listed in (and proposed to be added to) subparagraph (b)(5)(i)(C) of the Rule are significant and should become known to the issuer or obligated person expeditiously.<sup>72</sup> For example, some events, such as payment defaults, tender offers and bankruptcy filings, generally involve the issuer's or obligated person's participation.<sup>73</sup> Other events, such as the failure of a credit or liquidity provider to perform, are of such importance that an issuer or obligated person likely would become aware of such events within the proposed ten business day time frame<sup>74</sup> or would expect an indenture trustee, paying agent or other transaction participant to bring the event to the issuer's or obligated person's attention within the proposed time frame for submission of event notices.<sup>75</sup> Although a few events, such as rating changes, are not directly within the issuer's control, the Commission expects that issuers and obligated persons usually would become aware of the events specified in paragraph (b)(5)(i)(C) of the Rule

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<sup>72</sup> See supra note 9 for a description of events currently contained in Rule 15c2-12(b)(5)(i)(C); See infra Section II.E. for a description of events proposed to be added to the Rule.

<sup>73</sup> In addition, issuer or obligated person involvement is often required for substitution of credit or liquidity providers; modifications to rights of security holders; release, substitution, sale of property securing repayment of the securities; and optional redemptions. See Form Indenture and Commentary, National Association of Bond Lawyers, 2000.

<sup>74</sup> For example, issuers or obligated persons should have direct knowledge of principal and interest payment delinquencies, receipt of preliminary or proposed determinations of taxability from the IRS, tender offers that they initiate, and bankruptcy filings.

<sup>75</sup> The Commission believes that indenture trustees generally would be aware of principal and interest payment delinquencies; material non-payment related defaults, unscheduled draws on credit enhancements reflecting financial difficulties; the failure of credit or liquidity providers to perform; and adverse tax opinions or events affecting the tax-exempt status of the security.

within the proposed ten business day time frame.<sup>76</sup> Accordingly, the Commission believes that the proposed ten business day time frame within which issuers or obligated persons would submit notices pursuant to a continuing disclosure agreement would provide an adequate amount of time for issuers or obligated persons to prepare and submit event notices to the MSRB. While the proposed maximum time period for submitting event notices would be ten business days, in many instances it is likely that a notice could be submitted in fewer than ten business days. This, however, would depend upon the particular facts and circumstances of each event.

The Commission requests comment concerning the ability of issuers and obligated persons to obtain information regarding the occurrence of events currently specified in, and that the proposed amendments would add to, paragraph (b)(5)(i)(C) of the Rule, in sufficient time to prepare and file a notice of such an occurrence in a timely manner not in excess of ten business days. If commenters believe that the time frame that would be set forth in continuing disclosure agreements for submission of event notices should be longer or shorter, they should provide suggestions for the appropriate time and the reasons for their views. For example, should the time frame be four business days, which is generally commensurate with the time period required by Form 8-K?<sup>77</sup> Would a shorter period of time raise difficulties for smaller municipal issuers and obligated persons, and if so, why would it? Furthermore, comment is requested regarding the need to establish such a time frame for submissions of event notices. Should the trigger for the ten business day time frame begin when the issuer or obligated person knew or

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<sup>76</sup> Those issuers or obligated persons required by Section 13(a) or Section 15(d) of the Exchange Act to report certain events on Form 8-K (17 CFR 249.308) would already make such information public in the Form 8-K. The Commission believes that such persons should be able to file material event notices, pursuant to the issuer's or obligated person's undertakings, within a short time after the Form 8-K filing. See 15 U.S.C. 78m and 78o(d).

<sup>77</sup> 17 CFR 249.308.

should have known of the occurrence of the event, rather than the actual occurrence of the event? Comment is also requested on whether an issuer's need to monitor for events that would trigger an event notice would impose any new burdens or costs. Comment is requested on whether the proposal would help to reduce untimely submissions of event notices, or whether untimely submissions of event notices are caused by other factors. Comment is also requested on whether there are alternative ways to modify a Participating Underwriter's obligations that would result in more prompt availability of event notices to investors.

C. Materiality Determinations Regarding Event Notices

In the 1994 Proposing Release, the Commission stated that the list of events in paragraph (b)(5)(i)(C) of the Rule consists of recognized material events that reflect on the creditworthiness of the issuer of the municipal security or any significant obligor, as well as on the terms of the securities that they issue.<sup>78</sup> The Commission is proposing to delete the condition in paragraph (b)(5)(i)(C) of the Rule that presently provides that notice of all of the listed events need be made only "if material." In connection with the proposed deletion of the materiality condition, the Commission has reviewed each of the Rule's current specified events to determine whether or not a materiality determination should be retained for that particular event and preliminarily believes such a determination is still appropriate for certain listed events, as discussed below.<sup>79</sup> As a result of this proposed change, for those events listed in paragraph (b)(5)(i)(C) that are not proposed to contain the "if material" condition, the Participating Underwriter must reasonably

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<sup>78</sup> See Securities Exchange Act Release No. 33742 (March 9, 1994), 59 FR 12759, 12761-2 (March 17, 1994).

<sup>79</sup> The discussion in this section pertains to materiality determinations for events currently specified in paragraph (b)(5)(i)(C) of the Rule. For events proposed to be added to the Rule, whether a materiality determination would be included is noted in the discussion below for each such proposed event.

determine that the issuer or other obligated person has agreed to submit event notices to the MSRB whenever such an event occurs.

The Commission now believes, based on its experience with the operation of paragraph (b)(5)(i)(C) of the Rule, that notice of certain events currently listed in paragraph (b)(5)(i)(C) need not be preceded by a materiality determination and always should be available because of their importance to investors and other market participants. These events include: (1) principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes. The availability of this information to investors would enable them to better protect themselves from misrepresentations and fraud. Furthermore, the availability of this information would assist brokers, dealers and municipal securities dealers to satisfy their obligation to have a reasonable basis on which to recommend municipal securities.

The Commission believes that the proposal to remove the materiality condition for the aforementioned events should not alter greatly the current practice. Because of the significant nature of these events and their importance to investors in the marketplace, the Commission believes that issuers and obligated persons would already be providing notice of most, if not all, such events pursuant to existing continuing disclosure agreements.

More specifically, the Commission believes that notice of principal and interest payment delinquencies should always be provided to aid investors in protecting themselves from fraud and to assist brokers, dealers and municipal securities dealers in satisfying their obligation to have a reasonable basis to recommend municipal securities. Even a small payment default may

indicate that an issuer or other obligated party has begun to experience financial distress. Further, a payment default often adversely affects the market value of a municipal security. Similarly, unscheduled draws on debt service reserves reflecting financial difficulties and unscheduled draws on credit enhancements reflecting financial difficulties often have an adverse impact on the market value of a security and therefore should always be available to investors to protect against fraud and to other market participants to satisfy their securities law obligations. The Commission believes that investors should always be provided with these notice of events because such events likely indicate that the financial condition of a municipal securities issuer or obligor has deteriorated and therefore that there is potentially an increased risk of a payment default or, in the case of default by an issuer or other obligated party that results in payment of the securities by the provider of credit enhancement (such as a standby letter of credit), premature redemption. Bondholders and other market participants also would be concerned with the sufficiency of the amount of debt service and other reserves available to support an issuer or obligor through a period of temporary difficulty, along with the present financial condition of the provider of any credit enhancement.

The identity of credit or liquidity providers and their ability to perform is important to investors. The Commission understands that credit ratings of municipal securities are typically based on the higher of the issuer's (or other obligor's) rating or the rating of the credit provider.<sup>80</sup> With occasional exceptions, credit enhancement is obtained from a credit provider with a higher rating than that of the issuer or other obligor. When a credit enhancer such as a bond insurer is

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<sup>80</sup> See, e.g., Municipal Structured Finance Criteria Report: Dual-Party Pay Criteria for Long-Term Ratings on LOC-Supported U.S. Public Finance Bonds, Fitch Ratings, Public Finance, June 11, 2009 (noting that "U.S. public finance bonds supported by bank letters of credit (LOC) are assigned long-term ratings one-to-two notches higher than the rating on the LOC provider or the underlying rating of the bond, whichever is higher, if [certain] conditions hold true[.]")

downgraded, the market value and liquidity of the securities that it has enhanced generally decline.<sup>81</sup> Similarly, the identity and ability of a liquidity provider to perform is typically critical to investors. Investors in VRDOs, for example, depend on liquidity providers to satisfy holders' right to "put" their securities in a timely manner. As a result, the Commission preliminarily believes that notice of the substitution of credit or liquidity providers, or their failure to perform, should always be provided in an event notice to aid investors to protect against fraud and brokers, dealers and municipal securities dealers to satisfy their obligation to have a reasonable basis to recommend municipal securities.

Further, the Commission preliminarily believes, for the same purposes, that defeasances and rating changes should always be available to investors and other market participants.

Defeasances secured by a pool of U.S. Treasury securities sufficient to pay principal and interest

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<sup>81</sup> See, e.g., Alistair Varr, Moody's Warning Ripples Through Municipal Bond Market, MarketWatch, December 17, 2007 (noting that "when a security is cut to AA from AAA, the value of the bond would go down.") (available at <http://www.marketwatch.com/story/moodys-bond-insurer-call-has-unprecedented-effect-on-muni-market>); Jeffrey R. Kosnett, Why Municipal Bonds Are Stumbling, Kiplinger.com, December 4, 2007 (stating that municipal bonds normally meriting a triple-B or single-A rating being upgraded to triple-A status as a result of having bond insurance) (available at <http://www.kiplinger.com/columns/balance/archive/2007/balance1204.html>); "[T]he municipal industry chose to use bond insurance to enhance an issuer's lower credit rating to that of the higher insurance company's rating. The last 18 months have exposed the risks of this choice when insurance company downgrades, and auction-rate security failures, forced numerous leveraged investors to unwind massive amounts of debt into an illiquid secondary market. The consequence was that issuers of new debt were forced to pay extremely high interest rates and investors were confused by volatile evaluations of their investments." Enhancing Investor Protection and the Regulation of Securities Markets: Before the S. Comm. on Banking, Housing and Urban Affairs, 111<sup>th</sup> Cong. \_\_, March 10, 2009 (statement of Thomas Doe, Founder and CEO Municipal Market Advisors) (available at [http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing\\_ID=faf91bea-ca58-4bc1-873d-33739dbb4f76&Witness\\_ID=64207b41-3512-414b-8085-ae4b71520b0a](http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=faf91bea-ca58-4bc1-873d-33739dbb4f76&Witness_ID=64207b41-3512-414b-8085-ae4b71520b0a)).

commonly result in a bond receiving the highest rating<sup>82</sup> and thus can affect the security's market value. Rating changes more generally may affect the market price of the security, making it important both to bondholders and to investors who may be considering the purchase of a particular security.

The Commission, however, believes that a materiality determination should be retained for other events currently listed in paragraph (b)(5)(i)(C) because the occurrence of such events, in some circumstances, may not be of such importance to investors that they always should be disclosed. Experience with the operation of the Rule has not provided information to propose a change at this time, and the Commission continues to believe that information about these events may, depending on the facts and circumstances, not need to be available to investors and other market participants in all instances to accomplish the Rule's goals.<sup>83</sup> Therefore, the Commission proposes to modify the text of subparagraph (b)(5)(i)(C) and subparagraphs (b)(5)(i)(C)(2), (7), (8), and (10) of the Rule, with regard to the Participating Underwriter's obligations, to specify that a determination of materiality would be retained for event notices regarding non-payment

<sup>82</sup> Such defeasances are known as "advance refundings" or "pre-refundings". See MSRB, Municipal Securities Rulemaking Board Glossary, Second Edition (January 2004) (defining "advance refunding" and "defeasance") (available at <http://www.msrb.org/msrb1/glossary>). See also MSRB, EMMA Education Center, FAQ: "How am I affected if my bond is advance refunded?" (available at <http://emma.msrb.org/EducationCenter/FAQs.aspx?topic=AboutARD>); Fitch Ratings, Municipal Structured Finance Criteria Report: Guidelines for Rating Prerefunded Municipal Bonds, April 2, 2009 (available at [http://www.fitchratings.com/corporate/reports/report\\_frame.cfm?rpt\\_id=431370&sector\\_flag=&marketsector=3&detail=](http://www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=431370&sector_flag=&marketsector=3&detail=)); and Moody's Investors Service, Rating Methodology: Refunded Bonds, June, 2007 (available at [http://www.moodys.com/moodys/cust/research/MDCdocs/29/2006700000441141.pdf?doc\\_id=2006700000441141&frameOfRef=municipal](http://www.moodys.com/moodys/cust/research/MDCdocs/29/2006700000441141.pdf?doc_id=2006700000441141&frameOfRef=municipal)).

<sup>83</sup> For example, a release of substitution of property may involve a small amount of property that is not particularly valuable or important to the business of the issuer or obligated person, and minor modifications to the rights of securities holders are often made pursuant to the provisions of trust indentures that allow them only if they are not materially adverse to the interests of bondholders.

related defaults; modifications to rights of security holders; bond calls; and the release, substitution, or sale of property securing repayment of the securities.

The Commission requests comment on the proposed amendment to delete the phrase “if material” in the case of notices for the following events: (1) principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes. Are these events of such importance to investors that their occurrence always should be disclosed? Are there situations in which notice of the occurrence of these events would not need to be available to investors to protect themselves from fraud and to brokers, dealers and municipal securities dealers to aid them in satisfying their obligations under the securities laws? Are there other events listed in the Rule as to which the materiality determination should be eliminated because their occurrence always should be disclosed to investors? Should a materiality determination be retained for event notices regarding non-payment related defaults; modifications to rights of security holders; bond calls; and the release, substitution, or sale of property securing repayment of the securities? Does the proposed amendment to eliminate the materiality determination for certain events create or eliminate any burdens on issuers?

D. Amendment Relating to Event Notices Regarding Adverse Tax Events under a Continuing Disclosure Agreement

The Commission proposes to modify paragraph (b)(5)(i)(C)(6) of the Rule, which presently requires Participating Underwriters reasonably to determine that the issuer or obligated person has entered into a continuing disclosure agreement to submit a notice for “[a]dverse tax

opinions or events affecting the tax-exempt status of the security,” if material.<sup>84</sup> The proposed amendment would revise paragraph (b)(5)(i)(C)(6) of the Rule to provide specifically for the disclosure of adverse tax opinions, the issuance, by the Internal Revenue Service (“IRS”), of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of securities, or other events affecting the tax-exempt status of the security.<sup>85</sup> As stated above, such disclosure would be made to the MSRB.

In adopting the 1994 Amendments, the Commission noted that “an ‘event’ affecting the tax-exempt status of the security may include the commencement of litigation and other legal proceedings, including an audit by the Internal Revenue Service . . . .”<sup>86</sup> While the Commission continues to believe that “events affecting the tax-exempt status of the security” in paragraph

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<sup>84</sup> 17 CFR 240.15c2-12(b)(5)(i)(C)(6).

<sup>85</sup> The Commission understands that when determining whether interest on a bond issue is taxable, the IRS first issues an audit letter to the issuer (which may indicate whether or not IRS staff suspects a problem with the particular transaction). In the event that, as a result of the audit, IRS staff believes that it has found a reasonable basis to declare the interest on a bond issue under audit to be taxable, IRS staff issues a Notice of Proposed Issue (IRS Form 5701-TEB), which it recently began to use instead of a letter referred to as a “preliminary determination of taxability.” If, following subsequent discussions with, and review of additional documents provided by, the entity under audit, IRS staff continues to believe that interest on the bonds should be declared taxable and no settlement has been reached, it issues a letter to the issuer referred to as a “proposed determination of taxability.” Unless appealed to the Office of Appeals of the IRS, a proposed determination of taxability becomes a final determination of taxability in 30 days. Final determinations of taxability are not appealable to the IRS and may not be appealed in a federal court by an issuer. A bondholder who has received a tax assessment on account of such a final determination may take an appeal in federal court. See Internal Revenue Manual (“IRM”) 4.81.14 to 4.81.1.19. See also IRM 4.18.5.9 (setting forth Office of Tax-Exempt Bonds’ current practice regarding the issuance of a Notice of Proposed Issue (IRS Form 5701-TEB) in instances in which preliminary determinations of taxability would previously have been issued).

<sup>86</sup> See 1994 Amendments, supra note 5, 59 FR at 59600.

(b)(5)(i)(C)(6) of the Rule<sup>87</sup> can include an audit, and thus an audit should be the subject of an event notice when it is material, the Commission recognizes that not all audits are indications of a risk to the tax-exempt status of interest on a municipal security. The IRS Office of Tax Exempt Bonds, through its examination classification process, initiates examinations in various market segments with a view toward ensuring broad examination coverage of the various tax-exempt bond segments.<sup>88</sup> However, determinations by the IRS, such as proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB), indicating that the IRS believes the securities are or may be taxable and has begun a formal administrative process in that regard, indicate that there could be a significant risk to the tax-exempt status of a security. Accordingly, the Commission believes that proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB) by the IRS relating to the taxability of a municipal security are of such importance that they always should be disclosed pursuant to a continuing disclosure agreement.

Investors consider the tax-exempt status of a municipal security, specifically the issuance of such IRS notices, to be of great importance when making investment decisions.<sup>89</sup> Because the

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<sup>87</sup> 17 CFR 240.15c2-12(b)(5)(i)(C)(6).

<sup>88</sup> E-mail communication among Clifford Gannett, Director, Office of Tax-Exempt Bonds, Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on December 9, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

<sup>89</sup> See In the Matter of Neshannock Township School District, Securities Act Release No. 8411 and Securities Exchange Act Release No. 49600, AP 3-11461 (April 22, 2004) (settled action) (“A substantial risk to the tax-exempt status of securities which have been sold as tax-exempt is a material item.”); In the Matter of Rauscher Pierce Refsnes, Inc., Dain Rauscher Inc., and James R. Feltham, Securities Act Release No. 7844 and Securities Exchange Act Release No. 42644, A.P. File No. 3-10182 (April 6, 2000)

interest rate on a tax-exempt municipal security generally is significantly lower than the interest rate on a comparable taxable security because of the value of the municipal security's tax exemption, investors are sensitive to factors that could affect the value of the return that they would receive from such an investment, such as the tax exempt status of interest earned on a municipal security that they currently own or may purchase.<sup>90</sup> A determination by the IRS that interest may, in fact, be taxable on a municipal security purchased as tax-exempt not only could reduce the security's market value, but also could adversely affect each investor's federal and, in some cases, state income tax liability.<sup>91</sup> The tax-exempt status of a municipal security is also

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(settled action) (“ . . . an essential feature of the 1992B [Certificates of Participations] was the tax-exempt status of the interest component to be paid to investors”); and In re: County of Orange, California; Orange County Flood Control District and County of Orange, California Board of Supervisors, Securities Act Release No. 7260 and Securities Exchange Act Release No. 36760, AP 3-8937 (January 1, 1996) (identifying tax-exempt status of offering of securities as a material fact). See also, e.g., Lori Trawinski, et al., The Bond Market Association, Secondary Market Effects of Municipal Bond Tax Audit Disclosure, at 10 (August 2002) (settled action) (available at [http://www.gfoa.org/downloads/Tax\\_Audit\\_Study\\_August\\_2002.pdf](http://www.gfoa.org/downloads/Tax_Audit_Study_August_2002.pdf)) (study examining the effect of IRS audit announcements on the secondary market for municipal bonds and discussing the concerns of investors and other municipal market participants); Lynn Hume, Panel: This Top 10 List Doesn't Have Buy-Side Players Laughing, *The Bond Buyer*, May 5, 2006, NFMA Annual Conference, Vol. 356 No. 32375, at 7 (“ . . . and issuers' failures to disclose Internal Revenue Service notices that bonds are taxable are among the '10 top things that drive the buy side crazy,' analysts and lawyers said . . . during a panel session at the National Federation of Municipal Analysts' 23rd annual meeting . . .”).

<sup>90</sup> See, e.g., Lori Trawinski, et al., The Bond Market Association, Secondary Market Effects of Municipal Bond Tax Audit Disclosure, at 10 (August 2002); Kathleen Pender, State Energy Bonds Could Be Hard Sell; Treasurer says most won't be tax-exempt, *The San Francisco Chronicle*, February 21, 2001, at D1; and John Gin, Compare apples to apples when looking at bonds; Tax-equivalent yield is the test, *The Times-Picayune*, September 5, 2007, Money; Money Watch, at 1; and SIFMA, Calculator: Tax-Free vs. Taxable Yield Comparison (available at <http://www.investinginbonds.com/learnmore.asp?catid=8&subcatid=80>).

<sup>91</sup> For example, investors in such a circumstance may have to include interest on such a security as income when computing their federal income taxes for current and future tax years and may have to pay additional taxes for prior tax years.

important to many mutual funds whose governing documents, with certain exceptions, limit their investment to tax-exempt municipal securities.<sup>92</sup> Mutual funds may liquidate securities that become taxable, which could have adverse consequences for the fund and its holders. Therefore, retail and institutional investors alike are extremely interested in events that could adversely affect the tax-exempt status of the bonds that they own or may purchase.

Subsequent to a 1993 Report of the General Accounting Office,<sup>93</sup> the IRS established an Office of Tax-Exempt Bonds with more than 60 staff members devoted to audits and tax collections related to tax-exempt municipal securities.<sup>94</sup> Staff of the Office of Tax-Exempt Bonds has identified numerous offerings in which bonds sold as tax-exempt were determined to be taxable.<sup>95</sup> As a result, the IRS has collected a significant amount of taxes – generally through

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<sup>92</sup> See Investment Company Institute, Frequently Asked Questions About Money Market Funds (available at [http://www.ici.org/home/faqs\\_money\\_funds.html#TopOfPage](http://www.ici.org/home/faqs_money_funds.html#TopOfPage)) (“Typically, tax-exempt money market funds, which seek to pay dividends that are exempt from federal income tax and/or state income tax, invest in instruments issued by state and local governments (‘municipal securities’).”).

<sup>93</sup> See U.S. General Accounting Office, Tax Policy and Administration – Improvements for More Effective Tax-Exempt Bond Oversight, Report of the General Accounting Office to the Chairman, Subcommittee on Human Resources and Intergovernmental Relations, Committee on Government Operations, House of Representatives, May 10, 1993 (available at <http://archive.gao.gov/t2pbat5/149322.pdf>) (which recommended, in part, that the existing bond audit program be redirected and that program staffing levels, locations and training needs be reassessed in light of the program’s future).

<sup>94</sup> E-mail from Clifford Gannett, Director, Office of Tax-Exempt Bonds, IRS, to Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated August 26, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

<sup>95</sup> E-mail communications among Clifford Gannett, Director, Office of Tax-Exempt Bonds, Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated August 26, 2008 and December 9, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt

settlements with issuers and obligated persons, but also with bondholders.<sup>96</sup> Furthermore, staff of the IRS Office of Tax-Exempt Bonds has established a Bondholder Unit to increase the staff's efficiency in identifying bondholders in the case of bonds determined to be taxable.<sup>97</sup>

IRS staff has indicated<sup>98</sup> that during the period from April 2007 through July 2008, approximately 80% of the audits that received a preliminary determination of taxability (now IRS Form 5701-TEB<sup>99</sup>) and were resolved were settled through closing agreements with the IRS. During the same period, of those cases that received a proposed determination of taxability and were closed: approximately 25% were settled through a closing agreement with IRS; approximately 37.5% received final determinations that the bonds were taxable; and

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Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

<sup>96</sup> Id.

<sup>97</sup> According to the 2008 Work Plan for the IRS Office of Tax-Exempt Bonds, the bondholder identification process is expected to be initiated no later than the date a proposed adverse determination is issued (available at [http://www.irs.gov/pub/irs-tege/teb\\_fy08\\_work\\_plan.pdf](http://www.irs.gov/pub/irs-tege/teb_fy08_work_plan.pdf)). See, e.g., Susanna Duff Barnett and Lynn Hume, IRS to Warn Mutual Funds of Taxability Letters Being Sent to Over 12 Companies, The Bond Buyer, March 30, 2004, Washington, at 1 ("More mutual funds can expected to be contacted in the future.") and Susanna Duff Barnett, A Growing Caseload; More Challenges Face IRS Bond Office in '05, The Bond Buyer, December 23, 2004, Washington, Vol. 350 No. 32036, at 1 ("One result that has stemmed from the lengthier audits is the IRS' aggressive search for bondholder names earlier in an audit cycle through so-called John Doe summonses and other methods.").

<sup>98</sup> E-mail from Robert Henn, Manager, Office of Tax-Exempt Bonds Field Operation, IRS, to Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated July 14, 2009.

<sup>99</sup> The IRS Office of Tax-Exempt Bonds now issues Notices of Proposed Issue (IRS Form 5701-TEB) in instances in which it previously would have issued preliminary determinations of taxability. E-mail from Clifford Gannett, Director, Office of Tax-Exempt Bonds, IRS, to Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated August 26, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

approximately 37.5% were appealed to the IRS Office of Appeals. In light of the foregoing discussion, the Commission believes that the risk of taxability following the issuance of proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB) is significant.

Despite the possibility that these events could adversely affect the tax-exempt status of the bonds that investors own or may purchase and thus could significantly affect the pricing of those municipal securities,<sup>100</sup> it has been reported that notices regarding such tax events are not always filed.<sup>101</sup> The Commission believes that the issuance of proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB) by the IRS is important information that should be made available to investors and therefore should be part of a

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<sup>100</sup> See, e.g., Susanna Duff Barnett and Lynn Hume, IRS to Warn Mutual Funds of Taxability Letters Being Sent to Over 12 Companies, *The Bond Buyer*, March 30, 2004, Washington, at 1 (“The bondholder community has been saying for years that they want prompt disclosure of audits and issuer discussions with the IRS relating to the tax-exempt status of the bonds.” – Tom Metzold, president and portfolio manager at Eaton Vance Management; “It’s vital to disclose the risk of taxability to the entire marketplace to protect potential investors.” – Gerard J. Lian, then chairman of the National Federation of Municipal Analysts and vice president and senior analyst at Morgan Stanley Investment Management.); and National Federation of Municipal Analysts, NFMA releases results of member survey (November 30, 2001) (available at [http://www.nfma.org/publications/survey\\_results.pdf](http://www.nfma.org/publications/survey_results.pdf)) (“Over 54% of analysts responding to the survey felt that all IRS audits, whether routine, targeted or based on external information, should be disclosed to the market.”). See also, Lori Trawinski, et al., The Bond Market Association, Secondary Market Effects of Municipal Bond Tax Audit Disclosure (August 2002) (available at [http://www.gfoa.org/downloads/Tax\\_Audit\\_Study\\_August\\_2002.pdf](http://www.gfoa.org/downloads/Tax_Audit_Study_August_2002.pdf)) (“This study clearly demonstrates that effect for certain variable-rate tax-exempt bonds, where rates paid by state and local bond issuers have risen significantly when news of the audit is made public. While anecdotal evidence suggests similar effects for long-term, fixed-rate bonds, empirical evidence is inconclusive.”).

<sup>101</sup> See, e.g., Susanna Duff Barnett, IRS Answers Toxic Query; Post 1986 Radioactive Waste Debt Not Exempt, *The Bond Buyer*, November 2, 2004 (material event notice filed October 29, 2004 regarding IRS technical advice memorandum dated August 27, 2004 that bonds issued to finance certain radioactive solid waste facilities were taxable; related preliminary adverse determination letter was issued in January, 2002).

Participating Underwriter's obligation to determine whether such events are included in a continuing disclosure agreement.

The Commission requests comment on the proposed amendment to modify the provision of the Rule regarding the submission of a notice with respect to adverse tax opinions to include the issuance by the IRS of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the securities, or other events affecting the tax-exempt status of the security. Comment is requested on whether the proposed amendment would further the disclosure of such events and thereby aid investors to protect themselves from misrepresentations and fraud and brokers, dealers and municipal securities dealers to carry out their obligations. The Commission requests comment regarding the extent to which investors and other market participants would find it useful to be informed of the issuance of proposed and final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of securities by the IRS. Commenters should advise whether the proposal would aid investors in their understanding of potential adverse tax consequences that may arise with respect to a particular municipal security. In addition, commenters should address whether such information is important to investors of various types of municipal securities, such as fixed and variable rate securities or demand securities. Should the continuing disclosure agreement specify that a copy of the determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices issued by the IRS be provided to the MSRB, or would a notice of any such determination provide sufficient information to investors? What would be the benefit of disclosing a copy of any such determination? What drawbacks, if any, might such disclosure entail? Should the Rule be

amended to require a Participating Underwriter to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement to submit a notice of tax audits? If so, why?

E. Addition of Events to be Disclosed under a Continuing Disclosure Agreement

The Commission also proposes to amend paragraph (b)(5)(i)(C) of the Rule by including notice of four additional events the Participating Underwriter must reasonably determine that the issuer or other obligated person has agreed to provide in its continuing disclosure agreement. These would include: (1) tender offers; (2) bankruptcy, insolvency, receivership or similar proceeding of the obligated person; (3) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (4) appointment of a successor or additional trustee, or the change of name of a trustee, if material.

1. Tender Offers

The Commission proposes to add tender offers to the list of events in subparagraph (b)(5)(i)(C)(8) of the Rule.<sup>102</sup> Under the proposed amendment, the Participating Underwriter must reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to provide notice of tender offers to the MSRB.<sup>103</sup> The Commission

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<sup>102</sup> Generally, municipal securities are not subject to Commission rules governing tender offers, including Rule 13e-4 under the Exchange Act, 17 CFR 240.13e-4, which sets forth disclosure, time periods, and other requirements governing tender offers by issuers. In passing the Williams Act, P.L. 90-439, in 1968, Congress recognized that regulation of tender offers was necessary for the purposes of disclosure of material information and substantive protection to investors. See Rep. No. 550, 90th Cong., 1st Sess. 3 (1967) at 1.

<sup>103</sup> See supra note 11 and accompanying text.

believes that notice of the existence of tender offers for municipal securities would help investors to be better able to protect themselves from misrepresentations and fraud, including deciding whether to tender their holdings to the issuer or its representative, and assist brokers, dealers and municipal securities dealers to carry out their obligations. Tender offers typically require an investor to respond within a limited time frame.<sup>104</sup> Tender offers may provide an avenue of liquidity to investors, such as during periods of market turmoil.<sup>105</sup> The Commission believes that communication of the existence of a tender offer to municipal securities investors is important to assist each investor to make an informed, timely decision whether or not to tender.<sup>106</sup>

Indeed, the recent events in the market for ARS could be seen as an example of the need to provide timely notice within ten business days of a tender offer. Since approximately mid-February of 2008, the market for ARS has experienced severe illiquidity, with consequences to investors who purchased what they may have believed to be liquid, cash equivalent

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<sup>104</sup> See Edward N. Gadsby, et al., Regulation of Tender Offers, Federal Securities Exchange Act of 1934, § 7A.03 (David Colby, et al., ed., Matthew Bender & Company, Inc.) (2008) (describing that usually a time limit is placed on a tender offer).

<sup>105</sup> See, e.g., Caitlin Devitt, Midwest Health Systems Use New ARS Strategy; Two Systems See to Ease ARS Sting, The Bond Buyer, March 7, 2008, The Regions, Vol. 363 No. 32833, at 1 (describing an issuer's use of a tender offer in its auction rate securities to provide liquidity).

<sup>106</sup> The Commission proposes to retain in Rule 15c2-12(b)(5)(i)(C)(8) the requirement that Participating Underwriters reasonably determine that the issuer or obligated person has agreed in a continuing disclosure agreement to provide to the MSRB notice of bond calls, if material. Thus, unlike with respect to tender offers, the issuer would make a materiality determination with respect to a notice regarding a bond call. The Commission believes that this distinction is appropriate in light of the various types of bond calls (e.g., sinking fund redemptions, extraordinary redemptions, and optional redemptions) that can occur. In addition, the specific amounts to be redeemed and dates for some redemptions (i.e., sinking fund redemptions) are generally included in official statements; therefore, information about such events is already available to investors.

investments.<sup>107</sup> Some issuers and obligated persons have offered to purchase some or all of their outstanding ARS from investors who desire liquidity.<sup>108</sup> Notices about these tender offers may not always be widely disseminated. Had this information been available from the then-existing information repositories, it may have become more widely known to the market through these repositories and through private information vendors and news media who obtain information from the repositories.

During a tender offer for municipal securities, such as ARS, some investors may be left in doubt whether their securities were the subject of the offer. To determine the facts about such offers, it often is necessary for investors to seek the information independently by contacting the issuer or other obligated person directly. Some investors may not have been able to learn of the existence of a tender offer for municipal securities that they hold, in a timely fashion and, in such a case, may not have been able to tender their securities. The Commission believes that the proposed amendment requiring Participating Underwriters to reasonably determine that such notices are provided pursuant to a continuing disclosure agreement would help ensure the consistent availability of this information to investors when they make investment decisions, and thereby assist them to be better able to protect themselves from misrepresentation and fraud.

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<sup>107</sup> See, e.g., MSRB Notice 2008-09 (February 19, 2008) (reminding brokers, dealers and municipal securities dealers of the application of MSRB disclosure and suitability requirements that apply to all customer transactions in municipal ARS and stating, for example, that it may be a material fact for an investor that an ARS recently was subject to a failed auction); Press Release 2009-127, Commission, SEC Finalizes ARS Settlements With Bank of America, RBC, and Deutsche Bank (June 3, 2009) (announcing settlement of SEC's complaints alleging that Bank of America, RBC Capital Markets, and Deutsche Bank failed to make their customers aware of risks in ARS investments.).

<sup>108</sup> See, e.g., notice dated March 28, 2008 of Nationwide Children's Hospital regarding the intent of the hospital to bid for auction rate bonds (available at <https://www.nationalcity.com/content/private-client-group/products-services/create-grow-wealth/pages/documents/2008-03-28.pdf>) and Caitlin Devitt, Midwest Health Systems Use New ARS Strategy; Two Systems Seek To Ease ARS Sting, The Bond Buyer, March 7, 2008, The Regions, Vol. 363 No. 32833, at 1.

The Commission believes that the proposed amendment requiring Participating Underwriters to reasonably determine that issuers and other obligated persons have agreed in their continuing disclosure agreements to provide notice of tender offers to the MSRB<sup>109</sup> would result in this information being more widely available to investors through the MSRB. In addition, the proposal to revise paragraph (b)(5)(i)(C) of the Rule to specify that event notices be submitted in a timely manner not in excess of ten business days after the event's occurrence, as discussed above, would help to improve the timely availability of tender offer information so that investors would be afforded the opportunity to make more informed decisions whether to hold or tender their securities. The Commission believes that its proposal regarding notice of tender offer disclosures would enhance the ability of issuers, other obligated persons, or others making such tender offers to effectively communicate their offers to a wider constituency of bondholders and thereby would increase the likelihood that those holders would be informed of the offer.

The Commission requests comment regarding all aspects of the proposed amendment of subparagraph (b)(5)(i)(C)(8) of the Rule to include tender offers. For example, would specifying in Rule 15c2-12 the submission to the MSRB of a notice of a tender offer assist issuers and other obligated persons in providing tender offer information to bondholders on a wider basis? Is there a benefit or drawback to adding tender offers as an event item in subparagraph (b)(5)(i)(C)(8) of the Rule? Would the proposal help prevent fraud? If so, would the proposed amendment to modify subparagraph (b)(5)(i)(C)(8) to include notice of tender offers to the MSRB be an appropriate avenue to address this objective? If a tender offer is open for a short period of time, is the proposed "ten business day" standard appropriate in the context of a tender offer or would another time frame be more appropriate? The Commission seeks comment regarding whether

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<sup>109</sup> See supra note 11 and accompanying text.

tender offers should be added to this provision of Rule 15c2-12 and requests suggestions concerning alternative methods to address the concerns stated above with regard to tender offers for municipal securities. In addition, comment is requested about the existence and prevalence of exchange offers for municipal securities and whether exchange offers also should be included in this provision. Further, the Commission requests comment regarding whether it should specify that the Participating Underwriter reasonably determine that the issuer or obligated person has agreed to provide particular information regarding a tender offer that should be included in such notices, such as: the offer price; change in offer price; withdrawal rights; identity of the offeror; an offeror's ability to finance the offer; conditions to the offer; and the time frame and manner for tendering securities and the method for acceptance (e.g., whether all securities tendered would be accepted and, if not, the method for determining which securities would be accepted). Are there other items of information that should be included in the notice to help accomplish the purposes of the Rule or would some of the items listed above be unnecessary in this context? If so, please specify which ones and explain the rationale as to why they should or should not be included.

2. The Occurrence of Bankruptcy, Insolvency, Receivership or Similar Events Regarding an Issuer or an Obligated Person

The Commission proposes to add new subparagraph (b)(5)(i)(C)(12) to the Rule to require a Participating Underwriter to reasonably determine that the continuing disclosure agreement requires a notice to be submitted to the MSRB,<sup>110</sup> in the case of bankruptcy, insolvency, receivership or similar event of the obligated person. Rule 15c2-12 would state in a Note following the events specified in subparagraph (b)(5)(i)(C)(12) that, for the purposes of the subparagraph (b)(5)(i)(C)(12), the event would be considered to occur when any of the following

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<sup>110</sup> See supra note 11 and accompanying text.

occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the issuer or obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan or reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.<sup>111</sup> Although issuers and other obligated persons of municipal securities rarely are involved in bankruptcy, insolvency, receivership or similar events, the Commission notes that the occurrence of such events, even if rare, can significantly impact the value of the municipal securities. Information about these events is important to investors and other market participants,<sup>112</sup> and knowledge of the bankruptcy, insolvency, receivership or similar event

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<sup>111</sup> See Form 8-K, Item 1.03 for provisions relating to bankruptcy or receivership that are applicable to entities subject to Exchange Act reporting requirements. 17 CFR 249.308. Item 1.03 of Form 8-K requires the registrant to provide specified items of disclosure on Form 8-K if a receiver, fiscal agent or similar officer has been appointed for a registrant or its parent, in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state and federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the registrant or its parent, or if such jurisdiction has been assumed by leaving the existing directors and officers in possession but subject to the supervision and orders of a court or governmental authority. The proposed Rule 15c2-12 event item is intended to be consistent with the Form 8-K, Item 1.03 provisions applicable to entities subject to the reporting requirements of the Exchange Act.

<sup>112</sup> See, e.g., Letter from Karrie McMillan, General Counsel, ICI, to Florence E. Harmon, Secretary, Commission (September 22, 2008) (“ICI Letter”) (available at <http://www.sec.gov/comments/s7-21-08/s72108-12.pdf>) (suggesting that disclosure information should include information relating to bankruptcy and receivership); National Federation of Municipal Analysts, Recommended Best Practices in Disclosure for Land Secured Debt Transactions, June 2000 (available at

involving an issuer or other obligated person would allow investors to make informed decisions about whether to buy, sell or hold the municipal security and help prevent fraud.<sup>113</sup> Accordingly, the Commission believes that Participating Underwriters should be required to reasonably determine that such information is provided pursuant to a continuing disclosure agreement.

Under current Rule 15c2-12(b)(5)(i)(C)(2), notice of a material “non-payment related default” is to be provided to the MSRB pursuant to a continuing disclosure agreement. The Commission understands that the governing documents for some municipal securities include bankruptcy, insolvency, receivership or similar events involving an issuer or obligated person as a “non-payment related default.”<sup>114</sup> However, the Commission further understands that this may not be uniformly the case. The proposed amendment would help improve the availability of notice of bankruptcy, insolvency, receivership, or similar events to all investors. The proposed Note, as described above, is intended to clarify the scope of the event item contained in new subparagraph (b)(5)(i)(C)(12) of the Rule. Moreover, because of the importance of such events to investors and their possible impact on the value of the security, a materiality condition would not be added to proposed subparagraph (b)(5)(i)(C)(12).

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<http://data.memberclicks.com/site/nfma/DG.BP.landsecuredpractices.doc.pdf>  
(recommending best practice disclosures, including disclosures of bankruptcy).

<sup>113</sup> The Commission is aware that bonds are often secured by letters of credit, bond insurance, and other forms of credit enhancement that some have argued could reduce the importance of the creditworthiness of an issuer or obligated person. However, the Commission has long been of the view that information regarding obligated persons generally is material to investors in credit enhanced offerings. See 1989 Adopting Release, *supra* note 3, 54 FR at 28812 (“The presence of credit enhancements generally would not be a substitute for material disclosure concerning the primary obligor on municipal bonds.”). See also Regulation AB, 17 CFR 229.1100 *et. seq.*

<sup>114</sup> See National Association of Bond Lawyers (NABL) Form Indenture, dated June 1, 2002 (“NABL Form Indenture”).

The Commission requests comment regarding all aspects of the proposed addition of the event relating to bankruptcy, insolvency, receivership or similar proceeding of the issuer or other obligated person in the Rule. In particular, the Commission requests comment regarding whether there are other similar events or proceedings affecting the financial condition of issuers or other obligated persons that should be included as events requiring notice. The Commission seeks input regarding whether commenters believe that the items contained in proposed subparagraph (b)(5)(i)(C)(12) of the Rule are already addressed by current subparagraph (b)(5)(i)(C)(2) of the Rule and thus whether it is unnecessary to revise the Rule in this regard. The Commission also seeks comment on whether it is appropriate to exclude a materiality determination from this proposed event item.

3. Merger, Consolidation, Acquisition, and Sale of All or Substantially All Assets

The Commission proposes to add subparagraph (b)(5)(i)(C)(13) to the Rule, which would require a Participating Underwriter reasonably to determine that the continuing disclosure agreement provides for the submission of notice to the MSRB<sup>115</sup> of any of the following events with respect to the securities being offered: the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material.<sup>116</sup> Although mergers,

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<sup>115</sup> See supra note 11 and accompanying text.

<sup>116</sup> Although the Commission's disclosure rules that are applicable to reporting companies do not apply to municipal securities, the Commission notes that reporting companies are required to make disclosures upon the occurrence of similar events. See Items 1.01 and 2.01 of Form 8-K relating to entry into a material definitive agreement and completion of the acquisition or disposition of assets, respectively, which require entities subject to

consolidations, acquisitions, and substantial asset sales are events believed to be rare among governmental issuers,<sup>117</sup> they are not uncommon for obligated persons such as health care institutions, other non-profit entities, and for-profit businesses.<sup>118</sup> Currently, Rule 15c2-12 does not require Participating Underwriters to reasonably determine that continuing disclosure agreements provide for notice of a merger, consolidation, acquisition and substantial asset sales involving such obligated persons, if material.<sup>119</sup> Investors often are not readily able to obtain information about such actions by obligated persons.

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Exchange Act reporting requirements to disclose specified information within four business days of the occurrence of such events. 17 CFR 249.308. Item 1.01 of Form 8-K requires the registrant to provide specified items of disclosure on Form 8-K if the registrant has entered into a material definitive agreement not made in the ordinary course of business of the registrant, or into any amendment of such agreement that is material to the registrant. For purposes of Item 1.01, a "material definitive agreement" means an agreement that provides for obligations that are material to and enforceable against the registrant, or rights that are material to the registrant and enforceable by the registrant against one or more parties to the agreement, in each case whether or not subject to conditions. Item 2.01 of Form 8-K requires the registrant to provide specified items of disclosure on Form 8-K if the registrant or any of its majority-owned subsidiaries has completed the acquisition or disposition of a significant amount of assets, other than in the ordinary course of business.

<sup>117</sup> But see Illinois Finance Authority, which was created on January 1, 2004 following the consolidation of seven existing state authorities. See Illinois Finance Authority, Illinois Finance Authority Bond Program Handbook, November 1, 2004 (available at <http://www.il-fa.com/policies/BondHandbook11-1-04.pdf>).

<sup>118</sup> For example, according to the American Hospital Association, more than 680 hospital mergers were announced from 1998 – 2006. See American Hospital Association, TRENDWATCH CHARTBOOK 2008 – Trends in the Overall Health Care Market, Chart 2.10: Announced Hospital Mergers and Acquisitions, 1998-2006 (available at <http://www.aha.org/aha/trendwatch/chartbook/2008/08chart2-10.pdf>).

<sup>119</sup> The materiality of the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions must be determined through a review of the particular facts and circumstances of such event. Although in a number of instances such events may be determined to be material, it is possible for such an event to be so sufficiently insignificant that an event notice would not be required. For example, a merger or

The Commission believes that notice of the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material, is important information for investors and market participants.<sup>120</sup> The foregoing events may signal that a significant change in the obligated person's corporate structure could occur or has occurred. In the case of such event, investors may want to have information about the identity and financial stability of the obligated person that would be responsible, following such event, for payment of a municipal security. Further, municipal security holders generally may wish to know about the obligated person's creditworthiness, particularly its ability to support payment of the security following such event when they assess whether to buy, sell or hold a municipal security. A notice regarding such an event, if material, would help further the availability of relevant information to bondholders, market professionals, and the public generally. Accordingly, the Commission believes that it is appropriate to include in the Rule the proposed event item relating to the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions other than pursuant to its terms, if material. The Commission does not believe that all mergers are necessarily of sufficient

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acquisition of a small entity by one of substantial size may not be material to investors in bonds for which the larger entity is the obligated person, absent other circumstances. On the other hand, such a merger or acquisition may be material to investors in bonds for which the small entity is the obligated person.

<sup>120</sup> See ICI Letter, supra note 112 (suggesting that disclosure information should include information relating to material acquisitions and dispositions).

importance that information on mergers needs to be made available in all instances. For example, a merger could involve the combination of a shell corporation or other small entity into a very large healthcare organization that is a conduit borrower. Such a merger generally would not have a significant impact on the business or financial condition of the larger corporation and, under all of the applicable facts and circumstances, would not be important to investors.

The Commission requests comment regarding all aspects of the proposed addition to the Rule with respect to the consummation or entry into or termination of a definitive agreement involving a merger, consolidation, acquisition, or the sale of all or substantially all of the assets of the obligated person. The Commission requests comment regarding the frequency of such events, and whether this information would be meaningful to investors. The Commission further requests comment on whether a determination of materiality for such events is an appropriate condition to add to this proposed provision. The Commission also requests comments regarding the benefits and drawbacks of this proposed event item.

#### 4. Successor, Additional, or Change in Trustee

Finally, the Commission proposes to add subparagraph (b)(5)(i)(C)(14) to the Rule to require Participating Underwriters to reasonably determine that the issuer or other obligated person has contractually agreed to submit notice to the MSRB<sup>121</sup> when there is an appointment of a successor or additional trustee, or a change of name of a trustee, if material.<sup>122</sup> The proposed amendment reflects the Commission's belief in the importance of an investor's ability to learn of

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<sup>121</sup> See supra note 11 and accompanying text.

<sup>122</sup> The materiality of the name change of a trustee must be determined through a review of the particular facts and circumstances of such event. For instance, it is possible for a name change by a trustee to be so minor that an event notice would not be required. For example, a name change such as "ABC National Bank and Trust Company of XYZ," to "ABC National Bank and Trust Company" may not be material in the absence of other factors, such as a change of the location at which the trustee can be reached.

a material change in the trustee's identity, given the significant function and role of the trustee for the holders of the municipal security. The trustee makes critical decisions that impact investors and has a duty to represent the interests of bondholders. For example, the trustee often must determine whether: proposed amendments to the governing documents of the municipal security are permissible without bondholder consent; parity obligations could be issued; security could be released; or an event of default has occurred.<sup>123</sup> In addition, a trustee is responsible for sending payments to investors and computing applicable interest rates. In some cases, a trustee may be responsible for taking certain actions at the direction of a designated percentage of bondholders.<sup>124</sup> A trustee may also be responsible for providing information requested by investors; often the trustee serves as the issuer's dissemination agent for continuing disclosures. Although the identity of the trustee may have little or no influence on a decision whether to buy or sell a security under normal circumstances, bondholders would need to know the identity of a trustee to be able to contact the trustee for various reasons, particularly when an issuer or other obligated person may be experiencing financial difficulty. These factors support the need for investors to know the identity of the trustee. Yet, the Commission is unaware of any method by which investors, particularly individual investors, presently have a consistent means of obtaining up-to-date information about changes to the identity of the trustee. The proposed amendment therefore would require that the Participating Underwriter reasonably determine that the continuing disclosure agreement provide that a notice concerning a change in the identity of the trustee be submitted to the MSRB.

The Commission requests comment regarding all aspects of the proposed addition of subparagraph (b)(5)(i)(C)(14) concerning the appointment of a successor or additional trustee or

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<sup>123</sup> See NABL Form Indenture, supra note 114.

<sup>124</sup> Id.

the change of name of a trustee. In particular, the Commission requests comment relating to the frequency of such an event and the importance of such information to investors. Commenters should advise whether the continuing disclosure agreement should set forth other information regarding the trustee that should be disclosed and whether a determination of materiality for such events is an appropriate condition to add to this proposed provision. Commenters are requested to provide their views on the benefits and drawbacks of this aspect of the proposal.

F. Effective Date and Transition

The proposed amendments to Rule 15c2-12 would impact only continuing disclosure agreements that are entered into in connection with primary offerings occurring on or after the effective date of these proposed amendments, if they were adopted by the Commission. The Commission understands that existing undertakings by issuers and obligated persons that were entered into prior to the effective date of any final amendments would not require a broker, dealer, or municipal securities dealer to reasonably determine that the issuer or other obligated person had agreed to provide notice of specified events in a timely manner not in excess of ten business days of the event's occurrence or include the additional items discussed above that are proposed to be added to paragraph (b)(5)(i)(C) of the Rule. In addition, such existing undertakings would provide for the submission of the events specified in paragraph (b)(5)(i)(C) of the Rule, "if material."

Further, the Commission is aware that, prior to the effective date of any final amendments, a broker, dealer, or municipal securities dealer in primary offerings of demand securities in authorized denominations of \$100,000 would not be required reasonably to determine that the issuer or other obligated person had entered into a continuing disclosure agreement, as prescribed by the Rule. The Commission requests comment regarding the

potential effects and implications of existing continuing disclosure agreements having different terms (e.g., lacking the proposed additional events for which notices would be sent to the MSRB and the specified ten business day deadline for doing as discussed above) than continuing disclosure agreements entered into on or after any effective date of the proposed amendments, should the proposed amendments be adopted by the Commission.

The Commission preliminarily believes that, if the proposed amendments to Rule 15c2-12 were adopted, it would be preferable to implement them expeditiously. If the Commission were to approve the proposed amendments, the Commission is preliminarily considering an effective date that would be no earlier than three months after any final adoption of the proposed amendments in order to permit sufficient time for the MSRB to make necessary modifications to the EMMA system and for Participating Underwriters to comply with the new Rule. The Commission requests comment on such an effective date and whether another effective date might be preferable, if the Commission were to adopt the proposed rule amendments. In particular, comment is requested regarding any transition issues with respect to the proposed amendments, such as whether there would be any conflicts with respect to terms in existing continuing disclosure agreements.

The Commission notes that under paragraph (c) of the Rule, a broker, dealer, or municipal securities dealer cannot recommend the purchase or sale of a municipal security unless such broker, dealer, or municipal securities dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to paragraphs (b)(5)(i)(C) and (D) and paragraph (d)(2)(ii)(B) of the Rule with respect to the security. The Commission recognizes that continuing disclosure agreements entered into prior to the effective date of any final amendments that the Commission may adopt would not reflect

changes made to the Rule by such amendments, including with respect to event notices. As a result, event items covered by a continuing disclosure agreement entered into prior to the effective date of any amendments that the Commission may adopt may be different from those event items covered by a continuing disclosure agreement entered into on or after the effective date of any final amendments that the Commission may adopt. Thus, in the case of municipal securities subject to a continuing disclosure agreement entered into prior to the effective date of any final amendments that the Commission may adopt, the recommending broker, dealer or municipal securities dealer would receive notice solely of those events covered by that continuing disclosure agreement, namely, the eleven events specified in the current Rule. Because, in that case, the continuing disclosure agreement would not cover any of the items proposed to be added to the Rule, it would not be necessary for the recommending broker, dealer, or municipal securities dealer to have procedures in place that provide reasonable assurance that it received prompt notice of events proposed to be added to the Rule. The Commission requests comment on the impact of the proposed amendments with respect to brokers, dealers, and municipal securities dealers that recommend the purchase or sale of municipal securities. The Commission also requests comment on what changes, if any, brokers, dealers and municipal securities dealers would have to make to their procedures as a result of any final amendments that the Commission may adopt relating to the receipt of event notices. The Commission also requests comment on whether it should amend the Rule or otherwise provide further guidance to take into account differences in event notices included in continuing disclosure agreements entered into prior to the effective date of any final amendments that the Commission may adopt and those event notices included in continuing disclosure agreements

entered into on or after the effective date of any final amendments that the Commission may adopt.

The Commission seeks comment on any other transition issues in connection with the proposed amendments to Rule 15c2-12. For example, in connection with the 2008 Amendments, one commenter suggested that continuing disclosure agreements executed following the effective date of the 2008 Amendments should amend all prior continuing disclosure agreements of the same issuer to incorporate the changes to the Rule made in the 2008 Amendments. In the event that the proposed amendments were to be adopted, would transitional issues be minimized by the fact that over time fewer bonds would be subject to continuing disclosure agreements entered into prior to the effective date? Would an effective date that is no earlier than three months after any final approval of the proposed amendments, should the Commission determine to adopt the proposed amendments, provide adequate time for issuers and underwriters to become informed about the proposed amendments and adapt to them?

### **III. Interpretive Guidance With Respect to Obligations of Participating Underwriters**

As noted above in Section I.B., the Commission is aware that municipal securities industry participants have expressed concern that some municipal issuers and other obligated persons may not consistently submit continuing disclosure documents, particularly event notices and failure to file notices, in accordance with their undertakings in continuing disclosure agreements.<sup>125</sup>

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<sup>125</sup> See the comments of participants at the 2001 SEC Municipal Market Roundtable – Secondary Market Disclosure for the 21st Century, (available at <http://www.sec.gov/info/municipal/roundtables/thirdmuniround.htm>). See also E-mail from Peter J. Schmitt, CEO, DPC Data Inc., to SEC, Rule-Comments, dated September 19, 2008, regarding the 2008 Proposed Amendments.

Municipal security holders' access to meaningful information promotes informed investment decision-making about whether to buy, sell or hold municipal securities<sup>126</sup> and thereby better protection against misrepresentations and fraudulent activities. Availability of that information also will aid brokers, dealers, and municipal securities dealers to satisfy their obligations under the federal securities laws to have a reasonable basis for recommending municipal securities. In the Commission's view, the flow of municipal securities disclosure to investors and other market participants depends on issuers and obligated persons abiding by their undertakings in continuing disclosure agreements.<sup>127</sup> Accordingly, the Commission emphasizes that it is important for an underwriter in a municipal offering to evaluate carefully the likelihood that the issuer or obligated person will comply on a timely basis with the undertakings it has made.

In prior releases, the Commission set forth its interpretations of the obligations of municipal underwriters under the antifraud provisions of the federal securities laws.<sup>128</sup> The Commission discussed the duty of underwriters to the investing public to have a reasonable basis for recommending any municipal securities and, in fulfilling that obligation, it is their responsibility to review the issuer's or obligated person's disclosure documents in a professional manner with respect to the accuracy and completeness of statements made in connection with the

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<sup>126</sup> See e.g., 2008 Amendments Adopting Release, supra note 11, 73 FR at 76129.

<sup>127</sup> See 1994 Amendments Adopting Release, supra note 5, 59 FR at 59594-5.

<sup>128</sup> See Securities Exchange Act Release No. 26100 (September 22, 1988), 53 FR at 37787-91 (September 28, 1988) ("1988 Proposing Release"); the 1989 Adopting Release, supra note 3, 54 FR at 28811-12; and the 1994 Interpretive Release, supra note 5, 59 FR at 12757-58 (reaffirming the Commission's interpretation of the obligations of municipal underwriters under the antifraud provisions of the federal securities laws).

offering.<sup>129</sup> The Commission today reaffirms its previous interpretations and provides additional guidance with respect to underwriters' responsibilities under the antifraud provisions of the federal securities laws.<sup>130</sup>

The provisions of paragraph (b) of Rule 15c2-12 are intended to assist a municipal underwriter in meeting its "reasonable basis" obligations, including the requirement that an underwriter receive and review a nearly complete final official statement prior to bidding for or purchasing securities in connection with the offering.<sup>131</sup> Under paragraph (b)(5)(i)(C) of the Rule, the underwriter is obligated to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract for the benefit of the bondholders, to provide continuing disclosure documents to the MSRB.<sup>132</sup> Further, the Rule's definition of "final official statement" provides for the disclosure of any instances in the previous five years in which any person identified in the continuing disclosure agreement has failed to comply, in all material respects, with any previous informational undertakings in the continuing disclosure agreement.<sup>133</sup> When the Commission in 1994 adopted these provisions of the Rule, it stated its belief that the failure of the issuer or other obligated person to comply in all material respects with prior

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<sup>129</sup> See 1989 Adopting Release, supra note 3, 54 FR at 28811. See also 1988 Proposing Release, supra note 128, 53 FR at 37787.

<sup>130</sup> In light of the underwriter's obligation, as discussed in the 1988 Proposing Release, supra note 128, 53 FR at 37787-91, the 1989 Adopting Release, supra note 3, 54 FR 28811-12, and the 1994 Interpretive Release, supra note 5, 59 FR 12757-58, to review the official statement and to have a reasonable basis for its belief in the accuracy and completeness of the official statement's key representations, the Commission noted that disclaimers by underwriters of responsibility for the information provided by the issuer or other parties without further clarification regarding the underwriter's belief as to accuracy, and the basis therefore, are misleading and should not be included in official statements. See 1994 Interpretive Release, supra note 5, 59 FR 12758 n.103.

<sup>131</sup> See 1988 Proposing Release, supra note 128, 53 FR at 37790.

<sup>132</sup> Under the 2008 Amendments, the MSRB is the sole information repository.

<sup>133</sup> Rule 15c2-12(f)(3), 17 CFR 15c2-12(f)(3).

informational undertakings is information that is important to the market, and should, therefore, be disclosed in the final official statement.<sup>134</sup> As the Commission noted at that time, the provision in the Rule regarding disclosure of a prior history of material non-compliance by issuers or other obligated persons with their undertakings was specifically intended to serve as an incentive for them to comply with their undertakings to provide secondary market disclosure.<sup>135</sup> Moreover, such disclosure would assist underwriters and others in assessing the reliability of issuers' or obligated persons' disclosure representations.<sup>136</sup> The Commission continues to believe in the importance of these Rule provisions and would like to remind underwriters of their obligations under Rule 15c2-12.

The Commission previously has stated that, in its view, the reasonableness of a belief in the accuracy and completeness of the key representations in the final official statement, and the extent of a review of the issuer's or other obligated person's situation necessary to arrive at that belief, will depend upon all the circumstances.<sup>137</sup> In both negotiated and competitively bid municipal offerings, the Commission expects, at a minimum, that underwriters will review the issuer's disclosure documents in a professional manner for possible inaccuracies and omissions.<sup>138</sup> The Commission previously has provided a non-exclusive list of factors that it believes generally would be relevant in determining the reasonableness of an underwriter's basis for assessing the truthfulness of key representations in final official statements.<sup>139</sup> These factors

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<sup>134</sup> See 1994 Amendments Adopting Release, supra note 5, 59 FR at 59594-5.

<sup>135</sup> Id. at 59595.

<sup>136</sup> Id.

<sup>137</sup> See 1988 Proposing Release, supra note 128, 53 FR at 37789 and 1989 Adopting Release, supra note 3, 54 FR 28811-12.

<sup>138</sup> Id.

<sup>139</sup> Id.

include: (1) the extent to which the underwriter relied upon municipal officials, employees, experts, and other persons whose duties have given them knowledge of particular facts; (2) the role of the underwriter (manager, syndicate member, or selected dealer); (3) the type of bonds being offered (general obligation, revenue, or private activity); (4) the past familiarity of the underwriter with the issuer; (5) the length of time to maturity of the bonds; and (6) whether the bonds are competitively bid or are distributed in a negotiated offering.<sup>140</sup> Sole reliance on the representations of the issuer will not suffice.<sup>141</sup>

The Commission has determined further to expound upon its prior interpretations regarding municipal underwriter's responsibilities. As articulated in a prior interpretation, the Commission believes that it is doubtful that an underwriter could form a reasonable basis for relying on the accuracy or completeness of the issuer's or obligated person's ongoing disclosure representations, if such issuer or obligated person has a history of persistent and material breaches or if it has not remedied such past failures by the time the offering commences.<sup>142</sup> The Commission believes that, if the underwriter finds that the issuer or obligated person has on multiple occasions during the previous five years,<sup>143</sup> failed to provide on a timely basis continuing disclosure documents, including event notices and failure to file notices, as required in continuing disclosure agreements for prior offerings, it would be very difficult for the underwriter to make a reasonable determination that the issuer or obligated person would provide such information under a continuing disclosure agreement in connection with a subsequent offering. In the Commission's view, it is doubtful that an underwriter could meet the reasonable

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<sup>140</sup> Id.

<sup>141</sup> See 1988 Proposing Release, supra note 128, 53 FR at 37789.

<sup>142</sup> See 1994 Amendments Adopting Release, supra note 5, 59 FR at 59595.

<sup>143</sup> 17 CFR 240.15c2-12(f)(3).

belief standard without the underwriter affirmatively inquiring as to that filing history.<sup>144</sup> The underwriter's reasonable belief would be based on its independent judgment, not solely on representations of the issuer or obligated person as to the materiality of any failure to comply with any prior undertaking. If the underwriter finds that the issuer or obligated person has failed to provide such information, the underwriter should take that failure into account in forming its reasonable belief in the accuracy and completeness of representations made by the issuer or obligated person.

Comment is solicited regarding whether there are alternative or additional ways in which an underwriter could satisfy its obligations, including obligations to ascertain whether issuers or obligated persons are abiding by their municipal disclosure commitments. Commenters should address the current practices used by underwriters to satisfy their "reasonable basis" obligation and any aspects of such practices that could be addressed through further Commission interpretation or rulemaking.

#### **IV. Request for Comments**

The Commission seeks comment on all aspects of the proposed amendments to the Rule. In addition to the comments requested throughout this release, comment is requested on whether the proposed amendments would further the Commission's goal of enhancing the availability to investors important information regarding municipal securities and their issuers in a prompt manner, and whether the proposed amendments would improve investors' ability to obtain such information. Further, the Commission seeks comment regarding the impact of the proposed amendments on Participating Underwriters, issuers and obligated persons, institutional and

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<sup>144</sup> The Commission notes that, in light of the adoption of the 2008 Amendments and their effective date of July 1, 2009, for disclosures made on or after July 1, 2009, an underwriter could verify that the information has been submitted electronically to the MSRB.

individual investors, the MSRB, information vendors, and others that may be affected by the proposed amendments.

In addition, the Commission requests comment on whether there are additional events for which notices should be provided, and alternative approaches or modifications to the Commission's proposed approach to improving the public's ability to obtain important information about municipal securities that the Commission should consider. Commenters are requested to indicate their views and to provide any other suggestions that they may have.

#### V. Paperwork Reduction Act

Certain provisions of the proposed amendments to the Rule contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>145</sup> In accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, the Commission has submitted revisions to the currently approved collection of information titled "Municipal Securities Disclosure" (17 CFR 240.15c2-12) (OMB Control No. 3235-0372) to OMB. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

##### A. Summary of Collection of Information

Under paragraph (b) of Rule 15c2-12, a Participating Underwriter currently is required: (1) to obtain and review an official statement "deemed final" by an issuer of the securities, except for the omission of specified information, prior to making a bid, purchase, offer, or sale of municipal securities; (2) in non-competitively bid offerings, to send, upon request, a copy of the most recent preliminary official statement (if one exists) to potential customers; (3) to send, upon request, a copy of the final official statement to potential customers for a specified period of

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<sup>145</sup> 44 U.S.C. 3501 et. seq.

time; (4) to contract with the issuer to receive, within a specified time, sufficient copies of the final official statement to comply with the Rule's delivery requirement, and the requirements of the rules of the MSRB; and (5) before purchasing or selling municipal securities in connection with an offering, to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices (i.e., continuing disclosure documents) to the MSRB in an electronic format as prescribed by the MSRB.<sup>146</sup> Under paragraph (c) of the Rule, a broker-dealer that recommends the purchase or sale of a municipal security must have procedures in place that provide reasonable assurance that it will receive prompt notice of any event specified in paragraph (b)(5)(i)(C) of the Rule and any failure to file annual financial information regarding the security.<sup>147</sup>

Under paragraph (d)(1)(iii) of the Rule, a primary offering of municipal securities in authorized denominations of \$100,000 or more is exempt from the Rule, if the securities, at the option of the holder thereof, may be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent.<sup>148</sup> These securities are referred to as demand securities or variable rate demand obligations ("VRDOs").

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<sup>146</sup> As noted above, the Commission recently approved amendments to Rule 15c2-12 that, among other things, established the MSRB as the sole repository for continuing disclosure documents and provided that those documents are to be submitted to the MSRB in an electronic format. See 2008 Amendments Adopting Release, supra note 11. Previously, continuing disclosure documents were to be submitted to the NRMSIRs and the appropriate SID, if any. The 2008 Amendments became effective on July 1, 2009. The Commission proposes that the effective date of the proposed amendments discussed herein would be no earlier than three months after the final approval of the proposed amendments, should the Commission adopt them.

<sup>147</sup> 17 CFR 240.15c2-12(c).

<sup>148</sup> 17 CFR 240.15c2-12(d)(1)(iii).

The Commission proposes to modify the exemption for demand securities by adding proposed paragraph (d)(5) to the Rule, which would apply current paragraphs (b)(5) and (c) of the Rule to a primary offering of demand securities in authorized denominations of \$100,000 or more.

Under the current Rule, a Participating Underwriter must reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide an event notice to the MSRB when any of the following events with respect to the securities being offered in an offering occurs, if material: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse opinions or events affecting the tax-exempt status of the security; (7) modifications to rights of security holders; (8) bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of securities; and (11) rating changes.<sup>149</sup>

Under the proposed amendments, Participating Underwriters would be required to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide event notices to the MSRB, in an electronic format as prescribed by the MSRB, in a timely manner not in excess of ten business days, rather than only in “a timely manner.” In addition, the Commission proposes to add the following event items to paragraph (b)(5)(i)(C) of the Rule: (1) the issuance by the IRS of proposed or final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the securities; (2) tender offers; (3) bankruptcy, insolvency, receivership or similar event of the issuer or obligated person; (4) the

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<sup>149</sup> 17 CFR 240.15c2-12(b)(5)(i)(C).

consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (5) appointment of a successor or additional trustee, or the change of name of a trustee, if material. Further, the Commission proposes to delete the generally applicable “if material” condition from paragraph (b)(5)(i)(C) of the Rule and instead indicate in specific event items listed in that paragraph whether notice of such event must be made only to the extent that such event is material. In this regard, Participating Underwriters would need to reasonably determine that notice of the following events would be made in all circumstances : (1) principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.

B. Proposed Use of Information

By specifying the time period for submission of event notices, expanding the Rule’s current categories of events, and modifying an exemption in the current Rule used for demand securities, the proposed amendments are intended to promptly make available to broker-dealers, institutional and retail investors, and others important information about significant events relating to municipal securities and their issuers. The proposed amendments would help enable investors and other municipal securities market participants to be better informed about important events that occur with respect to municipal securities and their issuers, including with respect to demand securities, and thus would allow investors to better protect themselves against

fraud. In addition, the proposed amendments would provide brokers, dealers, and municipal securities dealers with access to important information about municipal securities that they can use to carry out their obligations under the securities laws. This information could be used by individual and institutional investors; underwriters of municipal securities; other market participants, including broker-dealers and municipal securities dealers; analysts; municipal securities issuers; the MSRB; vendors of information regarding municipal securities; Commission's staff; and the public generally.

C. Respondents

In December 2008, OMB approved a revision to the collection of information associated with the Rule in accordance with 2008 Amendments to the Rule. The current paperwork collection associated with Rule 15c2-12 applies to broker-dealers, issuers of municipal securities, and the MSRB. The paperwork collection associated with today's proposed amendments applies to the same respondents.

The proposal would require that a Participating Underwriter in a primary offering of municipal securities reasonably determine that the issuer or an obligated person has undertaken in a continuing disclosure agreement to submit event notices in a timely manner not in excess of ten business days of their occurrence to the MSRB, as well as to submit such notices for proposed additional disclosure items. The proposal also would revise the Rule with respect to whether or not a materiality condition would apply to each of the Rule's specified events prompting submission of notices to the MSRB. In addition, the proposed amendments would revise the Rule with respect to its treatment of demand securities. The Commission gathered updated information regarding the paperwork burden associated with Rule 15c2-12 in connection with the Commission's adoption of the 2008 Amendments and is using these estimates in

preparing the paperwork collection associated with its current proposal. In the 2008 Amendments Adopting Release, the Commission estimated that the number of respondents impacted by the paperwork collection associated with the Rule consists of 250 broker-dealers and 10,000 issuers.<sup>150</sup> The Commission's staff expects that the proposed amendments would not change the number of broker-dealer respondents described in the 2008 Amendments Adopting Release. The Commission's staff expects that the proposed amendments would increase the number of issuer respondents in comparison to the Rule's paperwork current collection, as set forth in the 2008 Amendments Adopting Release. This is because the proposed amendments would expand the types of securities covered under subparagraphs (b)(5) and (c) of the Rule, thus increasing the number of issuers having a paperwork burden. Specifically, the Commission's staff estimates that the proposed revision of the Rule's exemption for demand securities would increase the number of issuers with a paperwork burden by 2,000 issuers, for a total of 12,000 issuer respondents.<sup>151</sup> The Commission's 2008 Amendments Adopting Release included a paperwork collection burden for the MSRB and, for purposes of the proposed amendments, the Commission's staff expects that the MSRB also would be a respondent.

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<sup>150</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>151</sup> In 2008, there were approximately 2,000 offerings of demand securities. See Two Decades of Bond Finance: 1989-2008, The Bond Buyer/Thomson Reuters 2009 Yearbook 7 (Matthew Kreps ed., SourceMedia, Inc.) (2009). To provide estimates that would not be under-inclusive, the Commission's staff has elected to assume that all 2,000 offerings of demand securities were issued by separate issuers and that each of those issuers currently is not a party to a continuing disclosure agreement that provides for the submission of continuing disclosure documents to the MSRB. Thus, the Commission's staff estimates that approximately 2,000 additional issuers would be affected by the proposed amendments to the Rule. These 2,000 additional issuers represent a 20% increase in the total number of issuers affected by the Rule.  $10,000$  (number of issuers under current Rule) /  $2,000$  (number of additional issuers under proposed amendments to the Rule)  $\times 100 = 20\%$ .

D. Total Annual Reporting and Recordkeeping Burden

In the 2008 Amendments Adopting Release, the Commission included estimates for the hourly burdens that the Rule imposes upon broker-dealers, issuers of municipal securities, and the MSRB. The Commission's staff has relied on these estimates to prepare the analysis discussed below for each of the aforementioned entities.

The Commission's staff estimates the aggregate information collection burden for the amended Rule would consist of the following:

1. Broker-Dealers

The Commission's staff estimates that approximately 250 broker-dealers potentially could serve as Participating Underwriters in an offering of municipal securities.<sup>152</sup> Therefore, the Commission's staff estimates that, under the proposed amendments, the maximum number of broker-dealer respondents would be 250.

a. Proposed Amendment to Modify the Exemption for Demand Securities

Under the current Rule, the Commission has estimated that the total annual burden on all 250 broker-dealers is 250 hours (1 hour annually per broker-dealer).<sup>153</sup> The Commission believes that the proposed amendment to modify the exemption from the Rule for a primary offering of demand securities in authorized denominations of \$100,000 or more, would increase the number of issuers with municipal securities offerings that are subject to the Rule annually by 20%, based on the Commission's staff estimate of the ratio of demand securities outstanding in relation to the municipal security market generally.<sup>154</sup> The Commission's staff estimates that this

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<sup>152</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>153</sup> Id.

<sup>154</sup> See supra note 151.

20% increase in the number of issuers with offerings subject to the Rule also would increase the estimated average annual burden for each broker-dealer by 20%, or .20 hours (12 minutes = 60 minutes x .20 (20%)) and the total estimated annual paperwork burden for all broker-dealers by 20%, or 50 hours.<sup>155</sup> This increased burden represents the estimated additional time broker-dealers would need annually to review the continuing disclosure agreements associated with the additional municipal securities offerings that would be subject to the amended Rule. As discussed in more detail below,<sup>156</sup> the Commission notes that the continuing disclosure agreements that are reviewed by broker-dealers as part of their obligation under the Rule are form agreements. The proposed changes to the Rule would result in minor changes to certain provisions of these continuing disclosure agreements. However, because these continuing disclosure agreements are form agreements, the Commission does not believe that there would be a substantial increase in the annual hourly burden for broker-dealers under the proposed amendments to the Rule. Accordingly, the Commission's staff estimates that 250 broker-dealers would incur an estimated average burden of 300 hours per year to comply with the Rule, as proposed to be amended.<sup>157</sup>

b. Proposed Amendments to Events to be Disclosed under a Continuing Disclosure Agreement

The proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule would not alter a broker-dealer's obligation to reasonably determine that the issuer or obligated person

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<sup>155</sup> 250 hours (total annual burden for all broker-dealers under the current Rule) x .20 (20% increase in total hourly burden) = 50 hours. This estimated increase in the annual burden for broker-dealers also accounts for their review of continuing disclosure agreements in connection with remarketings of VRDOs that are primary offerings.

<sup>156</sup> See Section V.D.2., *infra*.

<sup>157</sup> (250 hours (total estimated annual hourly burden for all broker-dealers under the current Rule) + 50 hours (total estimated additional annual hourly burden for all broker-dealers under the proposed amendments to the Rule) = 300 hours.

has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices to the MSRB. As described above, the proposed amendments to paragraph (b)(5)(i)(C) of the Rule would add four new event disclosure items to the Rule, as well as amend an existing event disclosure item currently contained in the Rule, and would modify the events that are subject to a materiality determination before triggering a notice to the MSRB. In addition, the proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule would change the timing for filing event notices from “in a timely manner” to “in a timely manner not to exceed ten business days.” The Commission believes that these amendments would not change the obligation of broker-dealers under the Rule to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices to the MSRB.<sup>158</sup> Accordingly, the Commission does not believe that the proposed amendments relating to the timing and scope of event notices would affect the annual paperwork burden for broker-dealers.

c. One-Time Paperwork Burden

The Commission’s staff estimates that a broker-dealer would incur a one-time paperwork burden to have its internal compliance attorney prepare and issue a notice advising its employees about the proposed revisions to Rule 15c2-12, if they are adopted by the Commission. In the 2008 Amendments Adopting Release, the Commission estimated that it would take a broker-dealer’s internal compliance attorney approximately 30 minutes to prepare and issue a notice

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<sup>158</sup> The Commission notes that while the proposed amendments to the Rule do not change this obligation, broker-dealers would need to reasonably determine that the written agreement or contract entered into by an issuer or obligated person contains the proposed change to the timing for filing event notices.

describing the broker-dealer's obligations in light of the 2008 Amendments to the Rule.<sup>159</sup> The Commission's staff believes that this 30 minute estimate to prepare a notice would also apply to a broker-dealer's internal compliance attorney to prepare such a notice for these current amendments to the Rule. The Commission's staff believes that the task of preparing and issuing a notice advising the broker-dealer's employees about the proposed amendments, if they are adopted, is consistent with the type of compliance work that a broker-dealer typically handles internally. Accordingly, the Commission's staff estimates that 250 broker-dealers would each incur a one-time, first-year burden of 30 minutes to prepare and issue a notice to its employees regarding the broker dealer's obligations under the proposed amendments.

d. Total Annual Burden for Broker-Dealers

Under the proposed amendments, the total burden on broker-dealers would be 425 hours for the first year<sup>160</sup> and 300 hours for each subsequent year.<sup>161</sup>

2. Issuers

Issuers' undertakings regarding the submission of annual filings, event notices, and failure to file notices that are set forth in continuing disclosure agreements contemplated by the existing Rule, as well as the proposed amendments to the Rule, impose a paperwork burden on issuers of municipal securities.

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<sup>159</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>160</sup> (250 (broker-dealers impacted by the proposed amendments to the Rule) x 1.20 hours) + (250 (broker-dealers impacted by the proposed amendments to the Rule) x .5 hour (estimate for one-time burden to issue notice regarding broker-dealer's obligations under the proposed amendments to the Rule)) = 425 hours.

<sup>161</sup> 250 (broker-dealers impacted by the proposed amendments to the Rule) x 1.20 hours = 300 hours.

a. Proposed Amendment to Modify the Exemption for Demand Securities

The Commission's staff believes that the proposed amendment to delete paragraph (d)(1)(iii) from the Rule, which contains an exemption from the Rule for a primary offering of demand securities in authorized denominations of \$100,000 or more, and add new paragraph (d)(5) to the Rule to apply paragraphs (b)(5) and (c) of the Rule to a primary offering of demand securities in authorized denominations of \$100,000 or more, would increase the number of issuers with a paperwork burden under the Rule. In the 2008 Amendments Adopting Release, the Commission estimated that the Rule affected approximately 10,000 issuers.<sup>162</sup> Using the estimate of 10,000 issuers from the 2008 Amendments Adopting Release, the Commission's staff estimates that, under the proposed amendments, the number of issuers with a paperwork burden would increase by approximately 20%<sup>163</sup> to 12,000 issuers.<sup>164</sup> These additional issuers would increase the aggregate number of annual filings, event notices and failure to file notices submitted each year. In the 2008 Amendments Adopting Release, the Commission estimated the hourly burdens for an issuer to prepare and submit an annual filing (45 minutes), an event notice (45 minutes) and a failure to file notice (30 minutes).<sup>165</sup> The proposed modification to the Rule's exemption for demand securities would not alter these hourly burdens. Thus, the Commission's staff estimates that the aggregate number of annual filings, event notices and

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<sup>162</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>163</sup> See supra note 151.

<sup>164</sup>  $10,000$  (number of issuers under current Rule)  $\times$   $1.20$  (20% increase) =  $12,000$ . To provide estimates that would not be under-inclusive, the Commission's staff has elected to use an estimate that assumes that all issuers of demand securities currently are not a party to a continuing disclosure agreement that provides for the submission of continuing disclosure documents to the MSRB.

<sup>165</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

failure to file notices submitted by issuers also would increase by 20% from the estimates contained in the 2008 Amendments Adopting Release.<sup>166</sup>

(i) Annual Filings

In the 2008 Amendments Adopting Release, the Commission estimated that Rule 15c2-12 imposed a total paperwork burden of 11,250 hours on 10,000 issuers to prepare and submit annual filings in any given year.<sup>167</sup> In determining the paperwork burden for issuers under the 2008 Amendments Adopting Release, the Commission estimated that issuers would prepare and submit a total of approximately 15,000 annual filings yearly.<sup>168</sup> Under the proposed amendment to modify the current exemption for demand securities contained in the Rule, the Commission's staff estimates that 12,000 municipal issuers with continuing disclosure agreements would prepare and submit approximately 18,000 annual filings yearly.<sup>169</sup>

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to prepare and submit annual filings to the MSRB in an electronic format would require approximately 45 minutes.<sup>170</sup> The proposed amendments to the Rule would not change the way annual filings are prepared and submitted. The Commission's staff estimates that, under the proposed amendments, an issuer would still require approximately 45 minutes to prepare and submit annual filings to the MSRB in an electronic format. Therefore, under the proposed

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<sup>166</sup> The Commission's staff believes that this estimated 20% increase in the number of each type of continuing disclosure document filed by issuers is appropriate since it maintains the same ratio between the number of issuers and the number of each type of document submitted by these issuers as set forth in the 2008 Amendments Adopting Release.

<sup>167</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>168</sup> Id.

<sup>169</sup> 15,000 (annual filings under 2008 Amendments Adopting Release) x 1.20 (20% increase in filings under proposed amendments) = 18,000 annual filings.

<sup>170</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

amendments, the total burden on issuers of municipal securities to prepare and submit 18,000 annual filings to the MSRB in an electronic format is estimated to be 13,500 hours.<sup>171</sup>

(ii) Event Notices

In determining the paperwork burden for issuers under the 2008 Amendments Adopting Release, the Commission estimated that issuers would prepare and submit a total of approximately 60,000 event notices yearly.<sup>172</sup> Under the proposed amendments to modify the exemption for demand securities contained in the Rule, the Commission's staff estimates that the 12,000 municipal issuers with continuing disclosure agreements would prepare and submit approximately 72,000 event notices yearly.<sup>173</sup>

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to prepare and submit event notices to the MSRB in an electronic format would require approximately 45 minutes.<sup>174</sup> Since the proposed amendments to the Rule would not change the way event notices are prepared and submitted, the Commission's staff estimates that, under today's proposed amendments, an issuer still would require approximately 45 minutes to

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<sup>171</sup> 18,000 (estimated number of annual filings under proposed amendments) x .75 hours (45 minutes) (estimated time to prepare and submit annual filings under the 2008 Amendments Adopting Release) = 13,500 hours. To provide an estimate for the paperwork burden that would not be under-inclusive, the Commission's staff elected to use the higher end of the estimate for the total number of annual filings estimated to be submitted each year.

<sup>172</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>173</sup> 60,000 (number of event notices under 2008 Amendments Adopting Release) x 1.20 (20% increase in filings under proposed amendments) = 72,000 event notices. The Commission's staff's estimates of the additional event notices associated with the proposed amendments relating to the materiality condition and additional event disclosure items contained in paragraph (b)(5)(1)(C) of the Rule are discussed in Sections V.D.2.a.iii. through vii. infra. As discussed below, the total number of event notices estimated to be submitted to the MSRB in connection with the proposed amendments is 78,757 notices.

<sup>174</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

prepare and submit an event notice. Therefore, under today's proposed amendments relating to demand securities, the total burden on issuers of municipal securities to prepare and submit 72,000 event notices to the MSRB is estimated to be 54,000 hours.<sup>175</sup>

(iii) Failure to File Notices

In the 2008 Amendments Adopting Release, the Commission estimated that Rule 15c2-12 currently imposes a total paperwork burden of 1,000 hours on 10,000 issuers to submit failure to file notices in any given year.<sup>176</sup> In determining the paperwork burden for issuers under the 2008 Amendments Adopting Release, the Commission estimated that 10,000 issuers would prepare and submit a total of approximately 2,000 failure to file notices yearly.<sup>177</sup> Under the proposed amendment to modify the exemption for demand securities contained in the Rule, the Commission's staff estimates that the 12,000 municipal issuers with continuing disclosure agreements would prepare and submit approximately 2,400 failure to file notices yearly.<sup>178</sup>

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to submit failure to file notices would require approximately 30 minutes.<sup>179</sup> Since the proposed amendments to the Rule would not change the way failure to file notices are prepared and submitted, the Commission's staff estimates that, under today's proposed amendments, an issuer would require approximately 30 minutes to prepare and submit a failure to file notice. Therefore, under the proposed amendments, the total burden on issuers of

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<sup>175</sup> 72,000 (estimated number of material event notices under proposed amendments) x .75 hours (45 minutes) (estimated time to prepare and submit material event notices under the 2008 Amendments Adopting Release) = 54,000 hours.

<sup>176</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>177</sup> Id.

<sup>178</sup> 2,000 (failure to file notices) x 1.20 (20% increase in filings) = 2,400 failure to file notices.

<sup>179</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

municipal securities to prepare and submit 2,400 failure to file notices to the MSRB is estimated to be 1,200 hours.<sup>180</sup>

b. Proposed Amendments to Event Notice Provisions of the Rule

The Commission proposes to modify paragraph (b)(5)(i)(C) of the Rule, which presently requires Participating Underwriters to reasonably determine that an issuer or obligated person has entered into a continuing disclosure agreement that, among other things, contemplates the submission of a event notice to the MSRB in an electronic format upon the occurrence of any events set forth in the Rule, if such event is material. The current Rule contains eleven such events. The proposed amendments to this paragraph of the Rule would add four new event disclosure items and revise an existing event disclosure item. In addition, the proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) would revise the Rule to state that event notices should be submitted in a timely manner “not to exceed ten business days after the occurrence of the event,” rather than simply in a timely manner, as set forth in the current Rule, and would apply to some (but not all) events the materiality condition that applies to the current eleven events. In the 2008 Amendments Adopting Release, the Commission estimated that 60,000 event notices would be prepared and submitted annually. As described above, the Commission’s staff estimates that the proposed amendments to modify the Rule’s exemption for demand securities would increase the number of event notices to be prepared and submitted to 72,000 annually.<sup>181</sup> The Commission’s staff believes that these proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule would further increase the current annual

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<sup>180</sup> 2,400 (estimated number of failure to file notices under proposed amendments) x .5 hours (30 minutes) (estimated time to prepare and submit failure to file notices under the 2008 Amendments Adopting Release) = 1,200 hours.

<sup>181</sup> See supra note 173.

paperwork burden for issuers because they would result in an increase in the number of event notices to be prepared and submitted.<sup>182</sup>

(i) Time Frame for Submitting Event Notices under a Continuing Disclosure Agreement

Currently, paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule state that notice of an event should be provided in “a timely manner.” The proposed amendment would revise these provisions to state that such notice should be provided “in a timely manner not in excess of ten business days after the occurrence of the event.” As noted above, the Commission’s staff estimates that an issuer can prepare and submit an event notice in 45 minutes, which is the hourly burden noted in the 2008 Amendments Adopting Release.<sup>183</sup> The proposed revision to the Rule regarding the time period for submission of event notices would not change this estimated burden of 45 minutes, which is the amount of time under the Rule’s current paperwork collection to prepare and submit event notices. Rather, the change in burden hours results from the fact that more event notices are expected to be filed under the proposed amendments. The Commission’s staff believes that the proposed change to “not in excess of ten business days after the occurrence of the event” to submit a event notice would not affect the length of time it takes an issuer to prepare and submit the notice and thus would not have any impact on the current paperwork burden with respect to the length of time of time it would take an issuer to prepare and submit a event notice.

(ii) Modification with regard to Those Events for which a Materiality Determination Is Necessary

As discussed earlier, the Commission believes that it is appropriate to delete the condition in paragraph (b)(5)(i)(C) of the Rule that presently provides that notice of all of the listed events

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<sup>182</sup> Id.

<sup>183</sup> See supra note 174 and accompanying text.

need be made only “if material.” In connection with the proposed deletion of the materiality condition, the Commission has reviewed each of the Rule’s current specified events to determine whether a materiality determination should be retained for that particular event and preliminarily believes such a determination is still appropriate for certain listed events.<sup>184</sup> As a result of this proposed change, for those events listed in paragraph (b)(5)(i)(C) that are not proposed to contain the “if material” condition, the Participating Underwriter must reasonably determine that the issuer or other obligated person has agreed to submit event notices to the MSRB whenever such an event occurs. These events include: (1) principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.<sup>185</sup> The Commission, however, believes that for other events currently listed in paragraph (b)(5)(i) a materiality determination should be retained.

In a telephone conversation between the Commission’s staff and MSRB staff on June 12, 2009, Commission staff was advised that the increase in the number of event notices in connection with the proposal to modify the materiality condition would result in an increase of no more than 1,000 event notices, taking into account the increase in event notices that would result from the proposed amendment relating to demand securities.<sup>186</sup> Therefore, the

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<sup>184</sup> The discussion in this section pertains to materiality determinations for events currently specified in paragraph (b)(5)(i)(C) of the Rule. For events proposed to be added to the Rule, whether a materiality determination is specified is included in the discussion below for each such proposed event.

<sup>185</sup> See *supra* Section II.C. for a discussion of the Commission’s rationale regarding why the Commission proposes not to retain a materiality condition for these events.

<sup>186</sup> Telephone conversation between Ernesto A. Lanza, General Counsel, MSRB, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, June 12, 2009. The MSRB staff believes that the potential increase could

Commission's staff estimates that this proposed change to the materiality condition would increase the total number of event notices to be submitted annually by issuers by 1,000 notices.

(iii) Amendment to the Submission of Event Notices Regarding Adverse Tax Events under a Continuing Disclosure Agreement

Subparagraph (b)(5)(i)(C)(6) of the Rule refers to an event notice in the case of adverse tax events. Under the proposed amendments, subparagraph (b)(5)(i)(C)(6) of the Rule would be amended to include "the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the securities." This proposed amendment would address the circumstances in which issuers would submit an event notice to the MSRB with respect to IRS determinations of taxability or other material notices or determinations with respect to the tax status of a municipal security. As discussed above,<sup>187</sup> the Commission believes that the proposed amendment to subparagraph (b)(5)(i)(C)(6) of the Rule would clarify that IRS determinations of taxability or other material notices or determinations with respect to the tax status of a municipal security are events that currently should be disclosed under a continuing disclosure agreement. The Commission's staff estimates that the proposed amendments to paragraph (b)(5)(i)(C)(6) of the Rule would increase the total number of event notices to be submitted by issuers annually by approximately 130 notices.<sup>188</sup>

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be much smaller; however, the Commission's staff is using the estimate of 1,000 event notices to provide a conservative estimate.

<sup>187</sup> See supra Section II.C.

<sup>188</sup> During conversations with the Commission's staff in December 2008, the staff of the IRS indicated that during a 12-month period it issues approximately 130 notices of determinations of taxability. To provide an estimate that is not under-inclusive, the Commission's staff has estimated that event notices are not currently submitted for any of these IRS notices. Accordingly, the Commission's staff estimates that approximately 130

(iv) Tender Offers

Subparagraph (b)(5)(i)(C)(8) of the Rule refers to notice of an event in the case of bond calls. Under the proposed amendments, subparagraph (b)(5)(i)(C)(8) of the Rule would be amended to include tender offers. The inclusion of tender offers in this subparagraph of the Rule would expand the circumstances in which issuers would submit an event notice to the MSRB. The Commission's staff estimates that proposed amendments to subparagraph (b)(5)(i)(C)(8) of the Rule would increase the total number of event notices to be submitted by issuers annually by approximately 100 notices.<sup>189</sup>

(v) The Occurrence of Bankruptcy, Insolvency, Receivership or Similar Event Regarding an Issuer or an Obligated Person

Under the proposed amendments, subparagraph (b)(5)(i)(C)(12) would be added to the Rule and would contain a new disclosure event in the case of bankruptcy, insolvency, receivership or similar event of the issuer or obligated person. The proposed addition to the Rule of bankruptcy, insolvency, receivership or similar event of the issuer or obligated person would expand the circumstances in which issuers would submit an event notice. Based on a review of industry sources by the Commission's staff, the Commission's staff estimates that the proposed amendment to add the new bankruptcy, insolvency, receivership or similar event of the issuer or

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additional event notices would be submitted under the proposed amendments to subparagraph (b)(5)(i)(C)(6) of the Rule.

<sup>189</sup> Based on industry sources that included lawyers, trade associations and vendors of municipal disclosure information, the Commission's staff has estimated that there are typically no more than 100 tender offers annually in the municipal securities market. The Commission's staff believes that the actual number of tender offers annually is significantly less than 100. However, to provide an estimate for the paperwork burden that would not be under-inclusive, the Commission's staff has elected to use the higher end of the estimate with respect to the number of municipal tender offers that occur each year.

obligated person in subparagraph (b)(5)(i)(C)(8) of the Rule would increase the total number of event notices submitted by issuers annually by approximately 24 notices.<sup>190</sup>

(vi) Merger, Consolidation, Acquisition, and Sale of All or Substantially All Assets

Under the proposed amendments, subparagraph (b)(5)(i)(C)(13) would be added to the Rule and would contain a new disclosure event in the case of a merger, consolidation, acquisition involving an obligated person or sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material. The proposed addition to the Rule of the merger, consolidation, acquisition, or sale of all or substantially all of the assets to the Rule would expand the circumstances in which issuers would submit an event notice. The Commission's staff believes that the proposed amendment to add the new event of merger, consolidation, acquisition, or sale of all or substantially all of the assets in subparagraph (b)(5)(i)(C)(13) of the Rule would increase the total number of event notices submitted by issuers annually. Based on a review of industry sources, the Commission's staff estimates that the proposed amendment to add the new bankruptcy, insolvency, receivership or similar event of

<sup>190</sup> The Commission's staff based this estimate on the following: (i) 917 (number of issuances of municipal securities that defaulted during the 1990's based on statistics contained in Standard and Poor's "A Complete Look at Monetary Defaults in the 1990s" (June, 2000)) / 10 (number of years in a decade) = 91.7 (estimated number of issuances defaulting per year) (rounded to 92); (ii) 92 (estimated number of issuances defaulting per year) / 50,000 (estimated total number of municipal issuers) = .002 (.2 %) (estimated percentage of all issuers that default annually); and (iii) 12,000 (estimated number of issuers under proposed amendments to the Rule) x (.002) (.2%) (estimated percentage of all issuers that default annually) x 1 (estimated number of material event notices that an issuer would file) = 24 notices. The Commission's staff notes that not all issuers that default eventually enter bankruptcy. However, to provide an estimate for the paperwork burden that would not be under-inclusive, the Commission staff has elected to use the number of defaults as a basis for this estimate.

the issuer or obligated person in subparagraph (b)(5)(i)(C)(8) of the Rule would increase the total number of event notices submitted by issuers annually by approximately 1,783 notices.<sup>191</sup>

(vii) Successor or Additional Trustee, or Change in Trustee Name

Under the proposed amendments, paragraph (b)(5)(i)(C)(14) would be added to the Rule and would contain a new disclosure event related to the appointment of a successor or additional trustee or the change of name of a trustee, if material. The proposed addition to the Rule of the event relating to trustee changes would expand the circumstances in which issuers would submit an event notice to the MSRB. The Commission's staff believes that a change affecting the largest trustee of municipal securities would provide a reasonable estimate of the number of additional event notices that would be submitted annually under this proposed amendment to the Rule. In 2008, the largest trustee covered approximately 31% of the municipal issuances in 2008.<sup>192</sup> The Commission's staff believes that this percentage represents a reasonable estimate of the percentage of issuers covered by the largest trustee. Thus, the Commission's staff

<sup>191</sup> The Commission's staff based this estimate on the following: (i) 2,201 (total number of merger transactions reported under the Hart-Scott-Rodino Act in 2007 contained in the Hart-Scott-Rodino Annual Report Fiscal Year 2007 (November 2008) available at <http://www.ftc.gov/os/2008/11/hsrreportfy2007.pdf> ("HSR Report") x 81% (percentage of mergers in industries in which municipal securities may exist) = 1782.81 notices (rounded to 1783). The Commission staff estimated the percentage of mergers in the municipal industry based on data contained in the HSR Report. The HSR Report contained data regarding the percentage of merger transactions reported from nine industry segments. Of these nine segments, the only segment that does not issue municipal securities is the banking and insurance industry segment which accounted for 19% of reported merger transactions. The Commission notes that each of the mergers reported under the other industry segments may not involve entities that have issued municipal securities. However, to provide an estimate that is not under-inclusive, the Commission's staff has estimated that all of the reported mergers in the remaining industry segments would involve entities that have issued municipal securities.

<sup>192</sup> See Two Decades of Bond Finance: 1989-2008, The Bond Buyer/Thomson Reuters 2009 Yearbook 7 (Matthew Kreps ed., SourceMedia, Inc.) (2009) and Top 50 Trustee Banks: 2008, The Bond Buyer/Thomson Reuters 2009 Yearbook 89 (Matthew Kreps ed., SourceMedia, Inc.) (2009).

estimates that a change to the largest trustee would cover approximately 31% of issuers, or 3,720 issuers, which would serve as a conservative proxy for the number of event notices to be submitted regarding a change in trustee.<sup>193</sup> Therefore the Commission's staff estimates that the proposed amendment to add the new disclosure event contained in paragraph (b)(5)(i)(C)(14) of the Rule would increase the total number of event notices submitted by issuers annually by approximately 3,720 notices.<sup>194</sup>

c. Total Burden on Issuers for Proposed Amendments to Event Notices

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to prepare and submit event notices to the MSRB in an electronic format would require approximately 45 minutes.<sup>195</sup> As discussed above, under the proposed amendment to modify the Rule's exemption for demand securities, the total number of issuers affected by the Rule would increase to 12,000, the total number of event notices submitted by issuers would increase to 72,000, and the annual paper work burden for issuers to submit event notices would increase to 54,000 hours. Under the proposed amendments to paragraph (b)(5)(i)(C) of the Rule, the Commission's staff estimates that the 12,000 municipal issuers with continuing disclosure

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<sup>193</sup> The Commission's staff based this estimate on the following: 12,000 (estimated number of issuers under proposed amendments) x .31 (31%) (estimated percentage of issuers that would be impacted by a change to the largest trustee of municipal securities) = 3,720 issuers.

<sup>194</sup> The Commission's staff based this estimate on the following: 3,720 (estimated number of issuers that would be impacted by a change to the largest trustee of municipal securities) x 1 (estimated number of event notices that an issuer would file) = 3,720 notices. The Commission staff believes that the actual number of changes involving the trustee that occur annually is significantly less than 3,720. However, to provide an estimate for the paperwork burden that would not be under-inclusive, the Commission's staff has elected to use an estimate that takes into account a change involving the largest trustee.

<sup>195</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

agreements would prepare an additional 6,757 event notices annually,<sup>196</sup> raising the total number of event notices prepared by issuers annually to approximately 78,757.<sup>197</sup> This increase in the number of event notices would result in an increase of 5,068 hours in the annual paperwork burden for issuers to submit event notices.<sup>198</sup> This increase would result in an annual paperwork burden for issuers to submit event notices of approximately 59,068 hours (54,000 hours + 5,068 hours).

d. Total Burden for Issuers

Accordingly, under the proposed amendments, the total burden on issuers to submit annual filings, event notices and failure to file notices would be 73,768 hours.<sup>199</sup>

3. MSRB

In the 2008 Amendments Adopting Release, the Commission estimated that the MSRB incurred an annual burden of approximately 7,000 hours to collect, index, store, retrieve, and

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<sup>196</sup> 1000 (estimated number of additional notices submitted under change to events materiality condition) + 130 (estimated number of adverse tax event notices under proposed amendments) + 100 (estimated number of tender offers event notices under proposed amendments) + 24 (estimated number of bankruptcy/insolvency event notices under proposed amendments) + 1,783 (estimated number of merger or acquisition event notices under proposed amendments) + 3,720 (estimated number of appointment/change of trustee event notices under proposed amendments) = 6,757 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule).

<sup>197</sup> 72,000 (number of event notices under proposed amendments modifying the exemption for demand securities exemption) + 6,757 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule) = 78,757 event notices.

<sup>198</sup> 6,757 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule) x .75 hours (45 minutes) (estimated time to prepare an event notice under 2008 Amendments Adopting Release) = 5,067.75 hours (rounded to 5,068 hours).

<sup>199</sup> 13,500 hours (estimated burden for issuers to submit annual filings) + 59,068 hours (estimated burden for issuers to submit event notices) + 1,200 hours (estimated burden for issuers to submit failure to file notices) = 73,768 hours.

make available the pertinent documents under the Rule.<sup>200</sup> As discussed above, the Commission's staff anticipates that the proposed amendments to modify the Rule's exemption for demand securities would increase filings submitted by approximately 20% annually.<sup>201</sup> In addition, the Commission's staff estimates that the proposed amendments to the event notice provisions of the Rule would increase filings submitted by approximately an additional 9% annually.<sup>202</sup> Accordingly, the Commission's staff estimates that the total burden on the MSRB of collecting, indexing, storing, retrieving and disseminating information requested by the public also would increase by approximately 29% or 2,030 hours (7,000 hours x .29). Thus, the Commission's staff estimates that the total burden on the MSRB to collect, store, retrieve, and make available the disclosure documents covered by the proposed amendments to the Rule would be 9,030 hours annually.<sup>203</sup>

#### 4. Annual Aggregate Burden for Proposed Amendments

The Commission's staff estimates that the ongoing annual aggregate information collection burden for the proposed amendments to the Rule would be 83,098 hours.<sup>204</sup>

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<sup>200</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>201</sup> See *supra* note 151.

<sup>202</sup>  $6,757$  (estimated additional event notices under the proposed event notice amendments) /  $77,000$  (estimated number of continuing disclosure documents submitted under current Rule ( $60,000$  (event notices) +  $15,000$  (annual filings) +  $2,000$  (failure to file notices) =  $77,000$ )) =  $.087 \times 100$  = approximately 9%.

<sup>203</sup> Annual burden for MSRB:  $7000$  hours (annual burden under 2008 Amendments Adopting Release) +  $2,030$  hours (additional hourly burden under proposed amendments) =  $9,030$  hours.

<sup>204</sup>  $300$  hours (total estimated burden for broker-dealers) +  $73,768$  hours (total estimated burden for issuers) +  $9,030$  hours (total estimated burden for MSRB) =  $83,098$  hours. The initial first-year burden would be  $83,223$  hours:  $425$  hours (total estimated burden for broker-dealers in the first year) +  $73,768$  hours (total estimated burden for issuers) +  $9,030$  hours (total estimated burden for MSRB) =  $83,223$  hours.

E. Total Annual Cost Burden

1. Broker-Dealers and the MSRB

The Commission does not expect broker-dealers to incur any additional external costs associated with the proposed amendments to the Rule since the proposed amendments do not change the obligation of broker-dealers under the Rule to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices to the MSRB.

The Commission believes that the MSRB may incur costs to modify the indexing system in its EMMA system to accommodate the proposed changes to the Rule that would add additional material disclosure events. Based on information provided to the Commission's staff by MSRB staff in a telephone conversation on November 7, 2008, the MSRB staff estimated that the MSRB's costs to update its EMMA system to accommodate the proposed changes to the material disclosure events of the Rule would be no more than approximately \$10,000.<sup>205</sup>

2. Issuers

(a) Current Issuers

The Commission expects that some issuers that currently submit continuing disclosure documents to the MSRB in an electronic format (referred to herein as "current issuers") could be subject to some additional costs associated with the proposed amendments to the Rule. For current issuers that convert their annual filings, event notices and/or failure to file notices into the

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<sup>205</sup> Telephone conversation between Harold Johnson, Deputy General Counsel, MSRB, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, November 7, 2008.

MSRB's prescribed electronic format through a third party there would be costs associated with any additional submissions of event notices and failure to file notices.

The cost for an issuer to have a third-party vendor convert paper continuing disclosure documents into the MSRB's prescribed electronic format could vary depending on what resources are required to transfer the documents into the appropriate electronic format. One example of such a transfer would be the scanning of paper-based continuing disclosure documents into an electronic format. In the 2008 Amendments Adopting Release, the Commission estimated that the cost for an issuer to have a third-party vendor scan documents would be \$6 for the first page and \$2 for each page thereafter.<sup>206</sup> In the 2008 Amendments Adopting Release, the Commission also estimated that event notices and failure to file notices consist of one to two pages.<sup>207</sup> Accordingly, the approximate cost for an issuer to use a third party vendor to scan an event notice or failure to file notice would be \$8 per notice. The Commission believes these estimates are still accurate. In the 2008 Amendments Adopting Release, the Commission estimated that the high end of the estimate for the number of event notices submitted by an issuer annually is three.<sup>208</sup> Under the proposed amendments to the Rule, some current issuers would need to prepare additional event notices for submission to the MSRB. Some current issuers could need to submit these additional event notices to a third party to convert into an electronic format for submission to the MSRB. Under the proposed amendments to the Rule, the Commission's staff estimates that a conservative estimate of the number of additional event notices that an issuer would need to submit annually under the

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<sup>206</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>207</sup> Id.

<sup>208</sup> Id.

proposed amendments would be one, increasing the total estimate to four.<sup>209</sup> Each of these issuers would incur an annual cost of \$8 to convert the additional event notice into an electronic format for submission to the MSRB.<sup>210</sup> The Commission believes that current issuers that already have the technology resources to convert continuing disclosure documents into an electronic format for submission to the MSRB would not incur any additional external costs associated with the proposed amendments to the Rule.

There may be some costs incurred by issuers to revise their current template for continuing disclosure agreements to reflect the proposed amendments to the Rule, if they are adopted. The Commission understands that models currently exist for continuing disclosure agreements that are relied upon by legal counsel to issuers and, accordingly, these documents are likely to be updated by outside attorneys to reflect the proposed amendments, if the Commission should adopt them. Based on a review of industry sources, the Commission believes that continuing disclosure agreements are form agreements. Based on a review of industry sources, the Commission's staff estimates that it would take an outside attorney approximately 15 minutes to revise the template for continuing disclosure agreements for a current issuer, if the proposed amendments are adopted. Thus, the Commission's staff estimates that the approximate cost of revising a continuing disclosure agreement to reflect the proposed amendments for each

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<sup>209</sup>  $6,757$  (estimated additional event notices submitted under proposed amendments to event notices) /  $12,000$  (estimated number of issuers under proposed amendments) =  $.563$  notices per issuer (rounded up to 1) (estimated number of additional event notices submitted annually per issuer). To provide an estimate that would not be under-inclusive, the Commission's staff has elected to use an estimate that expects each issuer would submit one additional event notice as a result of the proposed amendments.

<sup>210</sup>  $\$8$  (cost to have third party convert an event notice or failure to file notice into an electronic format) x 1 (maximum estimated number of additional event or failure to file notices filed per year per issuer)] =  $\$8$ .

current issuer would be approximately \$100,<sup>211</sup> for a one-time total cost of \$1,000,000<sup>212</sup> for all current issuers, if an outside counsel were used to revise the continuing disclosure agreement.

(b) VRDO Issuers

As discussed above, the Commission's staff estimates that the proposal relating to demand securities would increase the number of issuers affected by the Rule by approximately 20% or 2,000 issuers (referred to herein as "VRDO issuers"). VRDO issuers may have some external costs associated with the preparation and submission of annual filings, event notices and failure to file notices. Under the Rule, Participating Underwriters are required to reasonably determine that an issuer has entered into a continuing disclosure agreement to provide continuing disclosure documents to the MSRB in an electronic format as prescribed by the MSRB. Under the proposed amendments to the Rule, Participating Underwriters of VRDO issuers would need to reasonably determine that these VRDO issuers have entered into continuing disclosure agreements. The Commission understands that models currently exist for continuing disclosure agreements that are relied upon by legal counsel to issuers and, accordingly, these documents are likely to be updated by outside attorneys to reflect the proposed amendments, if the Commission should adopt them. Based on a review of industry sources, the Commission believes that continuing disclosure agreements are form agreements. Also, based on a review of industry sources, the Commission's staff estimates that it would take an outside attorney approximately 1.5 hours to draft a continuing disclosure agreement. Thus, the Commission's staff estimates

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<sup>211</sup> 1 (continuing disclosure agreement) x \$400 (hourly wage for an outside attorney) x .25 hours (estimated time for outside attorney to revise a continuing disclosure document in accordance with the proposed amendments to the Rule) = \$100. The \$400 per hour estimate for an outside attorney's work is based on the Commission's staff review of industry sources.

<sup>212</sup> \$100 (estimated cost to revise a continuing disclosure agreement in accordance with the proposed amendments to the Rule) x 10,000 (number of current issuers) = \$1,000,000.

that the approximate cost of preparing a continuing disclosure agreement for each VRDO issuer would be approximately \$600,<sup>213</sup> for a one-time total cost of \$1,200,000<sup>214</sup> for all VRDO issuers, if an outside counsel were to prepare the entire agreement.

The Commission believes that VRDO issuers generally would not incur any other external costs associated with the preparation of annual filings, event notices (including those notices for the new event disclosure items included in the proposed amendments) and failure to file notices. The Commission believes that VRDO issuers would prepare the information contained in these continuing disclosure documents internally and that these internal costs have been accounted for in the hourly burden section above.<sup>215</sup>

The Commission believes that the only external costs VRDO issuers could incur in connection with the submission of continuing disclosure documents to the MSRB would be the costs associated with converting them into an electronic format. The Commission believes that many issuers of municipal securities currently have the computer equipment and software necessary to convert paper copies of continuing disclosure documents to electronic copies and to electronically transmit the documents to the MSRB. VRDO issuers that presently do not have the ability to prepare their annual filings, event notices and/or failure to file notices in an electronic format could incur some costs to obtain electronic copies of such documents if they are prepared by a third party (e.g. accountant or attorney) or, alternatively, to have a paper copy converted into an electronic format. These costs would vary depending on how the VRDO issuer

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<sup>213</sup> 1 (continuing disclosure agreement) x \$400 (hourly wage for an outside attorney) x 1.5 hours (estimated time for outside attorney to draft a continuing disclosure document) = \$600. The \$400 per hour estimate is based on the Commission's staff review of industry sources.

<sup>214</sup> \$600 (cost for continuing disclosure agreement) x 2,000 (number of VRDO issuers) = \$1,200,000.

<sup>215</sup> See supra Section V.D.

elect to convert its continuing disclosure documents into an electronic format. An issuer could elect to have a third-party vendor transfer its paper continuing disclosure documents into the appropriate electronic format. An issuer also could decide to undertake the work internally, and its costs would vary depending on the issuer's current technology resources. An issuer also could elect to use a designated agent to submit its continuing disclosure documents to the MSRB. In the 2008 Amendments Adopting Release, the Commission estimated that 30% of issuers would elect to use designated agents to submit continuing disclosure documents to the MSRB.<sup>216</sup> Generally, when issuers utilize the services of a designated agent, they enter into a contract with the agent for a package of services, including the submission of continuing disclosure documents, for a single fee. Based on a review of industry sources, the Commission's staff estimates this fee to range from \$100 to \$500 per year depending on which designated agent an issuer uses.<sup>217</sup> Accordingly, the Commission's staff estimates that the high end of the total annual cost that could be incurred by VRDO issuers that use the services of a designated agent would be approximately \$300,000.<sup>218</sup>

The cost for an issuer to have a third-party vendor transfer its paper continuing disclosure documents into an appropriate electronic format could vary depending on what resources are required to transfer the documents into the appropriate electronic format. One example of such a transfer would be the scanning of paper-based continuing disclosure documents into an

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<sup>216</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>217</sup> This estimated range of the annual fee for the services of a designated agent is based on the Commission's staff review of industry sources in December 2008.

<sup>218</sup>  $2,000$  (number of VRDO issuers)  $\times$   $.30$  (percentage of issuers that use designated agents)  $\times$   $\$500$  (estimated annual cost for issuer's use of a designated agent) =  $\$300,000$ . In order to provide a total cost estimate that is not under-inclusive the Commission's staff elected to use the higher end of the estimated range of annual fees for designated agent's services.

electronic format. In the 2008 Amendments Adopting Release, the Commission estimated that the approximate cost for an issuer to use a third party vendor to scan an event notice or failure to file notice would be \$8 per notice, and that the maximum number of event notices or failure to file notices that an issuer would submit annually is three.<sup>219</sup> The Commission still believes these estimates are accurate. Under the proposed amendments to the Rule, the Commission's staff estimates that the maximum number of event notices and failure to file notices submitted by issuers would increase to four.<sup>220</sup> Accordingly, the Commission's staff estimates that the maximum external costs for a VRDO issuer who elects to have a third-party scan continuing event notices or failure to file notices into an electronic format under the proposed amendments would be \$32.<sup>221</sup> In the 2008 Amendments Adopting Release, the Commission estimated that the approximate cost for an issuer to use a third party vendor to scan an average-sized annual financial statement would be \$64 per annual statement, and that the maximum number of annual filings submitted per year is two.<sup>222</sup> The Commission believes that these estimates are still accurate. The proposed amendments to the Rule would increase the number of issuers submitting annual filings each year. However, the proposed amendments to the Rule would not increase the number of annual filings each issuer submits yearly. Thus, the Commission expects that the number of annual filings submitted yearly, per issuer, under the proposed amendments to

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<sup>219</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>220</sup>  $6,757$  (estimated additional event notices submitted under proposed amendments) /  $12,000$  (estimated number of issuers under proposed amendments) = .563 notices per issuer (rounded up to 1) (estimated number of additional event notices submitted annually per issuer). To provide an estimate that would not be under-inclusive, the Commission's staff has elected to use an estimate that expects each issuer would submit one additional material event notice as a result of the proposed amendments.

<sup>221</sup> The maximum cost is the cost to scan and convert four material event or failure to file notices:  $4$  (number of notices submitted annually)  $\times$   $\$8.00$  (cost to scan and convert each notice) =  $\$32$ .

<sup>222</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

the Rule would remain the same. Accordingly, the Commission's staff estimates that the maximum external costs for a VRDO issuer who elects to have a third-party scan annual filings into an electronic format under the proposed amendments would be \$128.<sup>223</sup>

Alternatively, a VRDO issuer that currently does not have the appropriate technology to convert paper continuing disclosure documents into an electronic format could elect to purchase the resources to do so.<sup>224</sup> In the 2008 Amendments Adopting Release, the Commission estimated that an issuer's initial cost to acquire these technology resources could range from \$750 to \$4,300.<sup>225</sup> Some VRDO issuers may have the necessary hardware to transmit documents electronically to the MSRB, but may need to upgrade or obtain the software necessary to submit documents to the MSRB in the electronic format that it prescribes. In the 2008 Amendments Adopting Release, the Commission estimated that an issuer's cost to update or acquire this software could range from \$50 to \$300.<sup>226</sup> The Commission believes these estimates are still accurate.

In addition, VRDO issuers without direct Internet access could incur some costs to obtain such access to submit the documents. In the 2008 Amendments Adopting Release, the

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<sup>223</sup> The maximum cost is the cost to scan and convert two annual filings: 2 (number of annual filings submitted annually) x \$64.00 (cost to scan and convert each annual filing) = \$128.

<sup>224</sup> Generally, the technology resources necessary to transfer a paper document into an electronic format are a computer, scanner and possibly software to convert the scanned document into the appropriate electronic document format. Most scanners include a software package that is capable of converting scanned images into multiple electronic document formats. An issuer would only need to purchase software if the issuer (i) has a scanner that does not include a software package that is capable of converting scanned images into the appropriate electronic format, or (ii) purchases a scanner that does not include a software package capable of converting documents into the appropriate electronic format.

<sup>225</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>226</sup> Id.

Commission noted that Internet access is now broadly available to and utilized by businesses, governments, organizations and the public, and the Commission expects that most issuers of municipal securities currently have Internet access.<sup>227</sup> In the event that a VRDO issuer does not have Internet access, it could incur costs in obtaining such access, which the Commission estimates to be approximately \$50 per month, based on its limited inquiries to Internet service providers.<sup>228</sup> Otherwise, there are multiple free or low cost locations that an issuer could utilize, such as various commercial sites, which could help an issuer to avoid the costs of maintaining continuous Internet access solely to comply with the proposed amendments to the Rule.<sup>229</sup>

Accordingly, the Commission estimates that the costs to some of the VRDO issuers to acquire technology necessary to convert continuing disclosure documents into an electronic format to submit to the MSRB could include: (i) an approximate cost of \$8 per notice to use a third party vendor to scan an event notice or failure to file notice, and an approximate cost of \$64 to use a third party vendor to scan an average-sized annual financial statement, (ii) an approximate cost ranging from \$750 and \$4,300 to acquire technology resources to convert continuing disclosure documents into an electronic format, (iii) \$50 to \$300 solely to upgrade or acquire the software to submit documents in an electronic format; and (iv) approximately \$50 per month to acquire Internet access. The Commission included these estimates in the 2008 Amendments Adopting Release and the Commission believes that they are still accurate.<sup>230</sup>

For a VRDO issuer that does not have Internet access and elects to have a third party convert continuing disclosure documents into an electronic format ("Category 1"), the total

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<sup>227</sup> Id.

<sup>228</sup> Id.

<sup>229</sup> Id.

<sup>230</sup> Id.

maximum external cost such issuer would incur would be \$760 per year.<sup>231</sup> For an issuer that does not have Internet access and elects to acquire the technological resources to convert continuing disclosure documents into an electronic format internally (“Category 2”), the total maximum external cost such VRDO issuer would incur would be \$4,900 for the first year and \$600 per year thereafter.<sup>232</sup> To be conservative for purposes of the PRA, the Commission estimates that any VRDO issuers that incur costs associated with converting continuing disclosure documents into an electronic format would choose the Category 2 option.<sup>233</sup> The Commission’s staff estimates that approximately no more than 400 VRDO issuers would incur costs associated with acquiring technology resources to convert continuing disclosure documents into an electronic format.<sup>234</sup> Additionally, the Commission’s staff estimates that the estimated

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<sup>231</sup> The total maximum external cost for a Category 1 VRDO issuer would be calculated as follows: [\$64 (cost to have third party convert annual filing into an electronic format) x 2 (maximum estimated number of annual filings filed per year per issuer)] + [\$8 (cost to have third party convert material event notice or failure to file notice into an electronic format) x 4 (maximum estimated number of event or failure to file notices filed per year per issuer)] + [\$50 (estimated monthly Internet charge) x 12 months] = \$760. The Commission’s staff estimates that an issuer would file one to six continuing disclosure documents per year. These documents generally would consist of no more than two annual filings and four event or failure to file notices. The Commission’s staff estimates the maximum number of documents filed annually per issuer as follows: 5 documents (consisting of 2 annual filings and 3 event or failure to file notices based on the Commission’s estimate from the 2008 Amendment Adopting Release) + 1 document (consisting of the additional event notice that would be filed under the proposed amendments to the Rule).

<sup>232</sup> The total maximum external cost for a Category 2 VRDO issuer would be calculated as follows: [\$4300 (maximum estimated one-time cost to acquire technology to convert continuing disclosure documents into an electronic format)] + [\$50 (estimated monthly Internet charge) x 12 months] = \$4900. After the initial year, issuers who acquire the technology to convert continuing disclosure documents into an electronic format internally would only have the cost of obtaining Internet access. \$50 (estimated monthly Internet charge) x 12 months = \$600.

<sup>233</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>234</sup> 2,000 VRDO issuers x 20% = 400 VRDO issuers. The Commission used a 20% estimate in the 2008 Amendment Adopting Release. See 2008 Amendments Adopting Release,

maximum annual costs for those VRDO issuers that need to acquire technology resources to submit documents to the MSRB would be approximately \$1,960,000<sup>235</sup> for the first year after the adoption of the proposed amendments and approximately \$240,000<sup>236</sup> for each year thereafter.

(c) Current and VRDO Issuers

Lastly, some current and VRDO issuers may incur a one-time external cost associated with the proposed amendment to change the timing requirement for submitting event notices in the Rule from “in a timely manner” to “in a timely manner not to exceed ten business days after the occurrence of the event.” In particular, some current and VRDO issuers may incur a one-time external cost associated with monitoring for a change in the name of the issuer’s trustee. One way an issuer may monitor a change in the name of its trustee cost would be to have outside counsel add a notice provision to the issuer’s trust indenture requiring the trustee to provide the issuer with notice of any change in the trustee’s name. Based on a review of industry sources, the Commission’s staff estimates that it would take an outside attorney approximately 15 minutes to draft and add a notice provision for a change in name of the trustee to an indenture agreement. Thus, the Commission’s staff estimates that the approximate cost of adding this

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supra note 11, 73 FR 76104. The Commission believes that this estimate is still appropriate.

<sup>235</sup> 400 (Category 2 issuers) x \$4,900 = \$1,960,000.

<sup>236</sup> 400 (Category 2 issuers) x \$600 = \$240,000.

notice provision to an issuer's trust indenture for each issuer would be approximately \$100,<sup>237</sup> for a one-time annual cost of \$1,200,000<sup>238</sup> for all issuers.

F. Retention Period of Recordkeeping Requirements

As an SRO subject to Rule 17a-1 under the Exchange Act,<sup>239</sup> the MSRB is required to retain records of the collection of information for a period of not less than five years, the first two years in an easily accessible place. The proposed amendments to the Rule would contain no recordkeeping requirements for any other persons.

G. Collection of Information is Mandatory

Any collection of information pursuant to the proposed amendments to the Rule would be a mandatory collection of information.

H. Responses to Collection of Information Will Not Be Kept Confidential

The collection of information pursuant to the proposed amendments to the Rule would not be confidential and would be publicly available. The collection of information that would be provided pursuant to the continuing disclosure documents under the proposed amendments would be accessible through the MSRB's EMMA system and would be publicly available via the Internet.

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<sup>237</sup> 1 (continuing disclosure agreement) x \$400 (hourly wage for an outside attorney) x .25 hours (estimated time for outside attorney to draft and add a change of name notice provision to a trust indenture) = \$100. The \$400 per hour estimate for an outside attorney's work is based on the Commission's staff review of industry sources.

<sup>238</sup> \$100 (estimated cost to have outside counsel add a change of name notice provision to a trust indenture) x 12,000 (number of issuers under the proposed amendments) = \$1,200,000.

<sup>239</sup> 17 CFR 240.17a-1.

I. Request for Comments

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments regarding: (1) whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) the accuracy of the Commission's estimate of the burden of the revised collections of information; (3) whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The Commission has submitted to OMB for approval the proposed revisions to the current collection of information titled "Municipal Securities Disclosure." Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-0609, with reference to File No. S7-15-09, and be submitted to the Securities and Exchange Commission, Public Reference Room, 100 F Street, NE, Washington, DC 20549. As OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, should refer to File No. S7-15-09, and be submitted to the Securities and Exchange Commission, Public Reference Room, 100 F Street, NE, Washington, DC 20549.

## **VI. Costs and Benefits of Proposed Amendment to Rule 15c2-12**

The Commission is proposing amendments to Rule 15c2-12 that would amend certain requirements regarding the information that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities must reasonably determine that an issuer of municipal securities or an obligated person has undertaken, in a written agreement or contract for the benefit of holders of the issuer's municipal securities, to provide to the MSRB. Specifically, the proposed amendments would require a broker, dealer, or municipal securities dealer to reasonably determine that the issuer or obligated person has agreed to provide notice of specified events in a timely manner not in excess of ten business days after the event's occurrence, would amend the list of events for which a notice must be provided, and would modify the events that are subject to a materiality determination before triggering a notice to the MSRB. In addition, the amendments would revise an exemption from the rule for certain offerings of municipal securities with put features. These proposed amendments are intended to help improve the availability of timely and important information to investors and other market participants regarding municipal securities, including demand securities, so that investors could make more knowledgeable investment decisions, effectively manage and monitor their investments, and help protect themselves against fraud, and so brokers, dealers, and municipal securities dealers could satisfy their obligation to have a reasonable basis on which to recommend a municipal security.

The Commission is sensitive to the costs and benefits of the proposed rule amendments and requests comment on the costs and benefits of the proposed amendments to Rule 15c2-12 discussed above. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data regarding any such costs or benefits.

A. Benefits

The proposed amendments would modify paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule to provide that a Participating Underwriter must reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide event notices to the MSRB in a timely manner not to exceed ten business days after the occurrence of the event. The current provisions of the Rule state that a Participating Underwriter must reasonably determine that the continuing disclosure agreement provides that event notices are to be provided "in a timely manner" to the MSRB in an electronic format. As discussed above, the Commission preliminarily believes that more timely availability of such significant information would assist investors in making better informed investment decisions and should help reduce instances of fraud. The Commission also anticipates that, in providing for a maximum time frame within which event notices should be disclosed under a continuing a disclosure agreement, the proposed amendment should foster the availability of up-to-date information about municipal securities, thereby further promoting greater transparency and investor confidence in the municipal securities market as a whole, and assisting investors to better protect themselves against fraud. Moreover, brokers, dealers and municipal securities dealers should be able to more readily carry out their responsibilities under the securities laws. The Commission believes that the proposed change regarding the maximum time frame for submission of event notices should continue to provide an issuer with adequate time to become aware of the event and, pursuant to its undertaking, submit notice of the event's occurrence to the MSRB. In proposing that event notices be provided "in a timely manner not in excess of ten business days after the occurrence of the event," the Commission intends to strike a balance between the need for such information to be disseminated promptly and the need to allow adequate time for an issuer to become aware

of the event and to prepare and file such a notice. The Commission preliminarily believes that the proposed time frame of ten business days after the occurrence of the event would provide a reasonable amount of time for issuers to comply with their obligations under their continuing disclosure agreements, while also allowing event notices to be made available to investors in a more timely manner. The Commission notes that issuers would not be precluded from submitting subsequent notices as additional information relating to the event becomes available.

The proposed amendments would modify subparagraph (b)(5)(i)(C)(6) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide notice to the MSRB of the issuance of proposed and final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB), or other material notices or determinations with respect to the tax-exempt status of securities by the Internal Revenue Service, as well as adverse tax opinions and other events affecting the tax-exempt status of such securities. As discussed earlier, the Commission believes that the tax-exempt status of municipal securities is of significant importance to investors and other participants in the municipal securities market.<sup>240</sup> The Commission believes that this tax-exempt status has a significant impact on the value of municipal securities, as well as on the potential tax liability a municipal security holder may incur if such status were to change. Accordingly, the Commission believes that this amendment to subparagraph (b)(5)(i)(C)(6) of the Rule would clarify a Participating Underwriter's obligation to determine that the issuer has undertaken in its continuing disclosure agreements to provide notice of these events that could affect the tax-exempt status of its municipal securities.

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<sup>240</sup> See supra Section II.C.

The Commission is proposing to delete the condition in paragraph (b)(5)(i)(C) of the Rule that presently provides that notice of all of the listed events need be made only “if material.” The Commission has reviewed each of the Rule’s current disclosure event items and determined six instances in which no materiality evaluation should be necessary.<sup>241</sup> Issuers would not need to undertake the determination of materiality for these six events, which should help speed the disclosure of these events to investors and the public and eliminate the costs presently required of an issuer to make such a determination.

The proposed amendments would add tender offers to subparagraph (b)(5)(i)(C)(8) of the Rule, which currently covers bond calls.<sup>242</sup> The Commission believes that the need to reach all investors with important information regarding a tender offer, which necessitates that an investor decide whether or not to tender within the prescribed time period, makes its proposed addition to the Rule appropriate. As a result, the proposal would help improve the ability of issuers and other obligated persons to communicate tender offers to bondholders effectively and of bondholders to respond within the tender offer period. In addition, the proposed amendment to subparagraph (b)(5)(i)(C)(8) of the Rule could help eliminate the possibility of any investor confusion regarding whether a certain municipal security is the subject of a tender offer. In all these ways, the availability of this information would help investors protect themselves from misrepresentation and fraud, and would also aid brokers, dealers and municipal securities dealers to satisfy their obligation to have a reasonable basis to recommend a municipal security.

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<sup>241</sup> These events are: (1) principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.

<sup>242</sup> See supra Section II.E.1.

The proposed addition of subparagraph (b)(5)(i)(C)(12) to the Rule would require the Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide notice to the MSRB, upon its bankruptcy, insolvency, receivership or similar event.<sup>243</sup> The Commission notes that, while bankruptcy, insolvency, receivership or similar event of the issuer or obligated person are uncommon in the municipal market, these events can have a significant impact on the price of the municipal issuer's securities. The Commission believes that the potential severity of the consequences to investors from bankruptcy, insolvency, receivership or similar event of the issuer or obligated person, and the corresponding benefit of the availability of that information to help prevent fraud, supports its proposal that the Participating Underwriter should be required to reasonably determine that the issuer or obligated person has undertaken in its continuing disclosure agreement to provide notice to the MSRB if such an event should occur.

In addition, the proposed amendments would add subparagraph (b)(5)(i)(C)(13) to the Rule, which would require the Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide notice to the MSRB, if material, of the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms.<sup>244</sup> As with bankruptcy, insolvency, receivership or similar event of the issuer or obligated person, there can be a potential impact on the price of a municipal security as a result of the consummation of a material merger, consolidation, or acquisition involving an

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<sup>243</sup> See supra Section II.E.2.

<sup>244</sup> See supra Section II.E.3.

obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms. In such a circumstance, the Commission believes that the proposed amendment would help to ensure that investors and other market participants could obtain knowledge of the identity of the entity that would have responsibility for municipal security repayment obligations after the transaction is consummated. In addition, investors and other market participants would have the opportunity to review the creditworthiness and other aspects of the acquiring entity that would support repayment of the security following the transaction. Thus, the proposed amendment would help to prevent fraud.

Proposed subparagraph (b)(5)(i)(C)(14) to the Rule would add the appointment of a successor or additional trustee or the change of name of a trustee to the list of events contained in the Rule, if material. As discussed earlier, the Commission believes that the trustee of a municipal security performs important functions for investors in that security.<sup>245</sup> The Commission notes that the proposed amendment would benefit investors by helping to ensure that the continuing disclosure agreement would provide that investors be made aware of the identity of and contact information for the most current trustee for a municipal security and that any changes to the trustee's identity would be made known to investors in a timely manner, not in excess of ten business days of the event's occurrence.

Further, the Commission proposes to modify the exemption in the Rule for demand securities. As discussed above, when the Commission adopted this exemption, demand

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<sup>245</sup> See supra Section II.E.4.

obligations made up a relatively small portion of the municipal market.<sup>246</sup> Recently, issuances of demand securities have increased.<sup>247</sup> The Commission believes that it is important that there be greater information regarding these securities available to investors, market professionals, and the public generally. Accordingly, the Commission believes that modifying the Rule's exemption for demand securities would be beneficial to investors and the prevention of fraud. The modification of the Rule's exemption for demand securities would provide investors with notice of the events set forth in the Rule regarding demand securities that may not have been available previously. In addition, this proposal would restrict a broker, dealer or municipal securities dealer from making recommendations regarding such securities unless it has procedures in place that provide reasonable assurance that it would receive prompt notice of the events set forth in the Rule,<sup>248</sup> which should benefit investors because the broker, dealer or municipal securities dealer should have available to it continuing disclosure information regarding the demand obligation it recommends.

The Commission believes that the proposed amendments would benefit individual and institutional investors who would be able to obtain greater information about municipal securities that they could use to make informed investment decisions. Moreover, this information would aid investors by helping them to determine that they are not the subject of fraudulent or manipulative acts or practices with respect to municipal security transactions. In addition, the Commission believes that the proposed amendments could assist broker-dealers and others, such as mutual funds, with their compliance with regulatory requirements because they would have access to greater information about municipal securities. Moreover, municipal securities vendors

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<sup>246</sup> See supra Section II.A.

<sup>247</sup> Id.

<sup>248</sup> See 17 CFR 240.15c2-12(c).

could benefit from the proposed amendments because additional information about municipal securities and their issuers would be made available, which they then could use in developing or enhancing value-added products to offer to interested parties.

In the Commission's view, the proposed amendments would have a positive impact on the municipal securities market and participants in that market sector. It is possible that, with more information available to market professionals, individual investors, and others regarding municipal securities, including VRDOs, there could be greater competition in the marketplace with respect to the offer and sale of municipal securities, to the benefit of these individuals and entities. Greater information enhances the ability of market professionals, investors and others to make investment-related decisions about particular municipal securities, which in turn can promote competition in the marketplace. Moreover, individual and institutional investors might take into account the fact that more information would be available about municipal securities, including VRDOs, when they decide whether to purchase municipal securities.

The Commission seeks comment on the anticipated benefits of the proposed amendments.

B. Costs

1. Broker-Dealers

The proposed amendments to paragraph (b)(5)(i)(C) of the Rule would add events that would require Participating Underwriters to reasonably determine that issuers or obligated persons agreed to provide notice of and would specify the maximum time period in which such notices would need to be submitted to the MSRB. The Commission does not believe that the proposed amendments to paragraph (b)(5)(i)(C) of the Rule would cause broker-dealers to incur any additional recurring external or internal costs in connection with their implementation, if the

proposals are adopted, because they would not significantly alter the existing Rule's requirements for broker-dealers. Under the Rule, broker-dealers already must reasonably determine that issuers or obligated persons have undertaken to provide notice of specified events in their continuing disclosure agreements and the addition of a few more events that would require notice to the MSRB and the addition of a provision regarding the timeliness of such notices should not significantly increase broker-dealers' obligations and thus their costs. As noted above, continuing disclosure documents generally are form documents. The broker-dealer must reasonably determine that provisions relating to the issuer's or obligated person's undertaking to provide notice of those events that are specified in the current Rule, as well as those events that are proposed to be added to the Rule, are contained in the continuing disclosure agreement.

The proposed amendments also would modify the Rule's exemption for demand securities. The Commission preliminarily believes that these proposed amendments would not result in any external recurring costs for broker-dealers but could result in their incurring a small increase in internal recurring costs because these proposals would increase the number of municipal securities offerings subject to paragraphs (b)(5) and (c) of the Rule. The proposed deletion of paragraph (d)(1)(iii) of the Rule and the addition of new paragraph (d)(5) to the Rule, would modify an exemption from the Rule for primary offerings of demand securities. As noted above, the Commission's staff estimates that the modification of this exemption from the Rule would increase the number of issuers with municipal securities offerings subject to the Rule by 20%.<sup>249</sup> The Commission's staff estimates that the annual information collection burden for each broker-dealer under this proposed amendment to the Rule would be 1.20 hours (1 hour and 12

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<sup>249</sup> See supra Section V.D.1.a.

minutes).<sup>250</sup> Accordingly, the Commission's staff estimates that it would cost each broker-dealer \$324 annually to comply with the Rule, which represents a cost increase of \$54 annually over each broker-dealer's current annual cost to comply with the Rule.<sup>251</sup>

In addition, the Commission's staff estimates that a broker-dealer could have a one-time internal cost associated with having an in-house compliance attorney prepare and issue a memorandum advising the broker-dealer's employees about the proposed revisions to Rule 15c2-12. The Commission's staff estimates it would take internal counsel approximately 30 minutes to prepare this memorandum,<sup>252</sup> for a cost of approximately \$135.<sup>253</sup> The Commission further believes that the ongoing obligations of broker-dealers under the Rule would be handled internally because compliance with these obligations is consistent with the type of work that a broker-dealer typically handles internally.

The Commission seeks comment on any other potential costs that may result from the proposal amendments, including whether there would be any change to the cost of underwriting

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<sup>250</sup> Id.

<sup>251</sup> 1.20 hours (estimated annual information collection burden for each broker-dealer) x \$270 (hourly cost for a broker-dealer's internal compliance attorney) = \$324. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. Cost increase for Broker-Dealers under the proposed amendments to the Rule: \$324 (annual cost under amended rule) - \$270 (annual cost under current Rule) = \$54. This estimated cost for broker-dealers also accounts for their review of continuing disclosure agreements in connection with remarketings of VRDOs that are primary offerings.

<sup>252</sup> See supra Section V.D.1.c.

<sup>253</sup> .5 hours (estimated annual information collection burden for each broker-dealer) x \$270 (hourly cost for a broker-dealer's internal compliance attorney) = \$135. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

variable rate demand obligations or other types of municipal securities for which greater information would be available as a result of the Commission's proposals and, if so, whether there would be any effect on a broker-dealer's business and revenues. The Commission seeks comment on whether the proposed amendments would adversely affect the ability of broker-dealers to serve as Participating Underwriters in municipal securities offerings, particularly in the case of offerings of variable rate demand obligations. While the Commission does not anticipate that there would be any adverse consequences to a broker-dealer's business, activities or financial condition as a result of the proposed amendments, it seeks commenters' views regarding the possibility of any such impact. The Commission requests comment on any direct or indirect costs broker-dealers could incur as a result of the proposed amendments and asks commenters to quantify those costs, where possible.

2. Issuers

(a) Current Issuers

The Commission expects that some current issuers could be subject to some internal and external costs associated with the proposed amendments to the Rule. As noted above, the proposed revisions to the Rule regarding the time period for submission of event notices and regarding the materiality condition for such notices would not change the substance of an event notice, the method for filing an event notice, or the location to which an event notices would be submitted.<sup>254</sup> Accordingly, the Commission preliminarily does not believe that issuers would incur any costs associated with the proposed change to the timing provision of the Rule, except to the extent that some issuers may need to submit notices more speedily than they do currently

<sup>254</sup>

See supra Section V.D.2.b.i. See infra Section V.I.B.2.b. for a discussion of the costs associated with an increase in the number of issuers as a result of the proposed amendment modifying the exemption for demand securities.

and may need to be cognizant of events not within their direct control, such as a rating change, that would prompt submission of an event notice. The Commission preliminarily believes that the costs for current issuers would result from the proposed amendments to the Rule associated with the proposed new and modified event notice provisions and the elimination of the materiality determination for certain event notices in the current Rule.<sup>255</sup> Current issuers would incur internal costs associated with the preparation of the additional event notices that may result from these proposed changes to the event notice provisions of the Rule. Current issuers also would incur costs if they issue demand obligations, as discussed below.

For current issuers that convert their annual filings, event notices and/or failure to file notices into the MSRB's prescribed electronic format through a third party there would be additional costs associated with any additional submissions of event notices and failure to file notices. As noted above, the Commission estimates that each current issuer would submit one additional event notice annually as a result of the proposed amendments.<sup>256</sup> If the current issuer uses a third-party vendor to scan the additional event notice into an electronic format for submission to the MSRB, the Commission estimates that such issuer would have an additional annual cost of \$8 per notice.<sup>257</sup> For current issuers that convert their annual filings, event notices and/or failure to file notices into the MSRB's prescribed electronic format internally there would

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<sup>255</sup> As to two of the proposed new events, the amendments would include a materiality determination. Such a materiality determination could result in costs to investors, market professionals and others to the extent the issuer or obligated person determined that the event was not material and thus did not submit a notice to the MSRB. If investors, market professionals and others would have considered the information important and had access to it, they might have made a different investment decision.

<sup>256</sup> See supra Section V.E.2.a.

<sup>257</sup> Id.

be no additional external costs associated with the conversion of the event notice into the MSRB's prescribed electronic format.

As discussed above,<sup>258</sup> some current issuers may incur a one-time cost of \$100 associated with the need to revise the template for continuing disclosure agreements, if the proposed amendments are adopted.<sup>259</sup>

The Commission also believes that current issuers could incur some internal labor costs associated with the preparation and submission of the additional event notice. As discussed above,<sup>260</sup> the Commission's staff estimates that a current issuer would submit a maximum of one additional event notice annually.<sup>261</sup> Thus, the Commission staff estimates that the maximum annual labor cost to prepare and submit the additional event notice is approximately \$47 per current issuer.<sup>262</sup>

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<sup>258</sup> Id.

<sup>259</sup> Id. The Commission's staff estimates that there is an approximate cost of \$100 associated with revising each continuing disclosure agreement by the current issuer's outside counsel. Thus, the total cost for revising continuing disclosure agreements for all current issuers by the current issuers' outside counsel would be approximately \$1,000,000.

<sup>260</sup> Id.

<sup>261</sup> This estimate includes additional event notices that may be submitted as a result of the proposed modification of the materiality condition in paragraph (b)(5)(i)(C) of the Rule.

<sup>262</sup>  $1$  (maximum estimated number of additional material event notices submitted per year per issuer) x \$63 (hourly wage for a compliance clerk) x .75 hours (45 minutes) (estimated time for compliance clerk to prepare and submit a material event notice) = \$47.25 (rounded to \$47). The \$63 per hour estimate for a compliance clerk is from SIFMA's Office Salaries in the Securities Industry 2008, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead. In order to provide an estimate of total costs for issuers that would not be under-inclusive, the Commission's staff elected to use the higher end of the estimate of annual submissions of continuing disclosure documents. See supra note 220.

The Commission seeks comment on any other costs that the proposed addition of several new event items, the proposed maximum time frame to submit event notices, and the revisions with respect to the materiality condition would have on issuers. While the Commission preliminarily does not believe that these proposals would have a significant cost impact on issuers, it seeks commenters' views on any direct or indirect cost consequences as a result of the proposals. For example, would the proposed amendments in any way make it more likely or less likely for issuers to obtain needed financing or to obtain a broker-dealer to conduct a primary offering on their behalf? Would there be any costs incurred by investors, market professionals or others as a result of the proposed amendments? Are there other internal or external costs not identified by the Commission that could result from the proposed amendments? The Commission requests comment on any direct or indirect costs issuers could incur as a result of the proposed amendments and asks commenters to quantify those costs, where possible.

(b) VRDO Issuers

As discussed above, the Commission estimates that the proposed modification of the Rule's exemption for demand securities would increase the number of issuers affected by the Rule by approximately 20% or 2,000 issuers.<sup>263</sup> These VRDO issuers may have some costs associated with the preparation and submission of continuing disclosure documents. As discussed above, the Commission believes that each VRDO issuer may have a one-time external cost of \$600 associated with entering into a continuing disclosure agreements.<sup>264</sup> The Commission believes that the only other external costs for VRDO issuers would be the costs

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<sup>263</sup> See supra Section V.D.2.a.

<sup>264</sup> See supra Section V.E.2.b. The Commission's staff has estimated that there is an approximate cost of \$600 associated with drafting each continuing disclosure agreement by the VRDO issuer's outside counsel. Thus, the total cost for preparing continuing disclosure documents for all VRDO issuers by the VRDO issuers' outside counsel would be approximately \$1,200,000.

associated with converting continuing disclosure documents into an electronic format to submit to the MSRB. As noted earlier, the Commission believes that many issuers of municipal securities currently have the computer equipment and software necessary to convert paper copies of continuing disclosure documents to electronic copies and to electronically transmit the documents to the MSRB.<sup>265</sup> VRDO issuers that presently do not have the ability to prepare their annual filings, event notices and/or failure to file notices in an electronic format could incur some costs to obtain electronic copies of such documents if they are prepared by a third party (e.g., accountant or attorney) or, alternatively, to have a paper copy converted into an electronic format. These costs would vary depending on how the VRDO issuer elected to convert its continuing disclosure documents into an electronic format. An issuer could elect to have a third-party vendor transfer its paper continuing disclosure documents into the appropriate electronic format. An issuer also could decide to undertake the work internally, and its costs would vary depending on the issuer's current technology resources. An issuer also could use the services of a designated agent to submit its continuing disclosure documents to the MSRB. In the 2008 Amendments Adopting Release, the Commission noted that approximately 30% of municipal issuers rely on the services of a designated agent to submit continuing disclosure documents for them.<sup>266</sup> Generally, when issuers utilize the services of a designated agent, they enter into a contract with the agent for a package of services, including the submission of continuing disclosure documents, for a single fee. As noted above, the Commission's staff estimates that the annual fees for designated agents range from \$100 to \$500 per issuer, for a total maximum annual cost of \$300,000 for all VRDO issuers.<sup>267</sup>

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<sup>265</sup> Id.

<sup>266</sup> See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>267</sup> See supra Section V.E.2.b.

As noted above, the Commission estimates that the costs to some of the VRDO issuers may incur costs associated with converting continuing disclosure documents into an electronic format to submit to the MSRB. These costs could include: (i) an approximate cost of \$8 per notice to use a third party vendor to scan a event notice or failure to file notice, and an approximate cost of \$64 to use a third party vendor to scan an average-sized annual financial statement, (ii) an approximate cost ranging from \$750 and \$4,300 to acquire technology resources to convert continuing disclosure documents into an electronic format, (iii) \$50 to \$300 solely to upgrade or acquire the software to submit documents in an electronic format; and (iv) approximately \$50 per month to acquire Internet access.<sup>268</sup>

For a VRDO issuer that does not have Internet access and elects to have a third party convert continuing disclosure documents into an electronic format ("Category 1"), the total maximum external cost such issuer would incur would be \$760 per year.<sup>269</sup> For an issuer that does not have Internet access and elects to acquire the technological resources to convert continuing disclosure documents into an electronic format internally ("Category 2"), the total maximum external cost such VRDO issuer would incur would be \$4,900 for the first year and \$600 per year thereafter. As noted above, in order to provide a conservative cost estimate, the Commission has estimated that any VRDO issuer that incurs costs associated with converting continuing disclosure documents into the MSRB's prescribed electronic format would choose the more expensive Category 2 approach.<sup>270</sup> The Commission's staff estimates that approximately 400 VRDO issuers would incur costs associated with acquiring technology resources to convert

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<sup>268</sup> Id.

<sup>269</sup> See supra note 231.

<sup>270</sup> See supra Section V.E.2.b.

continuing disclosure documents into an electronic format.<sup>271</sup> Additionally, the Commission's staff estimates that the maximum annual costs for those VRDO issuers that need to acquire technology resources to submit documents to the MSRB would be approximately \$1,960,000 for the first year after the adoption of the proposed amendments and approximately \$240,000 for each year thereafter.<sup>272</sup>

Although the Commission preliminarily does not believe that there are any additional costs to issuers or obligated persons of VRDOs as a result of the proposed amendments, it requests comment regarding any possible direct or indirect costs that such issuers could incur, such as any potential impact on underwriting fees, interest costs, or other costs generally. Would the proposed amendments adversely affect the business, activities or financial condition of VRDO issuers or obligated persons, their ability to engage broker-dealers to underwrite or to act as remarketing agents of VRDOs, or to engage financial advisors?

(c) Current and VRDO Issuers

Lastly, as discussed above, some current and VRDO issuers may incur a one-time external cost associated with the proposed amendment to change the timing requirement for submitting event notices in the Rule from "in a timely manner" to "in a timely manner not to exceed ten business days after the occurrence of the event." In particular, some current and VRDO issuers may incur a one-time external cost associated with monitoring for a change in the name of the issuer's trustee. One way an issuer may monitor a change in the name of its trustee cost would be to have outside counsel add a notice provision to the issuer's trust indenture requiring the trustee to provide the issuer with notice of any change in the trustee's name. The

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<sup>271</sup> 2000 VRDO issuers x 20% = 400 VRDO issuers. See 2008 Amendments Adopting Release, supra note 11, 73 FR 76104.

<sup>272</sup> See supra Section V.E.2.b.

Commission's staff estimates that the approximate cost of adding this notice provision to an issuer's trust indenture for each issuer would be approximately \$100,<sup>273</sup> for a one-time annual cost of \$1,200,000<sup>274</sup> for all issuers.

The Commission requests comment on any direct or indirect costs issuers or obligated persons could incur as a result of the proposed amendments and asks commenters to quantify those costs, where possible.

3. MSRB

Since the number of continuing disclosure documents submitted would increase as a result of the proposed amendments, the MSRB could incur costs associated with the proposed amendments. The Commission's staff estimates that these costs for the MSRB may include: (i) the cost to hire additional clerical personnel at an estimated annual cost of \$127,890 to process the additional submissions associated with the proposed amendments to the Rule;<sup>275</sup> and (ii) the cost to update its EMMA system to accommodate indexing information in connection with the proposed changes to the material disclosure events of the Rule. Based on information provided to Commission staff by MSRB staff in a telephone conversation on November 7, 2008, the MSRB staff estimated that the MSRB's costs to update its EMMA system to accommodate the proposed changes to the material disclosure events of the Rule would be approximately

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<sup>273</sup> See supra note 237.

<sup>274</sup> See supra note 238.

<sup>275</sup> 2,030 hours (estimated additional annual number of hours worked by a compliance clerk) x \$63 (hourly wage for a compliance clerk) = \$127,890 (annual salary for compliance clerk). The \$63 per hour estimate for a compliance clerk is from SIFMA's Office Salaries in the Securities Industry 2008, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead. The estimate for additional annual hours worked by a compliance clerk is the estimated additional hourly burden the MSRB would incur on an annual basis under the proposed amendments to the Rule. See Section V.D.

\$10,000.<sup>276</sup> Therefore, in connection with the proposed amendments the MSRB would incur a one-time cost of approximately \$10,000 as well as a recurring annual cost of approximately \$127,890.<sup>277</sup>

Given that the MSRB has provided a preliminary estimate of the costs that it would incur in connection with the proposed amendments, the Commission does not believe that there are any other direct or indirect additional costs that the MSRB may incur as a result of the proposals. The Commission seeks comment on all direct and indirect costs that its proposals would impose on the MSRB and requests that those costs be quantified, where possible.

C. Request for Comment on Costs and Benefits

The Commission preliminarily believes that any additional burden or costs on broker-dealers, issuers, and the MSRB as a result of the proposed amendments would be justified by the improved availability of information to broker-dealers, mutual funds that hold municipal securities, analysts and other market professionals, institutional and retail investors, vendors of municipal securities information, and the public generally, all of which contribute to investors' ability to make more knowledgeable investment decisions, effectively manage and monitor their investments, and protect themselves from misrepresentation and fraud. This availability also would contribute to brokers, dealers and municipal securities dealers' reasonable basis to recommend the purchase or sale of municipal securities. To assist the Commission in evaluating the costs and benefits that could result from the proposed amendments to the Rule, the Commission requests comments on the potential costs and benefits identified in this proposal, as well as any other costs or benefits that could result from the proposed amendments to the Rule.

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<sup>276</sup> Telephone conversation between Harold Johnson, Deputy General Counsel, MSRB, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, November 7, 2008.

<sup>277</sup> See supra notes 261 and 262.

In particular, comments are requested on whether there are costs or benefits to any entity not identified above. Commenters should provide analysis and data to support their views on the costs and benefits. In particular, the Commission requests comment on the costs and benefits of the proposed amendments on broker-dealers, issuers, the MSRB, other municipal securities information vendors, as well as any costs on others, including market participants and investors.

**VII. Consideration of Burden and Promotion of Efficiency, Competition, and Capital Formation**

Section 3(f) of the Exchange Act<sup>278</sup> requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act<sup>279</sup> requires the Commission, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition. Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The proposed amendments to the Rule would revise paragraph (b)(5) of Rule 15c2-12 to require Participating Underwriters to reasonably determine that the issuer or obligated person has agreed at the time of a primary offering: (i) to provide notice of the events listed in paragraph (b)(5)(i)(C) of the Rule in a timely manner, but not later than ten business days after the occurrence of the event;<sup>280</sup> and (ii) to expand the list of events in paragraph (b)(5)(i)(C) of the

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<sup>278</sup> 15 U.S.C. 78c(f).

<sup>279</sup> 15 U.S.C. 78w(a)(2).

<sup>280</sup> The Commission proposes a similar revision to the limited undertaking in paragraph (d)(2)(ii)(B) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB "in a timely manner not in excess of ten business days

Rule to include the following: the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the securities; a tender offer; bankruptcy, insolvency, receivership or similar event of the issuer or obligated person; and the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material. The proposed amendments would delete the materiality condition for some, but not all, of the events currently listed in paragraph (b)(5)(i)(C) of the Rule. In addition, the proposed amendments would narrow the exemption currently contained in paragraph (d)(1)(iii) of the Rule for demand securities, by deleting paragraph (d)(1)(iii), and adding paragraph (d)(5) to the Rule to make the event disclosure provisions contained in section (b)(5)(i)(C) of the Rule applicable to this category of municipal securities.

As discussed below, the Commission preliminarily believes that the proposed amendments to the Rule should help make the municipal disclosure process more efficient because of the proposed new events to be added to paragraph (b)(5)(i)(C) of the Rule; the proposal that submissions of event notices to the MSRB must be made in a timely manner not in excess of ten business days of the event's occurrence; and the proposed modification of the exemption for demand securities through the elimination of paragraph (d)(1)(iii) of the Rule, and the addition of paragraph (d)(5) to the Rule. Currently, the Rule does not contain a specific time

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after the occurrence of the event," instead of "in a timely manner" as the Rule currently provides.

frame within which a continuing disclosure agreement must specify that event notices will be provided to the MSRB. Thus, the Commission believes the proposed change should help individuals or entities interested in obtaining information about events relating to municipal issuers to obtain this information from the MSRB within a specific time frame of the event's occurrence. In addition, certain events regarding municipal securities that may be important to investors, such as certain tender offers or the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material, are not currently included in the Rule. Further, certain events listed in paragraph (b)(5)(i)(C) of the rule would need to be disclosed, without the issuer having to make a materiality determination. Moreover, the Rule currently contains an exemption for demand securities, which means that broker-dealers are not required to reasonably determine that the issuer or obligated person has undertaken to provide the information set forth in paragraph (b)(5) of the Rule. As a consequence of the proposed amendments, greater information about municipal securities and their issuers should be more readily accessible on a more-timely basis to broker-dealers, mutual funds, analysts and other market professionals, institutional and retail investors, and the public generally. Thus, these individuals and entities should be able to obtain greater information about municipal securities within a specific ten business day time frame, which could aid them in making better informed and more efficient investment decisions and should help reduce instances of fraud.

The Commission preliminarily believes that this proposal could promote competition in the purchase and sale of municipal securities because the greater availability and timeliness of

information as a result of the proposed amendments could instill greater investor confidence in the municipal securities market. As a result, more investors could be attracted to this market sector and broker-dealers and municipal issuers could compete for their business. The proposed amendments also could encourage improvement in the completeness and timeliness of issuer disclosures and could foster additional interest in municipal securities by retail and institutional customers. In addition, the greater availability of information about municipal securities would be beneficial to vendors of municipal securities information as they develop their value-added products. Thus, the proposed amendments could promote competition among those vendors of municipal securities information that could utilize the information provided to the MSRB pursuant to continuing disclosure agreements and would compete with each other in creating and offering for sale value-added products relating to municipal securities. As discussed above,<sup>281</sup> the proposed amendments to the Rule could result in some additional cost and hourly burdens for broker-dealers, issuers and the MSRB. However, the Commission preliminarily believes that these increased burdens are justified by the positive competitive impact of the proposed amendments to the Rule. Accordingly, the Commission preliminarily does not believe that the proposed amendments would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The proposed amendments to the Rule would provide investors and other municipal market participants with notice of additional events, to be provided in a timely manner not in excess of ten business days of the event's occurrence, which could have an impact on the value of the applicable municipal security. In addition, the proposed amendments would help to provide investors and other municipal market participants with access to important information

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<sup>281</sup> See supra Sections V. and VI.

about demand securities that previously were not subject to the Rule's disclosure provisions. The Commission believes that these proposals should help improve investors' ability to make informed investment decisions, which, in turn, should help promote capital formation generally. The proposed amendments could have a positive effect on capital formation because the greater availability of information about municipal securities could provide institutional and retail investors with more complete information regarding these securities. As a result, investors could be more comfortable that they would have better access to important information about a particular municipal security when deciding whether to purchase that security.

Based on the analysis above, the Commission preliminarily believes that the proposed amendments to the Rule would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendments to the Rule would place a burden on competition, as well as the effect of the proposed amendments on efficiency, competition, and capital formation. The Commission specifically seeks comment on whether the proposed amendments would place a burden on competition or have an effect on efficiency, competition, and capital formation with respect to issuers or obligated persons, the MSRB, broker-dealers, other market participants, investors, or others.

#### **VIII. Consideration of Impact on the Economy**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"<sup>282</sup> the Commission must advise the OMB as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more

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<sup>282</sup> Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

(either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation.

The Commission requests comment on the potential impact of the proposed rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

#### **IX. Regulatory Flexibility Analysis**

This Initial Regulatory Flexibility Analysis (“IRFA”) has been prepared in accordance with the provisions of the Regulatory Flexibility Act (“RFA”).<sup>283</sup> It relates to proposed amendments to Rule 15c2-12,<sup>284</sup> under the Securities Exchange Act of 1934, as amended.<sup>285</sup> The proposed amendments would amend certain requirements regarding the information that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities must reasonably determine that an issuer of municipal securities or an obligated person has undertaken, in a written agreement or contract for the beneficial holders of the issuer’s municipal securities, to provide, and revise an exemption from the rule. Specifically, the amendments would require a broker, dealer, or municipal securities dealer (or “Participating Underwriter,” when used in connection with primary offerings), to reasonably determine that an issuer or obligated person has agreed to provide notice of specified events in a timely manner not in excess of ten business days of the occurrence of the event and amend the list of events for which notices would be provided. In addition, the proposal would modify the condition that event notices be submitted to the Municipal Securities Rulemaking Board, “if material”, for

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<sup>283</sup> 5 U.S.C. 603(a).

<sup>284</sup> 17 CFR 240.15c2-12.

<sup>285</sup> 15 U.S.C. 78a et seq.

some, but not all, of the Rule's specified events. Further, the amendments would modify an exemption from the rule for certain offerings of municipal securities with put features, by making the offering of such securities subject to continuing disclosure obligations set forth in the Rule.

A. Reasons for the Proposed Action

The main purpose of the proposal is to improve the availability of significant and timely information to the municipal securities markets and to help deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and subsequent recommendation of transactions in municipal securities for which adequate information is not available on an ongoing basis.

The Commission proposes to modify paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of Rule 15c2-12 to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to provide event notices to the MSRB in an electronic format as prescribed by the MSRB, in a timely manner not in excess of ten business days after the occurrence of any such event, instead of "in a timely manner" as the Rule currently provides. In the 1994, the Commission adopted amendments to Rule 15c2-12 and noted that it had not established a specific time frame with respect to "timely" because of the wide variety of events and issuer circumstances.<sup>286</sup> However, the Commission stated that, in general, this determination must take into consideration the time needed to discover the occurrence of the event, assess its materiality, and prepare and disseminate the notice.<sup>287</sup> It has been reported that there have been some instances in which event notices were not submitted

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<sup>286</sup> See Securities Exchange Act Release No. 34961 (November 10, 1994), 59 FR 59590, 59601 (November 17, 1994) ("1994 Amendments").

<sup>287</sup> Id.

until months after the events occurred.<sup>288</sup> The Commission believes that delays deny investors important information that they need in order to make informed decisions regarding whether to buy, sell, or hold their municipal securities and to aid them in determining whether the price that they pay or receive for their transactions is appropriate.<sup>289</sup>

The Commission preliminarily believes that codifying in the Rule a specific time within which event notices would be provided, in accordance with the continuing disclosure agreement, to the MSRB should result in these notices being made available more promptly than at present. Accordingly, the proposed amendments would require a broker, dealer, or municipal securities dealer (*i.e.*, a Participating Underwriter) to reasonably determine that an issuer or obligated person has agreed, in a continuing disclosure agreement, to provide notice of specified events in a timely manner not in excess of ten business days after the event's occurrence. The Commission believes this change would help promote more timely disclosure of this important information to municipal security investors.

The Commission proposes to modify paragraph (b)(5)(i)(C)(6) of the Rule, which presently requires Participating Underwriters reasonably to determine that the issuer or obligated person has entered into a continuing disclosure agreement to submit a notice for "[a]dverse tax opinions or events affecting the tax-exempt status of the security." The proposal would revise paragraph (b)(5)(i)(C)(6) of the Rule also to provide for the disclosure of the issuance of material "proposed or final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of securities" by the IRS to the MSRB under a continuing disclosure agreement. A determination by the IRS that interest on a municipal security may, in fact, be taxable not only could reduce the security's

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<sup>288</sup> See supra Section II.B.

<sup>289</sup> Id.

market value, but also could adversely affect each investor's federal and, in some cases, state income tax liability.<sup>290</sup> The tax-exempt status of a municipal security is also important to many mutual funds whose governing documents, with certain exceptions, limit their investments to tax-exempt municipal securities.<sup>291</sup> Therefore, retail and institutional investors alike are extremely interested in events that could adversely affect the tax-exempt status of the municipal securities that they own or may wish to purchase.<sup>292</sup>

The Commission is proposing that no determination of materiality would be necessary for the following six existing events: (1) principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.<sup>293</sup> The Commission preliminarily believes that these events are of such a high level of importance to investors that notice of their occurrence should always be included in a continuing disclosure agreement. Furthermore, the Commission preliminarily believes that eliminating the necessity to make a materiality decision upon the occurrence of these events would simplify issuer compliance with the terms of continuing disclosure agreements to which they are a party and would help to make such filings available more quickly.

The proposal also would add the following events, for which disclosure notices would be provided pursuant to a continuing disclosure agreement: (i) tender offers (paragraph

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<sup>290</sup> See supra Section II.D.

<sup>291</sup> Id.

<sup>292</sup> Id.

<sup>293</sup> Id.

(b)(5)(i)(C)(8) of the Rule);<sup>294</sup> (ii) bankruptcy, insolvency, receivership or similar event of the issuer or obligated person (paragraph (b)(5)(i)(C)(12) of the Rule);<sup>295</sup> (iii) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material (paragraph (b)(5)(i)(C)(13) of the Rule);<sup>296</sup> and (iv) appointment of a successor or additional trustee, or the change of name of a trustee (paragraph (b)(5)(i)(C)(14) of the Rule), if material.<sup>297</sup>

The Commission believes that there is a need to make available to all investors such important information affecting their decisions and the value of their securities. The Commission believes that the proposed addition of these four events disclosure items would substantially improve the availability of important information in the municipal securities market.

Finally, the proposal would modify the Rule's exemption for demand securities by eliminating paragraph (d)(1)(iii) to Rule 15c2-12, and adding new paragraph (d)(5) to the Rule. The Commission's experience with the operation of the Rule and changes in the municipal securities market over the last fourteen years suggests a need to increase the availability of information to investors regarding demand securities.<sup>298</sup> Furthermore, the recent period of turmoil in the markets for municipal auction rate securities and variable rate demand obligations ("VRDOs") and the comments of numerous primary purchasers of demand securities also

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<sup>294</sup> See supra Section II.E.1.

<sup>295</sup> See supra Section II.E.2.

<sup>296</sup> See supra Section II.E.3.

<sup>297</sup> See supra Section II.E.4.

<sup>298</sup> See supra Section II.A.

suggest that a full exemption for demand securities is no longer appropriate and that the exemption should be modified to provide that paragraphs (b)(5) and (c) of the Rule relating to the disclosure of continuing disclosure documents and recommendations by broker-dealers also would apply to the offerings of demand securities.<sup>299</sup>

B. Objectives

The purpose of the proposal is to achieve more efficient, effective, and wider availability of municipal securities information to broker-dealers, mutual funds, analysts and other market professionals, institutional and retail investors, and the public generally, and to help prevent, fraudulent, deceptive, or manipulative acts or practices in the municipal securities market.

C. Legal Basis

Pursuant to the Exchange Act, and particularly Sections 2, 3(b), 10, 15(c), 15B, 17 and 23(a)(1) thereof, 15 U.S.C. 78b, 78c(b), 78j, 78o(c), 78o-4, 78q and 78w(a)(1), the Commission is proposing amendments to § 240.15c2-12 of Title 17 of the Code of Federal Regulations.

D. Small Entities Subject to the Rule

The proposal would apply to any broker, dealer, or municipal securities dealer that acts as an underwriter in a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more and issuers of such securities.

The RFA defines "small entity" to mean "small business," "small organization," or "small government jurisdiction."<sup>300</sup> The Commission's rules define "small business" and "small organization" for purposes of the RFA for each of the types of entities regulated by the Commission.

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<sup>299</sup> Id.

<sup>300</sup> 5 U.S.C. 601(6).

A broker-dealer is a small business if its total capital (net worth plus subordinated liabilities) on the last day of its most recent fiscal year was \$500,000 or less, and is not affiliated with any entity that is not a "small business."<sup>301</sup>

A municipal securities dealer that is a bank (including a separately identifiable department or division of a bank) is a small business if it has total assets of less than \$10 million at all times during the preceding fiscal year; had an average monthly volume of municipal securities transactions in the preceding fiscal year of less than \$100,000; and is not affiliated with any entity that is not a "small business."<sup>302</sup>

For purposes of Commission rulemaking, an issuer or person, other than an investment company, is a "small business" or "small organization" if its "total assets on the last day of its most recent fiscal year were \$5 million or less."<sup>303</sup>

Based on information obtained by the Commission's staff in connection with the 2008 Adopted Amendments, the Commission estimates that 250 broker-dealers, including municipal securities dealers, would be Participating Underwriters within the meaning of Rule 15c2-12. Based on a recent review of industry sources, the Commission does not believe that any Participating Underwriters would be small broker-dealers or municipal securities dealers.

A "small governmental jurisdiction" is defined by the RFA to include "governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand."<sup>304</sup> Currently, there are more than 50,000 state and local issuers of

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<sup>301</sup> 17 CFR 240.0-10(c).

<sup>302</sup> 17 CFR 240.0-10(f).

<sup>303</sup> 17 CFR 230.157. See also 17 CFR 240.0-10(a).

<sup>304</sup> 5 U.S.C. 601(5).

municipal securities<sup>305</sup> that would be subject to the proposal. The Commission estimates that approximately 40,000 state and local issuers would be "small" entities for purposes of the RFA. However, the Commission believes that most issuers of municipal securities would qualify for the limited exemption in paragraph (d)(2) of the Rule.<sup>306</sup> The Commission has estimated that currently 10,000 issuers have entered into continuing disclosure agreements that provide for their submitting continuing disclosure documents to the MSRB and that, under the proposed amendment to narrow the Rule's exemption for demand securities, the number of affected issuers would increase to 12,000 issuers. It is possible that some of these issuers may be small issuers.

The proposed amendments would apply to all small entities that are currently subject to Rule 15c2-12. Because small entities already may submit event notices for the current disclosure items, these entities are able to prepare event notices that are proposed to be incorporated into the Rule. The Commission expects that providing the additional event disclosure items would increase costs incurred by small entities, to the extent that their primary offerings of municipal securities are covered by the Rule, because they potentially would have to provide a greater number of event notices than they do currently. However, the Commission notes this increased cost would be approximately \$8 per entity annually. The Commission's staff has estimated that for purposes of the Paperwork Reduction Act each issuer, including small entities, would be subject to an annual reporting burden of approximately 4.5 hours and an estimated annual cost

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<sup>305</sup> See Securities Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748 (March 17, 1994).

<sup>306</sup> Specifically, Rule 15c2-12(d)(2) provides an exemption from the application of paragraph (b)(5) (Rule's provisions regarding continuing disclosure agreements) of the Rule with respect to primary offerings if, among other things, the issuer or obligated person has agreed to a limited disclosure obligation, including sending certain material event notices to the MSRB. See 17 CFR 240.15c2-12(d)(2).

ranging from \$600 to \$760.<sup>307</sup> In addition, some issuers could have one-time costs ranging from \$50 to \$4,300.<sup>308</sup>

E. Reporting, Recordkeeping and other Compliance Requirements

Rule 15c2-12 currently sets forth eleven disclosure items that the Participating Underwriter must reasonably determine would be provided, in accordance with the continuing disclosure agreement, to the MSRB. The proposed amendments to Rule 15c2-12 would amend an existing event disclosure item and add four new event disclosure items. The proposed amendments would clarify the current disclosure item regarding adverse tax opinions, add tender offers to the current disclosure item regarding bond calls contained in paragraph (b)(5)(C)(8), and add three new disclosure items: bankruptcy, insolvency, receivership or similar event of the issuer or obligated person; merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and the appointment of a successor or additional trustee or the change of name of a trustee, if material. In addition, the proposal would modify the condition that event notices be submitted to the MSRB, "if material," for some, but not all, of the Rule's specified events. The proposal also would delete the current exemption for demand securities in paragraph (d)(1)(iii) and add language in new paragraph (d)(5) so that paragraphs (b)(5)<sup>309</sup> and (c)<sup>310</sup> of the

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<sup>307</sup> See supra Section V.E.2.

<sup>308</sup> Id.

<sup>309</sup> Rule 15c2-12(b)(5) requires a Participating Underwriter, before purchasing or selling municipal securities in connection with an offering of municipal securities, to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of the holders of the municipal securities, to provide annual

Rule also would apply to a primary offering of demand securities. Lastly, the proposed amendments would modify paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB, "in a timely manner not in excess of ten business days after the occurrence of the event," instead of "in a timely manner" as the Rule currently provides.

F. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap, or conflict with the proposed amendments to Rule 15c2-12.

G. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed revisions to the Rule, the Commission considered the following alternatives:

- (1) Establishing differing compliance or reporting requirements or timetables which take into account the resources available to smaller entities;
- (2) Exempting smaller entities from coverage of the disclosure requirements, or any part thereof;

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filings, material event notices, and failure to file notices (*i.e.*, continuing disclosure documents) to the MSRB. See 17 CFR 240.15c2-12(b)(5).

<sup>310</sup> Rule 15c2-12(c) requires a broker, dealer, or municipal securities dealer that recommends the purchase or sale of a municipal security to have procedures in place that provide reasonable assurance that it will receive prompt notice of any material event and any failure to file annual financial information regarding the municipal security. See 17 CFR 240.15c2-12(c).

- (3) The clarification, consolidation, or simplification of disclosure for small entities;  
and
- (4) Use of performance standards rather than design standards.

The Commission believes that separate compliance or reporting requirements or timetables for smaller entities that would differ from the proposed requirements, or exempting broker-dealers from the obligations in paragraph (b)(5) and (c) of the Rule with respect to small issuers, would not achieve the Commission's objectives. At the outset, the Commission notes that most small issuers of municipal securities are eligible for the limited exemption currently contained in paragraph (d)(2) of the Rule. The exemption in Rule 15c2-12(d)(2) provides that paragraph (b)(5) of the Rule, which relates to the submission of continuing disclosure agreements, does not apply to a primary offering if the conditions contained therein are met.<sup>311</sup>

This limited exemption from the Rule is intended to assist small governmental jurisdictions that issue municipal securities. In the case of primary offerings by small governmental jurisdictions that are not covered by the exemption, the Commission notes that the proposal balances the informational needs of investors and others with regard to municipal securities issued by small governmental jurisdictions with the effects of the proposed rule change. The adoption of separate rules for broker-dealers with respect to continuing disclosure agreements entered into by smaller entities would not be consistent with the Commission's intent to improve the greater availability and timeliness of disclosures in the municipal securities market. Furthermore, the municipal securities market could be disadvantaged by disparate disclosures by small and large

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<sup>311</sup> Specifically, Rule 15c2-12(d)(2) provides an exemption from the application of paragraph (b)(5) (Rule's provisions regarding continuing disclosure agreements) of the Rule with respect to primary offerings if, among other things, the issuer or obligated person has agreed to a limited disclosure obligation, including sending certain material event notices to the MSRB. See 17 CFR 240.15c2-12(d)(2).

entities pursuant to their continuing disclosure agreements. Broker-dealers and other market participants would be better able to satisfy their legal obligations under the federal securities laws to have a reasonable basis on which to recommend municipal securities. In addition, the proposal would impose performance standards rather than design standards.

H. Request for Comments

The Commission encourages written comments on matters discussed in the IRFA. In particular, the Commission requests comments on: (a) the number of small entities that would be affected by the proposed amendments; (b) the nature of any impact the proposed amendments would have on small entities and empirical data supporting the extent of the impact; (c) how to quantify the number of small entities that would be affected by and/or how to quantify the impact of the proposed amendments; and (d) potential costs to small entities, if any, including costs associated with providing event notices. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule is adopted, and will be placed in the same public file as comments on the proposed rule itself. Persons wishing to submit written comments should refer to the instructions for submitting comments in the front of this release.

X. Statutory Authority

Pursuant to the Exchange Act, and particularly Sections 2, 3(b), 10, 15(c), 15B, 17 and 23(a)(1) thereof, 15 U.S.C. 78b, 78c(b), 78j, 78o(c), 78o-4, 78q and 78w(a)(1), the Commission is proposing amendments to § 240.15c2-12 of Title 17 of the Code of Federal Regulations in the manner set forth below.

**Text of Proposed Rule Amendments**

**List of Subjects in 17 CFR Part 240**

Brokers, Reporting and recordkeeping requirements, Securities.

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

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

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

2. Section 240.15c2-12 is amended by the following:

- A. Revise the introductory text of paragraph (b)(5)(i)(C), and paragraphs (b)(5)(i)(C)(2),(6), (7), (8), (10), and (11);
- B. Add new paragraphs (b)(5)(i)(C)(12), (13) and (14);
- C. Revise the text in paragraph (d)(1)(ii);
- D. Remove the text in paragraph (d)(1)(iii) in its entirety; and
- E. Revise the introductory text of paragraph (d)(2)(ii)(B); and
- F. Add new paragraph (d)(5).

The additions and revisions read as follows.

**§ 240.15c2-12 Municipal securities disclosure.**

\* \* \* \* \*

(b) \* \* \*

(5)(i) \* \* \*

(C) In a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the following events with respect to the securities being offered in the Offering:

\* \* \* \* \*

(2) Non-payment related defaults, if material;

\* \* \* \* \*

(6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the securities, or other events affecting the tax-exempt status of the security;

(7) Modifications to rights of security holders, if material;

(8) Bond calls, if material, and tender offers;

\* \* \* \* \*

(10) Release, substitution, or sale of property securing repayment of the securities, if material;

(11) Rating changes;

(12) Bankruptcy, insolvency, receivership or similar event of the obligated person;

Note: For the purposes of the event identified in subparagraph (b)(5)(i)(C)(12), the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or

officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan or reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person;

(13) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;

(14) Appointment of a successor or additional trustee or the change of name of a trustee, if material; and

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

(ii) Have a maturity of nine months or less.

\* \* \* \* \*

(2) \* \* \*

(ii) \* \* \*

\* \* \* \* \*

(B) In a timely manner not in excess of ten business days after the occurrence of the event, notice of events specified in paragraph (b)(5)(i)(C) of this section with respect to the securities that are the subject of the Offering; and

\* \* \* \* \*

(5) With the exception of paragraphs (b)(5) and (c), this section shall not apply to a primary offering of municipal securities in authorized denominations of \$100,000 or more if such securities may, at the option of the holder thereof, be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent.

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**PART 241 - INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER**

\* \* \* \* \*

3. Part 241 is amended by adding Release No. 34-XXXXX and the release date of X to the list of interpretative releases.

\* \* \* \* \*

By the Commission.

*EMM*  
Elizabeth M. Murphy  
Secretary

Dated: July 17, 2009

*Chairman Shapiro  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 9053 / July 20, 2009

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60341 / July 20, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13557

In the Matter of  
  
TD AMERITRADE, INC.,  
  
Respondent.

ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS, PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933 AND SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A CEASE-  
AND-DESIST ORDER.

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against TD Ameritrade, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the 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 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

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

#### Summary

Respondent offered and sold to some of its customers financial instruments known as auction rate securities ("ARS") while not accurately characterizing or while failing to disclose the true nature and risks of these investments. ARS are bonds or preferred stock whose liquidity depends upon sufficient demand at periodic securities auctions. When soliciting customers to purchase ARS, Respondent's registered representatives improperly described ARS as safe, liquid alternatives to money market funds and other cash-like investments, without disclosing the auction process or the risk of illiquidity if these auctions failed. On February 13, 2008, a significant number of ARS auctions failed, resulting in an overall market collapse that has left thousands of investors, including Respondent's customers, holding ARS that they have not been able to liquidate. By engaging in the conduct described herein, Respondent violated Section 17(a)(2) of the Securities Act.

#### Respondent

1. Respondent, a New York corporation headquartered in Omaha, Nebraska, is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of the Financial Industry Regulatory Authority ("FINRA"). Respondent is a wholly-owned subsidiary of TD Ameritrade Online Holding Corporation. Respondent was formed as a result of the consolidation of retail brokerage operations of Ameritrade, Inc. and TD Waterhouse Investors Services, Inc. following Ameritrade Holding Corporation's acquisition of TD Waterhouse Group, Inc. on January, 24, 2006 (the "Merger Date").

#### Background

##### Description of ARS

2. ARS are bonds or preferred stock which provide for interest rates or dividend yields that are periodically reset through auctions, typically held every seven, twenty-eight, or thirty-five days. ARS are usually issued with maturities of thirty years, but the maturities can range from five years to perpetuity. ARS yields are determined at the periodic auctions during which the ARS are auctioned at par. ARS typically can be bought or sold only at one of these periodic auctions.

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

3. Under the typical procedures for an auction for ARS, investors who wished to purchase ARS at an auction submitted a bid which included the minimum interest or dividend rate that the investors would accept. Holders of ARS could either choose to keep their securities until the next auction or submit an offer to sell their ARS. An auction agent collected all of the bids and offers for a particular auction.

4. The final rate at which all of the ARS offered for sale were sold was the "clearing rate" that applied to that particular ARS until the next auction. Bids with the lowest rate and then successively higher rates were accepted until all of the sell orders were filled. The clearing rate was the lowest rate bid sufficient to cover all of the securities for sale in the auction.

5. If there were not enough bids to cover the securities offered for sale in an auction, then an auction would fail. In a failed auction, investors who want to sell securities are not able to do so, and hold their ARS until at least the next auction. In this event, the issuer pays the holders a maximum rate or "penalty" rate. These rates might be higher or lower than the prior clearing rate or market rates on similar products.

#### **Respondent's Role in the ARS Market**

6. To facilitate the auction process, the issuers of the ARS selected one or more broker-dealers to underwrite the offering and/or manage the auction process. In many instances, these broker-dealers submitted their own bids to support the auctions and to prevent the auctions from failing.

7. Respondent did not act as an underwriter, manager, or agent for any issuer of ARS. Instead, Respondent acted as agent, both on a solicited and unsolicited basis, for its customers by submitting their bids to purchase and orders to sell ARS. As a distributing or "downstream" broker-dealer, Respondent did not submit bids in an effort to support any of the ARS auctions or to prevent them from failing. Respondent also did not hold any significant inventory of ARS in its proprietary accounts. However, as more fully described below, Respondent's registered representatives did not accurately characterize the investment nature of ARS or provide adequate disclosures regarding the risks associated with ARS and the complexities of the auction process to Respondent's customers.

#### **Collapse of the ARS Market and the Effect on Respondent's Customers**

8. In the early part of 2008, many of the broker-dealers that acted as underwriters of the ARS offerings or as lead managers for the ARS auctions stopped submitting their own bids in support of the ARS auctions. As a result, by February 13, 2008, the ARS market began to experience widespread auction failures, leaving investors throughout the industry unable to sell their ARS holdings.

9. From February 13, 2008, through the present, the ARS market continues to experience widespread failures, making many ARS holdings illiquid. Some ARS have been redeemed by their issuers since that time. However, numerous investors, including Respondent's

customers, currently hold ARS that they have been unable to sell through the auction process and have not yet been redeemed by the issuers.

### Purchases of ARS by Respondent's Customers

10. Prior to the middle of February 2008, Respondent's registered representatives sold ARS to customers through telephone, email, and other interstate communications. Respondent's representatives made inaccurate comparisons between ARS and other investments, such as certificates of deposit or money market accounts, telling customers that ARS were similar investments but with a slightly higher yield. Respondent's representatives did not accurately characterize the investment nature of ARS since ARS are highly complex securities that are very different from money market funds or certificates of deposit, as evidenced by, among other things, the dependence of ARS on successful auctions for liquidity.

11. Respondent's registered representatives also did not provide customers with adequate and complete disclosures regarding the complexity of the auction process and the risks associated with ARS, including the circumstances under which an auction could fail. For example, Respondent's representatives did not adequately disclose to customers that their ability to liquidate the ARS depended on the willingness of other investors to buy the instruments at an auction. This information was material, and Respondent should have provided it to its customers when offering and selling ARS.

12. Respondent was aware that its registered representatives marketed ARS to customers as liquid and as an alternative to cash, certificates of deposit, or money market funds without adequately disclosing that ARS are complex securities that may become illiquid.

13. Currently, thousands of customers who purchased ARS through Respondent prior to the collapse of the ARS market in the middle of February 2008 hold hundreds of millions of dollars in illiquid ARS.

### Violations

14. As a result of the conduct described above, Respondent willfully<sup>2</sup> violated Section 17(a)(2) of the Securities Act, which prohibits the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, 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.

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

## Undertakings

15. Respondent has undertaken to purchase Eligible ARS held by Eligible Customers, and other measures, as specified under the terms set forth below. In determining whether to accept Respondent's Offer, the Commission has considered these undertakings.

### A. Key Definitions

1. Eligible Auction Rate Securities. As used in these undertakings, "Eligible ARS" shall mean auction rate securities that were purchased at Respondent on or before February 13, 2008 and that have failed at auction at least once since February 13, 2008. Notwithstanding the foregoing definition, the term "Eligible ARS" shall not include ARS that were purchased at Respondent or through entities acquired by Respondent's parent companies in accounts owned, managed or advised by or through independent registered investment advisers.

2. Eligible Customers. As used in these undertakings, "Eligible Customers" shall mean the following current and former account owners who purchased Eligible ARS at Respondent on or before February 13, 2008, did not transfer such Eligible ARS away from Respondent prior to the Merger Date, and held those securities on February 13, 2008:

a. Natural persons (including their IRA accounts, testamentary trust and estate accounts, custodial accounts established under the Uniform Transfers to Minors Act or the Uniform Gifts to Minors Act, and guardianship accounts);

b. Charities, endowments or foundations with Internal Revenue Code Section 501(c)(3) status; or

c. Small Businesses and Institutions. For purposes of this class of Eligible Customers, "Small Businesses and Institutions" shall mean the following account owners with total assets at Respondent of \$10 million or less as of March 13, 2009: trusts; corporate trusts; corporations; employee pension plans/ERISA and Taft Hartley Act plans; educational institutions; incorporated not-for-profit organizations; limited liability companies; limited partnerships; non-public companies; partnerships; personal holding companies; unincorporated associations; and government and quasi-government entities.

i. In calculating total assets at Respondent for the purposes of this paragraph, Respondent may include household accounts.

ii. If an account owner described within this paragraph had transferred his Eligible ARS away from Respondent prior to March 13, 2009, then the date of the account owner's request to transfer his Eligible ARS shall be used for determining whether the account holder had total assets of \$10 million or less.

iii. For purposes of this paragraph, "Small Businesses and Institutions" shall not include broker-dealers or banks acting as conduits for their customers or customers that had total assets of greater than \$50 million as of the date of this Order.

iv. In no event shall Respondent be required to purchase more than \$10 million of Eligible ARS from any Small Business or Institution.

B. Customer Notification -- Customer Assistance Line and Internet Page. No later than two (2) business days after the date of this Order, Respondent shall establish: 1) a dedicated toll-free telephone assistance line, with appropriate staffing, to provide information and to respond to questions concerning the terms of this Order; and 2) a public Internet page on its corporate Web site(s), with a prominent link to that page appearing on Respondent's relevant homepage(s), to provide information concerning the terms of this Order and, via an e-mail address or other reasonable means, to respond to questions concerning the terms of this Order. Respondent shall maintain the telephone assistance line and Internet page through at least the Purchase Deadline, as defined below.

C. Respondent's Offer to Purchase Eligible ARS

1. Offer Notices.

a. First Offer Notice. No later than fifteen (15) business days after the date of this Order, or, for those Eligible Customers not identified prior to this date despite Respondent's best efforts, as soon as practicable thereafter, Respondent shall offer to purchase, at par plus accrued and unpaid dividends/interest, Eligible ARS from Eligible Customers ("Purchase Offer"), and explain what the Eligible Customers must do to accept, in whole or in part, the Purchase Offer. Respondent shall also inform the Eligible Customers of the relevant terms of this Order and any other material issues regarding the Eligible Customers' rights.

b. Second Offer Notice. To the extent that any Eligible Customers have not responded to the Purchase Offer on or before forty-five (45) days before the end of the applicable Offer Period (defined below), Respondent shall provide any such Eligible Customers a second written notice informing them again of the Respondent's Purchase Offer, the relevant terms of this Order and any other material issues regarding the Eligible Customers' rights.

2. Offer Periods.

a. First Offer Period. For those Eligible Customers with assets at Respondent of \$250,000 or less as of March 13, 2009, the Purchase Offer shall remain open for a period of seventy-five (75) days from the date on which the Purchase Offer was sent ("First Offer Period"). To the extent any Eligible Customer had transferred his Eligible ARS away from Respondent before March 13, 2009, then the measurement date for the \$250,000 threshold shall be the date on which the transfer was requested by the Eligible Customer.

b. Second Offer Period. For those Eligible Customers with assets at Respondent of more than \$250,000 as of March 13, 2009, the Purchase Offer shall remain open until at least March 23, 2010 ("Second Offer Period"), subject to extension under the purchase procedures described below. To the extent any Eligible Customer had transferred his Eligible ARS away from Respondent before March 13, 2009, then the measurement date for the \$250,000 threshold shall be the date on which the transfer was requested by the Eligible Customer.

D. Acceptance and Purchase Procedures

1. Eligible Customer Acceptance. Eligible Customers may accept Respondent's Purchase Offer by notifying Respondent in writing at any time before midnight, Eastern Time, on the last day of the applicable offer period, or such later date and time as may be extended by Respondent. An acceptance must be received by Respondent prior to the expiration of the applicable offer period, or such later date as may be extended by Respondent and the Commission staff.

2. Purchase Notice. For those Eligible Customers who accept Respondent's Purchase Offer within the applicable Offer Period, Respondent shall send those Eligible Customers a notice ("Purchase Notice"), indicating when ("Purchase Date") and how Respondent will purchase their Eligible ARS.

3. Eligible Customers' Right to Revoke. Eligible Customers may revoke their acceptance of Respondent's Purchase Offer up until Respondent purchases an Eligible Customer's Eligible ARS.

4. Purchases Relating to Eligible Customers to Whom the First Offer Period Applies. For those Eligible Customers to whom the First Offer Period applies, and who accept Respondent's Purchase Offer within the First Offer Period, Respondent shall purchase their Eligible ARS no later than five (5) business days following expiration of the First Offer Period.

5. Purchases Relating to Eligible Customers to Whom the Second Offer Period Applies. For those Eligible Customers to whom the Second Offer Period applies, and who accept Respondent's Purchase Offer within the Second Offer Period, Respondent shall purchase their Eligible ARS as soon as practicable and by no later than five (5) business days following the expiration of the Second Offer Period.

a. Respondent shall use its best efforts to effectuate all purchases under this paragraph by March 31, 2010, and in no event shall the purchases extend beyond June 30, 2010.

b. In the event that Respondent's purchases under this paragraph extend beyond March 31, 2010, then the Second Offer Period shall be extended from March 23, 2010 until June 23, 2010. Under such circumstances, Respondent shall issue a notice of such extension in conformity with the federal securities laws by no later than March 24, 2010.

6. Purchases Relating to Eligible Customers Who Have Since Transferred Their Eligible ARS Away from Respondent. Respondent's purchase obligations described above apply equally to those Eligible Customers who accept Respondent's Purchase Offer within the applicable Offer Period, but who have since transferred their Eligible ARS away from Respondent.

a. Respondent's purchase obligations to these Eligible Customers shall be contingent on: (1) Respondent receiving reasonably satisfactory assurance from the financial services firm currently holding the Eligible Customer's Eligible ARS that the bidding rights associated with the Eligible ARS will be transferred to the Respondent; (2) the Eligible Customer opening a new account with Respondent; and (3) the transfer of the Eligible ARS to the Eligible Customer's new account with Respondent.

b. Respondent shall use its best efforts to identify, contact and assist such Eligible Customers to open a new account at Respondent and to transfer the Eligible ARS to such account, and shall not charge such Eligible Customers any fees relating to or in connection with the transfer to Respondent or custodianship by Respondent of such Eligible ARS.

E. Customers Who Transferred Their Eligible ARS Away from Respondent before the Merger Date. In the event that Respondent receives a purchase request from a customer who purchased Eligible ARS at Respondent prior to February 13, 2008 but who transferred such Eligible ARS away from Respondent before the Merger Date, Respondent shall engage in good faith negotiations with such customer in an attempt to resolve the customer's request. Respondent shall notify the Commission staff of all such requests and their ultimate resolutions, if any.

F. Reimbursement for Related Loan Expenses. Respondent shall use its best efforts to identify Eligible Customers who took out loans from Respondent after February 13, 2008 secured by Eligible ARS that were not successfully auctioning at the time the loan was taken and who paid interest associated with the ARS-based portion of those loans in excess of the total interest and dividends received on the Eligible ARS during the duration of the loan. Respondent shall reimburse such customers for the excess expense, plus reasonable interest thereon. Such reimbursement shall occur no later than seventy-five (75) days after the date of this Order.

G. Relief for Eligible Customers Who Sold Below Par. Respondent shall use its best efforts to identify any Eligible Customers who: (1) purchased Eligible ARS at Respondent on or before February 13, 2008; and (2) subsequently sold those Eligible ARS below par between February 13, 2008 and the date of this Order (referred to as "Below Par Sellers"). Within seventy-five (75) days of the date of this Order, Respondent shall pay any such identified Below Par Sellers the difference between par and the price at which the Below Par Seller sold the Eligible ARS, plus reasonable interest thereon. Respondent shall promptly pay any such Below Par Seller identified thereafter.

H. Consequential Damages Claims

1. Special Arbitration Procedures. Respondent shall consent to participate, at the election of an Eligible Customer, in the special arbitration procedures announced by FINRA on December 16, 2008, and available on its website at <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/documents/arbmed/p117445.pdf> for the exclusive purpose of arbitrating an Eligible Customer's claim for consequential damages against Respondent related to the customer's investment in Eligible ARS. As explained by the special arbitration procedures, the following shall apply:

a. Forum Fees. Respondent will pay all forum fees associated with the arbitration.

b. Burden of Proof. Eligible Customers shall bear the burden of proving by a preponderance of the evidence the existence and amount of consequential damages suffered as a result of the illiquidity of the Eligible ARS. Although it may defend itself against consequential damage claims, Respondent shall not argue against liability for the illiquidity of the underlying Eligible ARS position or use as part of its defense any decision by the Eligible Customer not to borrow money from Respondent.

c. Other Damages. Eligible Customers who elect to use the special arbitration procedures provided for within this subparagraph shall not be eligible for punitive damages, or any other type of damages other than consequential damages. Eligible Customers proceeding under the special arbitration procedures may not recover as consequential damages any attorneys' fees incurred in connection with the arbitration or any related mediation proceeding.

I. Other Proceedings/Relief. All Eligible Customers who avail themselves of the relief provided pursuant to this Order may pursue any remedies against Respondent available under the law subject to any defenses Respondent may have. However, those customers that elect to utilize the special arbitration procedures set forth above are limited to the remedies available in that process and may not bring or pursue a claim relating to ARS in another forum.

J. Reports and Meetings

1. Within 45 days of the end of each month, beginning with a report covering the month ended after the date of this Order and continuing through and including a report covering the month ended June 30, 2010, Respondent shall submit a monthly written report detailing Respondent's progress with respect to its undertakings. The report shall be submitted to Noel M. Franklin, Esq., U.S. Securities and Exchange Commission, 1801 California Street, Suite 1500, Denver, Colorado 80202 or as directed in writing by the Commission Staff.

2. Beginning in September 2009, Respondent shall confer at least quarterly with the Commission staff to discuss its progress with respect to these undertakings. Such quarterly progress reports shall continue until June, 2010.

3. The reporting and conference deadlines set forth above may be amended or modified with agreement from the Commission Staff.

#### IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 15(b) of the Exchange Act, it is hereby ORDERED that:

A. Respondent TD Ameritrade, Inc. cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act;

B. Respondent TD Ameritrade, Inc. is censured; and

C. The Commission is not imposing a penalty against Respondent at this time. However, in the event the Division of Enforcement ("Division") believes that Respondent has not complied with its undertakings as more fully described above, the Division may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider the appropriateness of a penalty; and (2) seek an order directing payment of up to the maximum civil penalty allowable under the law. In determining whether to impose a penalty, the Commission will take into consideration its traditional criteria in determining whether to assess civil penalties, including the extent to which Respondent has satisfied its undertakings and cooperated with the Commission and other regulators in their investigations. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 20, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13556

In the Matter of

RDM Sports Group, Inc.,  
Real Del Monte Mining Corp.,  
Recoton Corp.,  
Red Hot Concepts, Inc.,  
RedHand International, Inc.  
(n/k/a African Diamond Co., Inc. or  
Coal Corp.),  
Redlaw Industries, Inc.,  
Republic Resources, Inc.,  
Reward Enterprises, Inc.,  
Rhino Enterprises Group, Inc.  
(n/k/a Physicians Adult Daycare, Inc.),  
Ridgeview, Inc.,  
Riverside Group, Inc., and  
Rocky Mount Undergarment Co., Inc.

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents RDM Sports Group, Inc., Real Del Monte Mining Corp., Recoton Corp., Red Hot Concepts, Inc., RedHand International, Inc. (n/k/a African Diamond Co., Inc. or Coal Corp.), Redlaw Industries, Inc., Republic Resources, Inc., Reward Enterprises, Inc., Rhino Enterprises Group, Inc. (n/k/a Physicians Adult Daycare, Inc.), Ridgeview, Inc., Riverside Group, Inc., and Rocky Mount Undergarment Co., Inc.

II.

After an investigation, the Division of Enforcement alleges that:

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## A. RESPONDENTS

1. RDM Sports Group, Inc. (CIK No. 818350) is a void Delaware corporation located in Peachtree City, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RDM 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 29, 1997, which reported a net loss of over \$30 million for the prior six months. As of July 13, 2009, the company's stock (symbol "RDMG") was quoted on the Pink Sheets operated by the Pink OTC Markets, Inc. ("Pink Sheets"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Real Del Monte Mining Corp. (CIK No. 812356) is a British Columbia corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Real Del Monte is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the fiscal year ended December 31, 1997, which reported a net loss of over \$10 million for the prior six months. As of July 13, 2009, the company's stock (symbol "RDMMF") 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. Recoton Corp. (CIK No. 82536) is a New York corporation located in Lake Mary, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Recoton is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002, which reported a net loss of over \$92 million for the prior nine months. On April 8, 2003, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of New York, the reorganization plan was confirmed on May 6, 2004, which was closed on March 10, 2008. As of July 13, 2009, the company's stock (symbol "RCOTQ") 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).

4. Red Hot Concepts, Inc. (CIK No. 932623) is a void Delaware corporation located in Bethesda, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Red Hot is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 30, 2001. As of July 13, 2009, the company's stock (symbol "RHCS") was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. RedHand International, Inc. (n/k/a African Diamond Co., Inc. or Coal Corp.) (CIK No. 1070512) is a defaulted Nevada corporation located in Herndon, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RedHand is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2005, which reported a net loss of \$505,250 for the prior nine months. As of July 13, 2009, the company's stock (symbol "AFDM") was quoted on the Pink Sheets, had nine

market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Redlaw Industries, Inc. (CIK No. 310793) is an Ontario corporation located in Orillia, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Redlaw 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 over \$4.89 million (Canadian) for the prior nine months. As of July 13, 2009, the company's stock (symbol "RDLI") was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Republic Resources, Inc. (CIK No. 76878) is a Nevada corporation located in Grand Junction, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Republic is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended September 30, 2003, which reported a net loss of \$312,814 for the prior nine months. As of July 13, 2009, the company's stock (symbol "RPRS") 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).

8. Reward Enterprises, Inc. (CIK No. 1067342) is a Nevada corporation located in Carson City, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Reward Enterprises 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, 2005, which reported a net loss of \$124,350 for the prior nine months. As of July 13, 2009, the company's stock (symbol "RWRD") was quoted on the Pink Sheets, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

9. Rhino Enterprises Group, Inc. (n/k/a Physicians Adult Daycare, Inc.) (CIK No. 1101809) is a Nevada corporation located in Valencia, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Rhino is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of over \$2.48 million for the prior nine months. On May 22, 2006, Rhino filed a Form 15 to voluntarily deregister its securities, but the form was unsigned and therefore invalid on its face. As of July 13, 2009, the company's stock (symbol "PHYA") was quoted on the Pink Sheets, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

10. Ridgeview, Inc. (CIK No. 1018891) is a suspended North Carolina corporation located in Newton, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ridgeview is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1999, which reported a net loss of over \$1.94 million for the prior nine months. As of July 13, 2009, the company's stock

(symbol "RIDG") was quoted on the Pink Sheets, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

11. Riverside Group, Inc. (CIK No. 277356) is a Florida corporation located in Jacksonville, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Riverside 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 \$130,000 for the prior nine months. As of July 13, 2009, the company's stock (symbol "RSGI") 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).

12. Rocky Mount Undergarment Co., Inc. (CIK No. 84655) is a void Delaware corporation located in Rocky Mount, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Rocky Mount 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 October 1, 1995, which reported a net loss of over \$1.73 million for the prior nine months. On January 9, 1989, the Commission obtained a permanent injunction against the company in the U.S. District Court for the Eastern District of North Carolina prohibiting it from violating the antifraud, reporting, and bookkeeping provisions of the federal securities laws. Thus, the company is now in violation of that injunction. As of July 13, 2009, the company's stock (symbol "RMUC") was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

13. 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.

14. 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. Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

15. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 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  
In the Matter of RDM Sports Group, Inc., et. al.**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>RDM Sports Group, Inc.</b>	10-Q	09/30/97	11/14/97	Not filed	140
	10-K	12/31/97	03/31/98	Not filed	136
	10-Q	03/31/98	05/15/98	Not filed	134
	10-Q	06/30/98	08/14/98	Not filed	131
	10-Q	09/30/98	11/16/98	Not filed	128
	10-K	12/31/98	03/31/99	Not filed	124
	10-Q	03/31/99	05/17/99	Not filed	122
	10-Q	06/30/99	08/16/99	Not filed	119
	10-Q	09/30/99	11/15/99	Not filed	116
	10-K	12/31/99	03/30/00	Not filed	112
	10-Q	03/31/00	05/15/00	Not filed	110
	10-Q	06/30/00	08/14/00	Not filed	107
	10-Q	09/30/00	11/14/00	Not filed	104
	10-K	12/31/00	04/02/01	Not filed	99
	10-Q	03/31/01	05/15/01	Not filed	98
	10-Q	06/30/01	08/14/01	Not filed	95
	10-Q	09/30/01	11/14/01	Not filed	92
	10-K	12/31/01	04/01/02	Not filed	87
	10-Q	03/31/02	05/15/02	Not filed	86
	10-Q	06/30/02	08/14/02	Not filed	83
	10-Q	09/30/02	11/14/02	Not filed	80
	10-K	12/31/02	03/31/03	Not filed	76
	10-Q	03/31/03	05/15/03	Not filed	74
	10-Q	06/30/03	08/14/03	Not filed	71
	10-Q	09/30/03	11/14/03	Not filed	68
	10-K	12/31/03	03/30/04	Not filed	64
	10-Q	03/31/04	05/17/04	Not filed	62
	10-Q	06/30/04	08/16/04	Not filed	59
	10-Q	09/30/04	11/15/04	Not filed	56
	10-K	12/31/04	03/31/05	Not filed	52
10-Q	03/31/05	05/16/05	Not filed	50	
10-Q	06/30/05	08/15/05	Not filed	47	
10-Q	09/30/05	11/14/05	Not filed	44	
10-K	12/31/05	03/31/06	Not filed	40	
10-Q	03/31/06	05/15/06	Not filed	38	
10-Q	06/30/06	08/14/06	Not filed	35	
10-Q	09/30/06	11/14/06	Not filed	32	

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>RDM Sports Group, Inc.</b> (continued)	10-K	12/31/06	04/02/07	Not filed	27
	10-Q	03/31/07	05/15/07	Not filed	26
	10-Q	06/30/07	08/14/07	Not filed	23
	10-Q	09/30/07	11/14/07	Not filed	20
	10-K	12/31/07	03/31/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	14
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-K	12/31/08	04/01/09	Not filed	3
	10-Q	03/31/09	05/15/09	Not filed	2
Total Filings Delinquent					47

**Real Del Monte Mining Corp.**

20-F	12/31/97	06/30/98	Not filed	133
20-F	12/31/98	06/30/99	Not filed	121
20-F	12/31/99	06/30/00	Not filed	109
20-F	12/31/00	07/02/01	Not filed	96
20-F	12/31/01	07/01/02	Not filed	84
20-F	12/31/02	06/30/03	Not filed	73
20-F	12/31/03	06/30/04	Not filed	61
20-F	12/31/04	06/30/05	Not filed	49
20-F	12/31/05	06/30/06	Not filed	37
20-F	12/31/06	07/02/07	Not filed	24
20-F	12/31/07	06/30/08	Not filed	13
Total Filings Delinquent				11

**Recoton Corp.**

10-K	12/31/02	03/31/03	Not filed	76
10-Q	03/31/03	05/15/03	Not filed	74
10-Q	06/30/03	08/14/03	Not filed	71
10-Q	09/30/03	11/14/03	Not filed	68
10-K	12/31/03	03/30/04	Not filed	64
10-Q	03/31/04	05/17/04	Not filed	62
10-Q	06/30/04	08/16/04	Not filed	59
10-Q	09/30/04	11/15/04	Not filed	56
10-K	12/31/04	03/31/05	Not filed	52
10-Q	03/31/05	05/16/05	Not filed	50
10-Q	06/30/05	08/15/05	Not filed	47
10-Q	09/30/05	11/14/05	Not filed	44
10-K	12/31/05	03/31/06	Not filed	40
10-Q	03/31/06	05/15/06	Not filed	38

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Recoton Corp.</b> (continued)	10-Q	06/30/06	08/14/06	Not filed	35
	10-Q	09/30/06	11/14/06	Not filed	32
	10-K	12/31/06	04/02/07	Not filed	27
	10-Q	03/31/07	05/15/07	Not filed	26
	10-Q	06/30/07	08/14/07	Not filed	23
	10-Q	09/30/07	11/14/07	Not filed	20
	10-K	12/31/07	03/31/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	14
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-K	12/31/08	04/01/09	Not filed	3
	10-Q	03/31/09	05/15/09	Not filed	2

Total Filings Delinquent 26

**Red Hot Concepts, Inc.**

10-QSB	03/31/02	05/15/02	Not filed	86
10-QSB	06/30/02	08/14/02	Not filed	83
10-QSB	09/29/02	11/13/02	Not filed	80
10-KSB	12/29/02	03/31/03	Not filed	76
10-QSB	03/30/03	05/14/03	Not filed	74
10-QSB	06/29/03	08/13/03	Not filed	71
10-QSB	09/28/03	11/12/03	Not filed	68
10-KSB	12/28/03	03/29/04	Not filed	64
10-QSB	03/28/04	05/12/04	Not filed	62
10-QSB	06/27/04	08/11/04	Not filed	59
10-QSB	09/26/04	11/10/04	Not filed	56
10-KSB	12/26/04	03/28/05	Not filed	52
10-QSB	03/27/05	05/11/05	Not filed	50
10-QSB	06/26/05	08/10/05	Not filed	47
10-QSB	09/25/05	11/09/05	Not filed	44
10-KSB	12/25/05	03/27/06	Not filed	40
10-QSB	03/26/06	05/10/06	Not filed	38
10-QSB	06/25/06	08/09/06	Not filed	35
10-QSB	09/24/06	11/08/06	Not filed	32
10-KSB	12/31/06	04/02/07	Not filed	27
10-QSB	04/01/07	05/16/07	Not filed	26
10-QSB	07/01/07	08/15/07	Not filed	23
10-QSB	09/30/07	11/14/07	Not filed	20
10-KSB	12/30/07	03/31/08	Not filed	16
10-Q*	03/30/08	05/14/08	Not filed	14

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Red Hot Concepts, Inc.</b> (continued)	10-Q*	06/29/08	08/13/08	Not filed	11
	10-Q*	09/28/08	11/12/08	Not filed	8
	10-K*	12/28/08	03/30/09	Not filed	4
	10-Q*	03/29/09	05/13/09	Not filed	2
Total Filings Delinquent		29			

**RedHand International, Inc.**  
(n/k/a African Diamond Co. Inc.  
or Coal Corp.)

10-K	12/31/05	03/31/06	Not filed	40
10-Q	03/31/06	05/15/06	Not filed	38
10-Q	06/30/06	08/14/06	Not filed	35
10-Q	09/30/06	11/14/06	Not filed	32
10-K	12/31/06	04/02/07	Not filed	27
10-Q	03/31/07	05/15/07	Not filed	26
10-Q	06/30/07	08/14/07	Not filed	23
10-Q	09/30/07	11/14/07	Not filed	20
10-K	12/31/07	03/31/08	Not filed	16
10-Q	03/31/08	05/15/08	Not filed	14
10-Q	06/30/08	08/14/08	Not filed	11
10-Q	09/30/08	11/14/08	Not filed	8
10-K	12/31/08	04/01/09	Not filed	3
10-Q	03/31/09	05/15/09	Not filed	2
Total Filings Delinquent		14		

**Redlaw Industries, Inc.**

10-Q	06/30/00	08/14/00	Not filed	107
10-Q	09/30/00	11/14/00	Not filed	104
10-Q	12/31/00	02/14/01	Not filed	101
10-K	03/31/01	06/29/01	Not filed	97
10-Q	06/30/01	08/14/01	Not filed	95
10-Q	09/30/01	11/14/01	Not filed	92
10-Q	12/31/01	02/14/02	Not filed	89
10-K	03/31/02	07/01/02	Not filed	84
10-Q	06/30/02	08/14/02	Not filed	83
10-Q	09/30/02	11/14/02	Not filed	80
10-Q	12/31/02	02/14/03	Not filed	77
10-K	03/31/03	06/30/03	Not filed	73
10-Q	06/30/03	08/14/03	Not filed	71
10-Q	09/30/03	11/14/03	Not filed	68
10-Q	12/31/03	02/17/04	Not filed	65

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Redlaw Industries, Inc.</b> (continued)	10-K	03/31/04	06/29/04	Not filed	61
	10-Q	06/30/04	08/16/04	Not filed	59
	10-Q	09/30/04	11/15/04	Not filed	56
	10-Q	12/31/04	02/14/05	Not filed	53
	10-K	03/31/05	06/29/05	Not filed	49
	10-Q	06/30/05	08/15/05	Not filed	47
	10-Q	09/30/05	11/14/05	Not filed	44
	10-Q	12/31/05	02/14/06	Not filed	41
	10-K	03/31/06	06/29/06	Not filed	37
	10-Q	06/30/06	08/14/06	Not filed	35
	10-Q	09/30/06	11/14/06	Not filed	32
	10-Q	12/31/06	02/14/07	Not filed	29
	10-K	03/31/07	06/29/07	Not filed	25
	10-Q	06/30/07	08/14/07	Not filed	23
	10-Q	09/30/07	11/14/07	Not filed	20
	10-Q	12/31/07	02/14/08	Not filed	17
	10-K	03/31/08	06/30/08	Not filed	13
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-Q	12/31/08	02/17/09	Not filed	5
10-Q	03/31/09	05/15/09	Not filed	2	

Total Filings Delinquent 36

**Republic Resources, Inc.**

10-KSB	12/31/03	03/30/04	Not filed	64
10-QSB	03/31/04	05/17/04	Not filed	62
10-QSB	06/30/04	08/16/04	Not filed	59
10-QSB	09/30/04	11/15/04	Not filed	56
10-KSB	12/31/04	03/31/05	Not filed	52
10-QSB	03/31/05	05/16/05	Not filed	50
10-QSB	06/30/05	08/15/05	Not filed	47
10-QSB	09/30/05	11/14/05	Not filed	44
10-KSB	12/31/05	03/31/06	Not filed	40
10-QSB	03/31/06	05/15/06	Not filed	38
10-QSB	06/30/06	08/14/06	Not filed	35
10-QSB	09/30/06	11/14/06	Not filed	32
10-KSB	12/31/06	04/02/07	Not filed	27
10-QSB	03/31/07	05/15/07	Not filed	26
10-QSB	06/30/07	08/14/07	Not filed	23
10-QSB	09/30/07	11/14/07	Not filed	20
10-KSB	12/31/07	03/31/08	Not filed	16
10-Q*	03/31/08	05/15/08	Not filed	14

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Republic Resources, Inc.</b> (continued)	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
	10-K*	12/31/08	04/01/09	Not filed	3
	10-Q*	03/31/09	05/15/09	Not filed	2
Total Filings Delinquent		22			

**Reward Enterprises, Inc.**

10-KSB	06/30/05	09/28/05	Not filed	46
10-QSB	09/30/05	11/14/05	Not filed	44
10-QSB	12/31/05	02/14/06	Not filed	41
10-QSB	03/31/06	05/15/06	Not filed	38
10-KSB	06/30/06	09/28/06	Not filed	34
10-QSB	09/30/06	11/14/06	Not filed	32
10-QSB	12/31/06	02/14/07	Not filed	29
10-QSB	03/31/07	05/15/07	Not filed	26
10-KSB	06/30/07	09/28/07	Not filed	22
10-QSB	09/30/07	11/14/07	Not filed	20
10-QSB	12/31/07	02/14/08	Not filed	17
10-QSB	03/31/08	05/15/08	Not filed	14
10-KSB	06/30/08	09/29/08	Not filed	10
10-Q*	09/30/08	11/14/08	Not filed	8
10-Q*	12/31/08	02/17/09	Not filed	5
10-Q*	03/31/09	05/15/09	Not filed	2

Total Filings Delinquent 16

**Rhino Enterprises Group, Inc.**  
(n/k/a Physicians Adult Daycare, Inc.)

10-QSB	03/31/04	05/17/04	Not filed	62
10-QSB	06/30/04	08/16/04	Not filed	59
10-QSB	09/30/04	11/15/04	Not filed	56
10-KSB	12/31/04	03/31/05	Not filed	52
10-QSB	03/31/05	05/16/05	Not filed	50
10-QSB	06/30/05	08/15/05	Not filed	47
10-QSB	09/30/05	11/14/05	Not filed	44
10-KSB	12/31/05	03/31/06	Not filed	40
10-QSB	03/31/06	05/15/06	Not filed	38
10-QSB	06/30/06	08/14/06	Not filed	35
10-QSB	09/30/06	11/14/06	Not filed	32
10-KSB	12/31/06	04/02/07	Not filed	27
10-QSB	03/31/07	05/15/07	Not filed	26
10-QSB	06/30/07	08/14/07	Not filed	23

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Rhino Enterprises Group, Inc.</b> <i>(n/k/a Physicians Adult Daycare, Inc.)</i> <i>(continued)</i>	10-QSB	09/30/07	11/14/07	Not filed	20
	10-KSB	12/31/07	03/31/08	Not filed	16
	10-Q*	03/31/08	05/15/08	Not filed	14
	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
	10-K*	12/31/08	04/01/09	Not filed	3
	10-Q*	03/31/09	05/15/09	Not filed	2

Total Filings Delinquent 21

**Ridgeview, Inc.**

10-K	12/31/99	03/30/00	Not filed	112
10-Q	03/31/00	05/15/00	Not filed	110
10-Q	06/30/00	08/14/00	Not filed	107
10-Q	09/30/00	11/14/00	Not filed	104
10-K	12/31/00	04/02/01	Not filed	99
10-Q	03/31/01	05/15/01	Not filed	98
10-Q	06/30/01	08/14/01	Not filed	95
10-Q	09/30/01	11/14/01	Not filed	92
10-K	12/31/01	04/01/02	Not filed	87
10-Q	03/31/02	05/15/02	Not filed	86
10-Q	06/30/02	08/14/02	Not filed	83
10-Q	09/30/02	11/14/02	Not filed	80
10-K	12/31/02	03/31/03	Not filed	76
10-Q	03/31/03	05/15/03	Not filed	74
10-Q	06/30/03	08/14/03	Not filed	71
10-Q	09/30/03	11/14/03	Not filed	68
10-K	12/31/03	03/30/04	Not filed	64
10-Q	03/31/04	05/17/04	Not filed	62
10-Q	06/30/04	08/16/04	Not filed	59
10-Q	09/30/04	11/15/04	Not filed	56
10-K	12/31/04	03/31/05	Not filed	52
10-Q	03/31/05	05/16/05	Not filed	50
10-Q	06/30/05	08/15/05	Not filed	47
10-Q	09/30/05	11/14/05	Not filed	44
10-K	12/31/05	03/31/06	Not filed	40
10-Q	03/31/06	05/15/06	Not filed	38
10-Q	06/30/06	08/14/06	Not filed	35
10-Q	09/30/06	11/14/06	Not filed	32
10-K	12/31/06	04/02/07	Not filed	27
10-Q	03/31/07	05/15/07	Not filed	26
10-Q	06/30/07	08/14/07	Not filed	23
10-Q	09/30/07	11/14/07	Not filed	20

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Ridgeview, Inc.</b> (continued)	10-K	12/31/07	03/31/08	Not filed	16
	10-Q	03/31/08	05/15/08	Not filed	14
	10-Q	06/30/08	08/14/08	Not filed	11
	10-Q	09/30/08	11/14/08	Not filed	8
	10-K	12/31/08	04/01/09	Not filed	3
	10-Q	03/31/09	05/15/09	Not filed	2
Total Filings Delinquent					38

**Riverside Group, Inc.**

10-KSB	12/31/02	03/31/03	Not filed	76	
10-QSB	03/31/03	05/15/03	Not filed	74	
10-QSB	06/30/03	08/14/03	Not filed	71	
10-QSB	09/30/03	11/14/03	Not filed	68	
10-KSB	12/31/03	03/30/04	Not filed	64	
10-QSB	03/31/04	05/17/04	Not filed	62	
10-QSB	06/30/04	08/16/04	Not filed	59	
10-QSB	09/30/04	11/15/04	Not filed	56	
10-KSB	12/31/04	03/31/05	Not filed	52	
10-QSB	03/31/05	05/16/05	Not filed	50	
10-QSB	06/30/05	08/15/05	Not filed	47	
10-QSB	09/30/05	11/14/05	Not filed	44	
10-KSB	12/31/05	03/31/06	Not filed	40	
10-QSB	03/31/06	05/15/06	Not filed	38	
10-QSB	06/30/06	08/14/06	Not filed	35	
10-QSB	09/30/06	11/14/06	Not filed	32	
10-KSB	12/31/06	04/02/07	Not filed	27	
10-QSB	03/31/07	05/15/07	Not filed	26	
10-QSB	06/30/07	08/14/07	Not filed	23	
10-QSB	09/30/07	11/14/07	Not filed	20	
10-KSB	12/31/07	03/31/08	Not filed	16	
10-Q*	03/31/08	05/15/08	Not filed	14	
10-Q*	06/30/08	08/14/08	Not filed	11	
10-Q*	09/30/08	11/14/08	Not filed	8	
10-K*	12/31/08	04/01/09	Not filed	3	
10-Q*	03/31/09	05/15/09	Not filed	2	
Total Filings Delinquent					26

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Rocky Mount Undergarment Co., Inc.</b>	10-KSB	12/31/95	04/01/96	Not filed	159
	10-QSB	03/31/96	05/15/96	Not filed	158
	10-QSB	06/30/96	08/14/96	Not filed	155
	10-QSB	09/30/96	11/14/96	Not filed	152
	10-KSB	12/31/96	03/31/97	Not filed	148
	10-QSB	03/31/97	05/15/97	Not filed	146
	10-QSB	06/30/97	08/14/97	Not filed	143
	10-QSB	09/30/97	11/14/97	Not filed	140
	10-KSB	12/31/97	03/31/98	Not filed	136
	10-QSB	03/31/98	05/15/98	Not filed	134
	10-QSB	06/30/98	08/14/98	Not filed	131
	10-QSB	09/30/98	11/16/98	Not filed	128
	10-KSB	12/31/98	03/31/99	Not filed	124
	10-QSB	03/31/99	05/17/99	Not filed	122
	10-QSB	06/30/99	08/16/99	Not filed	119
	10-QSB	09/30/99	11/15/99	Not filed	116
	10-KSB	12/31/99	03/30/00	Not filed	112
	10-QSB	03/31/00	05/15/00	Not filed	110
	10-QSB	06/30/00	08/14/00	Not filed	107
	10-QSB	09/30/00	11/14/00	Not filed	104
	10-KSB	12/31/00	04/02/01	Not filed	99
	10-QSB	03/31/01	05/15/01	Not filed	98
	10-QSB	06/30/01	08/14/01	Not filed	95
	10-QSB	09/30/01	11/14/01	Not filed	92
	10-KSB	12/31/01	04/01/02	Not filed	87
	10-QSB	03/31/02	05/15/02	Not filed	86
	10-QSB	06/30/02	08/14/02	Not filed	83
	10-QSB	09/30/02	11/14/02	Not filed	80
	10-KSB	12/31/02	03/31/03	Not filed	76
	10-QSB	03/31/03	05/15/03	Not filed	74
	10-QSB	06/30/03	08/14/03	Not filed	71
	10-QSB	09/30/03	11/14/03	Not filed	68
	10-KSB	12/31/03	03/30/04	Not filed	64
	10-QSB	03/31/04	05/17/04	Not filed	62
	10-QSB	06/30/04	08/16/04	Not filed	59
	10-QSB	09/30/04	11/15/04	Not filed	56
	10-KSB	12/31/04	03/31/05	Not filed	52
	10-QSB	03/31/05	05/16/05	Not filed	50
	10-QSB	06/30/05	08/15/05	Not filed	47
	10-QSB	09/30/05	11/14/05	Not filed	44
	10-KSB	12/31/05	03/31/06	Not filed	40
	10-QSB	03/31/06	05/15/06	Not filed	38

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
<b>Rocky Mount Undergarment Co., Inc.</b>	10-QSB	06/30/06	08/14/06	Not filed	35
(continued)	10-QSB	09/30/06	11/14/06	Not filed	32
	10-KSB	12/31/06	04/02/07	Not filed	27
	10-QSB	03/31/07	05/15/07	Not filed	26
	10-QSB	06/30/07	08/14/07	Not filed	23
	10-QSB	09/30/07	11/14/07	Not filed	20
	10-KSB	12/31/07	03/31/08	Not filed	16
	10-Q*	03/31/08	05/15/08	Not filed	14
	10-Q*	06/30/08	08/14/08	Not filed	11
	10-Q*	09/30/08	11/14/08	Not filed	8
	10-K*	12/31/08	04/01/09	Not filed	3
	10-Q*	03/31/09	05/15/09	Not filed	2
<b>Total Filings Delinquent</b>					<b>54</b>

\*Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. See Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now 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) 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

July 20, 2009

In the Matter of

RDM Sports Group, Inc.,  
Real Del Monte Mining Corp.,  
Recoton Corp.,  
Red Hot Concepts, Inc.,  
RedHand International, Inc.  
(n/k/a African Diamond Co., Inc. or  
Coal Corp.),  
Redlaw Industries, Inc.,  
Republic Resources, Inc.,  
Reward Enterprises, Inc.,  
Rhino Enterprises Group, Inc.  
(n/k/a Physicians Adult Daycare, Inc.),  
Ridgeview, Inc.,  
Riverside Group, Inc., and  
Rocky Mount Undergarment Co., Inc.

Respondents.

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 RDM Sports Group, Inc. because it has not filed any periodic reports since the period ended June 29, 1997.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Real Del Monte Mining Corp. because it has not filed any periodic reports since the period ended December 31, 1997.

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Recoton 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 Red Hot Concepts, Inc. because it has not filed any periodic reports since the period ended December 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of RedHand International, Inc. (n/k/a African Diamond Co., Inc. or Coal Corp.) because it has not filed any periodic reports since the period ended September 30, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Redlaw Industries, 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 Republic Resources, Inc. because it has not filed any periodic reports since the period ended September 30, 2003.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Reward Enterprises, Inc. because it has not filed any periodic reports since the period ended March 31, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Rhino Enterprises Group, Inc. (n/k/a Physicians Adult Daycare, Inc.) because it has not filed any periodic reports since the period ended September 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ridgeview, Inc. because it has not filed any periodic reports since the period ended September 30, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Riverside Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Rocky Mount Undergarment Co., Inc. because it has not filed any periodic reports since the period ended October 1, 1995.

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 above-listed companies is suspended for the period from 9:30 a.m. EDT on July 20, 2009, through 11:59 p.m. EDT on July 31, 2009.

By the Commission.

Elizabeth M. Murphy  
Secretary

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



purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, and the findings contained in Section III.4 below, which are admitted, Respondent 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. Roberts, age 43, a resident of Cape May, New Jersey, is a certified public accountant ("CPA") in New Jersey. Roberts joined Ulticom, Inc. ("Ulticom") in December 1994 and served in various accounting positions until becoming Vice President and Chief Financial Officer ("CFO") on July 2, 1998. Once she was replaced by a new CFO in December 1999, Roberts served as the Company's Vice President of Finance until September 2001, when she became Vice President of Corporate Administration. Her title changed to Vice President of Operations in November 2002. She became Ulticom's Senior Vice President of Operations in March 2006, a position she held until her termination on October 31, 2007. From March 13, 2000 to April 27, 2001, Roberts signed management representation letters to the Company's outside auditors. From at least January 2000 to May 2002, Roberts prepared and/or reviewed Ulticom's periodic reports on Forms 10-Q and 10-K, proxies, and registration statements.

2. On June 18, 2009, the Commission filed a complaint against Roberts in the civil action entitled Securities and Exchange Commission v. Lisa M. Roberts, (Civil Action No. 1:09-CV-2590), in the United States District Court for the Eastern District of New York. On July 13, 2009, the Court entered a final judgment against Roberts, permanently enjoining her from violating Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 13(b)(5) of the Exchange Act, and Exchange Act Rules 10b-5, 13b2-1, and 13b2-2, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act, and Exchange Act Rules 13a-1, 13a-11, 13a-13, and 14a-9. Roberts was also prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act, and was ordered to pay a \$25,000 civil money penalty.

3. The Commission's Complaint alleged, among other things, that Roberts, at the direction of former Ulticom senior executives, participated in two separate fraudulent schemes to materially misstate the financial results of Ulticom in a departure from generally accepted accounting principles ("GAAP"). The first scheme involved improper backdating of Ulticom stock options. The second scheme involved improper accounting practices, including (i) the improper establishment, maintenance, and release of excess reserves, and (ii) the improper recognition of revenue on certain inter-company shipments and service contracts. As a result of these schemes, Ulticom has announced that its historical financial statements and any related reports of its independent registered public accounting firm should no longer be relied upon, and that it will correct its historical financial statements in order to record additional material non-cash

charges for option-related compensation expenses and to address the material misstatement of its revenues and earnings. In addition, the Complaint alleged that Roberts made material misrepresentations to Ulticom's outside auditors in furtherance of these schemes.

#### IV.

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

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

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

B. After 5 years from the date of this order, Respondent may request that the Commission consider 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;

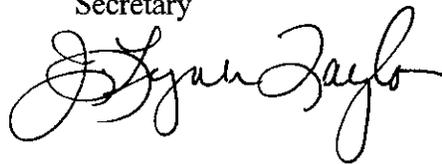
(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(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

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

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

*Chairman Schapiro and  
Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60342 / July 20, 2009

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2904 / July 20, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13558

In the Matter of

Morgan Stanley & Co.  
Incorporated,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Morgan Stanley & Co. Incorporated ("Morgan Stanley" or "Respondent").

II.

In anticipation of the institution of these proceedings, Morgan Stanley 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 Morgan Stanley and the subject matter of these proceedings, which are admitted, Morgan Stanley consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, a Censure, and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and

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Sections 203(e) 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<sup>1</sup> that:

#### A. SUMMARY

From 2000 through at least April 2006, Morgan Stanley (f/k/a Morgan Stanley DW Inc.) breached its fiduciary duty to certain of the firm's advisory clients and prospective advisory clients of its Nashville, Tennessee branch office ("Nashville advisory clients") by making material misstatements.

During the relevant period, Morgan Stanley's disclosure materials described the advisory services it provided which included assisting clients in identifying money managers to manage clients' assets. Morgan Stanley disclosed the detailed due diligence process it followed to select and approve money managers for participation in the firm's managed account program. According to its disclosure materials, Morgan Stanley financial advisers selected money managers from this approved list of managers to recommend to clients based on the client's investment profile and objectives.

Contrary to its disclosures, Morgan Stanley recommended to Nashville advisory clients certain money managers who were not approved for participation in Morgan Stanley's advisory programs and had not been subject to the firm's due diligence review. Further, the fact that Morgan Stanley and the former Morgan Stanley Financial Adviser in its Nashville office who serviced these clients ("Nashville FA") received or had the possibility of receiving substantial brokerage commissions and/or fees from those money managers created an incentive for them to recommend these non-approved money managers. These facts represented an actual or potential conflict of interest which was not disclosed to the Nashville advisory clients.

As a result, Morgan Stanley violated Section 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"). In addition, Morgan Stanley failed reasonably to supervise the Nashville FA with a view to preventing these violations within the meaning of Section 203(e)(6) of the Advisers Act. Further, Morgan Stanley violated Section 204 of the Advisers Act and Rules 204-2(a)(7) and 204-2(a)(10) thereunder by failing to maintain (1) all account paperwork reflecting Morgan Stanley's written agreements with its advisory clients; and (2) all written communications relating to recommendations of money managers.

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

## B. RESPONDENT

**Morgan Stanley & Co. Incorporated ("Morgan Stanley")**, located in New York, New York is dually registered with the Commission as an investment adviser pursuant to Section 203(a) of the Advisers Act and as a broker-dealer pursuant to Section 15 of the Securities Exchange Act of 1934. Respondent Morgan Stanley is a wholly-owned subsidiary of Morgan Stanley, a Delaware corporation, located in New York, New York whose shares are traded on the New York Stock Exchange. Prior to 2007, Respondent Morgan Stanley was registered and operated under the name Morgan Stanley DW Inc.

## C. FACTS

### Morgan Stanley's Investment Advisory Services

From 2000 through at least April 2006, through a subdivision of its Consulting Services Group called Investment Consulting Services ("ICS"), which is headquartered in New York, New York, Morgan Stanley provided investment advisory services. In providing investment advisory services, Morgan Stanley assisted clients in creating an investment profile, defining investment objectives and selecting money managers on whom the firm had conducted due diligence to manage clients' assets. Among the types of advisory accounts offered by Morgan Stanley were the so-called Vision I and Vision III accounts. Morgan Stanley described the Vision I and Vision III programs and its due diligence process in a disclosure statement and in its Form ADV, Part II, filed with the Commission.

In the Vision I program, Morgan Stanley assisted clients in developing investment objectives and in selecting money managers from a list of money managers, approved to participate in the Vision I program, to manage clients' assets. To become an approved manager for the Vision I program, Morgan Stanley performed due diligence through its due diligence group within ICS, as described in its disclosure statements. The due diligence group was comprised of approximately 25 individuals. The due diligence review included, among other things, on-site interviews of the manager's personnel and an evaluation of each manager's performance as compared to standard relative indices, as well as to the performance of managers within similar investment styles. Managers were further evaluated by Morgan Stanley on their investment strategy and on the strength and reputation of their organizations, such as the qualifications of management, their administrative capabilities, and their compliance with regulatory requirements. Final selection of managers was subject to review and approval by a Morgan Stanley senior management due diligence committee.

Morgan Stanley provided custody, execution, and performance reporting for clients and also performed ongoing due diligence and monitoring of all managers selected to participate in the Vision I program. The ongoing monitoring of approved managers, as described in disclosure materials, included periodic reevaluation of the manager by Morgan Stanley, including reviews of performance, assets under management, personnel

changes and account turnover to determine whether the manager should remain eligible for participation in the Vision I program. Morgan Stanley described the Vision I program as follows:

Each Vision account is individually managed by one or more investment managers selected by the client from a group of investment managers specifically chosen by the ICS Department to participate in the Vision program.

\* \* \*

After receipt of appropriate information from and about the client, Morgan Stanley identifies several investment managers deemed suitable for the client from among those participating in the Vision program.

The Vision III program was designed to accommodate advisory clients who came to Morgan Stanley from another advisory firm and sought services under the firm's Vision I program, but who had a pre-existing relationship with a money manager who was not approved for the Vision I program and consequently had not been subject to Morgan Stanley's due diligence review. Under Vision III, clients retained their relationship with the unapproved money manager and could also select additional money managers from Morgan Stanley's approved list of money managers. In the Vision III program, Morgan Stanley provided some of the same services as in the Vision I program (custody, execution, performance reporting); however, Morgan Stanley provided no due diligence on or ongoing monitoring of the non-approved money managers with which the client had a pre-existing relationship. Morgan Stanley also provided, as explained in its disclosure statements, ongoing monitoring of the money managers selected by the client who were approved to participate in the Vision I program. Morgan Stanley described the Vision III program as follows:

Certain clients may wish to receive some of Registrant's services under the Vision program but utilize an investment manager that does not participate in the Vision program. For such clients, Registrant provides an alternate version of the Vision program, Morgan Stanley Vision III. Except for the investment manager review and monitoring services described above, Vision III is the same in all material respects to the Vision program. Investment managers selected by clients in Vision III have not been approved by Morgan Stanley to participate in Vision, and are not monitored and evaluated by Morgan Stanley like managers in Vision.

### Morgan Stanley's Section 206 Violations

During the relevant time period, in breach of its fiduciary duty, Morgan Stanley materially misrepresented to certain clients of the Nashville, Tennessee branch office the process used to identify managers. As reflected above, Morgan Stanley's disclosure statement, in addition to its client services agreement, stated that Morgan Stanley would identify for clients of the Vision I program suitable money managers on whom the firm conducted due diligence and ongoing monitoring and who were specifically selected to participate in the Vision I program. However, contrary to these representations, the Nashville FA on several occasions recommended to the firm's Vision I advisory clients three money managers on whom Morgan Stanley had not conducted due diligence and who were not approved to participate in the Vision I program. Morgan Stanley did not disclose to these clients that the money managers recommended to them by the Nashville FA were not approved for participation in the Vision I program.

The Nashville FA had a financial incentive to recommend these three unapproved managers because of relationships he developed with the managers from which both he and Morgan Stanley benefited. First, Morgan Stanley, and consequently the Nashville FA, received brokerage commissions from the three unapproved managers for trading on behalf of the managers' institutional clients who were not clients of Morgan Stanley and whose assets were custodied outside of Morgan Stanley. During the relevant period, these three money managers generated at least \$3.3 million in brokerage commissions to Morgan Stanley. The Nashville FA received a portion of those commissions. Second, two of the unapproved managers caused certain of their clients to open advisory accounts with the Nashville FA, in some instances moving assets from another custodian. Morgan Stanley was compensated from these advisory accounts through either an asset fee or commissions. During the relevant period, the two unapproved managers generated at least \$200,000 in advisory fees for the benefit of Morgan Stanley. The Nashville FA received a portion of these fees. When the Nashville FA recommended the three money managers to the firm's advisory clients, the clients were not informed that Morgan Stanley and the Nashville FA had other relationships with the recommended money managers which gave Morgan Stanley an incentive to make those recommendations. These incentives created an actual or potential conflict of interest which should have been sufficiently disclosed so that the client could evaluate whether the recommendations were disinterested. Investment advisers, such as Morgan Stanley, owe fiduciary duties to their clients and, therefore, must, among other things, disclose all actual or potential conflicts of interest.<sup>2</sup>

<sup>2</sup> SEC v. Capital Gains Research Bureau Inc., 375 U.S. 180, 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 adviser, who is entitled to make the determination whether to waive the adviser's conflict.

Based on the above, Morgan Stanley knew or should have known that it made misrepresentations to its advisory clients and failed to disclose material conflicts of interest. As a result, Morgan Stanley willfully<sup>3</sup> 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.”<sup>4</sup>

### Morgan Stanley Failed to Supervise the Nashville FA

During the relevant time period, Morgan Stanley failed reasonably to supervise the Nashville FA with a view to preventing violations of the federal securities laws. The Nashville FA was recruited in March 2000 from another firm where he had been a top producer and financial adviser for ten years. The Nashville FA brought with him to Morgan Stanley several institutional money manager brokerage customers as well as several individual advisory clients. Morgan Stanley was well aware of the dual nature of his business; that he conducted both brokerage and advisory business. Morgan Stanley was also aware when the Nashville FA was hired that two of the Nashville FA’s former advisory clients had filed complaints against him alleging, among other things, that he had breached his fiduciary duty to them and failed to disclose certain conflicts of interest. Morgan Stanley also knew of a subsequent similar complaint made by a client of the Nashville FA during the course of his Morgan Stanley employment.

Notwithstanding these facts, Morgan Stanley’s supervision of the Nashville FA failed to monitor for such potential problems. Specifically, Morgan Stanley failed to ensure that the dual nature of the Nashville FA’s business, which had the potential for conflicts of interest, was appropriately supervised. To begin, there was confusion as to who had responsibility for overseeing certain aspects of the Nashville FA’s advisory business. For instance, the Nashville FA’s branch manager thought that the ICS department was responsible for supervising compliance with Morgan Stanley’s policies and procedures with regard to money manager recommendations, while instead, the ICS department thought that responsibility was the branch manager’s.

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Of course, if the adviser does not disclose the conflict, the client has no opportunity to evaluate, much less waive, the conflict.”).

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

<sup>4</sup> 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).

The confusion and lack of clarity in supervisory responsibilities resulted in an inadequate review of paperwork relating to the recommendation of money managers which allowed the Nashville FA to make material misrepresentations to certain Nashville advisory clients. The Nashville FA on several occasions submitted advisory account paperwork to his branch manager and ICS department reflecting that he was placing Vision I clients with non-vetted, unapproved managers, contrary to the firm's representations and disclosures regarding Vision I. In addition, the Nashville FA on several occasions submitted account paperwork that contained mixed Vision I and Vision III paperwork, two distinct types of accounts with contradictory client disclosures. These accounts were routinely approved without question by both the branch manager and the ICS department because each thought the other would ensure compliance.

Notably, during most of his six years at Morgan Stanley, the Nashville FA was supervised by a branch manager who previously had been sanctioned for supervisory failures. In addition, there were several instances when the Nashville FA refused to comply with Morgan Stanley's policies and procedures. For example, a year into his employment, the Nashville FA refused to sign an acknowledgment that he would abide by Morgan Stanley's code of conduct. Further, later in his tenure, the Nashville FA refused to be placed under heightened supervision by Morgan Stanley and the firm did not pursue the matter.

Based on the foregoing, Morgan Stanley failed reasonably to supervise the Nashville FA who aided and abetted Morgan Stanley's violations of Section 206(2) of the Advisers Act, with a view to preventing violations of the Advisers Act.

#### **Morgan Stanley Did Not Maintain Adequate Records**

During the relevant time period, as mentioned above, based on a client's responses to an Investor Questionnaire, Morgan Stanley generated an Investor Profile which recited the client's responses and identified suitable managers. Morgan Stanley failed to maintain all Investor Profiles or any other record of all written communications relating to recommendations of money managers. As a result, Morgan Stanley willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(7) thereunder which requires that investment advisers registered with the Commission maintain and preserve certain books and records. Rule 204-2(a)(7) requires that registered investment advisers keep "all written communications sent by such investment advisers relating to (i) any recommendation made or proposed to be made and any advice proposed to be given or given." In addition, Morgan Stanley failed to maintain all account paperwork including Morgan Stanley's written agreements with its advisory clients. As such Morgan Stanley willfully violated Rule 204-2(a)(10) which requires that registered investment advisers keep "all written agreements (or copies thereof) entered into by the investment adviser with any client . . . ."

\* \* \*

Beginning in 2006, Morgan Stanley took remedial steps to address the issues discussed herein.

IV.

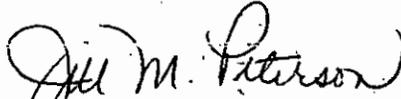
In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Morgan Stanley's Offer.

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

- A. Morgan Stanley is censured;
- B. Morgan Stanley cease and desist from committing or causing any violations and any future violations of Sections 204 and 206(2) of the Advisers Act, and Rules 204-2(a)(7) and 204-2(a)(10) thereunder; and
- C. Morgan Stanley shall, within 90 days of the entry of this Order, pay a civil money penalty in the amount of \$500,000 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 Morgan Stanley 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

  
By: Jill M. Peterson  
Assistant Secretary

*Chairman Schapiro and  
Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933  
Release No. 9055 / July 20, 2009

Securities Exchange Act of 1934  
Release No. 60343 / July 20, 2009

Administrative Proceeding  
File No. 3-13558

**In the Matter of**

**Morgan Stanley & Co.  
Incorporated,**

**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**

Morgan Stanley & Co. Incorporated ("Morgan Stanley") has submitted a letter, dated June 17, 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 July 20, 2009, pursuant to Morgan Stanley's Offer of Settlement, the Commission issued against Morgan Stanley an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, a Censure, and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940.

Under the Order, the Commission found that Morgan Stanley willfully violated Sections 204 and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"), and Rules 204-2(a)(7) and 204-2(a)(10) thereunder by breaching its fiduciary duty to certain of the firm's advisory clients and prospective advisory clients of its Nashville, Tennessee branch office by making material misstatements regarding the process used to identify

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money managers, failing reasonably to supervise the former Morgan Stanley Financial Adviser in its Nashville office who serviced these clients, and failing to maintain (1) all account paperwork reflecting Morgan Stanley's written agreements with its advisory clients; and (2) all written communications relating to recommendations of money managers. In the Order, the Commission ordered that Morgan Stanley 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 Rules 204-2(a)(7) and 204-2(a)(10) thereunder, and pay a civil money penalty of \$500,000 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 Morgan Stanley's June 17, 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 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 Morgan Stanley resulting from the Commission's Order is hereby granted.

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

*Chairman Schapiro and  
Commissioner Casey  
not participating*

Securities Act of 1933  
Release No. 9054 / July 20, 2009

Administrative Proceeding  
File No. 3-13558

In the Matter of

Morgan Stanley & Co.  
Incorporated,

Respondent.

**ORDER UNDER RULE 602(e) OF THE  
SECURITIES ACT OF 1933 GRANTING A  
WAIVER OF THE RULE 602(c)(3)  
DISQUALIFICATION PROVISION**

Morgan Stanley & Co. Incorporated ("Morgan Stanley") has submitted a letter, dated June 17, 2009, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from Morgan Stanley's settlement of an administrative proceeding commenced by the Commission.

On July 20, 2009, pursuant to Morgan Stanley's Offer of Settlement, the Commission issued against Morgan Stanley an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, a Censure, and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940. Under the Order, the Commission found that Morgan Stanley willfully violated Sections 204 and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"), and Rules 204-2(a)(7) and 204-2(a)(10) thereunder by breaching its fiduciary duty to certain of the firm's advisory clients and prospective advisory clients of its Nashville, Tennessee branch office by making material misstatements regarding the process used to identify money managers, failing reasonably to supervise the former Morgan Stanley Financial Adviser in its Nashville office who serviced these clients, and failing to maintain (1) all account paperwork reflecting Morgan Stanley's written agreements with its advisory clients; and (2) all written communications relating to recommendations of money managers. In the Order, the Commission ordered that Morgan Stanley 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)(7) and 204-2(a)(10) thereunder, and pay a civil money penalty of \$500,000 to the United States Treasury.

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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 15(b) of the Securities Exchange Act of 1934 or Section 203(e) of the Advisers Act. 17 C.F.R. § 230.602(c)(3). 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 Morgan Stanley'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

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

*Chairman Schapiro and  
Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
July 20, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13559

In the Matter of  
  
WILLIAM KEITH  
PHILLIPS,  
  
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 William Keith Phillips ("Respondent" or "Phillips").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent was employed as a Senior Institutional Consultant in Morgan Stanley & Co. Incorporated's ("Morgan Stanley") Nashville, Tennessee branch from 2000 until 2006. In April 2006, Morgan Stanley permitted Respondent to resign. During the relevant time period, Respondent worked as an investment adviser representative as well as a registered broker-dealer representative licensed with FINRA. In that capacity, Respondent serviced individual retail advisory clients as well as several institutional brokerage customers. Respondent was a member of Morgan Stanley's Chairman's Club, comprised of the firm's top 175 financial advisers, and ranked among the firm's top 25 financial advisers in revenue. At the time of his resignation, Respondent serviced

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approximately 90 advisory clients and about 2000 brokerage accounts. Respondent, age 50, is a resident of Nashville, Tennessee.

**B. OTHER RELEVANT ENTITIES<sup>1</sup>**

2. **Morgan Stanley & Co. Incorporated ("Morgan Stanley")**, located in New York, New York is dually registered with the Commission as an investment adviser pursuant to Section 203(a) of the Advisers Act and as a broker-dealer pursuant to Section 15 of the Exchange Act. Morgan Stanley is a wholly-owned subsidiary of Morgan Stanley ("Parent Morgan Stanley"), a Delaware corporation, located in New York, New York, whose shares are traded on the New York Stock Exchange. Prior to 2007, Morgan Stanley was registered and operated under the name Morgan Stanley DW Inc.

**C. FACTS**

**SUMMARY**

3. From 2000 through at least April 2006 (the "relevant time period"), Respondent worked as a financial adviser at Morgan Stanley, which provided investment advisory services to clients through a subdivision of its Consulting Services Group called Investment Consulting Services ("ICS"). In providing investment advisory services, Morgan Stanley assisted clients in creating an investment profile and objectives and in selecting money managers on whom the firm had conducted due diligence to manage clients' assets.

4. During the relevant time period, Morgan Stanley's disclosure materials described the advisory services it provided which included assisting clients in identifying money managers to manage clients' assets. Morgan Stanley disclosed the detailed due diligence process it followed to select and approve money managers for participation in the firm's managed account program. According to its disclosure materials, Morgan Stanley financial advisers selected money managers from this approved list of managers to recommend to clients based on the client's investment profile and objectives.

5. Contrary to Morgan Stanley's disclosures, Respondent recommended to certain advisory clients of Morgan Stanley's Nashville, Tennessee branch office ("Nashville Advisory Clients") certain money managers ("Manager A", "Manager B", and Manager C") (collectively, "the Managers") who were not approved for participation in Morgan Stanley's advisory programs and had not been subject to the firm's due diligence review. This fact was not disclosed to the Nashville Advisory Clients. Further, Respondent had undisclosed relationships with the Managers from which Respondent and Morgan Stanley received substantial brokerage commissions and/or fees. These facts represented a conflict of interest which was not disclosed to the Nashville Advisory Clients.

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<sup>1</sup> The following related administrative proceeding was instituted today: In the Matter of Morgan Stanley & Co. Incorporated.

6. As a result, Respondent aided and abetted and caused Morgan Stanley's violations of Section 206(2) of the Advisers Act.

### **BACKGROUND OF RESPONDENT'S EMPLOYMENT AT MORGAN STANLEY**

7. Respondent was recruited by Morgan Stanley in March 2000 from another firm where he had been a top producer and financial adviser for ten years.

8. While employed at Morgan Stanley, Respondent repeatedly disregarded Morgan Stanley's policies and procedures applicable to its investment adviser representatives. For instance, in May 2001, Respondent refused to sign an acknowledgment that he would abide by Morgan Stanley's code of conduct.

9. In addition, Respondent repeatedly failed to follow Morgan Stanley's policy that required its financial advisers to recommend to clients at least three approved money managers for each investment strategy. Instead, Respondent consistently recommended only a single manager to clients, and thereby steered clients to the Managers with whom he had an undisclosed relationship from which he received financial benefits.

10. Furthermore, as discussed more fully below, Respondent displayed a reckless disregard of the basic features of the advisory programs he was recommending to his clients - for example, whether or not money managers that had not been vetted by Morgan Stanley could be recommended to clients.

### **THE MORGAN STANLEY VISION PROGRAMS**

11. Vision I and Vision III were among the types of accounts Morgan Stanley offered its advisory clients. Morgan Stanley described the Vision I and Vision III programs and its due diligence process in a disclosure statement and in its Form ADV, Part II, filed with the Commission.

12. In the Vision I program, Morgan Stanley assisted clients in developing investment objectives and in selecting money managers from a list of money managers, approved to participate in the Vision I program, to manage clients' assets. To become an approved manager for the Vision I program, a money manager had to pass Morgan Stanley's due diligence review. As it was described in its disclosure statements, the due diligence review included, among other things, on-site interviews of the manager's personnel and an evaluation of each manager's performance as compared to standard relative indices, as well as compared to the performance of managers following similar investment styles. Managers were further evaluated by Morgan Stanley on their investment strategy and on the strength and reputation of their organizations, such as the qualifications of management, their administrative capabilities, and their compliance with regulatory requirements. Final selection of managers for the Vision I program was subject to review and approval by a Morgan Stanley senior management due diligence committee.

13. Morgan Stanley provided custody, execution, and performance reporting for clients and also performed ongoing due diligence and monitoring of all managers selected to participate in the Vision I program. The ongoing monitoring of approved managers, as described in disclosure materials, included periodic reevaluation of the manager by Morgan Stanley, including reviews of performance, assets under management, personnel changes and account turnover to determine whether the manager should remain eligible for participation in the Vision I program.

14. Morgan Stanley described the Vision I program as follows:

Each Vision account is individually managed by one or more investment managers selected by the client from a group of investment managers specifically chosen by the ICS Department to participate in the Vision program.

\* \* \*

After receipt of appropriate information from and about the client, Morgan Stanley identifies several investment managers deemed suitable for the client from among those participating in the Vision program.

15. The Vision III program was designed to accommodate advisory clients who came to Morgan Stanley from another advisory firm and sought services under Morgan Stanley's Vision I program, but who had a pre-existing relationship with a money manager who was not approved for the Vision I program and consequently, had not been subject to Morgan Stanley's due diligence review. Under Vision III, clients retained their relationship with the non-approved money manager. In the Vision III program, Morgan Stanley provided some of the same services as in the Vision I program (custody, execution, performance reporting); however, Morgan Stanley provided no due diligence on or ongoing monitoring of the non-approved money managers with which the client had a pre-existing relationship.

16. Morgan Stanley described the Vision III program as follows:

Certain clients may wish to receive some of Registrant's services under the Vision program but utilize an investment manager that does not participate in the Vision program. For such clients, Registrant provides an alternate version of the Vision program, Morgan Stanley Vision III. Except for the investment manager review and monitoring services described above, Vision III is the same in all material respects to the Vision program. Investment managers selected by clients in Vision III have not been approved by Morgan Stanley to participate in Vision, and are not

monitored and evaluated by Morgan Stanley like managers in Vision.

**RESPONDENT AIDED AND ABETTED AND CAUSED  
MORGAN STANLEY'S VIOLATIONS OF SECTION 206(2)  
OF THE ADVISERS ACT**

17. Under Section 206(2) of the Advisers Act, an investment adviser may not make materially false and misleading statements and must disclose all material potential conflicts of interest. During the relevant period, Respondent misrepresented the firm's money manager recommendation process to certain of his Nashville Advisory Clients and failed to disclose certain potential conflicts of interest inherent in those recommendations. Morgan Stanley thereby violated and Respondent aided and abetted and caused Morgan Stanley's violations of Section 206(2) of the Advisers Act.

18. As reflected above, Morgan Stanley's disclosure statement, in addition to its client services agreement, stated that Morgan Stanley would identify for clients of the Vision I program suitable money managers on whom the firm had conducted due diligence and ongoing monitoring, and who were specifically selected to participate in the Vision I program. Respondent knew or was reckless in not knowing that these were the terms of the Vision I program in which certain of his clients participated.

19. Contrary to the representations in the disclosure statement, during the relevant time period, Respondent on several occasions, recommended to his Vision I advisory clients Money Manager A, Money Manager B, and Money Manager C, who were not approved to participate in the Vision I program. Respondent knew or was reckless in not knowing that the Managers were not approved to participate in the Vision I program and had not been subject to Morgan Stanley's due diligence process. It was not disclosed to these clients that the money managers recommended to them by the Respondent were not approved for participation in the Vision I program.

20. In addition, Respondent had undisclosed relationships with Money Manager A, Money Manger B and Money Manager C from which both he and Morgan Stanley received financial benefits.

21. First, Morgan Stanley, and consequently Respondent, received brokerage commissions from the Managers for trading on behalf of the Managers' institutional clients who were not clients of Morgan Stanley and whose assets were custodied outside of Morgan Stanley. During the relevant period, these three money managers generated at least \$3.3 million in brokerage commissions to Morgan Stanley. Respondent received a portion of those commissions.

22. Second, Manager A and Manager C caused certain of their clients to open advisory accounts with Respondent, in some instances moving assets from another custodian. Respondent and Morgan Stanley were compensated from these advisory

accounts through either an asset fee or commissions. During the relevant time period, Manager A and Manager C generated at least \$200,000 in advisory fees for Morgan Stanley. Respondent received a portion of these fees.

23. When Respondent recommended the three unapproved money managers to advisory clients, the clients were not informed that Respondent and Morgan Stanley had other relationships with the recommended money managers from which both Morgan Stanley and Respondent received financial benefits. These undisclosed financial benefits created an actual or potential conflict of interest which should have been disclosed so that the client could evaluate whether Respondent's recommendations were disinterested.

24. Based on the above, Respondent knowingly or recklessly made misrepresentations about the manager recommendation process to his advisory clients and failed to ensure that the actual or potential conflicts of interest inherent in his recommendation of the Managers were disclosed to those clients. As a consequence, Respondent aided and abetted Morgan Stanley's violation of Section 206(2) of the Advisers Act.

#### **D. VIOLATIONS**

25. As a result of the conduct described above, Respondent willfully aided and abetted and caused Morgan Stanley'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."

### **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 any 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, 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

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

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 60346 / July 20, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Rel. No. 3017 / July 20, 2009

Admin. Proc. File No. 3-12208

In the Matter of  
  
KEVIN HALL, CPA  
and  
ROSEMARY MEYER, CPA

ORDER GRANTING PARTIAL PROTECTIVE ORDER

On May 8, 2008, Kevin Hall, CPA, and Rosemary Meyer, CPA submitted a joint motion seeking a protective order under Rule of Practice 322,<sup>1</sup> limiting disclosure of: an accompanying memorandum, portions of Respondents' briefs addressing the investigation leading to the institution of this proceeding, and the Division of Enforcement's response to such portions of the Respondents' briefs (collectively, the "Covered Arguments"). Under Rule 322, any party "may file a motion requesting a protective order to limit from disclosure to other parties or to the public documents or testimony that contain confidential information."<sup>2</sup> "A motion for a protective order shall be granted only upon a finding that the harm resulting from disclosure would outweigh the benefits of disclosure."<sup>3</sup> The Commission's staff has not opposed the Respondents' request for a protective order.

The Commission recognizes that the Covered Arguments contain sensitive information. At this stage in the proceeding, we believe that the harm resulting from complete disclosure outweighs the benefits. However, we have determined that disclosure of certain information included in Covered Arguments now filed with us may be necessary to the resolution of the issues before the Commission.

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<sup>1</sup> 17 C.F.R. § 201.322.

<sup>2</sup> 17 C.F.R. § 201.322(a).

<sup>3</sup> 17 C.F.R. § 201.322(b).

Accordingly, IT IS ORDERED that:

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

2. All persons who receive access to the Covered Arguments or the information contained in the Covered Arguments shall keep them confidential and, except as provided in this Order, shall not divulge the Covered Arguments or such information to any person.

3. No person to whom the Covered Arguments or information covered by this Order is disclosed shall make any copies or otherwise use such Covered Arguments or information, except in connection with this proceeding or any appeal thereof.

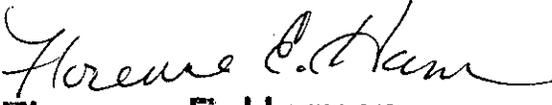
4. The Office of the Secretary shall place the briefs containing the Covered Arguments in sealed envelopes or other sealed containers marked with the title of this action, identifying each document, and marked "CONFIDENTIAL."

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

6. The Commission expressly reserves the authority to reach a different conclusion regarding the confidentiality of the Covered Arguments or information covered by this Order at any time before it determines the issues raised in the proceeding.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: **Florence E. Harmon**  
Deputy Secretary

*Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2906 / July 20, 2009

INVESTMENT COMPANY ACT OF 1940  
Release No. 28821 / July 20, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-11572

In the Matter of

FRANKLIN ADVISERS, INC.,

Respondent.

ORDER MODIFYING RESPONDENT'S  
OBLIGATION TO UNDERGO THIRD PARTY  
COMPLIANCE REVIEWS

I.

On August 2, 2004, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Franklin Advisers, Inc. ("Franklin" or "Respondent").<sup>1</sup>

<sup>1</sup> Respondent is a subsidiary of Franklin Resources, Inc. ("FRI"). FRI and its subsidiaries operate under the name "Franklin Templeton Investments," here shortened to "FT." Through the subsidiaries, FT provides a broad range of investment advisory, investment management, and related services to open-end investment companies, including a family of over 100 retail mutual funds referred to herein as the "FT funds."

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## II.

In anticipation of the proceedings, Franklin consented to the entry of an Order Instituting Administrative and Cease-and-Desist Proceedings 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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "2004 Order").<sup>2</sup> Among other things, the 2004 Order required Franklin to cease and desist from further violations of the federal securities laws, directed Franklin to pay disgorgement and civil money penalties, and directed Franklin to comply with various undertakings.

As part of the 2004 Order, Franklin undertook to undergo, at least once every other year beginning in 2005, a compliance review by a third party concerning Franklin's "supervisory, compliance, and other policies and procedures designed to prevent and detect breaches of fiduciary duty and federal securities law violations by Franklin and its employees in connection with their duties and activities on behalf of and related to the FT funds." 2004 Order, Section IV.E.

## III.

Franklin has submitted an Amended Offer of Settlement (the "Offer") proposing to relieve it of the obligation to continue to have a third party periodically review its compliance controls, which the Commission has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Franklin consents to the entry of this Order Modifying Respondent's Obligation to Undergo Third Party Compliance Reviews ("Order"), as set forth below.

## IV.

The Commission deems it appropriate and in the public interest to amend the 2004 Order as agreed to in Franklin's Offer.

Accordingly, IT IS HEREBY ORDERED that:

A. Section IV.E. of the 2004 Order is amended as follows to order:

E. *Compliance Review.* In 2005 and 2007, Franklin shall undergo a compliance review by a third party, who is not an interested person, as defined in the Investment Company Act, of Franklin. At the conclusion of these reviews, the third party shall issue a report of its findings and recommendations concerning Franklin's supervisory, compliance, and other policies and procedures designed to prevent and detect breaches of fiduciary duty and federal securities law violations by Franklin and its

<sup>2</sup>

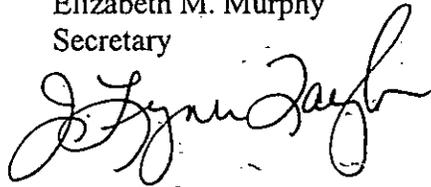
See Advisers Act Rel. No. IA-2271, August 2, 2004, Admin. Proc. File No. 3-11572.

employees in connection with their duties and activities on behalf of and related to the FT funds. The reports shall be promptly delivered to Franklin's chief compliance officer, the independent trustees and directors of the FT funds, and to the Compliance or Audit Committee of the board of trustees or directors of each FT fund.

B. All other provisions of the 2004 Order remain in effect.

By the Commission.

Elizabeth M. Murphy  
Secretary



By: J. Lynn Taylor  
Assistant Secretary

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
[Release No. 28822 / July 20, 2009]

In the Matter of

ADVISORSHARES INVESTMENTS, LLC  
ADVISORSHARES TRUST  
c/o Morgan, Lewis & Bockius LLP  
1111 Pennsylvania Avenue, N.W.  
Washington, D.C. 20004

(812-13488)

ORDER UNDER SECTION 6(c) OF THE INVESTMENT COMPANY ACT OF 1940  
GRANTING EXEMPTIONS FROM SECTIONS 2(a)(32), 5(a)(1), AND 22(d) OF THE ACT  
AND RULE 22c-1 UNDER THE ACT AND UNDER SECTIONS 6(c) AND 17(b) OF THE  
ACT GRANTING EXEMPTIONS FROM SECTIONS 17(a)(1) AND (2) OF THE ACT AND  
DENYING A REQUEST FOR HEARING

AdvisorShares Investments, LLC and AdvisorShares Trust (collectively, "AdvisorShares") filed an application on January 31, 2008, and amended the application on October 17, 2008 and January 15, 2009. Applicants requested an order under section 6(c) of the Investment Company Act of 1940 ("Act") for exemptions from sections 2(a)(32), 5(a)(1), and 22(d) of the Act and rule 22c-1 under the Act, and under sections 6(c) and 17(b) of the Act for exemptions from sections 17(a)(1) and (2) of the Act. The requested order would permit: (a) series of certain open-end management investment companies ("Funds") to issue shares ("Shares") redeemable in large aggregations only ("Creation Units"); (b) secondary market transactions in Shares to occur at negotiated market prices; and (c) certain affiliated persons of the Funds to deposit securities into, and receive securities from, the Funds in connection with the purchase and redemption of Creation Units.

On December 23, 2008, a notice of the filing of the application was issued (Investment Company Act Release No. 28568). 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. On January 13, 2009, Arrow Investment Advisors, LLC ("Arrow") submitted a hearing request on the application ("Hearing Request").

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Rule 0-5(c) states that the Commission will order a hearing on a matter, upon the request of an "interested person" or upon its own motion, if it appears that a hearing is "necessary or appropriate in the public interest or for the protection of investors." The Commission has reviewed the Hearing Request and finds that no issue raised warrants ordering a hearing on the application. Set forth below is a summary of the argument made by Arrow in support of a hearing and the Commission's findings.

Arrow states in the Hearing Request that it commenced an arbitration proceeding ("Arbitration") against Noah Hamman ("Hamman"), the founder and Chief Executive Officer of AdvisorShares, who previously served as president and chief executive officer of Arrow. In the Hearing Request, Arrow requests that the Commission await the arbitrators' determination. Arrow states that it intends to prove in the Arbitration that AdvisorShares' business is based on the improper usurpation and conversion by Hamman of Arrow's corporate opportunities and assets, including the business plan underlying AdvisorShares' proposed issuance of Shares. Arrow bases the Hearing Request on its conclusion that it is not in the best interest of investors for the Commission to grant the requested relief until the Arbitration has been concluded because the Arbitration may result in a decision that substantially affects the interests of any potential shareholder in the Funds.

The Commission has determined that the Arbitration is not relevant to the issues the Act requires the Commission to consider in deciding whether to grant or deny the application, and that Arrow has raised no issues that are necessary for the Commission to consider at a hearing. Arrow does not challenge any of the specific exemptions requested by AdvisorShares, nor does Arrow assert any claims under the Act. With respect to any potential detriment that shareholders might suffer if Arrow prevails in the Arbitration after the issuance of Shares, any conclusions that the Commission might reach, even if a hearing were held, would require the Commission to speculate on the outcome of the Arbitration and on the possible remedies that would be imposed. The Commission also has determined that it should not delay granting exemptive relief when the relevant standards for relief have been satisfied.

On the basis of the foregoing, the Commission finds that Arrow has not articulated any material issue of fact or law that is relevant to the Commission's decision whether to grant the requested relief or that has not been considered previously.<sup>1</sup> It therefore appears that a hearing is not necessary or appropriate in the public interest or for the protection of investors.

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<sup>1</sup> The Commission does not deem it necessary to make a formal determination with respect to the status of Arrow as an "interested person" within the meaning of section 40(a) of the Act and rule 0-5(c) under the Act inasmuch as the Commission has determined that the assertions made and the issue raised in connection with the application do not warrant a hearing.

Accordingly,

IT IS ORDERED that the request for a hearing is denied.

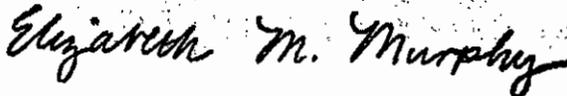
The matter having been considered, it is found, on the basis of the information set forth in the application, as amended, that granting the requested exemptions is appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

It is further found that the terms of the proposed transactions are fair and reasonable and do not involve overreaching on the part of any person concerned, and that the proposed transactions are consistent with the policy of each registered investment company concerned and the general purposes of the Act.

Accordingly,

IT IS FURTHER ORDERED, that the exemptions under section 6(c) of the Act from sections 2(a)(32), 5(a)(1), and 22(d) of the Act and rule 22c-1 under the Act, and under sections 6(c) and 17(b) of the Act from sections 17(a)(1) and (2) requested by AdvisorShares Investments, LLC, et al. (File No. 812-13488), are granted, effective immediately, subject to the conditions contained in the application, as amended.

By the Commission.



Elizabeth M. Murphy  
Secretary

*Commissioner Cased  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60351 / July 21, 2009

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2907 / July 21, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13561

In the Matter of

PERRY CORP.

Respondent

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Perry Corp. ("Respondent" or "Perry").

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 Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order as to Perry Corp. ("Order"), as set forth below.

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### III.

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

#### Summary

1. This matter concerns Perry's failure to file a required disclosure statement pursuant to Section 13(d) of the Exchange Act within ten days of acquiring beneficial ownership of more than five percent of the shares of Mylan Laboratories Inc. (now Mylan Inc.) ("Mylan").

2. At the time of Perry's purchases of Mylan shares, Mylan had announced a proposed acquisition, subject to shareholder approval, of King Pharmaceuticals, Inc. ("King"). Perry entered into an investment strategy known as "merger arbitrage," in which Perry would profit from consummation of the merger. The amount of the potential profit depended, at the time the arbitrage position was taken, on the spread in value between the shares of the acquirer and the target company. The spread, in turn, depended on how the market viewed the likelihood that the merger would be consummated. As the likelihood of consummation increased, the spread narrowed and the opportunity for profit diminished.

3. In order to increase the likelihood of consummation, Perry purchased Mylan shares in order to vote the shares in favor of the merger. At the same time, in order to avoid the economic risk of owning Mylan shares, Perry entered into a series of swap transactions designed to hedge fully its financial exposure from owning the Mylan shares. The swap transactions provided that the swap counterparty would reimburse Perry for any decrease in the market price of Mylan shares between the time of Perry's purchase and the time Perry's position was unwound, which had the effect of insulating Perry from movements in the Mylan share price. As a result, Perry acquired the voting rights to nearly ten percent of Mylan's outstanding shares without any economic risk of share ownership. Perry's ability to acquire the voting rights to Mylan shares without disclosure enhanced its ability to profit potentially from its merger arbitrage position.

4. In general, Section 13(d) of the Exchange Act requires any person who has acquired beneficial ownership of more than five percent of a voting class of equity securities registered under Section 12 of the Exchange Act to report such acquisition within ten days. When it exceeded the five percent threshold in September 2004, Perry determined not to file a beneficial ownership disclosure statement after receiving advice from outside counsel that it could defer filing pursuant to Rule 13d-1(b). However, Perry was not entitled to defer filing pursuant to Rule 13d-1(b) because Perry's acquisition of Mylan securities was not "in the ordinary course" of its business. Qualified institutional investors can defer their Section 13(d) reporting obligations in reliance on Exchange Act Section 13(g) and Rule 13d-1(b) thereunder only when they acquire securities as part of their ordinary market making or passive investment activities. When institutional investors, such as Perry, acquire ownership of securities for the purpose of influencing the direction or management of an issuer or affecting or influencing the outcome of a transaction – such as acquiring shares for the primary purpose of voting those shares in a contemplated merger – the acquisition is not made and the shares are not held in the "ordinary course" of business for

purposes of relying on Rule 13d-1(b). By failing to make a timely filing, Perry violated Section 13(d) of the Exchange Act and Rule 13d-1 thereunder.

### **Respondent**

5. **Perry**, a New York corporation headquartered in New York, New York, is a registered investment adviser that provides investment advice and asset management services to five private investment funds. Perry has been registered with the Commission as an investment adviser since April 2000. Perry operates its investment advisory business in the United States principally through Perry Capital, LLC ("Perry Capital"). As of March 30, 2009, Perry had approximately \$8.8 billion under management.

### **The Mylan/King Merger**

6. On July 26, 2004, Mylan, one of the nation's largest manufacturers of generic pharmaceutical products, announced an agreement to acquire King, an established brand-name pharmaceutical company. The agreement provided that King shareholders would receive 0.9 shares of Mylan common stock for each outstanding share of King stock, which represented a 61% premium for King shareholders as of the date of the announcement. Pursuant to the terms of the agreement, consummation of the merger was subject to the approval of both Mylan and King shareholders.

7. Perry had invested in King intermittently from October 2001, and beginning in March 2004 had built a significant position in King. As of the close of business on July 23, 2004, Perry had accumulated a total of 4,337,900 shares of King, at an average cost of \$15.08 per share. Because King's share price declined between March and July 2004, Perry sustained a paper loss of \$20,413,440. On the day of the merger announcement, King's stock price went up almost 25% and Perry could have sold its King shares then and recouped a portion of its trading losses.

8. Following the merger announcement, Perry engaged in "merger arbitrage." Perry tried to maximize its potential profits by converting its King position into a "risk-arbitrage spread" position through the short-sale of a corresponding number of Mylan shares. An arbitrage spread opportunity is created when, as a result of a merger announcement, the securities of the acquiring company (the "acquirer") trade at a higher adjusted price than the shares of the company it seeks to purchase (the "target"). The adjusted price refers to the stock price of the acquirer adjusted for how many shares of the acquirer the target's shares will convert to in the stock-for-stock merger. This pre-completion spread between the adjusted price of the acquirer's shares and the price of the target's shares reflects market uncertainty about deal consummation, *i.e.*, whether the premium offered to the target company will be realized. Thus, the pre-completion spread widens if there are indications that the merger will not be completed. Conversely, the pre-completion spread narrows as confidence grows that the merger will be completed. A transaction designed to take advantage of an arbitrage spread opportunity, called a risk-arbitrage spread trade, is established by acquiring shares of the target and selling short a corresponding number of shares of the acquirer. When the merger is completed, the shares of the target become shares of the acquirer, and these shares can be used by the investor to cover its short-sales of the acquirer's stock. Through these risk-arbitrage

spread trades, investors can profit from the pre-merger spread that resulted from the risk that the transaction would not be completed. If the merger is not completed, no profit is realized from the risk-arbitrage spread transaction and a loss may result.

9. In the five days immediately following the merger announcement, Perry sold short 3,839,500 shares of Mylan (and adjusted its King position) in order to establish a risk-arbitrage spread position, the profitability of which was contingent upon successful completion of the merger. If the merger had been completed at that time, Perry's existing risk-arbitrage spread position – the shares of King it currently held and corresponding Mylan short-sales – would have resulted in a gain to Perry of approximately \$14.4 million, off-setting much of its paper loss on King. Perry also continued to increase its King position, such that as of the close of business on August 13, 2004, Perry held 5,152,600 shares of King, representing 2.1% of King's outstanding shares.

### **Opposition to the Mylan-King Merger**

10. On August 18, 2004, a prominent activist investor (the "Activist Investor") and certain entities he controlled (the "Activist Investor Group") received Hart-Scott-Rodino clearance from the Federal Trade Commission to purchase between \$100 million and \$500 million worth of Mylan shares, representing between 2.4% and 11.9% of Mylan's outstanding common stock. On September 7, 2004, the Activist Investor Group filed a Schedule 13D with the Commission, disclosing that it had acquired 6.8% of Mylan's stock and that it opposed the Mylan-King merger and intended to solicit proxies against it.

11. The Activist Investor Group's Schedule 13D filing signaled that winning Mylan shareholder approval of the merger would be difficult and the market reacted swiftly. Between September 7, when the Activist Investor Group filed its Schedule 13D, and September 17, 2004, when it amended its Schedule 13D to disclose that it held 8.9% of Mylan's stock, the risk-arbitrage spread widened by 59%, from \$3.26 to \$5.19. The risk-arbitrage spread reflected market uncertainty as to whether the merger would succeed in the face of the Activist Investor's opposition, particularly given that there was no indication that any other large Mylan shareholder supported the merger. If the Activist Investor succeeded in blocking the merger, Perry would lose its anticipated profit from its risk-arbitrage spread trades.

### **Perry's Acquisition of Voting Rights to Mylan Stock**

12. Following the Activist Investor Group's initial Schedule 13D filing, Perry began exploring various ways of acquiring Mylan voting rights without economic risk and without public disclosure. Perry wanted to obtain Mylan stock in order to vote in favor of the merger, and thereby counter the Activist Investor's votes, but did not want to take on the economic risk of owning Mylan shares. In addition, because Perry wanted to profit from a wider risk arbitrage spread, Perry did not want the market to be aware that Perry was building a position to vote in favor of the merger. Had the market known that Perry was acquiring Mylan shares sufficient to offset the Activist Investor Group's position, the spread would have narrowed to reflect the increased likelihood that the merger would be completed, thereby reducing Perry's potential profits on its

spread trades. As a result, Perry researched possible mechanisms through which it could purchase or transfer Mylan stock in transactions which would not be reflected publicly in the market, and obtained pricing on various derivative products which could eliminate or come close to eliminating Perry's economic exposure to the Mylan stock. Perry had never before engaged in a similar strategy to acquire voting rights to a security in order to vote those shares in a merger, without having any economic interest in the shares.

13. On September 8, 2004, a Perry employee contacted a brokerage house specializing in derivative products to inquire about various ways that Perry might be able to purchase Mylan shares while simultaneously obtaining a derivative product to offset the economic risk of owning the stock. The Perry employee also inquired whether there was any way Perry could purchase the Mylan shares without the purchase being publicly reported:

If we traded like a million shares or two million shares of Mylan ... would it print, or would we have to see it hit the tape? ... [C]ould you print on like a consolidated tape at like 6:30 at night tonight or something, so that way it never really hits our tape.<sup>1</sup> ... You know what I mean, like, there's exchanges in the Caymans, there's exchanges in London. ... Ask your [brokerage trader] what is the most discreet way to print this ... and call me back.<sup>2</sup>

14. Thereafter, on September 10, a second Perry employee had several telephone calls with Perry's contact at an investment bank. During the calls, the Perry employee first asked who would see trades printed on the consolidated tape, and the bank representative expressed his understanding that trades done after 6:30 p.m. were reported only to the relevant exchange and not to the market as a whole. The Perry employee then asked: "So if we wanted to cross stock with you guys and have it print on a consolidated tape after 6:30, is that something that you guys would be willing to do for us?" The bank representative responded, "You mean you're doing it in a swap?" The Perry employee explained that Perry wanted to do it as a cross, which the bank representative rejected as not a "real trade." The Perry employee then asked, "So we could do it in swaps, you're saying. We could do it in swaps?" The bank representative responded that he thought they could. Minutes later, the Perry employee instructed the bank to begin looking into transactions whereby Perry would acquire Mylan shares in 500,000 to 1 million share lots, every few days, after 6:30 p.m. to avoid public disclosure while eliminating Perry's risk through "swap" agreements with the bank.

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<sup>1</sup> This conversation demonstrates Perry's understanding of then-existing trade reporting requirements. During the relevant period, over-the-counter ("OTC") trades made between 6:30 p.m. and midnight were reported to an NASD facility on the next trading day and marked "as of." Trades reported in this way were not disseminated to the public. By contrast, trades that took place during regular business hours involved trade reports that were immediately publicly disseminated.

<sup>2</sup> A "print" is an industry term for trade reporting.

15. Starting on September 8, 2004, Perry acquired 26.6 million shares, or 9.89% of Mylan's shares, to vote in favor of the Mylan-King merger and to counter the Activist Investor's opposition. Perry purchased 5.6 million of these Mylan shares in regular open-market transactions.<sup>3</sup> Perry acquired the remaining 21 million shares from, and engaged in a complex series of "swap" transactions with, two banks (collectively, the "Banks") that gave Perry voting rights to Mylan shares while eliminating Perry's economic risk of holding the shares.

16. The Banks borrowed and short-sold to Perry 21 million shares of Mylan stock, in blocks of 1 million to 2 million shares, which Perry purchased in foreign markets or after hours on the OTC market. Perry took several steps to ensure that the transactions would be hidden from the market. First, because the Banks were borrowing the shares, the transfer of the shares from the investors who owned them to the Banks did not hit the tape. Second, and more important, Perry instructed the Banks to conduct the Mylan short-sales in foreign markets or as OTC trades after hours so those trades also would not be disseminated to the public. By structuring the transactions this way, these trades were not reported by any volume-reporting or other public dissemination services, even though on many days Perry's share purchases eclipsed the total volume of all Mylan shares reported to have been purchased through all reporting exchanges. Thus other market participants were unaware that Perry was obtaining a very large voting interest in Mylan that could be used to counter the Activist Investor's opposition to the merger.

17. At the same time as it was acquiring its long position in Mylan through short sales by the Banks, Perry was executing "swap" agreements with the Banks tied to the underlying Mylan shares Perry was purchasing from the Banks. The "swaps" were governed by ISDA (International Swap Dealers Association) Master Agreements, with the specific terms of each transaction set forth in a "confirmation." These "swaps" were synthetic transactions tied to the price of the underlying security. Essentially, the parties to a "swap" transaction agree to pay one another the difference between the price of the underlying security at origination and termination, with one party being obligated to make payments if the price goes up, and the other obligated to make payments if the price goes down. In this case, the "swap" transactions had the effect of insulating both parties from movements in the price of the underlying stock, Mylan. Because the Banks were

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<sup>3</sup> From September 8 through September 10, 2004, the days in which it was exploring alternative mechanisms, Perry purchased 2,883,900 shares of Mylan through the New York Stock Exchange, all of which shares were offset by short sales Perry already had in Mylan, but did not cover its short position using these Mylan long purchases. Perry purchased another 2,742,400 shares in standard market transactions from September 23 through October 13, 2004, again offsetting these shares with Mylan shares it sold short as part of its risk-arbitrage position. Although an investor typically would "cover" a short position and close out the short (and stop paying financing fees to the bank through whom it was executing the short), Perry kept both positions open – long Mylan and short Mylan – thereby paying financing fees to its prime brokers for its existing short position while retaining the right to vote the shares purchased to cover the short. Payment of these unnecessary financing costs, which totaled \$5.7 million, was consistent with Perry's purpose in purchasing the Mylan shares solely for voting rights, further demonstrating the lack of any independent economic rationale for Perry's acquisition of Mylan stock.

borrowing the shares that they sold short to Perry, the Banks would be at risk if the price of Mylan stock was up at the time the Banks needed to cover their short positions. At the same time, Perry – which was long the 21 million shares – would be at risk if the price of Mylan stock was down at the time Perry wished to unwind its position. The “swaps” guaranteed both parties against these potential losses: through the “swap” Perry agreed to reimburse the Banks for the difference between the price at which the Banks short-sold the Mylan shares to Perry and the market price at the time the transaction was unwound, if the market price at that time was higher, and the Banks agreed to reimburse Perry for the difference between the price Perry paid for the stock and the market price at the time the transaction was unwound, if the market price at that time was lower. The “swap” agreements effectively eliminated any economic risk Perry had from owning Mylan shares. As a result of the “swap” transactions, neither Perry nor the Banks were at risk of any movement in the price of Mylan stock.

18. By entering into these “swap” transactions, Perry was able to acquire the voting rights to nearly ten percent of Mylan’s stock without having any economic risk and no real economic stake in the company. Moreover, Perry was able to do this without making a significant financial outlay. Perry financed its purchase of Mylan stock through an extension of its existing margin line of credit at its prime broker. For each purchase of Mylan stock, in the three days between trade date and settlement date, Perry drew upon its margin account to have enough cash deposited into its cash account to satisfy payment for the long position. The funds were then transferred to the Banks by the settlement date. In total, Perry paid less than \$7.2 million to its prime broker to finance the purchase of 26.6 million Mylan shares, worth approximately \$492 million. Perry also earned interest on its short positions and on the collateral it gave to the Banks for the “swaps.” As a result, accounting for all of Perry’s costs and also the interest it earned on its various positions, Perry paid only \$5.76 million to acquire voting rights to almost ten percent of Mylan’s shares.<sup>4</sup>

19. While Perry was engaging in its Mylan strategy of essentially buying votes, it was simultaneously adding to its risk-arbitrage spread position by purchasing additional King shares and continuing to short Mylan shares. As of November 11, 2004, the day on which Perry held its largest King position, Perry stood to capture an additional \$21.8 million gain on the further risk-arbitrage spread trades it had made since September 7.<sup>5</sup> If the merger had been consummated that

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<sup>4</sup> The Banks profited from this transaction through commissions earned and financing fees charged for establishing the swap positions. The Banks also benefited by virtue of holding a total of \$448,074,500 in funds obtained from Perry while the position was open, in what can be described as an extremely low interest loan from Perry to the Banks. The Banks received \$389,630,000 for the 21 million shares of Mylan the Banks short-sold to Perry, as well as \$58,444,500 in collateral that Perry posted for the swaps. Although Perry earned the nominal federal funds rate from the Banks on its collateral payment, the Banks were free to earn more on the total amount of \$448,074,500.

<sup>5</sup> By the close of business on September 7, 2004, Perry held 5,146,800 shares of King, which it had converted into risk-arbitrage spread positions by short-selling Mylan stock, and stood to earn at least \$19.97 million on this position if the merger were to be consummated.

day, Perry's July 26, 2004 \$20.4 million paper loss on its 4,337,900 share King position would have turned into a net profit of \$21.3 million on its 8,594,700 share King risk-arbitrage spread position – a \$41.7 million swing. Had the market known that Perry was acquiring voting rights in Mylan shares sufficient to offset the Activist Investor's Mylan position, the spread between the price of King and the price of Mylan would have been narrower. Because the market was unaware of Perry's position and conduct, however, Perry was able to not only protect its existing potential arbitrage-spread gain, but also further profit by engaging in additional risk-arbitrage spread trades at artificially wide spreads.

### Perry's Failure to File Required Reports

20. On September 20, 2004, Perry was approaching the five percent ownership threshold triggering reporting obligations pursuant to Section 13(d) of the Exchange Act and Rule 13d-1 thereunder. To determine whether it was required to file a Schedule 13D disclosing its Mylan position, Perry sought advice from outside counsel at two different law firms. First, Perry personnel contacted outside counsel from the law firm that routinely handled Perry's public filings, including its Section 13 filings ("Lawyer A"). Lawyer A advised Perry that, ordinarily in a merger situation, his initial reaction and general bias was that Perry should file a Schedule 13D.

21. Perry personnel then contacted another lawyer, who had previously provided advice to Perry on various mergers and acquisition matters ("Lawyer B") – including advice in August 2004 concerning the Activist Investor's acquisition of Mylan shares. Without informing Lawyer B that Perry previously had consulted with Lawyer A, Perry asked Lawyer B, who had not previously handled any of Perry's Section 13 filings, for his legal advice concerning Perry's Schedule 13D filing obligations. After discussing the matter with Perry, Lawyer B advised by email that Perry could defer filing "assuming the purchase of Mylan shares is [in the] ordinary course":

I think you're ok filing a 13G if you are acquiring the securities in the ordinary course of business and not with a view toward, or as part of a plan having the purpose or effect of, changing or influencing control of Mylan. My understanding of the deal is that it is a reverse triangular merger, with a subsidiary of Mylan merging into King, and that there will be no change in the Mylan board as a result of the merger. So, assuming the purchase of Mylan shares is ordinary course for Perry (and I'm not sure why it would not be), I think you can file a 13G if a filing is necessary.

22. Perry personnel then informed Lawyer A that Lawyer B had opined that Perry did not have to file a Schedule 13D because it was acquiring an interest in the acquirer, not the target company. After discussing the issue, Lawyer A agreed that, in general, Perry's ownership in an acquiring company would not amount to "influencing control" under Rule 13d-1(b)(1)(i) of the Exchange Act and therefore would not automatically trigger a Schedule 13D filing obligation.

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reducing Perry's pre-merger announcement paper loss on its King position from \$20.4 million to \$443,000.

23. In opining upon Perry's reporting obligations, neither attorney specifically considered whether Perry's vote-buying strategy was in the ordinary course of Perry's business. Perry's counsel did not ask questions or follow up with Perry concerning whether Perry's strategy was in the ordinary course of Perry's business. Nor did Perry conduct any internal assessment or follow up with counsel for legal advice on this issue. By the close of business on September 24, 2004, Perry had acquired 16.2 million shares of Mylan, representing more than five percent of Mylan shares. Pursuant to Section 13(d), Perry was required to disclose its acquisition within ten days, that is, by October 3, 2004.

#### **Perry's Untimely Schedule 13D Filing**

24. On November 19, 2004, the Activist Investor announced that he intended to make a \$20 per share tender offer for Mylan. Shortly thereafter, at the end of the day on November 22, 2004, a news article was published that speculated that Perry and other hedge funds had taken positions in Mylan to vote in favor of the merger and capture the significant risk arbitrage spread, without having any economic interest in the company or exposure to Mylan's stock price.

25. On November 23, 2004, Perry consulted with counsel at a third law firm ("Lawyer C"), who opined that Perry should file a Schedule 13D in light of the Activist Investor's tender offer. Lawyer C opined that because of the tender offer, Perry now could be said to hold its Mylan shares with the purpose or effect of changing or influencing the control of Mylan. On November 29, 2004, Perry filed a Schedule 13D disclosing its Mylan position, more than two months after Perry had acquired more than five percent of Mylan shares.<sup>6</sup>

26. The Mylan/King merger was not completed for reasons unrelated to the above-described trading. On December 8, 2004, King announced that it would have to restate earnings for 2002, 2003 and the first six months of 2004. On February 27, 2005, Mylan and King announced that they had mutually agreed to terminate the proposed merger because they were "not able to agree upon terms for a revised transaction."

#### **Violations**

27. Section 13(d) of the Exchange Act and Rule 13d-1 thereunder generally require any person who has acquired beneficial ownership of more than five percent of a voting class of equity securities registered under Section 12 of the Exchange Act to report such acquisition on Schedule 13D within ten days after such acquisition. However, as an alternative, the rules allow the use of short-form disclosure statements with differing timing requirements under certain conditions. Rule 13d-1(c) provides that, in lieu of filing a Schedule 13D, any person may file a short-form statement

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<sup>6</sup> On November 12, 2004, Perry filed a Schedule 13F disclosing among its holdings in 216 different companies that it owned over 16.9 million shares of Mylan as of September 30, 2004. Filing a required Schedule 13F does not relieve persons from their obligations with respect to filing Schedule 13D, which requires the disclosure of more detailed information than a Schedule 13F.

on Schedule 13G within ten days after the triggering acquisition (a "10-Day 13G"), so long as that person "has not acquired the securities with any purpose, or with the effect of, changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect," and is not directly or indirectly the beneficial owner of twenty percent or more of the class of securities. In addition, Rule 13d-1(b) provides that, in lieu of filing a Schedule 13D, certain qualified institutional investors may file a short-form statement on Schedule 13G within 45 days after the end of the calendar year in which they made the triggering acquisition (a "45-Day 13G"), so long as the institutional investor acquired the securities "in the ordinary course of his business and not with the purpose nor with the effect of changing or influencing the control of the issuer, nor in connection with or as a participant in any transaction having such purpose or effect."<sup>7</sup>

28. The institutional investors that can avail themselves of the more liberal timing requirements of the 45-Day 13G include broker-dealers, banks, insurance companies, investment companies, and persons registered as investment advisers. An institutional investor that does not meet the "ordinary course of business" requirement for filing a 45-Day 13G can still file a 10-Day 13G, in lieu of a Schedule 13D, so long as it meets the requirements of Rule 13d-1(c).<sup>8</sup>

29. The filing requirements of Section 13(d) of the Exchange Act were adopted for the twofold purposes of "(i) providing adequate disclosure and other protections to stockholders in connection with takeover attempts, such as tender offers, and corporate repurchases, and (ii) providing adequate disclosure to stockholders in connection with any substantial acquisition of securities within a relatively short period of time." Exchange Act Release No. 13291, 42 Fed. Reg. 12342, 12343 n.2 (Mar. 3, 1977); see also GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971) ("the purpose of section 13(d) is to alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control"); SEC v. Drexel Burnham Lambert, Inc., 837 F. Supp. 587, 607 (S.D.N.Y. 1993) (citing cases).

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<sup>7</sup> Under Rule 13d-1(b), qualified institutional investors who meet these tests need not file a 45-Day 13G unless they beneficially own more than five percent of a class of equity securities as of the end of the calendar year in which they acquired the securities. Rule 13d-1(b)(2).

<sup>8</sup> See, e.g., Exchange Act Release No. 34-37403, 1996 WL 374621, at \*6 (July 3, 1996) ("Even where an institutional investor is unable to make the 'ordinary course of business' certification [under Rule 13d-1(b)(1)] it would still be permitted to file on Schedule 13G under the Passive Investor provision so long as it does not have [beneficial ownership of equal to or greater than 20% of the outstanding class or acquire or hold the securities with] a disqualifying purpose or effect.") Perry never filed a Schedule 13G pursuant to Rule 13d-1(c) and therefore was legally precluded from satisfying its beneficial ownership reporting obligation by claiming that it was a "Passive Investor" as defined in Exchange Act Release 39538. (January 12, 1998) at footnote 9.

30. "Section 13(d) is not a mere 'technical' reporting provision; it is, rather, the 'pivot' of a regulatory scheme that may represent the only way that corporations, their shareholders and others can adequately evaluate . . . the possible effects of a change in substantial shareholdings." Drexel, 837 F. Supp. at 607 (internal citations omitted); see also H.R.Rep. No. 1711, 90th Cong., 2d Sess., at 8 (1968), reprinted in 1968 U.S.C.C.A.N. 2811, 2818 ("The purpose of section 13(d) is to require disclosure of information by persons who have acquired a substantial interest, or increased their interest in the equity securities of a company by a substantial amount, within a relatively short period of time."); SEC v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1230 (D.C. Cir. 1989) (a violator of Section 13(d) improperly benefits by purchasing stock at an artificially low price, because disclosure of a holding in excess of five percent of a company's stock suggests to the rest of the market a likely takeover and therefore may increase the price of the stock). Proof of scienter is not required to establish a violation of this reporting provision. See, e.g., SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1167 (D.C. Cir. 1978).

31. Section 13(d) and Section 13(g) are broad disclosure statutes. The availability of a short-form Schedule 13G is designed to ensure adequate disclosure to the marketplace while minimizing the burden on passive investors who would otherwise be required to complete a comprehensive Schedule 13D filing. All persons other than "Exempt Investors" filing pursuant to Exchange Act Rule 13d-1(d)<sup>9</sup> who avail themselves of Schedule 13G must certify that they have acquired the subject securities with a passive investment purpose.<sup>10</sup> Qualified institutional investors can defer their initial beneficial ownership reporting obligations by relying on Rule 13d-1(b) only if they can additionally certify that they have acquired the subject securities in the "ordinary course of [their] business."

32. The "ordinary course of business" provision was first added to Section 13(d) by Congressional amendment in 1970. The purpose of the amendment was to allow the Commission to exempt broker-dealers and stock exchange specialists acquiring the specified percentage of securities in the ordinary course of trading or market making activities from the more rigorous disclosure provisions of Schedule 13D. See, e.g., H.R. Rep. No. 91-1655, 91<sup>st</sup> Cong., 2d Sess. (1970) at 4-5 ("The Committee amendment adds a new paragraph to Section 13(d) of the Act to grant clearly to the Commission authority to permit simpler reporting for persons who, although acquiring more than 5 percent of any equity security, have done so in the ordinary course of business and have not acquired the shares for the purpose of changing or influencing the control of the issuer. Acquisitions by stock exchange specialists, over-the-counter marketmakers, and

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<sup>9</sup> The types of investors who may file on Schedule 13G pursuant to Rule 13d-1(d) are described as "Exempt Investors" and are identified in footnote 8 in Exchange Act Release 39538 (January 12, 1998). "Exempt Investors" who, as of the end of a calendar year, beneficially own more than five percent of a class of equity securities are required to file Schedule 13G within 45 days after the end of the calendar year but are not required to certify that the securities were acquired either in the "ordinary course of business" or with a passive investment purpose. Rule 13d-1(d). Perry was not an Exempt Investor.

<sup>10</sup> See Rules 13d-1(b)(1)(i) and 13d-1(c)(1).

investment companies might well fall within the class of persons to which this amendment addresses itself.”).<sup>11</sup>

33. Here, Perry engaged in a series of transactions in order to acquire voting rights to a large block of Mylan stock for the exclusive purpose of voting the shares in a merger and influencing the outcome of the vote. Perry’s acquisition of Mylan shares was not made in order to invest in, or profit from, ownership of the Mylan shares. Irrespective of whether transactions of this type are routine for an institutional investor, reliance on Rule 13d-1(b)(1)(i) based on the “ordinary course of business” provision is inappropriate when transactions of the type executed by Perry are undertaken. The exception to the ordinary 10-day disclosure requirements of Section 13(d) for qualified institutional investors is available only where such investors are acquiring securities for passive investment or ordinary market making purposes as part of their routine business operations.<sup>12</sup>

34. When institutional investors acquire, directly or indirectly, the beneficial ownership of securities with the purpose of influencing the management or direction of the issuer or affecting or influencing the outcome of a transaction – such as acquiring securities, or an interest in securities, for the purpose of voting those securities in favor of a merger – the acquisition of those securities cannot be said to be in the “ordinary course of [the institutional investor’s] business” for purposes of relying on Rule 13d-1(b) or making the certification under Item 10 of Schedule 13G. To the extent a qualified institutional investor, such as Perry, acquired shares outside of its ordinary course of business, Section 13(d) filing obligations automatically arise. Similarly, when institutional investors rapidly accumulate securities of an acquirer after the announcement of a business combination transaction with the intent to ensure completion of a merger by the acquirer, the legislative purpose of Section 13(d) is defeated in the absence of full disclosure. When such acquisitions are made, or when such institutional investors act in concert with the management or advisors of one of the parties to the transaction to ensure completion of the merger, those institutions are ineligible to certify that the securities were acquired and are held in the “ordinary course of [the institutional investor’s] business” for purposes of relying upon Exchange Act Rule 13d-1(b) to defer the filing of a beneficial ownership report.

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<sup>11</sup> See also, Additional Consumer Protection in Corporate Takeovers and Increasing the Securities Act Exemptions for Small Businessmen: Hearing on S. 336 and S. 3431 Before the Subcomm. on Secs. of the Senate Comm. on Banking and Currency, 91<sup>st</sup> Cong., 2d Sess. (1970) at 13, 103, 111, 113, 116 (discussing securities industry proposals to provide an exemption from the Section 13(d) disclosure provisions for broker-dealers and stock exchange specialists acquiring the specified percentage of securities in the course of normal market-making activities); 91 P.L. 567 (Dec. 22, 1970) (amending Section 13(d) to insert new subparagraph (5)). The “ordinary course of business” provision was incorporated in the rules allowing the use of the short-form Schedule 13G upon their adoption in 1978. Exchange Act Release No. 34-14692, 1978 WL 170898 (April 21, 1978).

<sup>12</sup> See, e.g., In the Matter of JWGenesis Financial, Inc., Release No. 34-43053, 2000 WL 987730 (July 19, 2000); Blunt, Ellis and Loewi, Inc., SEC No-Action Letter, 1988 WL 234209, at \*1 (April 15, 1988).

35. Because Perry did not acquire the Mylan securities in the ordinary course of its business, it was not eligible to file a Schedule 13G and was instead required to disclose its acquisition within 10 days.

36. As a result of the conduct described above, Perry willfully<sup>13</sup> violated Section 13(d) of the Exchange Act and Rule 13d-1 thereunder.

#### IV.

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

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

A. Respondent Perry shall cease and desist from committing or causing any violations and any future violations of Section 13(d) of the Exchange Act and Rule 13d-1 thereunder.

B. Respondent Perry is censured.

C. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$150,000 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 Perry as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to David Rosenfeld, Associate Regional Director, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

<sup>13</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Chairman Schapiro  
not participating

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 60361 / July 22, 2009.

Admin. Proc. File No. 3-13344

In the Matter of the Application of

GREGORY W. GRAY, Jr.

c/o Marni Weiss  
Weiss Imbesi PLLC  
462 Seventh Avenue, 12th Floor  
New York, NY 10018

For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY  
PROCEEDING

**Conduct Inconsistent with Just and Equitable Principles of Trade**

**Conduct Detrimental to the Interest or Welfare of the Exchange**

Registered representative entered unauthorized trades in customer accounts and harassed and/or threatened customers and/or their family members after they made complaints against representative. *Held*, association's findings of violation and sanctions imposed are *sustained*.

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## APPEARANCES:

*Marni Weiss and Vincent Imbesi*, of Weiss Imbesi PLLC, for Gregory W. Gray, Jr.

*Susan Light, Penny Rosenberg, Andrew D. Kampel, and Jennifer Mennella*, for FINRA, on behalf of NYSE Regulation, Inc.

Appeal filed: January 16, 2009

Last brief received: April 29, 2009

## I.

Gregory W. Gray, Jr., a former registered representative with Quick & Reilly, Inc. and H&R Block Financial Advisors, both members of the New York Stock Exchange LLC ("Exchange"), appeals from disciplinary action taken by NYSE Regulation, Inc. ("NYSE").<sup>1</sup> On December 17, 2008, NYSE found that Gray engaged in conduct inconsistent with just and equitable principles of trade in violation of Exchange Rule 476(a)(6) by effecting unauthorized trades in two of his customers' accounts. NYSE also found that Gray engaged in acts detrimental to the interest or welfare of the Exchange in violation of Exchange Rule 476(a)(7) by threatening and/or harassing complaining customers and/or their family members. NYSE censured Gray and barred him from acting in any capacity with a member firm for three years.<sup>2</sup> We base our findings on an independent review of the record.

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<sup>1</sup> On July 26, 2007, the Commission approved proposed rule changes in connection with the consolidation of certain member firm regulatory functions of NASD and NYSE Regulation, Inc. (the NYSE subsidiary responsible for enforcing NYSE regulatory compliance). See Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Pursuant to this consolidation, certain of the member firm regulatory and enforcement functions and employees of NYSE Regulation were transferred to NASD, and the expanded NASD changed its name to the Financial Industry Regulatory Authority, or "FINRA." See Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. This proceeding was initiated by NYSE Regulation before July 26, 2007 and was therefore also adjudicated by NYSE Regulation in accordance with its rules and procedures. Although FINRA has now briefed this appeal to us on behalf of NYSE Regulation, we use the designation NYSE to refer to both entities in this opinion.

<sup>2</sup> Gray sought a stay of that sanction, which was denied. See *Gregory W. Gray, Jr.*, Order Denying Stay, Admin. Proc. File No. 3-13344 (Feb. 19, 2009).

## II.

## A. Unauthorized trade in Konieczko's account

Upon joining Quick & Reilly in March 2002,<sup>3</sup> Gray inherited responsibility for a number of accounts of existing Quick & Reilly customers, including Michele Konieczko. Konieczko was the custodian of two accounts opened by her father for the benefit of her sons. The accounts, which were valued then at approximately \$100,000 and \$150,000, were invested mostly in money market funds and were used primarily for paying for Konieczko's sons' education. Konieczko testified that her father "took care of" the accounts until he became ill in 1997. Thereafter, Konieczko simply checked her monthly account statement "to make sure that it balance[d]" but "didn't buy or sell anything." Until Gray became her broker, she contacted Quick & Reilly only about once a year to request a withdrawal of funds to pay her sons' tuition bills.

Some time in the summer of 2003, Gray called Konieczko and suggested that she "should be doing something with" and "investing" the significant cash positions that they held. Gray solicited her interest in buying shares of Evergreen Income Opportunity Fund ("Evergreen"), a new-issue, closed-end mutual fund.<sup>4</sup> Konieczko did not agree to make any purchase and testified that she knew at the time she "wasn't going to invest in it." She told Gray to send her written information because she thought he was a "young, ambitious man" and she "[didn't] want to hang up on him." When Gray called to follow up two weeks later, Konieczko said she was not interested in buying the shares and explained that, in any event, she would not make any such purchase without first discussing it with her parents. When Gray offered to call her parents to discuss the purchase, Konieczko became "a little annoyed with [Gray] being so aggressive about this." Anticipating that her parents would reject his solicitation, she gave Gray her parents' phone number and told them to expect his call. When Gray called her parents, Konieczko testified, they told him they were not interested in the offer and "hung up."

Konieczko heard nothing from Gray until the end of June or early July 2003, when she received a message on her telephone answering machine informing her that "there was a trade made in error on my son's account" and that she would receive a confirmation of the trade and subsequent cancellation in the mail. Within a week, Konieczko received the trade confirmation and noticed that the "error" was a purchase of \$100,000 (*i.e.*, two-thirds of the value of her son's account) of Evergreen shares. Konieczko testified that she was "very upset" and "shook up" that

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<sup>3</sup> Gray entered the securities industry in May 1997. He was employed by four different securities firms before becoming associated with Quick & Reilly.

<sup>4</sup> Gray testified during the investigation by NYSE's Division of Enforcement ("NYSE Enforcement") that, at Quick & Reilly, financial advisors like himself were paid different levels of commission on different kinds of securities transactions: they earned nothing for equity trades, about 2.5% of the transaction value for bond trades, and 3% for closed-end mutual fund trades.

"there could be an error with that kind of money." Konieczko immediately called Quick & Reilly. She was unable to reach Gray but spoke to a representative who assured her the trade would be cancelled. Konieczko received written confirmation of the cancellation in July 2003.

At about this time, Quick & Reilly's automated account monitoring system flagged Konieczko's account because of the unusual activity and generated a report that was forwarded to Gray's supervisor, Peter Lynch.<sup>5</sup> Lynch was unsuccessful at reaching Konieczko by phone to discuss the activity in her account,<sup>6</sup> so he wrote to her on November 18, 2003 explaining that, until she contacted him, her account would be restricted from any further trading. Konieczko immediately called Lynch and explained to him the "error" that had been made and that she "was very shocked that an error like that could occur with that kind of money." Lynch assured Konieczko that someone else would be handling her account and confirmed in writing that the Evergreen trade "has been cancelled and removed from your account."<sup>7</sup> Konieczko ultimately suffered no economic loss from the transaction.

On November 24, 2003, Lynch sent Gray an e-mail asking about the transaction, but Gray did not respond. Gray left the firm three days later. Gray testified that he would have earned close to \$1,000 in commission for the purchase but, because the trade was cancelled, received nothing.

In contrast to Konieczko's testimony, before NYSE Gray claimed that Konieczko authorized the trade but then reversed her decision after her father expressed disapproval. He also denied leaving a message on her answering machine characterizing the trade as an error.

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<sup>5</sup> Lynch passed away during the course of NYSE's investigation. He did not testify regarding the allegations against Gray.

<sup>6</sup> The record suggests that the reason for Lynch's difficulty is that the phone number that Gray provided him was incorrect.

<sup>7</sup> According to Gray's investigative testimony, it was his own choice to stop servicing Konieczko's account. When asked if he contacted Konieczko with any other investment ideas after the Evergreen solicitation, he responded:

[If] someone is not going to buy into my philosophy for investing, do[es]n't see the benefit of what I can bring to the table, then it is a waste of my time to continue that relationship. . . . It was not in my best interest to continue a relationship with her going forward.

Gray testified during the investigation that he did not inform Lynch that he had decided to stop servicing Konieczko's account because Gray "just didn't think she was fit for a full service broker."

## B. Unauthorized trade in Ricotta's account

In September 2003, Gray wanted to acquire \$150,000 of shares in an initial public offering of Eaton Vance Tax Advantaged Fund ("EVT"), a closed-end mutual fund, for Dorothy Abhau. Gray testified that Abhau was a "referral from my top client, and I wanted to do everything I could for her to get that trade for her." However, Abhau's account was restricted because it had recently been transferred from another firm, and Gray had to secure Lynch's permission before purchasing the shares. In a brief conversation, Gray asked Lynch to approve the purchase but, according to Gray, Lynch was in a hurry to leave and said, "I don't have time to approve it now, no." Because the offering closed that same day, Gray decided to secure the shares in Lynch's absence by purchasing them instead with funds from another client, Deirdre Ricotta, who was chosen at random because she had at least \$150,000 in cash in her Quick & Reilly account. Gray admitted that his intent was to secure Lynch's approval to purchase EVT shares for Abhau's restricted account and then transfer the shares he had "parked" in Ricotta's account to Abhau's.<sup>8</sup> However, when Lynch returned to the office, he again refused to approve the trade, citing suitability concerns.<sup>9</sup>

Gray did not inform Lynch that he had already purchased EVT shares for Ricotta hoping that Lynch would approve their purchase for Abhau's account. Instead, Gray contacted Ricotta and told her that an "error" had been made in her account by his assistant and gave her the option of correcting the error by selling the shares for a small profit, as the value of her shares had increased by about \$400 since the purchase date. Ricotta declined and, in an e-mail to Gray dated October 11, 2003, requested that the "unauthorized transaction" be cancelled.

Lynch discovered this correspondence via the firm's e-mail monitoring system and contacted Ricotta, who filed a complaint with Lynch. Quick & Reilly cancelled the trade and sent her written confirmation. When Lynch asked Gray to explain the circumstances surrounding the trade, Gray wrote in an e-mail that "[i]f I could change my decision I would, but I was irate that I couldn't place this trade and I did what I thought was right at the time to get my client the shares."

On November 10, 2003, Lynch issued a written letter of warning to Gray, noting, among other things, that Gray had "violat[ed] firm and industry policy regarding unauthorized trading," engaged in "clear insubordination," and was subject to disciplinary action (including termination) if Gray committed further violations or received more customer complaints. About two weeks later, Lynch learned of the activity in Konieczko's account, described above, and requested an explanation from Gray (which, as noted above, Gray did not provide before departing Quick &

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<sup>8</sup> Gray testified that Lynch had approved other trades for Abhau's account in previous months and that he therefore assumed Lynch would approve this one.

<sup>9</sup> Gray could not recall Lynch's reasons for refusing to approve the trade, but stated in investigative testimony that he believed Lynch "made it personal for other reasons."

Reilly).<sup>10</sup> Gray testified during NYSE Enforcement's investigation that the EVT trade intended for Abhau's account was "\$4500 to me," but he ultimately received no commission because the transaction was cancelled.

### C. Gray's harassment of complaining customers

After leaving Quick & Reilly, Gray spent two months at BancOne Securities, Inc., and then joined H&R Block in February 2004. In August 2004, NYSE Enforcement notified Gray that it was investigating unauthorized trades in several customers' accounts while he had been employed at Quick & Reilly. In December 2005, H&R Block suspended Gray and then, in January 2006, terminated him. According to the Form U5 filed by H&R Block, the firm terminated Gray because he "[d]id not submit accurate information regarding clients' ages on insurance applications."<sup>11</sup>

In February 2006, NYSE Enforcement notified Gray that it had opened another investigation, concurrent with its investigation into Gray's alleged unauthorized trading at Quick & Reilly, into the reasons for his termination from H&R Block. In a letter dated July 5, 2006, NYSE Enforcement notified Gray that the investigation would include complaints filed with H&R Block by six of his former customers, including Harold Sharp and Lucille Wierzbicki.

#### 1. Harassment of Harold Sharp

According to Gray's investigative testimony, Sharp had complained to H&R Block in October 2005 that Gray never returned his calls. Gray testified that he was unaware that he had been assigned by H&R Block to service Sharp's account, which contained holdings worth about \$12,000. Gray testified during the investigation that he had never received Sharp's messages and learned about his calls only when H&R Block's investor center received Sharp's complaint and informed Gray about it. Gray then "called this clown back and asked him, I never spoke to him, I don't know who you are, how are you complaining about me?" Gray explained to NYSE investigators that "[t]he only client I strictly paid attention to was the [\$]20 million in assets that I brought over [to H&R Block] from . . . Quick & Reilly." Gray also testified during the investigation that he "told Mr. Sharp that if this [complaint] causes me any trouble he would hear back from me."

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<sup>10</sup> Quick & Reilly disclosed on Form U5 (Uniform Termination Notice) that it filed upon Gray's termination that the firm was conducting a review of Gray's activities because, "through routine active account calls[,] it was discovered that Gray entered unauthorized trades in two customers' accounts." The Form U5 nevertheless describes Gray's termination as a voluntary resignation.

<sup>11</sup> Gray asserts he resigned from H&R Block.

Within a day or two of receiving notice from NYSE Enforcement that Sharp's complaint was a basis for its new investigation in 2006, Gray again called Sharp. According to Gray,<sup>12</sup> he wanted to give Sharp "the opportunity to go ahead and have his complaint dismissed" by offering Sharp a letter to sign that retracted his complaint.

Sharp then called H&R Block, which forwarded the call to Gray's former supervisor, Michael Townsend. Townsend testified that Sharp was "upset that Mr. Gray was phoning him at his home and that he was phoning him repeatedly. He felt threatened. He's an older gentleman. He just wanted his money out of our firm and he didn't want Mr. Gray to bother him anymore." Townsend also testified that Sharp told him that Gray blamed him for having been "fired" by H&R Block, that Gray was "going to come from New York to [Sharp's] home [in Illinois] and have that letter signed." Townsend recalled that Sharp "felt physically threatened. He was very, very nervous that Mr. Gray was going to come to his house and physically harm him." Townsend advised Sharp that, "if he felt physically threatened, that was . . . something he needed to address with local law enforcement."

Sharp filed a report with his local police department that same day, July 7, 2006, a copy of which is in the record and corroborates Townsend's testimony.<sup>13</sup> The report reflects that Sharp told the police that Gray said he was "going to f—ing kill" Sharp, and that he "does not want to upset Mr. Gray more than he already is, but does not want Mr. Gray to call him." The officer contacted Gray and advised him to stop calling Sharp and not to visit Sharp's home. The report reflects that, a week later, the officer followed up with Sharp and was advised that, following the intervention by police, Sharp had had "no additional problems with Mr. Gray."

Gray denies threatening Sharp but admitted having called him "two to three times." Gray admitted during the hearing that he was "upset" and "extremely pissed off" at Sharp. In his petition for review, Gray admits that he "lost his temper" and "cursed at" Sharp when Sharp refused to sign the retraction letter.

## **2. Harassment of Lucille and Michael Wierzbicki**

Gray was assigned the account of Lucille Wierzbicki ("Mrs. Wierzbicki"), an elderly woman in ill health, when he joined H&R Block in 2004. In January 2005, Mrs. Wierzbicki filed a complaint with H&R Block regarding an unauthorized trade in her account. H&R Block investigated the matter at the time and took no action against Gray. However, when H&R Block

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<sup>12</sup> Sharp did not testify.

<sup>13</sup> Gray asserts in his application for review that Townsend "lied under oath."

suspended Gray at the end of 2005 (and ultimately terminated him in January 2006), Gray believed Mrs. Wierzbicki's complaint was the reason.<sup>14</sup>

Mrs. Wierzbicki's son, Michael ("Mr. Wierzbicki"), is a school superintendent. He testified that his mother was "very agitated and upset" because Gray had called her in late 2005 and threatened to sue her for \$100,000 because she caused him to lose a commission and his job.<sup>15</sup> Mr. Wierzbicki called Gray on his mother's behalf. During the phone call, Gray claimed that H&R Block was using Mrs. Wierzbicki's complaint "to deny him a commission and also for grounds for termination." Mr. Wierzbicki told Gray to have no further contact with his mother, and that, if Gray was going to sue his mother, their respective attorneys would handle the matter.

In July 2006, after learning of NYSE Enforcement's investigation, Gray called Mr. Wierzbicki and asked if Mrs. Wierzbicki would sign a letter Gray drafted retracting her complaint. Mr. Wierzbicki told Gray he "would consider it."

In October 2006, Mrs. Wierzbicki filed a police report after receiving a series of phone calls she did not answer but attributed to Gray. The calls originated from outside Mrs. Wierzbicki's local area and she was "adamant" that they were from Gray. Mr. Wierzbicki testified that he told his mother, "Enough already, we're going to file a police report. I'm tired of this nonsense." Mr. Wierzbicki testified that he was present when the report was filed and told police that he "can't attest that it's this person who made the last group of calls," but explained to them the contact he and his mother had had with Gray.<sup>16</sup>

Gray called Mr. Wierzbicki in January 2007 to see if Mrs. Wierzbicki would sign the letter retracting her complaint. According to Mr. Wierzbicki, the conversation became heated:

When I said to [Gray] that I had decided not to have my mother sign this and we're not going to do anything with this, he became extremely agitated and began to yell at me and told me, "You realize I have all of your information including your social security number." . . . I said, "Excuse me, if you're threatening me, you're making a big mistake." . . . We went up and back about it, and then . . . he said, "Well, you know, how would you like it if somebody called your school board and told a lie about something you did?"

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<sup>14</sup> Gray appears to have been mistaken. Townsend, Gray's former supervisor at H&R Block, testified that customer complaints were not the basis for taking disciplinary action against him.

<sup>15</sup> Mrs. Wierzbicki did not testify.

<sup>16</sup> The only copy of the police report in the record contains little information. It describes Mrs. Wierzbicki as the victim of telephone harassment by Gray but does not indicate who filed the report.

Mr. Wierzbicki testified that he "felt threatened" by Gray's remarks and believed that Gray "was going to create more problems" if his mother did not sign the letter. Mr. Wierzbicki hung up on Gray. Gray called one more time after this, and Mr. Wierzbicki told him, "I don't want to deal with you anymore. Don't call me." Mr. Wierzbicki testified that, as of the time of the hearing, he had not spoken to Gray in several months.<sup>17</sup>

Gray testified that he was "angry" at H&R Block and "frustrated" with Mrs. Wierzbicki when he called her in 2005, but that he did not threaten to sue her in "those exact words." He nevertheless admitted that he told Mrs. Wierzbicki it was her fault that he had been suspended by H&R Block. Gray also admitted having a "heated" conversation in which he yelled at Mr. Wierzbicki when he refused to recommend that his mother sign Gray's letter. Gray admitted that he was "angry" when he called Mr. Wierzbicki and that he "did say to Michael Wierzbicki, how would you like it if someone called your school and told a lie about you? That's exactly what his mom did to me." Gray testified that Mr. Wierzbicki hung up on him before he could explain that his "poor analogy" was intended to convey that Mrs. Wierzbicki "made a false accusation against me and my family and it's affecting my livelihood."

### 3. Harassment of Michele Konieczko

In November 2005, Gray gave on-the-record testimony during NYSE Enforcement's investigation into his alleged unauthorized trading at Quick & Reilly and was asked specifically about the Konieczko trade. Gray began calling Konieczko in 2006, leaving one message on her answering machine and a few messages with Konieczko's parents. This was Gray's first contact with Konieczko since the summer of 2003. Gray testified that he wanted to "let her know exactly what was transpiring, not only the New York Stock Exchange[']s side of the story] but my side of the story to see if we could make this issue go away." Konieczko did not return these calls. Konieczko testified that, during the month of January 2007,<sup>18</sup> a person calling from a number designated as "private" on her caller identification unit phoned her repeatedly. She believed the

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<sup>17</sup> Ten months after the hearing, on October 20, 2008, Gray's attorney sent a letter to Mr. Wierzbicki threatening to sue him and his mother "for all damages that have resulted" from Mr. Wierzbicki's supposed perjury regarding who filed the police report against Gray. Gray's attorney noted that "the first thing we will do upon commencing litigation is take the deposition of your mother so we can quickly get to the truth of what happened." In a January 12, 2009 e-mail to the NYSE Enforcement attorney handling his case and the Chief Hearing Officer who presided at his hearing, Gray stated that he "would drop my pending lawsuit against Lucille and Michael Wierzbicki" if NYSE agreed to commence the start date for his associational bar ten months earlier than ordered. NYSE denied Gray's request. It is not clear whether Gray has actually instituted a suit against the Wierzbickis.

<sup>18</sup> NYSE Enforcement represents that, in January 2007, they informed Gray that they would be instituting charges against him related to the trade in Konieczko's account, among other things. After a period of settlement discussions in January and February 2007, charges were formally instituted on April 3, 2007.

caller to be Gray because he left his name and phone number in a message on her answering machine once, and also left a message with her mother.<sup>19</sup>

On one "very excessive" day, she received forty-seven calls from a private number. Konieczko testified that she was "frightened and nerve-racked" because "[e]very five seconds the phone [was] ringing." Konieczko finally answered the phone and recorded the conversation. The caller was Gray. According to the transcript of the recorded call, Konieczko told Gray, "I do not care to discuss this with you. I do not want you calling my home or my mother's home or any member of my family. . . . Have I made myself clear?" Gray called back a few minutes later and left a message on her answering machine saying, according to Konieczko, that her "children would be ashamed" of the way she'd been "presenting" herself and that he intended to "fight [the allegations against him] with every fiber of his being."<sup>20</sup> Gray denied leaving this message. He also denied calling Konieczko more than forty times but admitted he called her "ten to fifteen" times.

### III.

Gray admits that he engaged in an unauthorized trade in Ricotta's account but denies that he did so in Konieczko's account, and also denies threatening or harassing anyone. Based on our independent review of the record, we find that a preponderance of the evidence supports the NYSE's findings of violation against Gray.<sup>21</sup>

#### A. Unauthorized trades

Exchange Rule 476(a)(6) subjects to disciplinary sanctions those persons under its jurisdiction, pursuant to proceedings under the rule, for engaging in conduct inconsistent with just and equitable principles of trade. It is well established that unauthorized trading in customer accounts is inconsistent with just and equitable principles of trade.<sup>22</sup>

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<sup>19</sup> Konieczko testified that she knew of only one other person with a private number who would call her, and that person would always leave a message.

<sup>20</sup> Konieczko testified that the message was accidentally deleted; the contents of the message are not in evidence other than through Konieczko's testimony.

<sup>21</sup> See *David M. Levine*, 57 S.E.C. 50, 73 n.42 (2003) (applying preponderance of the evidence standard in Commission review of disciplinary proceedings conducted by self-regulatory organizations), *petition denied*, 407 F.2d 178 (3d Cir. 2005).

<sup>22</sup> See, e.g., *William J. Murphy*, 54 S.E.C. 303, 308 (1999).

Gray has admitted throughout these proceedings and before the NYSE's Hearing Panel and Board of Directors that he entered an unauthorized trade in Ricotta's account. NYSE found that Gray violated Rule 476(a)(6), and we sustain that finding.

NYSE also found that Gray entered an unauthorized trade in the account of Konieczko. Konieczko testified that Gray solicited her interest in buying Evergreen shares, that she never authorized the trade, and that, two months later, Gray left a message saying an "error" had been made in her account that ultimately turned out to be a \$100,000 purchase of Evergreen. Gray's version of events differs from Konieczko's, and he asserts that she authorized the trade.<sup>23</sup> The NYSE Hearing Panel found Konieczko to be "a credible witness." It found that, given Konieczko's "history of trading inactivity, lack of sophistication regarding securities issues and conservative investment objectives, the Panel did not credit [Gray's] testimony that [Konieczko] had agreed to such a large purchase of shares in a closed end fund that she did not understand." The Hearing Panel also noted that it was "highly unlikely" that Konieczko would make a large purchase in one son's account without doing the same for the other son's account, "given her stated commitment to treat both accounts alike." As we have noted consistently in previous decisions, "[c]redibility determinations of an initial fact finder are entitled to considerable weight because they are based on hearing the witnesses' testimony and observing their demeanor."<sup>24</sup> Such determinations generally "can be overcome only where the record contains substantial evidence for doing so,"<sup>25</sup> and we do not find the record contains such evidence here. We sustain NYSE's finding that Gray placed an unauthorized trade in Konieczko's account, in violation of Exchange Rule 476(a)(6).<sup>26</sup>

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<sup>23</sup> Gray further asserted that Konieczko's testimony that approximately two months elapsed between the time he first solicited her and when he supposedly informed her of the error in her account is wrong, and that Konieczko was thereby shown to be a non-credible witness.

<sup>24</sup> *Joseph Abbondante*, Exchange Act Rel. No. 53066 (Jan. 6, 2006), 87 SEC Docket 203, 209 n.21, *petition denied*, 209 Fed. Appx. 6 (2d Cir. 2006) (unpublished).

<sup>25</sup> *Laurie Jones Canady*, 54 S.E.C. 65, 78 (1999) (citing *Anthony Tricarico*, 51 S.E.C. at 460), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000).

<sup>26</sup> Although Gray asserts that contemporaneous computer notes in his firm's database would have exonerated him, Gray represents that those notes have been lost. We cannot give any probative value to evidence that is not in the record. To the extent Gray complains that the Hearing Panel erred by not providing him access to the incomplete computer files that lack the notes he seeks to exonerate him, Gray has suffered no prejudice because, as Gray admits, the files do not contain the notes he wants. We therefore reject Gray's claim that NYSE "obstructed [his] legal rights to receive any and all documentation that related to [his] defense."

## B. Customer harassment

Exchange Rule 476(a)(7) subjects to disciplinary sanctions those persons under its jurisdiction, pursuant to proceedings under the rule, who have engaged in acts detrimental to the interest or welfare of the Exchange. NYSE charged, and found, that Gray "engaged in acts detrimental to the interest or welfare of the Exchange, in that he threatened and/or harassed one or more complaining customers and/or their family members."

### 1. Harassment of Sharp

Although Sharp did not testify, Townsend's testimony, corroborated by the police report that Sharp filed, showed that Gray's calls to Sharp made Sharp feel "nervous" and "physically threatened." Gray's own testimony establishes that he called Sharp with the intent of getting Sharp to retract his complaint against Gray, and that during his conversations with Sharp, Gray "lost his temper," was "extremely pissed off," and that he yelled and cursed at Sharp.

Gray asserts without elaboration that Townsend "lied under oath" and that NYSE Enforcement "concedes" this, apparently by not disputing Gray's claim in its filings.<sup>27</sup> We do not interpret NYSE Enforcement's silence on the issue as a concession. Moreover, even if we were to ignore Townsend's testimony, Gray's own admissions, together with the police report, are sufficient evidence upon which to base a finding that he harassed and/or threatened Sharp.<sup>28</sup> We therefore sustain NYSE's finding.

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<sup>27</sup> Gray suggests in his application for review that Townsend, as well as another former co-worker who testified at the hearing, were not credible because Gray has "a pending arbitration claim" against them.

<sup>28</sup> Although Gray complains that Sharp did not testify at the hearing to support the allegations in the police report, 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." *Scott Epstein*, Exchange Act Rel. No. 59328 (Jan. 30, 2009), 95 SEC Docket 13833, 13853 & n.32 (citing *David C. Ho*, Exchange Act Rel. No. 54481 (Sept. 22, 2006), 88 SEC Docket 3194, 3206, *aff'd*, 2007 U.S. App. LEXIS 9882 (Apr. 18, 2007)). We determine whether to rely on hearsay evidence after evaluating its "probative value and reliability, and the fairness of its use." Where, as here, the evidence is a signed narrative written by a police officer describing the contemporaneous statements of a customer and is corroborated by other testimony, we find it appropriate to include the evidence as one basis, among others, for our findings. See *Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992) (setting forth test for admission of hearsay evidence).

## 2. Harassment of Lucille and Michael Wierzbicki

Mr. Wierzbicki testified that his mother was "very agitated and upset" by Gray's calls, resulting in the filing of a police report for telephone harassment.<sup>29</sup> Mr. Wierzbicki also testified that he himself "felt threatened" by Gray's remark that Gray had access to Mr. Wierzbicki's social security number and Gray's "poor analogy" about false accusations, which Mr. Wierzbicki interpreted as indicating Gray's willingness to make a false accusation about him to Wierzbicki's employer. Gray admitted calling Mrs. Wierzbicki and telling her that his suspension was her fault. Gray also admitted having a "heated" conversation in which he "yelled" at Mr. Wierzbicki when he refused to have his mother sign Gray's letter.

Gray argues that Mr. Wierzbicki lied at the hearing about the circumstances surrounding the filing of the police report and that, had he known more about those circumstances, he might have called Mrs. Wierzbicki as a witness. The record contains only an incomplete copy of the police report which does not include a narrative explanation of the incident. After the NYSE Hearing Panel issued its decision, Gray obtained a complete copy of the report which has not been introduced into the record.<sup>30</sup> Gray claims that the complete report shows that Mrs. Wierzbicki, and not her son, filed the report, and that therefore Mr. Wierzbicki lied when he testified that he filed it.

There is some confusion in the record as to whether Mr. Wierzbicki, Mrs. Wierzbicki, or both of them filed the police report.<sup>31</sup> However, the Hearing Panel found Mr. Wierzbicki to be a credible witness, accepted his testimony that he felt threatened by Gray, and found that Wierzbicki "filed a complaint on behalf of his mother charging [Gray] with telephone harassment." We find that, even if Mrs. Wierzbicki, not Mr. Wierzbicki, filed the police report

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<sup>29</sup> As discussed *supra* at note 28, we may rely on hearsay evidence in making findings of violation. Here, however, we rely on the Wierzbicki police report simply as evidence of the fact that the Wierzbickis felt sufficiently harassed by Gray's phone calls that they reported him to the police, and we need not consider the document (which contains little other useful information, in any event) for the truth of any matters asserted therein.

<sup>30</sup> Gray appears to have had a copy of the report with him during oral argument before the NYSE Board of Directors and references the document in his application for review to the Commission. However, neither he nor NYSE has sought to introduce a copy of the full report into the record pursuant to Commission Rule of Practice 452, 17 C.F.R. § 201.452, by which the Commission may permit the admission of additional evidence under certain circumstances.

<sup>31</sup> Mr. Wierzbicki testified during direct examination that "I filed a complaint that my mother was getting harassing phone calls" and that he was "present when [the report] was filed." On cross-examination, Mr. Wierzbicki testified that "[m]y mother caused a police report to be filed."

(which, as noted, is not in the record), that fact does not provide a sufficient basis for overturning the panel's credibility determination or its finding of liability.

Moreover, Gray has not shown that he suffered prejudice by not calling Mrs. Wierzbicki to testify about the report<sup>32</sup> because other evidence establishes that he has threatened and/or harassed the Wierzbickis. As noted, the Hearing Panel found Mr. Wierzbicki to be credible. Moreover, Gray admitted that he called Mrs. Wierzbicki and blamed her for losing his job, and he has continued to threaten the Wierzbickis with a lawsuit because of the complaint she filed and for their involvement in this proceeding. We sustain NYSE's finding that Gray harassed and/or threatened the Wierzbickis.

### 3. Harassment of Konieczko

Konieczko testified that Gray called her and her parents repeatedly, and that, on one particular day, a caller from a private number she believed was Gray called more than forty times. Konieczko, "frightened and nerve-racked," answered the phone and felt compelled to record the call. Despite instructions to stop calling her home, Gray called again within minutes and told her in a message that her children "would be ashamed" of her. Gray admitted calling her "ten to fifteen times" but denied calling her after being instructed to stop. The Hearing Panel credited Konieczko's testimony over Gray's, and "found the similarities among the experiences of the three unrelated complaining customers to be significant." We find no reason to disagree with the Panel's credibility assessment here,<sup>33</sup> and we affirm NYSE's finding that Gray harassed and/or threatened Konieczko.

### 4. Summary

NYSE determined that "[t]he frequency and tone of the telephone calls [Gray] placed to these three customers and their family members were unreasonable and inconsistent with the behavior that is expected of a registered representative." It concluded that "[y]elling, cursing, harassing and threatening are inappropriate and unprofessional – especially, as here, when such behavior is repeated – and constitute acts detrimental to the interests of the [Exchange], which requires that customers be treated with respect, even during difficult times." We agree. We

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<sup>32</sup> In fact, descriptions of the complete copy of the report, as discussed briefly during oral argument before NYSE's Board of Directors, suggest that the narrative section of the report provides further details about Gray's alleged harassment of Mrs. Wierzbicki, including calling her "on a steady basis six times a day, requesting money and threatening a lawsuit."

<sup>33</sup> See *supra* note 25 and accompanying text.

sustain NYSE's findings that Gray violated NYSE Rule 476(a)(7) by threatening and/or harassing one or more complaining customers and/or their family members.<sup>34</sup>

#### IV.

Gray contends that NYSE "abandoned precedent and common reason when it imposed a penalty of a censure and a three-year bar against Mr. Gray," requesting that we reduce the bar against him to a period of "no greater than six months." Exchange Act Section 19(e)(2) directs us to sustain the sanctions imposed by the NYSE 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.<sup>35</sup>

In imposing sanctions for Gray's violations, NYSE was guided by the Second Circuit's decision in *McCarthy v. SEC*, which states:

The seriousness of the offense, the corresponding harm to the trading public, the potential gain to the broker for disobeying the rules, the potential for repetition in light of the current regulatory and enforcement regime, and the deterrent value to the offending broker and others are all relevant factors to be considered in deciding whether the sanction is appropriately remedial and not excessive or oppressive.<sup>36</sup>

Based on these considerations, NYSE deemed Gray's misconduct "serious," finding that the unauthorized trades "jeopardized one customer's account in order to benefit another" and "put the

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<sup>34</sup> Gray asserts that the NYSE hearing officer who presided at his hearing "biased herself and others" because she stated the Konieczko trade was unsuitable. He also asserts that, during his appeal to the NYSE Board of Directors, a security escort was detailed to him and that the escort "sat directly next to me, . . . announced his name and his title for the [Board, and] stated 'this is the first time this has ever been done,'" thereby causing the Board to be "prejudic[d] into believing I was guilty."

The Hearing Panel decision found Gray liable for the Konieczko trade on the sole basis that it was unauthorized. Moreover, the transcript of the oral argument before the Board does not show that any security escort announced his title or commented on the unusual nature of that assignment. In any event, our *de novo* review of the record in this case leads us to conclude the NYSE's findings against Gray were well supported by the evidence, as discussed herein, and we have found no suggestion of bias or prejudice by NYSE.

<sup>35</sup> 15 U.S.C. § 78s(e)(2). Gray does not allege, and the record does not show, that NYSE's action imposed an undue burden on competition.

<sup>36</sup> 406 F.3d 179, 190 (2d Cir. 2005).

tuition fund of [a customer] at risk." NYSE, moreover, found Gray's handling of customer complaints "even more troubl[ing]," stating that "rather than allowing complaints to run their course through appropriate channels inside and outside the firms, [Gray] repeatedly called complaining customers and their family members, at times yelling at them and threatening them."<sup>37</sup> NYSE stated that Gray's "interference with NYSE's investigatory process threatened both the integrity of that process and the confidence of investors therein."

Gray argues that certain facts should serve to mitigate the sanction imposed. He points out that neither Ricotta nor Konieczko, in whose accounts Gray made unauthorized trades, were financially harmed by his conduct and that he himself made no profit from the trades, earning no commissions on them. He also claims that he expressed remorse for his misconduct at the hearing and cites, as evidence of his remorse, his acknowledgment that he made an unauthorized trade in Ricotta's account.

We find that NYSE appropriately considered the mitigating and aggravating factors present in this case and that the sanction imposed is not excessive or oppressive. Although Ricotta and Konieczko suffered no actual financial harm because of Gray's actions, as the Hearing Panel noted, the unauthorized transactions put these customers' funds at risk. Further, although Gray did not ultimately profit from the trades, he would have earned thousands of dollars in commissions had the transactions not been cancelled. Moreover, Gray admitted the Ricotta trade to his manager only after Lynch discovered it by "surprise" and confronted him, and after Gray had at first sought to conceal his misconduct by asking Ricotta if she wanted to correct the "error" in her account by selling the shares for a small profit. The panel also explained that, in assessing sanctions, it gave significant weight to the aggravating circumstances surrounding Gray's harassment of customers and their families, conduct that caused distress to those persons and for which Gray has not accepted responsibility or expressed remorse.

The panel explicitly considered Gray's assertions that he "has taken responsibility for his actions by voluntarily removing himself from the retail securities industry," but, "having observed [Gray's] testimony and comportment at the hearing," the panel determined that it did "not believe that [Gray] truly understands the gravity of his actions or has learned from his experience such that he will not engage in such conduct in the future." Gray has subsequently demonstrated that he does not, in fact, understand the gravity of his actions and that he has not learned from his conduct: Gray has continued to harass Mr. Wierzbicki after the hearing by threatening him with litigation if he does not retract his testimony.<sup>38</sup>

Gray asserts that he is no longer in the securities industry and therefore poses no threat to the NYSE or the investing public. The Central Registration Depository ("CRD") indicates that,

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<sup>37</sup> NYSE further noted, "That two of those [harassed] customers were elderly makes Respondent's actions even more egregious."

<sup>38</sup> See *supra* note 17.

after leaving H&R Block, Gray worked for Summit Brokerage Services for five months and then became employed by a venture capital firm. Gray testified at the hearing (in January 2008) that his work at the venture capital firm focused on the "institutional side of the business," because, though he "love[d] the financial services industry, . . . the retail world isn't for me." Gray's CRD record indicates he was terminated by the venture capital firm in February 2008 for "violation of firm's written supervisory procedures."<sup>39</sup> Thus it appears that his decision to leave the securities industry in 2008 was not voluntary. We are not persuaded, therefore, that Gray's remorse is genuine or that the threat he poses to the industry has attenuated.<sup>40</sup>

Gray's conduct was unacceptable in a representative of the securities industry. As NYSE pointed out in its decision, "NYSE's ability to police its members necessarily relies on the willingness of customers to file complaints," and that Gray's "interference with the NYSE's

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<sup>39</sup> Gray's CRD record indicates that he is not currently associated with any FINRA-registered entity.

<sup>40</sup> We note in this regard that Gray represented in a letter to the Commission on January 22, 2009 that he has filed a "grievance with the New York State Bar Association" against the attorneys prosecuting the case against Gray on behalf of NYSE. In addition, Gray notes in his April 29, 2009 reply brief, without explanation, that one of those prosecuting attorneys "filed a police report against Mr. Gray because Mr. Gray wished her congratulations on the upcoming birth of her second child." There is no further information about this police report in the record. We see no basis for finding that NYSE staff acted improperly during these proceedings.

investigatory process threatened both the integrity of that process and the confidence of investors therein." We conclude, therefore, that the sanctions imposed by NYSE to redress the risk posed by Gray serve the public interest and are neither excessive nor oppressive.<sup>41</sup>

We sustain NYSE's findings of violation and imposition of sanctions.<sup>42</sup> An appropriate order will issue.

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

Elizabeth M. Murphy  
Secretary

  
By: Florence E. Harmon  
Deputy Secretary

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<sup>41</sup> We note that, although Gray argues that a three-year bar is "clearly inconsistent with NYSE and NASD precedent," none of the cases he cites in support of his argument involve brokers who threatened or harassed their customers. NYSE argues that "Gray's readiness to abuse his customers and his continuing reluctance to acknowledge his misconduct would support a higher sanction – consistent with [NYSE and NASD precedent] – even Gray's permanent exclusion from the securities industry." Exchange Act Section 19(e)(2), 15 U.S.C. § 78s(e)(2), permits us to "cancel, reduce, or require the remission of" a sanction imposed by a self-regulatory organization but does not permit us to increase the sanction.

<sup>42</sup> We have considered all of the arguments of the parties. We reject or sustain 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. 60361/ July 22, 2009

Admin. Proc. File No. 3-13344

In the Matter of the Application of

GREGORY W. GRAY, Jr.

c/o Marni Weiss  
Weiss Imbesi PLLC  
462 Seventh Avenue, 12th Floor  
New York, NY 10018

For Review of Disciplinary Action Taken by

NYSE Regulation, Inc.

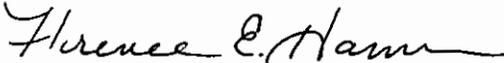
ORDER SUSTAINING DISCIPLINARY ACTION

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

ORDERED that the disciplinary action by NYSE against Gregory W. Gray, Jr. be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Florence E. Harmon  
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60373; File No. S7-17-09)

July 23, 2009

**ORDER GRANTING TEMPORARY EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH REQUEST ON BEHALF OF EUREX CLEARING AG RELATED TO CENTRAL CLEARING OF CREDIT DEFAULT SWAPS, AND REQUEST FOR COMMENTS**

**I. Introduction**

In response to the recent turmoil in the financial markets, the Securities and Exchange Commission ("Commission") has taken multiple actions to protect investors and ensure the integrity of the nation's securities markets, including actions<sup>1</sup> designed to address concerns related to the market in credit default swaps ("CDS").<sup>2</sup> The over-the-counter ("OTC") market for CDS has been a source of concern to us and other financial regulators, and we have recognized that facilitating the establishment of central counterparties ("CCPs") for CDS can

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<sup>1</sup> See generally Securities Exchange Act Release No. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009) (temporary exemption in connection with CDS clearing by Chicago Mercantile Exchange Inc.), Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009) (temporary exemption in connection with CDS clearing by ICE US Trust LLC), Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemption in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) and other Commission actions discussed therein.

<sup>2</sup> 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 under a CDS 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 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. See Semiannual OTC derivatives statistics at end-December 2008, Bank for International Settlement ("BIS"), available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

This growth has coincided with a significant rise in the types and number of entities participating in the CDS market. 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.

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play an important role in reducing the counterparty risks inherent in the CDS market, and thereby can help mitigate potential systemic impacts.<sup>3</sup> Thus, 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 Commission's authority over this OTC market for CDS is limited. Specifically, Section 3A of the Securities Exchange Act of 1934 ("Exchange Act") limits the Commission's authority over swap agreements, as defined in Section 206A of the Gramm-Leach-Bliley Act.<sup>4</sup> For those CDS that are swap agreements, the exclusion from the definition of security in Section 3A of the Exchange Act, and related provisions, will continue to apply. The Commission's action today does not affect these CDS, and this Order does not apply to them. For those CDS that are not swap agreements ("non-excluded CDS"), the Commission's action today provides conditional exemptions from certain requirements of the Exchange Act.

The Commission believes that using well-regulated CCPs to clear transactions in CDS would provide a number of benefits, by helping to promote efficiency and reduce risk in the CDS market and among its participants, requiring maintenance of records of CDS transactions that would aid the Commission's efforts to prevent and detect fraud and other abusive market practices, addressing concerns about counterparty risk – through the novation process – by substituting the creditworthiness and liquidity of the CCP for the creditworthiness and liquidity

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<sup>3</sup> See generally actions referenced in note 1, *supra*.

<sup>4</sup> 15 U.S.C. 78c-1. Section 3A excludes both a non-security-based and a security-based swap agreement from the definition of "security" under 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.

of the counterparties to a CDS,<sup>5</sup> contributing generally to the goal of market stability, and reducing CDS risks through multilateral netting of trades.<sup>6</sup>

In this context, Eurex Clearing AG ("Eurex") has requested that the Commission grant exemptions from certain requirements under the Exchange Act with respect to its proposed activities in clearing and settling certain CDS, as well as the proposed activities of certain other persons, as described below.<sup>7</sup>

Based on the facts presented and the representations made in the request on behalf of Eurex,<sup>8</sup> and for the reasons discussed in this Order, the Commission temporarily is exempting, subject to certain conditions, Eurex from the requirement to register as a clearing agency under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS transactions. The Commission also temporarily is exempting eligible contract participants and others from certain Exchange Act requirements with respect to non-

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<sup>5</sup> "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. Through novation, the CCP assumes counterparty risk.

<sup>6</sup> See generally actions referenced in note 1, supra.

<sup>7</sup> See Letter from Paul Architzel, Alston & Bird LLP, to Elizabeth M. Murphy, Secretary, Commission, July 23, 2009.

<sup>8</sup> See id. The exemptions we are granting today are based on representations made in the request on behalf of Eurex. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS associated with persons subject to those unavailable exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

excluded CDS cleared by Eurex.<sup>9</sup> The Commission's exemptions are temporary and will expire on [insert date nine months from the date of order].<sup>10</sup>

## II. Discussion

### A. Description of Eurex's Proposal

The exemptive request on behalf of Eurex describes how its proposed arrangement for central clearing of CDS would operate, and makes representations about the safeguards associated with those arrangements, as described below:

#### 1. Eurex Organization

Eurex is a stock corporation formed and incorporated under the laws of Germany. It is a wholly-owned subsidiary of Eurex Frankfurt AG ("Eurex Frankfurt"), a German stock corporation that is itself wholly-owned by Eurex Zürich AG ("Eurex Zürich"), a Swiss stock corporation. Eurex Zürich has two 50 percent parents: Deutsche Börse AG ("DBAG"), a German stock corporation listed on the Frankfurt Stock Exchange, and the SIX Swiss Exchange ("SIX").

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<sup>9</sup> This Order, however, does not provide exemptive relief in connection with Eurex's clearing of certain customer CDS transactions; specifically, customer CDS transactions cleared through U.S. clearing members (other than registered broker-dealers), and CDS transactions by U.S. customers cleared through non-U.S. clearing members. The Commission is considering the issues raised by that type of customer clearing activity – particularly with respect to the segregation of customer funds and securities that customers post with members as collateral, and the protection and transfer of those customer assets in the event of a member's insolvency. The Commission is working toward the goal of being able to provide exemptive relief to facilitate the central clearing, by Eurex, of these customer CDS transactions.

<sup>10</sup> To facilitate the operation of one or more CCPs for the CDS market, the Commission has also approved interim final temporary rules providing exemptions under the Securities Act of 1933 and the Exchange Act for non-excluded CDS. See Securities Act Release No. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009).

Further, the Commission has provided temporary exemptions in connection with Sections 5 and 6 of the Exchange Act for transactions in non-excluded CDS. See Securities Exchange Act Release No. 59165 (Dec. 24, 2008), 74 FR 133 (Jan. 2, 2009).

Eurex is regulated as a CCP under the German Banking Act ("Banking Act"), which explicitly treats the provision of central counterparty services as a banking activity. Operation of a banking institution requires prior written authorization from the German Federal Financial Supervisory Authority ("BaFin"). On an annual basis, BaFin requires Eurex to undergo an audit that covers financial requirements and risk management.

Eurex received permission to act as a CCP from BaFin on December 12, 2006. Eurex is supervised by BaFin cooperatively with the Deutsche Bundesbank, the German Federal Bank. BaFin is Eurex's principal regulator and is responsible for all sovereign measures, including licensing, monitoring, and closing individual institutions. BaFin also can issue general instructions, including principles and regulations that establish rules for carrying out banking business, providing financial services, and limiting risk. The Deutsche Bundesbank is responsible for current, ongoing oversight and supervision with respect to the safety and soundness of the institution's operations. In the U.K., Eurex is a Recognised Overseas Clearing House ("ROCH"), subject to regulation by the U.K. Financial Services Authority.

## 2. Eurex Central Counterparty Services for CDS

Eurex's CDS clearance and settlement services will accept for clearing bilateral CDS transactions within the product scope of its rules and that are recorded in the Depository Trust & Clearing Corporation's ("DTCC") Deriv/SERV Trade Information Warehouse ("TIW").<sup>11</sup> Eurex will act as a central counterparty for entities that are CDS clearing members of Eurex in

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<sup>11</sup> Eurex will offer CDS clearance and settlement services on the iTraxx Europe (Main), iTraxx HiVol, and iTraxx Europe Crossover CDS Indices. It will also offer CDS clearance and settlement services on single-name reference entities that are the constituents of those indices. Once it has offered clearance and settlement services for CDS transactions on the iTraxx indices and their constituents, Eurex will accept bilateral transactions on the CDX Index. Eventually, depending on market demand, Eurex may offer clearance and settlement services on single-name reference entities on the CDX constituents.

connection with clearing of CDS transactions by assuming, through novation, the obligations of all eligible CDS transactions accepted by it for clearing and collecting margin and other credit support from CDS clearing members to collateralize their obligations to Eurex. Eurex's trade submission process is designed to ensure that it maintains a matched book of offsetting CDS contracts.

Operationally, for a transaction to clear through Eurex, it must first be recorded in Deriv/SERV's Trade Information Warehouse ("TIW"). Eurex will leverage the Deriv/SERV infrastructure in operating its CDS clearing services by establishing an interface to DTCC's Deriv/SERV TIW to capture matched and confirmed trades.<sup>12</sup>

Under Eurex rules, each bilateral CDS contract between CDS clearing members that is submitted to and accepted by Eurex for clearing will be novated. At the time of novation, each bilateral CDS contract submitted to Eurex will be terminated and replaced by two CDS contracts between Eurex and each of the original counterparties. As central counterparty to each novated CDS contract, Eurex will be able to net offsetting positions on a multilateral basis, which will significantly reduce the outstanding notional amount of each CDS clearing member's CDS portfolio.

### 3. Eurex Risk Management

Eurex represents that it will maintain strict, objectively determined, risk-based margin and clearing fund requirements, which will be subject to ongoing regulation and oversight by the

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<sup>12</sup> Major market participants frequently use the Deriv/SERV comparison and confirmation service of DTCC when documenting their CDS transactions. This service creates electronic records of transaction terms and counterparties. As part of this service, market participants separately submit the terms of a CDS transaction to Deriv/SERV in electronic form. Paired submissions are compared to verify that their terms match in all required respects. If a match is confirmed, the parties receive an electronic confirmation of the submitted transaction. All submitted transactions are recorded in the Deriv/SERV TIW, which serves as the primary registry for submitted transactions.

BaFin. These requirements will also be consistent with clearing industry practice and international standards established for central counterparties as articulated in the Committee on Payment and Settlement Systems/International Organization of Securities Commissions ("CPSS-IOSCO") Recommendations for Central Counterparties ("RCCP").<sup>13</sup> Eurex has a multilevel system to mitigate counterparty risk. The amount of margin and guaranty fund required of each Eurex clearing member will be continuously monitored and periodically adjusted as required to reflect the size and profile of, and risk associated with, the Eurex clearing member's cleared CDS transactions (and related market factors). An initial level of protection is provided by a system of collateral margining. The margining system is supplemented by (i) mandatory contributions to the Eurex CDS clearing fund ("CDS Clearing Fund") and (ii) reserves maintained by Eurex.

Eurex will calculate the amount of up-front margin required for cleared CDS transactions based upon the overall risk exposure of the CDS clearing member. The CDS clearing member's risk exposure will be based on five components: (i) mark-to-market margin, based on the difference between the net present values based on the CDS spread in the agreement and the most recently observed market spread; (ii) next day margin, which accounts for the decay in value in liquidating outstanding positions of a defaulting member; (iii) liquidity margin, which takes into account the time necessary to unwind a position that is in default; (iv) accrued

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<sup>13</sup> The RCCP was drafted by a joint task force ("Task Force") composed of representative members of IOSCO and CPSS and published in November 2004. The Task Force consisted of securities regulators and central bankers from 19 countries and the European Union. The U.S. representatives on the Task Force included staff from the Commission, the Federal Reserve Board of Governors, and the Commodity Futures Trading Commission.

premium margin,<sup>14</sup> which represents the daily value of the spread the protection buyer pays to the protection seller; and (v) credit event margin.<sup>15</sup> Acceptable margin includes cash in currencies deemed acceptable by Eurex, currently the U.S. dollar, the Euro, the Swiss franc, and British pound, and securities in accordance with existing eligibility criteria.<sup>16</sup> The total margin requirement for CDS covers the market risk of the positions held by a CDS clearing member so that, should a CDS clearing member default, Eurex would have sufficient margin to cover losses to at least the 99 percent confidence interval without recourse to other financial resources.

Eurex will also maintain a clearing fund to cover losses arising from a Eurex CDS clearing member's default on cleared CDS transactions that exceed the amount of margin held by Eurex from the defaulting Eurex CDS clearing member. Each Eurex CDS clearing member will be required to contribute five percent of their margin requirement to the clearing fund, subject to a minimum of €50 million. Since the size of the clearing fund will grow in relation to the volume of each CDS clearing member's open positions, it is designed to maintain adequate, liquid resources to enable Eurex to handle a default in which the defaulting CDS clearing member's margin requirement is insufficient to cover the loss.

Eurex will also establish rules that mutualize the risk of a Eurex CDS clearing member default across all Eurex CDS clearing members. In the event of a Eurex CDS clearing member's default, Eurex will look to the following resources, in order: (i) the defaulting CDS clearing member's margin; (ii) the defaulting CDS clearing member's contribution to the clearing fund;

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<sup>14</sup> Accrued premium margin is applicable to CDS protection buyers only.

<sup>15</sup> Credit event margin is applicable to CDS protection sellers only.

<sup>16</sup> See [http://www.eurexclearing.com/risk/parameters\\_en.html](http://www.eurexclearing.com/risk/parameters_en.html) for admission criteria and current acceptable collateral.

(iii) Eurex's reserve fund; (iv) non-defaulting CDS clearing members' contribution to the clearing fund; and (v) a one-time assessment to non-defaulting CDS clearing members.

Eurex will conduct routine stress testing periodically throughout the trading day to ensure that it can meet its obligations as a CCP in normal and extreme market conditions to a 99.9 percent confidence level. Each CDS clearing member's risk exposure will be stress-tested against a comprehensive set of scenarios for all product groups that it clears. Stress-testing scenarios include the worst historical observations experienced in each of the product groups as well as Eurex's expectation on worst potential future price movements. Potential losses based on stress scenarios are compared to each CDS clearing member's additional margin. Losses beyond additional margin are then compared to the clearing fund. As soon as the consumption of the clearing fund by any CDS clearing member - irrespective of the CDS clearing member's credit quality - breaches a defined threshold, Eurex will take risk-mitigating actions. These risk-mitigating actions may be CDS clearing member-specific, such as imposing extra margin requirements, or general, such as calling for additional clearing fund contributions by all CDS clearing members.

#### 4. Member Default

Following a default by a CDS clearing member, Eurex would follow a procedure to help ensure an orderly liquidation and unwinding of the open positions of the defaulting member. First, the defaulting CDS clearing member is required to close its existing cleared CDS contracts and notify its customers so that they can transfer their transactions to another Eurex CDS clearing member. If the Eurex CDS clearing member does not close or transfer cleared CDS contracts within a reasonable period of time, Eurex can close the positions on behalf of the defaulting CDS clearing member. If Eurex is unable to close the cleared CDS contracts within a

reasonable period, it may use a voluntary auction process to liquidate the defaulting CDS clearing member's position as a whole or in meaningful amounts. Finally, Eurex may assign any remaining positions to non-defaulting CDS clearing members on a pro rata basis.

B. Temporary Conditional Exemption from Clearing Agency Registration Requirement

Section 17A of the Exchange Act sets forth the framework for the regulation and operation of the U.S. clearance and settlement system, including CCPs. Specifically, Section 17A directs the Commission to use its authority to promote enumerated Congressional objectives and to facilitate the development of a national clearance and settlement system for securities transactions. Absent an exemption, a CCP that novates trades of non-excluded CDS that are securities and generates money and settlement obligations for participants is required to register with the Commission as a clearing agency.

Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.<sup>17</sup>

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until **[insert date nine months from the date of**

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<sup>17</sup> 15 U.S.C. 78mm.

order] to Eurex from Section 17A of the Exchange Act, solely to perform the functions of a clearing agency for Cleared CDS,<sup>18</sup> subject to the conditions discussed below.

Our action today balances the aim of facilitating the prompt establishment of Eurex as a CCP for non-excluded CDS transactions – which should help reduce systemic risks – with ensuring that important elements of Commission oversight are applied to the non-excluded CDS market. In doing so, we are mindful that applying the full scope of the Exchange Act to transactions involving non-excluded CDS could deter the prompt establishment of Eurex as a CCP to settle those transactions.

While we are acting so that the prompt establishment of Eurex as a CCP for non-excluded CDS will not be delayed by the need to apply the full scope of Exchange Act Section 17A's requirements that govern clearing agencies, the relief we are providing is temporary and conditional. The limited duration of the exemptions will permit the Commission to continue to gain more direct experience with the non-excluded CDS market after Eurex becomes operational, giving the Commission the ability to oversee the development of the centrally

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<sup>18</sup> For purposes of this exemption, and the other exemptions addressed in this Order, "Cleared CDS" means a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to Eurex, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which: (1) the reference entity, the issuer of the reference security, or the reference security is one of the following: (i) an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; (ii) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; (iii) a foreign sovereign debt security; (iv) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or (v) an asset-backed security issued or guaranteed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or the Government National Mortgage Association ("Ginnie Mae"); or (2) the reference index is an index in which 80% or more of the index's weighting is comprised of the entities or securities described in subparagraph (1). As discussed above, the Commission's action today does not affect CDS that are swap agreements under Section 206A of the Gramm-Leach-Bliley Act. See note 4, supra. The Commission's action today also does not affect activities in CDS that are outside the jurisdiction of the United States.

cleared non-excluded CDS market as it evolves. During the exemptive period, the Commission will closely monitor the impact of the CCPs on the CDS market. In particular, the Commission will seek to assure itself that the CCPs do not act in an anticompetitive manner or indirectly facilitate anticompetitive behavior with respect to fees charged to members, the dissemination of market data and the access to clearing services by independent CDS exchanges or CDS trading platforms. The Commission will take that experience into account in future actions.

Moreover, this temporary exemption in part is based on Eurex's representation that it meets the standards set forth in the CPSS-IOSCO RCCP report. The RCCP establishes a framework that requires a CCP to have: (i) the ability to facilitate the prompt and accurate clearance and settlement of CDS transactions and to safeguard its users' assets; and (ii) sound risk management, including the ability to appropriately determine and collect clearing fund and monitor its users' trading. This framework is generally consistent with the requirements of Section 17A of the Exchange Act.

In addition, this Order is designed to assure that – as represented in the request on behalf of Eurex – information will be available to market participants about the terms of the CDS cleared by Eurex, the creditworthiness of Eurex or any guarantor, and the clearing and settlement process for the CDS. Moreover, to be within the definition of Cleared CDS for purposes of this exemption (as well as the other exemptions granted through this Order), a CDS may only involve a reference entity, a reference security, an issuer of a reference security, or a reference index that satisfies certain conditions relating to the availability of information about such persons or securities. For non-excluded CDS that are index-based, the definition provides that at least 80 percent of the weighting of the index must be comprised of reference entities, issuers of a reference security, or reference securities that satisfy the information conditions. The definition

does not prescribe the type of financial information that must be available or the location of the particular information, recognizing that eligible contract participants have access to information about reference entities and reference securities through multiple sources. The Commission believes, however, that it is important in the CDS market, as in the market for securities generally, that parties to transactions should have access to financial information that would allow them to appropriately evaluate the risks relating to a particular investment and make more informed investment decisions.<sup>19</sup> Such information availability also will assist Eurex and the buyers and sellers in valuing their Cleared CDS and their counterparty exposures. As a result of the Commission's actions today, the Commission believes that information should be available for market participants to be able to make informed investment decisions, and value and evaluate their Cleared CDS and their counterparty exposures.

This temporary exemption is subject to a number of conditions that are designed to enable Commission staff to monitor Eurex's clearance and settlement of CDS transactions, cooperate with BaFin, and help reduce risk in the CDS market. These conditions require that Eurex: (i) make available on its Web site annual audited financial statements; (ii) preserve records of all activities related to the business of Eurex as a CCP for Cleared CDS for at least five years (in an easily accessible place for the first two years); (iii) supply information relating to its Cleared CDS clearance and settlement services as may be reasonably requested by the Commission and provide access to the Commission to conduct on-site inspections of

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<sup>19</sup> The Commission notes the recommendations of the President's Working Group on Financial Markets regarding the informational needs and due diligence responsibilities of investors. See Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets, Mar. 13, 2008, available at: [http://www.ustreas.gov/press/releases/reports/pwgpolicystatemkkturmoil\\_03122008.pdf](http://www.ustreas.gov/press/releases/reports/pwgpolicystatemkkturmoil_03122008.pdf).

facilities, records and personnel related to its Cleared CDS clearance and settlement services;<sup>20</sup> (iv) notify the Commission about material disciplinary actions taken against any of its members with respect to Cleared CDS clearance and settlement services, and about the involuntary termination of the membership of an entity using those services; (v) notify the Commission not less than one day prior to implementation or effectiveness of changes to its rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services, or, in exigent circumstances, as promptly as reasonably practicable under the circumstances; (vi) provide the Commission with reports prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements<sup>21</sup> and its annual audited financial statements prepared by independent audit personnel; and (vii) report all significant systems outages to the Commission.

In addition, this relief is conditioned on Eurex, directly or indirectly, making available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) all end-of-day settlement prices and any other prices with respect to Cleared CDS that Eurex may establish to calculate mark-to-market margin requirements for Eurex clearing members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by Eurex. The Commission believes this is an appropriate condition for Eurex's exemption from registration as a clearing agency. In Section 11A of the Exchange Act,

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<sup>20</sup> The Commission's inspections shall be subject to cooperation with BaFin and upon terms and conditions agreed to between the Commission and BaFin in the bilateral MOU related to cooperation and information-sharing. "Memorandum of Understanding Concerning Consultation, Cooperation, and the Exchange of Information Related to Market Oversight and the Supervision of Financial Services Firms," Apr. 26, 2007.

<sup>21</sup> See Automated Systems of Self-Regulatory Organizations, Securities Exchange Act Release No. 27445 (Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989), and Automated Systems of Self-Regulatory Organizations, Securities Exchange Act Release No. 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991).

Congress found that "[i]t is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities."<sup>22</sup> The President's Working Group on Financial Markets has stated that increased transparency is a policy objective for the over-the-counter derivatives market,<sup>23</sup> which includes the market for CDS. The condition is designed to further this policy objective of both Congress and the President's Working Group by requiring Eurex to make useful pricing data available to the public on terms that are fair and reasonable and not unreasonably discriminatory. Congress adopted these standards for the distribution of data in Section 11A. The Commission long has applied the standards in the specific context of securities market data,<sup>24</sup> and it anticipates that Eurex will distribute its data on terms that generally are consistent with the application of these standards to securities market data. For example, data distributors generally are required to treat subscribers equally and not grant special access, fees, or other privileges to favored customers of the distributor. Similarly, distributors must make their data feeds reasonably available to data vendors for those subscribers who wish to receive their data indirectly through a vendor rather than directly from the distributor. In addition, a distributor's attempt to tie data products that

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<sup>22</sup> 15 U.S.C. 78k-1(a)(1)(C)(iii). See also 15 U.S.C. 78k-1(a)(1)(D).

<sup>23</sup> See President's Working Group on Financial Markets, Policy Objectives for the OTC Derivatives Market (Nov. 14, 2008), available at <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."). See also Department of the Treasury, Financial Regulatory Reform: A New Foundation, available at [http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf), at p.48 ("[m]arket efficiency and price transparency should be improved in derivatives markets . . . by requiring development of a system for timely reporting of trades and prompt dissemination of prices and other trade information.").

<sup>24</sup> See Securities Exchange Act Release No. 42209 (Dec. 9, 1999), 64 FR 70613, 70621-70623 (Dec. 17, 1999) ("Market Information Concept Release") (discussion of legal standards applicable to market data distribution since Section 11A was adopted in 1975).

must be made available to the public with other products or services of the distributor would be inconsistent with the statutory requirements.<sup>25</sup> The Commission carefully evaluates any type of discrimination with respect to subscribers and vendors to assess whether there is a reasonable basis for the discrimination given, among other things, the Exchange Act objective of promoting price transparency.<sup>26</sup> Moreover, preventing unreasonable discrimination is a practical means to promote fair and reasonable terms for data distribution because distributors are more likely to act appropriately when the terms applicable to the broader public also must apply to any favored classes of customers.<sup>27</sup>

As a CCP, Eurex will collect and process information about CDS transactions, prices, and positions from all of its clearing members. With this information, a CCP will, among other things, calculate and disseminate current values for open positions for the purpose of setting appropriate margin levels. The availability of such information can improve fairness, efficiency, and competitiveness of the market – all of which enhance investor protection and facilitate capital formation. Moreover, with pricing and valuation information relating to Cleared CDS, market participants would be able to derive information about underlying securities and indexes.

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<sup>25</sup> See Securities Exchange Act Release No. 59039 (Dec. 2, 2008), 73 FR 74770, 74793 (Dec. 9, 2008) (“NYSE ArcaBook Order”) (“[S]ection 6 and Exchange Act Rule 603(a) require NYSE Arca to distribute the ArcaBook data on terms that are not tied to other products in a way that is unfairly discriminatory or anticompetitive.”).

<sup>26</sup> See Market Information Concept Release, 64 FR at 70630 (“The most important objectives for the Commission to consider in evaluating fees are to assure (1) the wide availability of market information, (2) the neutrality of fees among markets, vendors, broker-dealers, and users, (3) the quality of market information – its integrity, reliability, and accuracy, and (4) fair competition and equal regulation among markets and broker-dealers.”).

<sup>27</sup> See NYSE ArcaBook Order, 73 FR at 74794 (“[T]he proposed fees for ArcaBook data will apply equally to all professional subscribers and all non-professional subscribers . . . The fees therefore do not unreasonably discriminate among types of subscribers, such as by favoring participants in the NYSE Arca market or penalizing participants in other markets.”).

This may improve the efficiency and effectiveness of the securities markets by allowing investors to better understand credit conditions generally.

C. Temporary General Exemption for Eurex and Certain Eligible Contract Participants

Applying the full panoply of Exchange Act requirements to participants in transactions in non-excluded CDS likely would deter some participants from using CCPs to clear CDS transactions. At the same time, it is important that the antifraud provisions of the Exchange Act apply to transactions in non-excluded CDS; indeed, OTC transactions subject to individual negotiation that qualify as security-based swap agreements already are subject to these antifraud provisions.<sup>28</sup>

We thus believe that it is appropriate in the public interest and consistent with the protection of investors temporarily to apply substantially the same framework to transactions by market participants in non-excluded CDS that applies to transactions in security-based swap agreements. Applying substantially the same set of requirements to participants in transactions in non-excluded CDS as apply to participants in OTC CDS transactions will avoid deterring

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<sup>28</sup> While Section 3A of the Exchange Act excludes “swap agreements” from the definition of “security,” certain antifraud and insider trading provisions under the Exchange Act explicitly apply to security-based swap agreements. See (a) paragraphs (2) through (5) of Section 9(a), 15 U.S.C. 78i(a), prohibiting the manipulation of security prices; (b) Section 10(b), 15 U.S.C. 78j(b), and underlying rules prohibiting fraud, manipulation or insider trading (but not prophylactic reporting or recordkeeping requirements); (c) Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices; (d) Sections 16(a) and (b), 15 U.S.C. 78p(a) and (b), which address disclosure by directors, officers and principal stockholders, and short-swing trading by those persons, and rules with respect to reporting requirements under Section 16(a); (e) Section 20(d), 15 U.S.C. 78t(d), providing for antifraud liability in connection with certain derivative transactions; and (f) Section 21A(a)(1), 15 U.S.C. 78u-1(a)(1), related to the Commission’s authority to impose civil penalties for insider trading violations.

“Security-based swap agreement” is defined in Section 206B of the Gramm-Leach-Bliley Act as a swap agreement in which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

market participants from promptly using CCPs, which would detract from the potential benefits of central clearing.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until **[insert date nine months from the date of order]** from certain requirements under the Exchange Act. This temporary exemption in part applies to Eurex, and to any Eurex U.S. Clearing Member<sup>29</sup> or Eurex non-U.S. Clearing Member<sup>30</sup> that is not a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof). This temporary exemption also applies to certain eligible contract participants<sup>31</sup> other than: eligible contract participants that receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling or holding Cleared CDS

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<sup>29</sup> For Purposes of this Order, a "Eurex U.S. Clearing Member" means any U.S. clearing member of Eurex that submits Cleared CDS to Eurex for clearance and settlement exclusively (i) for its own account or (ii) for the account of an affiliate that controls, is controlled by, or is under common control with the U.S. clearing member of Eurex.

<sup>30</sup> For Purposes of this Order, a "Eurex non-U.S. Clearing Member" means any Eurex clearing member, other than a clearing member that is a U.S. person, that submits Cleared CDS to Eurex for clearance and settlement exclusively (i) for its own account, (ii) for the account of an affiliate (including a U.S. affiliate) that controls, is controlled by, or is under common control with the non-U.S. clearing member of Eurex, or (iii) for the account of any other person except a U.S. person.

Consistent with these definitions of "Eurex U.S. Clearing Member" and "Eurex non-U.S. Clearing Member," this exemption is available to Eurex members that clear CDS transactions for themselves and their affiliates, or, in the case of non-U.S. members of Eurex, that clear CDS transactions on behalf of non-U.S. customers. The exemption otherwise does not extend to persons who engage in customer clearing activities on Eurex (e.g., customer clearing by a U.S. member of Eurex for any persons, or customer clearing by a non-U.S. member of Eurex for U.S. persons). See note 9, *supra*.

The exemptive relief for Eurex non-U.S. Clearing Members is intended to provide legal certainty for these non-U.S. persons in those circumstances when their activities in Cleared CDS are within the jurisdiction of the United States. The exemptive relief is not necessary for these non-U.S. persons when their activities in Cleared CDS are not otherwise subject to the federal securities laws.

<sup>31</sup> This exemption in general applies to eligible contract participants, as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order, other than persons that are eligible contract participants under paragraph (C) of that section.

positions for other persons;<sup>32</sup> eligible contract participants that are self-regulatory organizations; or eligible contract participants that are registered brokers or dealers.<sup>33</sup>

Under this temporary exemption, and solely with respect to Cleared CDS, these persons generally are exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements. Those persons thus would still be subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements.<sup>34</sup> In addition, all provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions would remain applicable.<sup>35</sup> In this way, the temporary exemption would apply the same Exchange Act requirements in connection with non-excluded CDS as apply in connection with OTC credit default swaps.

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<sup>32</sup> Solely for purposes of this requirement, an eligible contract participant would not be viewed as receiving or holding funds or securities for purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons, if the other persons involved in the transaction would not be considered "customers" of the eligible contract participant under the analysis used for determining whether certain persons would be considered "customers" of a broker-dealer under Exchange Act Rule 15c3-3(a)(1). For these purposes, and for the purpose of the definition of "Cleared CDS," the terms "purchasing" and "selling" mean the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under, a Cleared CDS, as the context may require. This is consistent with the meaning of the terms "purchase" or "sale" under the Exchange Act in the context of security-based swap agreements. See Exchange Act Section 3A(b)(4).

<sup>33</sup> A separate temporary exemption addresses the Cleared CDS activities of registered broker-dealers. See Part II.D, *infra*. Solely for purposes of this Order, a registered broker-dealer, or a broker or dealer registered under Section 15(b) of the Exchange Act, does not refer to someone that would otherwise be required to register as a broker or dealer solely as a result of activities in Cleared CDS in compliance with this Order.

<sup>34</sup> See note 28, *supra*.

<sup>35</sup> Thus, for example, the Commission retains the ability to investigate potential violations and bring enforcement actions in the federal courts and administrative proceedings, and to seek the full panoply of remedies available in such cases.

This temporary exemption, however, does not extend to Sections 5 and 6 of the Exchange Act. The Commission separately issued a conditional exemption from these provisions to all broker-dealers and exchanges.<sup>36</sup> This temporary exemption also does not extend to Section 17A of the Exchange Act; instead, Eurex is exempt from registration as a clearing agency under the conditions discussed above. In addition, this temporary exemption does not apply to Exchange Act Sections 12, 13, 14, 15(d) and 16;<sup>37</sup> eligible contract participants and other persons instead should refer to the interim final temporary rules issued by the Commission. Finally, this temporary exemption does not extend to the Commission's administrative proceeding authority under Sections 15(b)(4) and (b)(6),<sup>38</sup> or to certain provisions related to government securities.<sup>39</sup>

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<sup>36</sup> See note 10, *supra*. A national securities exchange that effects transactions in Cleared CDS would continue to be required to comply with all requirements under the Exchange Act applicable to such transactions. A national securities exchange could form subsidiaries or affiliates that operate exchanges exempt under that order. Any subsidiary or affiliate of a registered exchange could not integrate, or otherwise link, the exempt CDS exchange with the registered exchange including the premises or property of such exchange for effecting or reporting a transaction without being considered a "facility of the exchange." See Section 3(a)(2), 15 U.S.C. 78c(a)(2).

<sup>37</sup> 15 U.S.C. 78l, 78m, 78n, 78o(d), 78p.

<sup>38</sup> Exchange Act Sections 15(b)(4) and 15(b)(6), 15 U.S.C. 78o(b)(4) and (b)(6), grant the Commission authority to take action against broker-dealers and associated persons in certain situations. Accordingly, while this exemption generally extends to persons that act as inter-dealer brokers in the market for Cleared CDS and do not hold funds or securities for others, such inter-dealer brokers may be subject to actions under Sections 15(b)(4) and (b)(6) of the Exchange Act.

In addition, such inter-dealer brokers may be subject to actions under Exchange Act Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices. As noted above, Section 15(c)(1) explicitly applies to security-based swap agreements. Sections 15(b)(4), 15(b)(6) and 15(c)(1), of course, would not apply to persons subject to this exemption who do not act as broker-dealers or associated persons of broker-dealers.

<sup>39</sup> This exemption specifically does not extend to the Exchange Act provisions applicable to government securities, as set forth in Section 15C, 15 U.S.C. 78o-5, and its underlying rules and regulations; nor does the exemption extend to related definitions found at paragraphs (42) through (45) of Section 3(a), 15 U.S.C. 78c(a). The Commission does not have authority under Section 36 to issue exemptions in connection with those provisions. See Exchange Act Section 36(b), 15 U.S.C. 78mm(b).

D. Temporary General Exemption for Certain Registered Broker-Dealers

The temporary exemptions addressed above – with regard to Eurex and certain eligible contract participants – are not available to persons that are registered as broker-dealers with the Commission (other than those that are notice registered pursuant to Section 15(b)(11)).<sup>40</sup> The Exchange Act and its underlying rules and regulations require broker-dealers to comply with a number of obligations that are important to protecting investors and promoting market integrity. We are mindful of the need to avoid creating disincentives to the prompt use of CCPs, and we recognize that the factors discussed above suggest that the full panoply of Exchange Act requirements should not immediately be applied to registered broker-dealers that engage in transactions involving Cleared CDS. At the same time, we also are sensitive to the critical importance of certain broker-dealer requirements to promoting market integrity and protecting customers (including those broker-dealer customers that are not involved with CDS transactions).

This calls for balancing the facilitation of the development and prompt implementation of CCPs with the preservation of certain key investor protections. Pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until **[insert date nine months from the date of this Order]** from certain Exchange Act requirements. Consistent with the temporary exemptions discussed above, and solely with respect to Cleared CDS, we are exempting registered broker-dealers in general from the provisions of the Exchange Act and its underlying rules and regulations that do not apply to

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<sup>40</sup> Exchange Act Section 15(b)(11) provides for notice registration of certain persons that effect transactions in security futures products. 15 U.S.C. 78o(b)(11).

security-based swap agreements. As above, we are not excluding registered broker-dealers from Exchange Act provisions that explicitly apply in connection with security-based swap agreements or from related enforcement authority provisions.<sup>41</sup> As above, and for similar reasons, we are not exempting registered broker-dealers from: Sections 5, 6, 12(a) and (g), 13, 14, 15(b)(4), 15(b)(6), 15(d), 16 and 17A of the Exchange Act.<sup>42</sup>

Further we are not exempting registered broker-dealers from the following additional provisions under the Exchange Act: (i) Section 7(c),<sup>43</sup> which addresses the unlawful extension of credit by broker-dealers; (ii) Section 15(c)(3),<sup>44</sup> which addresses the use of unlawful or manipulative devices by broker-dealers; (iii) Section 17(a),<sup>45</sup> regarding broker-dealer obligations to make, keep and furnish information; (iv) Section 17(b),<sup>46</sup> regarding broker-dealer records subject to examination; (v) Regulation T,<sup>47</sup> a Federal Reserve Board regulation regarding extension of credit by broker-dealers; (vi) Exchange Act Rule 15c3-1, regarding broker-dealer net capital; (vii) Exchange Act Rule 15c3-3, regarding broker-dealer reserves and custody of

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<sup>41</sup> See notes 28 and 35, *supra*. As noted above, broker-dealers also would be subject to Section 15(c)(1) of the Exchange Act, which prohibits brokers and dealers from using manipulative or deceptive devices, because that provision explicitly applies in connection with security-based swap agreements. In addition, to the extent the Exchange Act and any rule or regulation thereunder imposes any other requirement on a broker-dealer with respect to security-based swap agreements (e.g., requirements under Rule 17h-1T to maintain and preserve written policies, procedures, or systems concerning the broker or dealer's trading positions and risks, such as policies relating to restrictions or limitations on trading financial instruments or products), these requirements would continue to apply to broker-dealers' activities with respect to Cleared CDS.

<sup>42</sup> We also are not exempting those members from provisions related to government securities, as discussed above.

<sup>43</sup> 15 U.S.C. 78g(c).

<sup>44</sup> 15 U.S.C. 78o(c)(3).

<sup>45</sup> 15 U.S.C. 78q(a).

<sup>46</sup> 15 U.S.C. 78q(b).

<sup>47</sup> 12 CFR 220.1 *et seq.*

securities; (viii) Exchange Act Rules 17a-3 through 17a-5, regarding records to be made and preserved by broker-dealers and reports to be made by broker-dealers; and (ix) Exchange Act Rule 17a-13, regarding quarterly security counts to be made by certain exchange members and broker-dealers.<sup>48</sup> Registered broker-dealers should comply with these provisions in connection with their activities involving non-excluded CDS because these provisions are especially important to helping protect customer funds and securities, ensure proper credit practices and safeguard against fraud and abuse.<sup>49</sup>

E. Solicitation of Comments

The Commission is continuing to monitor closely the development of the CDS market and intends to determine to what extent, if any, additional regulatory action may be necessary. For example, as circumstances warrant, certain conditions could be added, altered, or eliminated. Moreover, because these exemptions are temporary, the Commission will in the future consider whether they should be extended or allowed to expire. The Commission believes it would be prudent to solicit public comment on its action today, and on what action it should take with respect to the CDS market in the future. The Commission is soliciting public comment on all aspects of these temporary exemptions, including:

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<sup>48</sup> Solely for purposes of this exemption, in addition to the general requirements under the referenced Exchange Act sections, registered broker-dealers shall only be subject to the enumerated rules under the referenced Exchange Act sections.

<sup>49</sup> Indeed, Congress directed the Commission to promulgate broker-dealer financial responsibility rules, including rules regarding custody, the use of customer securities and the use of customers' deposits or credit balances, and regarding establishment of minimum financial requirements.

1. Whether the length of this temporary exemption (until [insert date nine months from the date of order]) is appropriate. If not, what should the appropriate duration be?
2. Whether the conditions to these temporary exemptions are appropriate. Why or why not? Should other conditions apply? Are any of the present conditions to the temporary exemptions provided in this Order unnecessary? If so, please specify and explain why such conditions are not needed.
3. Whether Eurex ultimately should be required to register as a clearing agency under the Exchange Act. Why or why not?

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](mailto:rule-comments@sec.gov). Please include File Number S7-17-09 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 S7-17-09. 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. We will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549,

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.

### III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36(a) of the Exchange Act, that, until **[insert date nine months from the date of this Order]**:

(a) Exemption from Section 17A of the Exchange Act.

Eurex Clearing AG ("Eurex") shall be exempt from Section 17A of the Exchange Act solely to perform the functions of a clearing agency for Cleared CDS (as defined in paragraph (d)(1) of this Order), subject to the following conditions:

(1) Eurex shall make available on its Web site its annual audited financial statements.

(2) Eurex shall keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts and other such records as shall be made or received by it relating to its Cleared CDS clearance and settlement services. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.

(3) Eurex shall supply information and periodic reports relating to its Cleared CDS clearance and settlement services as may be reasonably requested by the Commission, and shall provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to Eurex's Cleared CDS clearance and settlement services.

(4) Eurex shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any of its members using its Cleared CDS clearance and settlement services, including the denial of services, fines, or penalties. Eurex shall notify the Commission promptly when it terminates on an involuntary basis the membership of an entity that is using Eurex's Cleared CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to Eurex's disciplinary action.

(5) Eurex shall notify the Commission of all changes to its rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services, including its fee schedule and changes to risk management practices, not less than one day prior to effectiveness or implementation of such changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. All such rule changes will be posted on Eurex's Web site. Such notifications will not be deemed rule filings that require Commission approval.

(6) Eurex shall provide the Commission with reports prepared by independent audit personnel concerning its Cleared CDS clearance and settlement services that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements. Eurex shall provide the Commission with annual audited financial statements for Eurex prepared by independent audit personnel.

(7) Eurex shall report all significant systems outages to the Commission. If it appears that the outage may extend for 30 minutes or longer, Eurex shall report the systems outage immediately. If it appears that the outage will be resolved in fewer than

30 minutes, Eurex shall report the systems outage within a reasonable time after the outage has been resolved.

(8) Eurex, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) all end-of-day settlement prices and any other prices with respect to Cleared CDS that Eurex may establish to calculate mark-to-market margin requirements for Eurex clearing members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by Eurex.

(b) Exemption for Eurex, certain Eurex clearing members, and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (b)(2) is available to:

(i) Eurex;

(ii) Any Eurex U.S. Clearing Member (as defined in paragraph (d)(2) of this Order) that is not a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof);

(iii) Any Eurex non-U.S. Clearing Member (as defined in paragraph (d)(3) of this Order) that is not a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof); and

(iv) Any eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), other than: (A) an eligible contract participant that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding

Cleared CDS positions for other persons; (B) an eligible contract participant that is a self-regulatory organization, as that term is defined in Section 3(a)(26) of the Exchange Act; or (C) a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof).

(2) Scope of exemption.

(i) In general. Such persons generally shall, solely with respect to Cleared CDS, be exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply in connection with security-based swap agreements. Accordingly, under this exemption, those persons would remain subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements (i.e., paragraphs (2) through (5) of Section 9(a), Section 10(b), Section 15(c)(1), paragraphs (a) and (b) of Section 16, Section 20(d) and Section 21A(a)(1) and the rules thereunder that explicitly are applicable to security-based swap agreements). All provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions also remain applicable.

(ii) Exclusions from exemption. The exemption in paragraph (b)(2)(i), however, does not extend to the following provisions under the Exchange Act:

- (A) Paragraphs (42), (43), (44), and (45) of Section 3(a);
- (B) Section 5;
- (C) Section 6;
- (D) Section 12 and the rules and regulations thereunder;
- (E) Section 13 and the rules and regulations thereunder;

- (F) Section 14 and the rules and regulations thereunder;
- (G) Paragraphs (4) and (6) of Section 15(b);
- (H) Section 15(d) and the rules and regulations thereunder;
- (I) Section 15C and the rules and regulations thereunder;
- (J) Section 16 and the rules and regulations thereunder; and
- (K) Section 17A (other than as provided in paragraph (a)).

(c) Exemption for certain registered broker-dealers.

A broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (b)(2), solely with respect to Cleared CDS, except:

- (1) Section 7(c);
- (2) Section 15(c)(3);
- (3) Section 17(a);
- (4) Section 17(b);
- (5) Regulation T, 12 CFR 200.1 et seq.;
- (6) Rule 15c3-1;
- (7) Rule 15c3-3;
- (8) Rule 17a-3;
- (9) Rule 17a-4;
- (10) Rule 17a-5; and
- (11) Rule 17a-13.

(d) Definitions.

For purposes of this Order:

(1) "Cleared CDS" shall mean a credit default swap that is submitted (or offered, purchased or sold on terms providing for submission) to Eurex, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which:

(i) The reference entity, the issuer of the reference security, or the reference security is one of the following:

(A) An entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available;

(B) A foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States;

(C) A foreign sovereign debt security;

(D) An asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or

(E) An asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae; or

(ii) The reference index is an index in which 80 percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (i).

(2) "Eurex U.S. Clearing Member" shall mean any U.S. clearing member of Eurex that submits Cleared CDS to Eurex for clearance and settlement exclusively (i) for its own account or

(ii) for the account of an affiliate that controls, is controlled by, or is under common control with the U.S. clearing member of Eurex.

(3) "Eurex non-U.S. Clearing Member" shall mean any clearing member of Eurex, other than a clearing member that is a U.S. person, that submits Cleared CDS to Eurex for clearance and settlement exclusively (i) for its own account, (ii) for the account of an affiliate (including a U.S. affiliate) that controls, is controlled by, or is under common control with the non-U.S. clearing member of Eurex, or (iii) for the account of any other person except a U.S. person.

By the Commission.



Elizabeth M. Murphy  
Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 60369 / July 23, 2009

ADMINISTRATIVE PROCEEDING

File No. 3-13562

In the Matter of

STANDARD METALS  
CORPORATION,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO SECTION 12(j) OF  
THE SECURITIES EXCHANGE ACT OF 1934,  
MAKING FINDINGS, AND REVOKING  
REGISTRATION OF SECURITIES

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Standard Metals Corporation ("Standard Metals" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 12(j) of the Securities Exchange Act of 1934, Making Findings, and Revoking Registration of Securities ("Order"), as set forth below.

III.

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

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

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A. Standard Metals, a Delaware corporation with its principal place of business in Haverford, Pennsylvania, owns various abandoned precious metals mines and mining sites in Colorado and Arizona. The company ceased active operations in approximately 1996, and on March 1, 2000, the Delaware Secretary of State revoked the company's corporate charter for non-payment of taxes. Standard Metals' common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act. Standard Metals stock has previously traded on the American Stock Exchange, the Pacific Stock Exchange, and the Intermountain Stock Exchange, and was also previously quoted through the National Association of Securities Dealers Automated Quotation System. The stock is currently quoted under the name American Holdings, Inc. through the Pink Sheets managed by Pink OTC.

B. Standard Metals has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, while its common stock was registered with the Commission in that it has not filed an Annual Report on Form 10-K for any period subsequent to its fiscal year ending December 31, 1996, or periodic or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ending September 30, 1997.

#### IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means of instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

temporary exemptions provided in this Order unnecessary? If so, please specify and explain why such conditions are not needed.

3. Whether ICE Clear Europe ultimately should be required to register as a clearing agency under the Exchange Act. Why or why not?

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](mailto:rule-comments@sec.gov). Please include File Number S7-16-09 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 S7-16-09. 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. We will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, 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.

### III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36(a) of the Exchange Act, that, until [insert date nine months from date of order]:

(a) Exemption from Section 17A of the Exchange Act.

ICE Clear Europe Limited ("ICE Clear Europe") shall be exempt from Section 17A of the Exchange Act solely to perform the functions of a clearing agency for Cleared CDS (as defined in paragraph (e)(1) of this Order), subject to the following conditions:

(1) ICE Clear Europe shall make available on its Web site its annual audited financial statements.

(2) ICE Clear Europe shall keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it relating to its Cleared CDS clearance and settlement services. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.

(3) ICE Clear Europe shall supply information and periodic reports relating to its Cleared CDS clearance and settlement services as may be reasonably requested by the Commission and, subject to cooperation with the FSA and upon such terms and conditions as may be agreed between the FSA and the Commission, shall provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to ICE Clear Europe's Cleared CDS clearance and settlement services.

(4) ICE Clear Europe shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any of its members using its Cleared CDS clearance and settlement services, including the denial of services, fines, or penalties. ICE Clear Europe shall notify the Commission promptly when ICE Clear Europe terminates on an involuntary basis the membership of an entity that is using ICE Clear Europe's Cleared CDS clearance and settlement services. Both notifications shall

describe the facts and circumstances that led to the ICE Clear Europe's disciplinary action.

(5) ICE Clear Europe shall notify the Commission of all changes to its rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services, including its fee schedule and changes to risk management practices, not less than one day prior to effectiveness or implementation of such changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. If ICE Clear Europe gives notice to, or seeks approval from, the FSA regarding any other changes to its rules regarding its Cleared CDS clearance and settlement services, ICE Clear Europe will also provide notice to the Commission. All such rule changes will be posted on ICE Clear Europe's Web site. Such notifications will not be deemed rule filings that require Commission approval.

(6) ICE Clear Europe shall provide the Commission with reports prepared by independent audit personnel concerning its Cleared CDS clearance and settlement services that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements. ICE Clear Europe shall provide the Commission with annual audited financial statements for ICE Clear Europe prepared by independent audit personnel.

(7) ICE Clear Europe shall notify the Commission at the same time it notifies the FSA in accordance with FSA REC 3.15 and FSA REC 3.16 regarding the suspension of services or inability to operate its facilities in connection with its Cleared CDS clearance and settlement services.

(8) ICE Clear Europe, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) all end-of-day

settlement prices and any other prices with respect to Cleared CDS that ICE Clear Europe may establish to calculate mark-to-market margin requirements for ICE Clear Europe Clearing Members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by ICE Clear Europe.

(b) Exemption from Sections 5 and 6 of the Exchange Act

(1) ICE Clear Europe shall be exempt from the requirements of Sections 5 and 6 of the Exchange Act and the rules and regulations thereunder in connection with its calculation of mark-to-market prices for open positions in Cleared CDS, subject to the following conditions:

(i) ICE Clear Europe shall report the following information with respect to the calculation of mark-to-market prices for Cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports during the life of the enterprise and of any successor enterprise:

(A) The total dollar volume of transactions executed during the quarter, broken down by reference entity, security, or index; and

(B) The total unit volume and/or notional amount executed during the quarter, broken down by reference entity, security, or index;

(ii) ICE Clear Europe shall establish adequate safeguards and procedures to protect members' confidential trading information. Such safeguards and procedures shall include: (A) limiting access to the confidential trading information of members to those employees of ICE Clear Europe who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and (B) implementing standards controlling employees of ICE Clear Europe trading for their own accounts. ICE Clear Europe must adopt

and implement adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed; and

(iii) ICE Clear Europe shall satisfy the conditions of the temporary exemption from Section 17A of the Exchange Act set forth in paragraphs (a)(1) – (8) of this Order.

(2) Any ICE Clear Europe Clearing Member shall be exempt from the requirements of Section 5 of the Exchange Act to the extent such ICE Clear Europe Clearing Member uses any facility of ICE Clear Europe to effect any transaction in Cleared CDS, or to report any such transaction, in connection with ICE Clear Europe's clearance and risk management process for Cleared CDS.

(c) Exemption for ICE Clear Europe, ICE Clear Europe Clearing Members, and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (c)(2) is available to:

(i) ICE Clear Europe;

(ii) Any ICE Clear Europe Clearing Member (as defined in paragraph (e)(2) of this Order), which is not a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof); and

(iii) Any eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), other than: (A) an eligible contract participant that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons; (B) an eligible contract participant that is a self-regulatory organization, as that term is defined in Section 3(a)(26) of the

Exchange Act; or (C) a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof).

(2) Scope of exemption.

(i) In general. Such persons generally shall, solely with respect to Cleared CDS, be exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply in connection with security-based swap agreements. Accordingly, under this exemption, those persons would remain subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements (i.e., paragraphs (2) through (5) of Section 9(a), Section 10(b), Section 15(c)(1), paragraphs (a) and (b) of Section 16, Section 20(d) and Section 21A(a)(1) and the rules thereunder that explicitly are applicable to security-based swap agreements). All provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions also remain applicable.

(ii) Exclusions from exemption. The exemption in paragraph (c)(2)(i), however, does not extend to the following provisions under the Exchange Act:

- (A) Paragraphs (42), (43), (44), and (45) of Section 3(a);
- (B) Section 5;
- (C) Section 6;
- (D) Section 12 and the rules and regulations thereunder;
- (E) Section 13 and the rules and regulations thereunder;
- (F) Section 14 and the rules and regulations thereunder;
- (G) Paragraphs (4) and (6) of Section 15(b);
- (H) Section 15(d) and the rules and regulations thereunder;

- (I) Section 15C and the rules and regulations thereunder;
- (J) Section 16 and the rules and regulations thereunder; and
- (K) Section 17A (other than as provided in paragraph (a)).

(d) Exemption for certain registered broker-dealers.

A broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (c)(2), solely with respect to Cleared CDS, except:

- (1) Section 7(c);
- (2) Section 15(c)(3);
- (3) Section 17(a);
- (4) Section 17(b);
- (5) Regulation T, 12 CFR 200.1 et seq.;
- (6) Rule 15c3-1;
- (7) Rule 15c3-3;
- (8) Rule 17a-3;
- (9) Rule 17a-4;
- (10) Rule 17a-5; and
- (11) Rule 17a-13.

(e) Definitions.

For purposes of this Order:

(1) "Cleared CDS" shall mean a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to ICE Clear Europe, that is offered only to, purchased only by, and sold only to eligible contract participants (as

defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which:

(i) The reference entity, the issuer of the reference security, or the reference security is one of the following:

(A) An entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available;

(B) A foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States;

(C) A foreign sovereign debt security;

(D) An asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or

(E) An asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae; or

(ii) The reference index is an index in which 80 percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (i).

(2) "ICE Clear Europe Clearing Member" shall mean any clearing member of ICE Clear Europe that submits Cleared CDS to ICE Clear Europe for clearance and settlement exclusively (i) for its own account or (ii) for the account of an affiliate that controls, is

controlled by, or is under common control with the clearing member of ICE Clear  
Europe.

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60372; File No. S7-16-09)

July 23, 2009

**ORDER GRANTING TEMPORARY EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH REQUEST ON BEHALF OF ICE CLEAR EUROPE LIMITED RELATED TO CENTRAL CLEARING OF CREDIT DEFAULT SWAPS, AND REQUEST FOR COMMENTS**

**I. Introduction**

In response to the recent turmoil in the financial markets, the Securities and Exchange Commission ("Commission") has taken multiple actions to protect investors and ensure the integrity of the nation's securities markets, including actions<sup>1</sup> designed to address concerns related to the market in credit default swaps ("CDS").<sup>2</sup> The over-the-counter ("OTC") market for CDS has been a source of concern to us and other financial regulators, and we have recognized that facilitating the establishment of central counterparties ("CCPs") for CDS can

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<sup>1</sup> See generally Securities Exchange Act Release No. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009) (temporary exemption in connection with CDS clearing by Chicago Mercantile Exchange Inc.), Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009) (temporary exemption in connection with CDS clearing by ICE US Trust LLC), Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemption in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) and other Commission actions discussed therein.

<sup>2</sup> 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 under a CDS 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 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. See Semiannual OTC derivatives statistics at end-December 2008, Bank for International Settlement ("BIS"), available at <http://www.bis.org/statistics/otcder/dt1920a.pdf>.

This growth has coincided with a significant rise in the types and number of entities participating in the CDS market. 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.

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play an important role in reducing the counterparty risks inherent in the CDS market, and thereby can help mitigate potential systemic impacts.<sup>3</sup> Thus, 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 Commission's authority over this OTC market for CDS is limited. Specifically, Section 3A of the Securities Exchange Act of 1934 ("Exchange Act") limits the Commission's authority over swap agreements, as defined in Section 206A of the Gramm-Leach-Bliley Act.<sup>4</sup> For those CDS that are swap agreements, the exclusion from the definition of security in Section 3A of the Exchange Act, and related provisions, will continue to apply. The Commission's action today does not affect these CDS, and this Order does not apply to them. For those CDS that are not swap agreements ("non-excluded CDS"), the Commission's action today provides conditional exemptions from certain requirements of the Exchange Act.

The Commission believes that using well-regulated CCPs to clear transactions in CDS would provide a number of benefits, by helping to promote efficiency and reduce risk in the CDS market and among its participants, requiring maintenance of records of CDS transactions that would aid the Commission's efforts to prevent and detect fraud and other abusive market practices, addressing concerns about counterparty risk – through the novation process – by substituting the creditworthiness and liquidity of the CCP for the creditworthiness and liquidity

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<sup>3</sup> See generally actions referenced in note 1, *supra*.

<sup>4</sup> 15 U.S.C. 78c-1. Section 3A excludes both a non-security-based and a security-based swap agreement from the definition of "security" under 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.

of the counterparties to a CDS,<sup>5</sup> contributing generally to the goal of market stability, and reducing CDS risks through multilateral netting of trades.<sup>6</sup>

In this context, ICE Clear Europe Limited (“ICE Clear Europe”) has requested that the Commission grant exemptions from certain requirements under the Exchange Act with respect to its proposed activities in clearing and settling certain CDS, as well as the proposed activities of certain other persons, as described below.<sup>7</sup>

Based on the facts presented and the representations made in the request on behalf of ICE Clear Europe,<sup>8</sup> and for the reasons discussed in this Order, the Commission temporarily is exempting, subject to certain conditions, ICE Clear Europe from the requirement to register as a clearing agency under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS transactions. The Commission also temporarily is exempting eligible contract participants and others from certain Exchange Act requirements with respect to non-excluded CDS cleared by ICE Clear Europe. In addition, the Commission temporarily is exempting ICE Clear Europe and certain members of ICE Clear Europe from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the

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<sup>5</sup> “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 (Nov. 2004) at 66. Through novation, the CCP assumes counterparty risk.

<sup>6</sup> See generally actions referenced in note 1, supra.

<sup>7</sup> See Letter from Abigail Arms, Shearman & Sterling LLP, to Elizabeth M. Murphy, Secretary, Commission, July 23, 2009.

<sup>8</sup> See id. The exemptions we are granting today are based on representations made in the request on behalf of ICE Clear Europe. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS associated with persons subject to those unavailable exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

calculation of mark-to-market prices for non-excluded CDS cleared by ICE Clear Europe. The Commission's exemptions are temporary and will expire on **[insert date nine months from date of order]**.<sup>9</sup>

## II. Discussion

### A. Description of ICE Clear Europe's Proposal

The exemptive request on behalf of ICE Clear Europe describes how its proposed arrangement for central clearing of CDS would operate and makes representations about the safeguards associated with those arrangements, as described below:

#### 1. ICE Clear Europe Organization

ICE Clear Europe is indirectly a wholly-owned subsidiary of the IntercontinentalExchange, Inc. ("ICE").<sup>10</sup> ICE Clear Europe was incorporated in England and Wales on April 19, 2007 as a private limited company under the Companies Act 1985 (as amended, now largely superseded by the Companies Act 2006). ICE Clear Europe is subject to direct supervision by the United Kingdom's Financial Services Authority ("FSA") as a Recognised Clearing House ("RCH").

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<sup>9</sup> To facilitate the operation of one or more CCPs for the CDS market, the Commission has also approved interim final temporary rules providing exemptions under the Securities Act of 1933 and the Exchange Act for non-excluded CDS. See Securities Act Release No. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009).

Further, the Commission has provided temporary exemptions in connection with Sections 5 and 6 of the Exchange Act for transactions in non-excluded CDS. See Securities Exchange Act Release No. 59165 (Dec. 24, 2008), 74 FR 133 (Jan. 2, 2009).

<sup>10</sup> ICE Clear Europe is owned by IntercontinentalExchange Holdings, which itself is over 99% owned by ICE Netherlands C.V. ICE Netherlands C.V. is owned by ICE Markets, Inc. and by IntercontinentalExchange International Inc., both of which are wholly owned by ICE.

## 2. ICE Clear Europe Central Counterparty Services for CDS

ICE Clear Europe will act as a central counterparty for ICE Clear Europe Clearing Members<sup>11</sup> by assuming, through novation, the obligations of all eligible CDS transactions accepted by it for clearing and collecting margin and other credit support from ICE Clear Europe Clearing Members to collateralize their obligations to ICE Clear Europe. ICE Clear Europe's trade submission process is designed to ensure that it maintains a matched book of offsetting CDS contracts.

ICE Clear Europe will leverage the Deriv/SERV infrastructure in operating its CDS clearing service. Initially, all trades submitted by ICE Clear Europe Clearing Members for clearing through ICE Clear Europe will be recorded in the Deriv/SERV Trade Information Warehouse ("TIW").<sup>12</sup> ICE Clear Europe will, initially on a weekly basis, obtain from DTCC matched trades that have been recorded in the Deriv/SERV TIW as having been submitted for clearing through ICE Clear Europe. Eventually, ICE Clear Europe intends to obtain matched trades from DTCC on a real-time basis.

Members may use the facilities of an inter-dealer broker to execute CDS transactions, for example, to access liquidity more rapidly or to maintain pre-execution anonymity and submit such transactions for clearance and settlement to ICE Clear Europe. The inter-dealer brokers do not assume market positions in connection with their intermediation of CDS transactions.

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<sup>11</sup> See note 33, *infra*.

<sup>12</sup> Major market participants frequently use the Deriv/SERV comparison and confirmation service of The Depository Trust & Clearing Corporation ("DTCC") when documenting their CDS transactions. This service creates electronic records of transaction terms and counterparties. As part of this service, market participants separately submit the terms of a CDS transaction to Deriv/SERV in electronic form. Paired submissions are compared to verify that their terms match in all required respects. If a match is confirmed, the parties receive an electronic confirmation of the submitted transaction. All submitted transactions are recorded in the Deriv/SERV Trade Information Warehouse, which serves as the primary registry for submitted transactions.

Once a matched CDS contract has been forwarded to, or obtained by, ICE Clear Europe, and has been accepted for clearing by it, ICE Clear Europe will clear the CDS contract by becoming the central counterparty to each party to the trade. Deriv/SERV's current infrastructure will help to ensure that ICE Clear Europe maintains a matched book of offsetting CDS contracts. Maintaining a matched offsetting book is essential to managing the credit risk associated with CDS submitted to ICE Clear Europe for clearing.

Under ICE Clear Europe's draft CDS rules and CDS procedures ("ICE Clear Europe Rules"), each bilateral CDS contract between two ICE Clear Europe Clearing Members that is submitted to and accepted by ICE Clear Europe for clearing will be "novated." As part of this process, each bilateral CDS contract submitted to ICE Clear Europe will be replaced by two superseding CDS contracts between each of the original parties to the submitted transaction and ICE Clear Europe on standard terms mandated by ICE Clear Europe. Under these new contracts, ICE Clear Europe will act as the protection buyer to the original protection seller and protection seller to the original protection buyer. As central counterparty to each novated CDS contract, ICE Clear Europe will be able to net offsetting positions on a multilateral basis, even though ICE Clear Europe will have different counterparties with respect to the novated CDS contracts that are being netted.

As part of the novation process, the terms and conditions governing the CDS bilaterally negotiated by the submitting counterparties will be superseded by the relevant provisions of the ICE Clear Europe Rules, the ISDA 2002 Master Agreement, and the Schedule to the ISDA 2002 Master Agreement that is entered into by ICE Clear Europe and each ICE Clear Europe Clearing Member. Multilateral netting will significantly reduce the outstanding notional amount of each ICE Clear Europe Clearing Member's portfolio. When ICE Clear Europe acts as the central

counterparty to all cleared CDS of an ICE Clear Europe Clearing Member, that member's positions will be netted down to a single exposure to ICE Clear Europe.

### 3. ICE Clear Europe Risk Management

ICE Clear Europe will mitigate counterparty risk through a six-tiered waterfall consisting of: (i) membership criteria; (ii) initial margin; (iii) mark-to-market margin; (iv) intraday risk monitoring; (v) guaranty fund; and (vi) a one-time power of assessment. ICE Clear Europe's risk management infrastructure and related risk metrics are structured specifically for the CDS products that ICE Clear Europe clears. Each ICE Clear Europe Clearing Member's credit support obligations will be governed by a uniform credit support framework and applicable ICE Clear Europe Rules.

ICE Clear Europe will maintain strict, objectively determined, risk-based margin and guaranty fund requirements,<sup>13</sup> which will be consistent with clearing industry practice and international standards established for central counterparties as articulated in the Committee on Payment and Settlement Systems/International Organization of Securities Commissions ("CPSS-IOSCO") Recommendations for Central Counterparties ("RCCP").<sup>14</sup> These requirements will

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<sup>13</sup> ICE Clear Europe takes collateral, including margin and guaranty fund contributions and non-cash collateral, by way of a "title transfer financial collateral arrangement" for purposes of the Directive 2002/47/EC on Financial Collateral Arrangements ("Financial Collateral Regulations"). This is different from applicable U.S. law, which mandates that a clearinghouse receive pledged collateral. This collateral structure results in ICE Clear Europe having an unencumbered property right in all collateral provided to it, subject only to an obligation to return excess collateral or such collateral as remains unexpended following a closeout on a default. The Financial Collateral Regulations also provide for the effectiveness of financial collateral arrangements and close-out netting provisions under English law notwithstanding an insolvency of the counterparty.

<sup>14</sup> The RCCP was drafted by a joint task force ("Task Force") composed of representative members of IOSCO and CPSS and published in November 2004. The Task Force consisted of securities regulators and central bankers from 19 countries and the European Union. The U.S. representatives on the Task Force included staff from the Commission, the Federal Reserve Board of Governors, and the Commodity Futures Trading Commission.

also be subject to ongoing regulation and oversight by the FSA. The amount of margin and guaranty fund required of each ICE Clear Europe Clearing Member will be continuously monitored and periodically adjusted as required to reflect the size and profile of, and risk associated with, the ICE Clear Europe Clearing Member's cleared CDS transactions (and related market factors).

Each ICE Clear Europe Clearing Member's margin requirement will consist of two components: (i) initial margin, reflecting a risk-based calculation of potential loss on outstanding CDS positions in the event of a significant adverse market movement; and (ii) mark-to-market margin, based upon an end-of-day mark-to-market of outstanding positions. At any time when a requirement for initial margin falls due and insufficient permitted cover is held, the ICE Clear Europe Clearing Member must initially transfer cash. Thereafter, an ICE Clear Europe Clearing Member may substitute such cash margin with other permitted cover by delivery of the replacement permitted cover to ICE Clear Europe.<sup>15</sup> Mark-to-market margin payments, however, may be made by ICE Clear Europe or an ICE Clear Europe Clearing Member only in cash. ICE Clear Europe Clearing Members will be required to cover any end-of-day margin deficit with Euros (or such other currency as may be permitted under the proposed CDS finance procedures) by the following morning, and ICE Clear Europe will have the discretion to require and collect additional margin, both at the end of the day and intraday, as it deems necessary.<sup>16</sup>

ICE Clear Europe will also maintain a guaranty fund in respect of ICE Clear Europe Clearing Members (the "CDS Guaranty Fund") to cover losses arising from an ICE Clear

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<sup>15</sup> The full list of permitted cover is set out in ICE Clear Europe circulars. The most recent circular in this respect is available at: [https://www.theice.com/publicdocs/clear\\_europe/circulars/C09015\\_att.pdf](https://www.theice.com/publicdocs/clear_europe/circulars/C09015_att.pdf).

<sup>16</sup> An ICE Clear Europe Clearing Member would be permitted to withdraw mark-to-market margin amounts credited to its account to the extent not required to satisfy its initial margin requirement.

Clearing Member's default on cleared CDS transactions that exceed the amount of margin held by ICE Clear Europe from the defaulting ICE Clear Europe Clearing Member. Each ICE Clear Europe Clearing Member will be required to contribute a minimum of 15 million Euros to the CDS Guaranty Fund initially when it becomes a Clearing Member and additional amounts based on its actual and anticipated CDS position exposures plus such other amount as ICE Clear Europe at its discretion determines is necessary based on projected clearing activity. The adequacy of the total amount of the CDS Guaranty Fund will be monitored daily, and if ICE Clear Europe determines the total amount in the CDS Guaranty Fund is to change, ICE Clear Europe Clearing Members will be given notice and will be required to deposit their new contribution prior to the opening of business on the next business day. As a result, the CDS Guaranty Fund will grow in proportion to the position risk associated with the aggregate volume of CDS cleared by ICE Clear Europe.

ICE Clear Europe will also establish rules that "mutualize" the risk of an ICE Clear Europe Clearing Member default across all such clearing members.<sup>17</sup> In the event of an ICE Clear Europe Clearing Member's default, ICE Clear Europe may look to the margin posted by such ICE Clear Europe Clearing Members, such a ICE Clear Europe Clearing Member's CDS Guaranty Fund contributions and, if applicable, any recovery from a parent guarantor. In addition, at its discretion, ICE Clear Europe will be authorized to use, to the extent needed, other

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<sup>17</sup> In the event of a default of an ICE Clear Europe Clearing Member, only the CDS Guaranty Fund will be available to cover losses from the default. In the event of a default of an energy-only clearing member, only the Energy Guaranty Fund will be available to cover losses from the default. In the event of a default of a ICE Clear Europe Clearing Member that is active in both CDS and energy contracts, the Clearing Member's margin and guaranty fund are available to cover any loss, but the CDS Guaranty Fund deposits of the non-defaulting ICE Clear Europe Clearing Members can only be applied against losses in CDS contracts, and the Energy Guaranty Fund deposits of the non-defaulting Energy Clearing Members can only be applied against losses in energy contracts.

ICE Clear Europe Clearing Members' CDS Guaranty Fund contributions to satisfy any obligations of the defaulting ICE Clear Europe Clearing Member.

In the event that the total CDS Guaranty Fund is exhausted, remaining ICE Clear Europe Clearing Members will be obligated to contribute additional amounts to the CDS Guaranty Fund based on a one-time limited power of assessment. The amount of the assessment will be up to, but will not exceed,<sup>18</sup> each ICE Clear Europe Clearing Member's CDS Guaranty Fund obligation immediately prior to the default.

4. Member Default

Following a default by an ICE Clear Europe Clearing Member, ICE Clear Europe has a number of tools available to it under the ICE Clear Europe Rules to ensure an orderly liquidation and unwinding of the open positions of such defaulting ICE Clear Europe Clearing Member. In the first instance, upon determining that a default has occurred, ICE Clear Europe will have the ability to immediately enter into replacement CDS transactions with other ICE Clear Europe Clearing Members that are designed to mitigate, to the greatest extent possible, the market risk of the defaulting clearing member's open positions. ICE Clear Europe can also seek to sell or transfer positions to other ICE Clear Europe clearing members. For open positions in which there is no liquid trading market, ICE Clear Europe may enter into covering CDS transactions for which there is a liquid market and that are most closely correlated with such illiquid open positions.

After entering into covering transactions in the open market, if any, ICE Clear Europe will seek to close out any remaining open positions of the defaulting ICE Clear Europe Clearing

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<sup>18</sup> An ICE Clear Europe Clearing Member can limit the amount of its assessment to an amount equal to such clearing member's guaranty fund contribution immediately prior to the relevant default only by contributing such amount and terminating its membership from ICE Clear Europe, with the withdrawal effective three months after notice.

Member by using one or more auctions or other commercially reasonable unwind processes.

ICE Clear Europe may close out its position through auctions, open market processes, or by allocating replacement transactions to non-defaulting ICE Clear Europe Clearing Members at the floor price established by ICE Clear Europe.

B. Temporary Conditional Exemptions from Clearing Agency and Exchange Registration Requirements

1. Exemption from Section 17A of the Exchange Act

Section 17A of the Exchange Act sets forth the framework for the regulation and operation of the U.S. clearance and settlement system, including CCPs. Specifically, Section 17A directs the Commission to use its authority to promote enumerated Congressional objectives and to facilitate the development of a national clearance and settlement system for securities transactions. Absent an exemption, a CCP that novates trades of non-excluded CDS that are securities and generates money and settlement obligations for participants is required to register with the Commission as a clearing agency.

Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.<sup>19</sup>

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until **[insert date nine months from the date of this**

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<sup>19</sup> 15 U.S.C. 78mm.

Order] to ICE Clear Europe from Section 17A of the Exchange Act, solely to perform the functions of a clearing agency for Cleared CDS,<sup>20</sup> subject to the conditions discussed below.

Our action today balances the aim of facilitating the prompt establishment of ICE Clear Europe as a CCP for non-excluded CDS transactions – which should help reduce systemic risks – with ensuring that important elements of Commission oversight are applied to the non-excluded CDS market. In doing so, we are mindful that applying the full scope of the Exchange Act to transactions involving non-excluded CDS could deter the prompt establishment of ICE Clear Europe as a CCP to settle those transactions.

While we are acting so that the prompt establishment of ICE Clear Europe as a CCP for non-excluded CDS will not be delayed by the need to apply the full scope of Exchange Act Section 17A's requirements that govern clearing agencies, the relief we are providing is temporary and conditional. The limited duration of the exemptions will permit the Commission to continue to gain more direct experience with the non-excluded CDS market after ICE Clear Europe becomes operational, giving the Commission the ability to oversee the development of the centrally cleared non-excluded CDS market as it evolves. During the exemptive period, the

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<sup>20</sup> For purposes of this exemption, and the other exemptions addressed in this Order, "Cleared CDS" means a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to ICE Clear Europe, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which: (i) the reference entity, the issuer of the reference security, or the reference security is one of the following: (A) an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; (B) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; (C) a foreign sovereign debt security; (D) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or (E) an asset-backed security issued or guaranteed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or the Government National Mortgage Association ("Ginnie Mae"); or (ii) the reference index is an index in which 80 percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (i). As discussed above, the Commission's action today does not affect CDS that are swap agreements under Section 206A of the Gramm-Leach-Bliley Act. See note 4, *supra*. The Commission's action today also does not affect activities in CDS that are outside the jurisdiction of the United States.

Commission will closely monitor the impact of the CCPs on the CDS market. In particular, the Commission will seek to assure itself that the CCPs do not act in an anticompetitive manner or indirectly facilitate anticompetitive behavior with respect to fees charged to members, the dissemination of market data and the access to clearing services by independent CDS exchanges or CDS trading platforms. The Commission will take that experience into account in future actions.

Moreover, this temporary exemption in part is based on ICE Clear Europe's representation that it meets the standards set forth in the CPSS-IOSCO RCCP report. The RCCP establishes a framework that requires a CCP to have: (i) the ability to facilitate the prompt and accurate clearance and settlement of CDS transactions and to safeguard its users' assets; and (ii) sound risk management, including the ability to appropriately determine and collect clearing fund and monitor its users' trading. This framework is generally consistent with the requirements of Section 17A of the Exchange Act.

In addition, this Order is designed to assure that – as represented in the request on behalf of ICE Clear Europe – information will be available to market participants about the terms of the CDS cleared by ICE Clear Europe, the creditworthiness of ICE Clear Europe or any guarantor, and the clearing and settlement process for the CDS. Moreover, to be within the definition of Cleared CDS for purposes of this exemption (as well as the other exemptions granted through this Order), a CDS may only involve a reference entity, a reference security, an issuer of a reference security, or a reference index that satisfies certain conditions relating to the availability of information about such persons or securities. For non-excluded CDS that are index-based, the definition provides that at least 80 percent of the weighting of the index must be comprised of reference entities, issuers of a reference security, or reference securities that satisfy the information conditions. The definition does not prescribe the type of financial information that

must be available or the location of the particular information, recognizing that eligible contract participants have access to information about reference entities and reference securities through multiple sources. The Commission believes, however, that it is important in the CDS market, as in the market for securities generally, that parties to transactions should have access to financial information that would allow them to appropriately evaluate the risks relating to a particular investment and make more informed investment decisions.<sup>21</sup> Such information availability also will assist ICE Clear Europe and the buyers and sellers in valuing their Cleared CDS and their counterparty exposures. As a result of the Commission's actions today, the Commission believes that information should be available for market participants to be able to make informed investment decisions, and value and evaluate their Cleared CDS and their counterparty exposures.

This temporary exemption is subject to a number of conditions that are designed to enable Commission staff to monitor ICE Clear Europe's clearance and settlement of CDS transactions and help reduce risk in the CDS market. These conditions require that ICE Clear Europe: (i) make available on its Web site its annual audited financial statements; (ii) preserve records of all activities related to the conduct of its Cleared CDS clearance and settlement services for at least five years (in an easily accessible place for the first two years); (iii) supply information relating to its Cleared CDS clearance and settlement services as may be reasonably requested by the Commission and provide access to the Commission to conduct on-site inspections of facilities, records, and personnel related to its Cleared CDS clearance and settlement services, subject to cooperation with the FSA and upon terms and conditions agreed

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<sup>21</sup> The Commission notes the recommendations of the President's Working Group on Financial Markets regarding the informational needs and due diligence responsibilities of investors. See Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets, Mar. 13, 2008, available at: [http://www.ustreas.gov/press/releases/reports/pwgpolicystatemktturmoil\\_03122008.pdf](http://www.ustreas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf).

between the FSA and the Commission; (iv) notify the Commission about material disciplinary actions taken against any of its members using its Cleared CDS clearance and settlement services, and about the involuntary termination of the membership of an entity that is using ICE Clear Europe's Cleared CDS clearance and settlement services; (v) notify the Commission not less than one day prior to implementation or effectiveness of changes to rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services, or, in exigent circumstances, as promptly as reasonably practicable under the circumstances; (vi) provide the Commission with reports prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements<sup>22</sup> and its annual audited financial statements prepared by independent audit personnel; and (vii) provide notice to the Commission regarding the suspension of services or inability to operate facilities in connection with Cleared CDS clearance and settlement services at the same time it provides notice to the FSA.

In addition, this relief is conditioned on ICE Clear Europe, directly or indirectly, making available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) all end-of-day settlement prices and any other prices with respect to Cleared CDS that ICE Clear Europe may establish to calculate mark-to-market margin requirements for ICE Clear Europe Clearing Members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by ICE Clear Europe. The Commission believes this is an appropriate condition for ICE Clear Europe's exemption from registration as a clearing agency. In Section 11A of the Exchange Act, Congress found that "[i]t is in the public interest

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<sup>22</sup> See Automated Systems of Self-Regulatory Organizations, Securities Exchange Act Release No. 27445 (Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989), and Automated Systems of Self-Regulatory Organizations, Securities Exchange Act Release No. 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991).

and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities."<sup>23</sup> The President's Working Group on Financial Markets has stated that increased transparency is a policy objective for the over-the-counter derivatives market,<sup>24</sup> which includes the market for CDS. The condition is designed to further this policy objective of both Congress and the President's Working Group by requiring ICE Clear Europe to make useful pricing data available to the public on terms that are fair and reasonable and not unreasonably discriminatory. Congress adopted these standards for the distribution of data in Section 11A. The Commission long has applied the standards in the specific context of securities market data.<sup>25</sup> and it anticipates that ICE Clear Europe will distribute its data on terms that generally are consistent with the application of these standards to securities market data. For example, data distributors generally are required to treat subscribers equally and not grant special access, fees, or other privileges to favored customers of the distributor. Similarly, distributors must make their data feeds reasonably available to data vendors for those subscribers who wish to receive their data indirectly through a vendor rather than directly from the distributor. In addition, a distributor's attempt to tie data products that must be made available to the public with other products or services of the distributor would be inconsistent with the statutory

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<sup>23</sup> 15 U.S.C. 78k-1(a)(1)(C)(iii). See also 15 U.S.C. 78k-1(a)(1)(D).

<sup>24</sup> See President's Working Group on Financial Markets, Policy Objectives for the OTC Derivatives Market (Nov. 14, 2008), available at <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."). See also Department of the Treasury, Financial Regulatory Reform: A New Foundation, available at [http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf), at p.48 ("[m]arket efficiency and price transparency should be improved in derivatives markets . . . by requiring development of a system for timely reporting of trades and prompt dissemination of prices and other trade information.").

<sup>25</sup> See Securities Exchange Act Release No. 42209 (Dec. 9, 1999), 64 FR 70613, 70621-70623 (Dec. 17, 1999) ("Market Information Concept Release") (discussion of legal standards applicable to market data distribution since Section 11A was adopted in 1975).

requirements.<sup>26</sup> The Commission carefully evaluates any type of discrimination with respect to subscribers and vendors to assess whether there is a reasonable basis for the discrimination given, among other things, the Exchange Act objective of promoting price transparency.<sup>27</sup> Moreover, preventing unreasonable discrimination is a practical means to promote fair and reasonable terms for data distribution because distributors are more likely to act appropriately when the terms applicable to the broader public also must apply to any favored classes of customers.<sup>28</sup>

As a CCP, ICE Clear Europe will collect and process information about CDS transactions, prices, and positions from all of its participants. With this information, a CCP will, among other things, calculate and disseminate current values for open positions for the purpose of setting appropriate margin levels. The availability of such information can improve fairness, efficiency, and competitiveness of the market – all of which enhance investor protection and facilitate capital formation. Moreover, with pricing and valuation information relating to Cleared CDS, market participants would be able to derive information about underlying securities and indexes. This may improve the efficiency and effectiveness of the securities markets by allowing investors to better understand credit conditions generally.

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<sup>26</sup> See Securities Exchange Act Release No. 59039 (Dec. 2, 2008), 73 FR 74770, 74793 (Dec. 9, 2008) (“NYSE ArcaBook Order”) (“[S]ection 6 and Exchange Act Rule 603(a) require NYSE Arca to distribute the ArcaBook data on terms that are not tied to other products in a way that is unfairly discriminatory or anticompetitive.”).

<sup>27</sup> See Market Information Concept Release, 64 FR at 70630 (“The most important objectives for the Commission to consider in evaluating fees are to assure (1) the wide availability of market information, (2) the neutrality of fees among markets, vendors, broker-dealers, and users, (3) the quality of market information – its integrity, reliability, and accuracy, and (4) fair competition and equal regulation among markets and broker-dealers.”).

<sup>28</sup> See NYSE ArcaBook Order, 73 FR at 74794 (“[T]he proposed fees for ArcaBook data will apply equally to all professional subscribers and all non-professional subscribers . . . The fees therefore do not unreasonably discriminate among types of subscribers, such as by favoring participants in the NYSE Arca market or penalizing participants in other markets.”).

2. Exemption from Sections 5 and 6 of the Exchange Act

ICE Clear Europe represents that, in connection with its clearing and risk management process, it will calculate an end-of-day settlement price for each Cleared CDS in which an ICE Clear Europe Clearing Member has a cleared position, based on prices submitted by ICE Clear Europe Clearing Members. As part of this mark-to-market process, ICE Clear Europe will periodically require ICE Clear Europe Clearing Members to execute certain CDS trades at the applicable end-of-day settlement price. Requiring ICE Clear Europe Clearing Members to trade CDS periodically in this manner is designed to help ensure that such submitted prices reflect each ICE Clear Europe Clearing Member's best assessment of the value of each of its open positions in Cleared CDS on a daily basis, thereby reducing risk by allowing ICE Clear Europe to impose appropriate margin requirements.

Section 5 of the Exchange Act states that "[i]t shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange . . . to effect any transaction in a security, or to report any such transactions, unless such exchange (1) is registered as a national securities exchange under section 6 of [the Exchange Act], or (2) is exempted from such registration . . . by reason of the limited volume of transactions effected on such exchange. . . ."<sup>29</sup> Section 6 of the Exchange Act sets forth a procedure whereby an exchange<sup>30</sup> may register as a national securities exchange.<sup>31</sup> To facilitate the establishment of ICE Clear

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<sup>29</sup> 15 U.S.C. 78e.

<sup>30</sup> Section 3(a)(1) of the Exchange Act, 15 U.S.C. 78c(a)(1), defines "exchange." Rule 3b-16 under the Exchange Act, 17 CFR 240.3b-16, defines certain terms used in the statutory definition of exchange. See Securities Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844 (Dec. 22, 1998) (adopting Rule 3b-16 in addition to Regulation ATS).

<sup>31</sup> 15 U.S.C. 78f. Section 6 of the Exchange Act also sets forth various requirements to which a national securities exchange is subject.

Europe's end-of-day settlement price process, including the periodically required trading described above, the Commission is exercising its authority under Section 36 of the Exchange Act to temporarily exempt ICE Clear Europe and ICE Clear Europe Clearing Members from Sections 5 and 6 of the Exchange Act and the rules and regulations thereunder in connection with ICE Clear Europe's calculation of mark-to-market prices for open positions in Cleared CDS.

This temporary exemption is subject to the following conditions:

First, ICE Clear Europe must report the following information with respect to the calculation of mark-to-market prices for Cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports during the life of the enterprise and of any successor enterprise:

- The total dollar volume of transactions executed during the quarter, broken down by reference entity, security, or index; and
- The total unit volume and/or notional amount executed during the quarter, broken down by reference entity, security, or index.

Reporting of this information will assist the Commission in carrying out its responsibility to supervise and regulate the securities markets.

Second, ICE Clear Europe must establish adequate safeguards and procedures to protect members' confidential trading information. Such safeguards and procedures shall include: (i) limiting access to the confidential trading information of members to those employees of ICE Clear Europe who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and (ii) implementing standards controlling employees of ICE Clear Europe trading for their own accounts. ICE Clear Europe must adopt and implement adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed. This condition is designed to prevent any misuse of ICE Clear

Europe Clearing Members' trading information that may be available to ICE Clear Europe in connection with the daily marking-to-market process of open positions in Cleared CDS. This should strengthen confidence in ICE Clear Europe as a CCP for CDS, promoting participation.

Third, ICE Clear Europe must comply with the conditions to the temporary exemption from registration as a clearing agency granted in this Order. As set forth above, this Order is designed to facilitate the prompt establishment of ICE Clear Europe as a CCP for non-excluded CDS. ICE Clear Europe has represented that, to enhance the reliability of end-of-day settlement prices submitted as part of the daily mark-to-market process, it must require periodic trading of Cleared CDS positions by ICE Clear Europe Clearing Members whose submitted end-of-day prices lock or cross. The Commission's temporary exemption from Sections 5 and 6 of the Exchange Act is based on ICE Clear Europe's representation that the end-of-day settlement pricing process, including the periodically required trading, is integral to its risk management. Accordingly, as a condition to ICE Clear Europe's temporary exemption from Sections 5 and 6 of the Exchange Act, ICE Clear Europe must comply with the conditions to the temporary exemption from Section 17A of the Exchange Act in this Order.

The Commission is also temporarily exempting each ICE Clear Europe Clearing Member from the prohibition in Section 5 of the Exchange Act to the extent that such ICE Clear Europe Clearing Member uses any facility of ICE Clear Europe to effect any transaction in Cleared CDS, or to report any such transaction, in connection with ICE Clear Europe's calculation of mark-to-market prices for open positions in Cleared CDS. Absent an exemption, Section 5 would prohibit any ICE Clear Europe Clearing Member that is a broker or dealer from effecting transactions in Cleared CDS on ICE Clear Europe, which will rely on this Order for an exemption from exchange registration. The Commission believes that temporarily exempting ICE Clear Europe Clearing Members from the restriction in Section 5 is necessary and

appropriate in the public interest and is consistent with the protection of investors because it will facilitate their use of ICE Clear Europe's CCP for Cleared CDS, which for the reasons noted in this Order the Commission believes to be beneficial. Without also temporarily exempting ICE Clear Europe Clearing Members from this Section 5 requirement, the Commission's temporary exemption of ICE Clear Europe from Sections 5 and 6 of the Exchange Act would be ineffective, because ICE Clear Europe Clearing Members that are brokers or dealers would not be permitted to effect transactions on ICE Clear Europe in connection with the end-of-day settlement price process.

C. Temporary General Exemption for ICE Clear Europe, ICE Clear Europe Clearing Members, and Certain Eligible Contract Participants

Applying the full panoply of Exchange Act requirements to participants in transactions in non-excluded CDS likely would deter some participants from using CCPs to clear CDS transactions. At the same time, it is important that the antifraud provisions of the Exchange Act apply to transactions in non-excluded CDS; indeed, OTC transactions subject to individual negotiation that qualify as security-based swap agreements already are subject to these antifraud provisions.<sup>32</sup>

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<sup>32</sup> While Section 3A of the Exchange Act excludes "swap agreements" from the definition of "security," certain antifraud and insider trading provisions under the Exchange Act explicitly apply to security-based swap agreements. See (a) paragraphs (2) through (5) of Section 9(a), 15 U.S.C. 78i(a), prohibiting the manipulation of security prices; (b) Section 10(b), 15 U.S.C. 78j(b), and underlying rules prohibiting fraud, manipulation or insider trading (but not prophylactic reporting or recordkeeping requirements); (c) Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices; (d) Sections 16(a) and (b), 15 U.S.C. 78p(a) and (b), which address disclosure by directors, officers and principal stockholders, and short-swing trading by those persons, and rules with respect to reporting requirements under Section 16(a); (e) Section 20(d), 15 U.S.C. 78t(d), providing for antifraud liability in connection with certain derivative transactions; and (f) Section 21A(a)(1), 15 U.S.C. 78u-1(a)(1), related to the Commission's authority to impose civil penalties for insider trading violations.

We thus believe that it is appropriate in the public interest and consistent with the protection of investors temporarily to apply substantially the same framework to transactions by market participants in non-excluded CDS that applies to transactions in security-based swap agreements. Applying substantially the same set of requirements to participants in transactions in non-excluded CDS as apply to participants in OTC CDS transactions will avoid deterring market participants from promptly using CCPs, which would detract from the potential benefits of central clearing.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until **[insert date nine months from date of order]** from certain requirements under the Exchange Act. This temporary exemption applies to ICE Clear Europe, any ICE Clear Europe Clearing Member<sup>33</sup> which is not a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof), and any eligible contract participants<sup>34</sup> other than: eligible contract participants that receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling or holding Cleared CDS

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“Security-based swap agreement” is defined in Section 206B of the Gramm-Leach-Bliley Act as a swap agreement in which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

<sup>33</sup> For purposes of this Order, an “ICE Clear Europe Clearing Member” means any clearing member of ICE Clear Europe that submits Cleared CDS to ICE Clear Europe for clearance and settlement exclusively (i) for its own account or (ii) for the account of an affiliate that controls, is controlled by, or is under common control with the clearing member of ICE Clear Europe. In general, this exemption does not apply to any ICE Clear Europe Clearing Member that is registered with the Commission as a broker-dealer. A separate temporary exemption addresses the Cleared CDS activities of registered broker-dealers. See Part II.D., *infra*.

<sup>34</sup> This exemption in general applies to eligible contract participants, as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order, other than persons that are eligible contract participants under paragraph (C) of that section.

positions for other persons;<sup>35</sup> eligible contract participants that are self-regulatory organizations; or eligible contract participants that are registered brokers or dealers.<sup>36</sup>

Under this temporary exemption, and solely with respect to Cleared CDS, these persons generally are exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements. Those persons thus would still be subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements.<sup>37</sup> In addition, all provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions would remain applicable.<sup>38</sup> In this way, the temporary exemption would apply the same Exchange Act requirements in connection with non-excluded CDS as apply in connection with OTC credit default swaps.

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<sup>35</sup> Solely for purposes of this requirement, an eligible contract participant would not be viewed as receiving or holding funds or securities for purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons, if the other persons involved in the transaction would not be considered "customers" of the eligible contract participant under the analysis used for determining whether certain persons would be considered "customers" of a broker-dealer under Exchange Act Rule 15c3-3(a)(1). For these purposes, and for the purpose of the definition of "Cleared CDS," the terms "purchasing" and "selling" mean the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under, a Cleared CDS, as the context may require. This is consistent with the meaning of the terms "purchase" or "sale" under the Exchange Act in the context of security-based swap agreements. See Exchange Act Section 3A(b)(4).

<sup>36</sup> A separate temporary exemption addresses the Cleared CDS activities of registered broker-dealers. See Part II.D., *infra*. Solely for purposes of this Order, a registered broker-dealer, or a broker or dealer registered under Section 15(b) of the Exchange Act, does not refer to someone that would otherwise be required to register as a broker or dealer solely as a result of activities in Cleared CDS in compliance with this Order.

<sup>37</sup> See note 32, *supra*.

<sup>38</sup> Thus, for example, the Commission retains the ability to investigate potential violations and bring enforcement actions in the federal courts and administrative proceedings, and to seek the full panoply of remedies available in such cases.

This temporary exemption, however, does not extend to Sections 5 and 6 of the Exchange Act.<sup>39</sup> The Commission separately issued a conditional exemption from these provisions to all broker-dealers and exchanges.<sup>40</sup> This temporary exemption also does not extend to Section 17A of the Exchange Act; instead, ICE Clear Europe is exempt from registration as a clearing agency under the conditions discussed above. In addition, this temporary exemption does not apply to Exchange Act Sections 12, 13, 14, 15(d), and 16;<sup>41</sup> eligible contract participants and other persons instead should refer to the interim final temporary rules issued by the Commission. Finally, this temporary exemption does not extend to the Commission's administrative proceeding authority under Sections 15(b)(4) and (b)(6),<sup>42</sup> or to certain provisions related to government securities.<sup>43</sup>

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<sup>39</sup> This Order includes a separate temporary exemption regarding the mark-to-market process of ICE Clear Europe, discussed above.

<sup>40</sup> See note 9, *supra*. A national securities exchange that effects transactions in Cleared CDS would continue to be required to comply with all requirements under the Exchange Act applicable to such transactions. A national securities exchange could form subsidiaries or affiliates that operate exchanges exempt under that order. Any subsidiary or affiliate of a registered exchange could not integrate, or otherwise link, the exempt CDS exchange with the registered exchange including the premises or property of such exchange for effecting or reporting a transaction without being considered a "facility of the exchange." See Section 3(a)(2), 15 U.S.C. 78c(a)(2).

<sup>41</sup> 15 U.S.C. 78l, 78m, 78n, 78o(d), 78p.

<sup>42</sup> Exchange Act Sections 15(b)(4) and 15(b)(6), 15 U.S.C. 78o(b)(4) and (b)(6), grant the Commission authority to take action against broker-dealers and associated persons in certain situations. Accordingly, while this exemption generally extends to persons that act as inter-dealer brokers in the market for Cleared CDS and do not hold funds or securities for others, such inter-dealer brokers may be subject to actions under Sections 15(b)(4) and (b)(6) of the Exchange Act.

In addition, such inter-dealer brokers may be subject to actions under Exchange Act Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices. As noted above, Section 15(c)(1) explicitly applies to security-based swap agreements. Sections 15(b)(4), 15(b)(6) and 15(c)(1), of course, would not apply to persons subject to this exemption who do not act as broker-dealers or associated persons of broker-dealers.

<sup>43</sup> This exemption specifically does not extend to the Exchange Act provisions applicable to government securities, as set forth in Section 15C, 15 U.S.C. 78o-5, and its underlying rules and regulations; nor does the exemption extend to related definitions found at paragraphs (42) through (45) of Section 3(a), 15 U.S.C. 78c(a). The Commission does not have authority under Section 36 to issue exemptions in connection with those provisions. See Exchange Act Section 36(b), 15 U.S.C. 78mm(b).

D. Temporary General Exemption for Certain Registered Broker-Dealers

The temporary exemptions addressed above – with regard to ICE Clear Europe, certain ICE Clear Europe Clearing Members, and certain eligible contract participants – are not available to persons that are registered as broker-dealers with the Commission (other than those that are notice registered pursuant to Section 15(b)(11)).<sup>44</sup> The Exchange Act and its underlying rules and regulations require broker-dealers to comply with a number of obligations that are important to protecting investors and promoting market integrity. We are mindful of the need to avoid creating disincentives to the prompt use of CCPs, and we recognize that the factors discussed above suggest that the full panoply of Exchange Act requirements should not immediately be applied to registered broker-dealers that engage in transactions involving Cleared CDS. At the same time, we also are sensitive to the critical importance of certain broker-dealer requirements to promoting market integrity and protecting customers (including those broker-dealer customers that are not involved with CDS transactions).

This calls for balancing the facilitation of the development and prompt implementation of CCPs with the preservation of certain key investor protections. Pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant an exemption until **[insert date nine months from date of order]** from certain Exchange Act requirements. Consistent with the temporary exemptions discussed above, and solely with respect to Cleared CDS, we are temporarily exempting registered broker-dealers in general from the provisions of the Exchange Act and its underlying rules and regulations that do not apply to security-based swap agreements. As above, we are not excluding registered broker-dealers from Exchange Act

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<sup>44</sup> Exchange Act Section 15(b)(11) provides for notice registration of certain persons that effect transactions in security futures products. 15 U.S.C. 78o(b)(11).

provisions that explicitly apply in connection with security-based swap agreements or from related enforcement authority provisions.<sup>45</sup> As above, and for similar reasons, we are not exempting registered broker-dealers from: Sections 5, 6, 12(a) and (g), 13, 14, 15(b)(4), 15(b)(6), 15(d), 16 and 17A of the Exchange Act.<sup>46</sup>

Further we are not exempting registered broker-dealers from the following additional provisions under the Exchange Act: (i) Section 7(c),<sup>47</sup> which addresses the unlawful extension of credit by broker-dealers; (ii) Section 15(c)(3),<sup>48</sup> which addresses the use of unlawful or manipulative devices by broker-dealers; (iii) Section 17(a),<sup>49</sup> regarding broker-dealer obligations to make, keep and furnish information; (iv) Section 17(b),<sup>50</sup> regarding broker-dealer records subject to examination; (v) Regulation T,<sup>51</sup> a Federal Reserve Board regulation regarding extension of credit by broker-dealers; (vi) Exchange Act Rule 15c3-1, regarding broker-dealer net capital; (vii) Exchange Act Rule 15c3-3, regarding broker-dealer reserves and custody of securities; (viii) Exchange Act Rules 17a-3 through 17a-5, regarding records to be made and preserved by broker-dealers and reports to be made by broker-dealers; and (ix) Exchange Act

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<sup>45</sup> See notes 32 and 38, *supra*. As noted above, broker-dealers also would be subject to Section 15(c)(1) of the Exchange Act, which prohibits brokers and dealers from using manipulative or deceptive devices, because that provision explicitly applies in connection with security-based swap agreements. In addition, to the extent the Exchange Act and any rule or regulation thereunder imposes any other requirement on a broker-dealer with respect to security-based swap agreements (e.g., requirements under Rule 17h-1T to maintain and preserve written policies, procedures, or systems concerning the broker or dealer's trading positions and risks, such as policies relating to restrictions or limitations on trading financial instruments or products), these requirements would continue to apply to broker-dealers' activities with respect to Cleared CDS.

<sup>46</sup> We also are not exempting those members from provisions related to government securities, as discussed above.

<sup>47</sup> 15 U.S.C. 78g(c).

<sup>48</sup> 15 U.S.C. 78o(c)(3).

<sup>49</sup> 15 U.S.C. 78q(a).

<sup>50</sup> 15 U.S.C. 78q(b).

<sup>51</sup> 12 CFR 220.1 *et seq.*

Rule 17a-13, regarding quarterly security counts to be made by certain exchange members and broker-dealers.<sup>52</sup> Registered broker-dealers should comply with these provisions in connection with their activities involving non-excluded CDS because these provisions are especially important to helping protect customer funds and securities, ensure proper credit practices and safeguard against fraud and abuse.<sup>53</sup>

E. Solicitation of Comments

The Commission is continuing to monitor closely the development of the CDS market and intends to determine to what extent, if any, additional regulatory action may be necessary. For example, as circumstances warrant, certain conditions could be added, altered, or eliminated. Moreover, because these exemptions are temporary, the Commission will in the future consider whether they should be extended or allowed to expire. The Commission believes it would be prudent to solicit public comment on its action today, and on what action it should take with respect to the CDS market in the future. The Commission is soliciting public comment on all aspects of these temporary exemptions, including:

1. Whether the length of this temporary exemption (until **[insert date nine months from date of order]**) is appropriate. If not, what should the appropriate duration be?
2. Whether the conditions to these temporary exemptions are appropriate. Why or why not? Should other conditions apply? Are any of the present conditions to the

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<sup>52</sup> Solely for purposes of this exemption, in addition to the general requirements under the referenced Exchange Act sections, registered broker-dealers shall only be subject to the enumerated rules under the referenced Exchange Act sections.

<sup>53</sup> Indeed, Congress directed the Commission to promulgate broker-dealer financial responsibility rules, including rules regarding custody, the use of customer securities and the use of customers' deposits or credit balances, and regarding establishment of minimum financial requirements.

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 2908 / July 24, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13563

In the Matter of

BRADLEY L. RUDERMAN

Respondent.

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

I.

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

II.

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

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### III.

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

1. Between 2003 and 2009, Ruderman was associated with Ruderman Capital Management ("RCM"), an unregistered investment adviser. Ruderman, 46 years old, is a resident of Beverly Hills, California.

2. On May 7, 2009, a judgment was entered by consent against Ruderman, 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 and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Ruderman, et al., Civil Action No. CV 09-02974 VBF (JCx) (C.D. Cal. May 7, 2009), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that Ruderman raised at least \$38 million from investors through his two hedge funds. Ruderman defrauded his hedge fund investors by misrepresenting to them the hedge funds' investment returns and the assets under management. Ruderman falsely told investors that hedge funds that he controlled had earned positive returns between 15% and 60% per year and had over \$800 million in assets. In reality, the hedge funds lost money and had less than \$650,000 in assets. The complaint further alleges that in 2009, Ruderman made at least one Ponzi-like payment, using new investor money to pay returns to an earlier investor, and that Ruderman falsely told prospective investors that Lowell Milken (chairman of the Milken Family Foundation) and Larry Ellison (the CEO of Oracle Corporation) were investors in his hedge funds.

### IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Ruderman be, and hereby is barred from association with any investment adviser.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940  
Release No. 28837 / July 27, 2009

In the Matter of

FEDERATED CORE TRUST III  
FEDERATED INVESTMENT MANAGEMENT COMPANY  
5800 Corporate Drive  
Pittsburgh, PA 15237-7000

(812-13421)

ORDER UNDER SECTION 6(c) OF THE INVESTMENT COMPANY ACT OF 1940  
GRANTING AN EXEMPTION FROM SECTION 22(e) OF THE INVESTMENT COMPANY  
ACT OF 1940 AND RULE 22c-1 THEREUNDER

Federated Core Trust III and Federated Investment Management Company filed an application on August 31, 2007, and amendments to the application on November 15, 2007, July 21, 2008, September 8, 2008, November 21, 2008, and June 29, 2009 requesting an order under section 6(c) of the Investment Company Act of 1940 ("Act") for an exemption from section 22(e) of the Act and rule 22c-1 under the Act.

The order permits the series of a registered open-end management investment company whose outstanding securities are owned exclusively by persons who are qualified purchasers, as defined in section 2(a)(51) of the Act, to operate as an extended payment fund.

On June 30, 2009, a notice of the filing of the application was issued (Investment Company Act Release No. 28806). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that granting the requested exemption is appropriate in the public interest, and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

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Accordingly, in the matter of Federated Core Trust III, *et al.* (File No. 812-13421),

IT IS ORDERED, under section 6(c) of the Act, that the requested exemption from section 22(e) of the Act and rule 22c-1 under the Act is granted, effective immediately, subject to the conditions contained in the application, as amended.

By the Commission.

Elizabeth Murphy  
Secretary



By: Florence E. Harmon  
Deputy Secretary

*Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 9056 / July 27, 2009

Administrative Proceeding  
File No. 3-13561

In the Matter of

Perry Corp.

Respondent.

**ORDER UNDER RULE 602(e) OF THE  
SECURITIES ACT OF 1933 GRANTING A  
WAIVER OF THE RULE 602(c)(3)  
DISQUALIFICATION PROVISION**

I.

Perry Corp. ("Respondent" or "Perry") has submitted a letter, dated June 17, 2009, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from Respondent's settlement of an administrative proceeding commenced by the Commission.

II.

On July 21, 2009, pursuant to Respondent's Offer of Settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order against Respondent. Under the Order, the Commission found that Respondent willfully violated Section 13(d) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 13d-1 thereunder by failing to file a required disclosure statement within ten days of acquiring beneficial ownership of more than five percent of the shares of Mylan Laboratories Inc. (now Mylan Inc.). In the Order, the Commission ordered Respondent to cease and desist from committing or causing any violations and any future violations of Section 13(d) of the Exchange Act and Rule 13d-1 thereunder, censured Respondent, and ordered Respondent, within thirty days of the entry of the Order, to pay a civil money penalty in the amount of \$150,000 to the United States Treasury.

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### III.

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(e) of the Investment Advisers Act of 1940. 17 C.F.R. § 230.602(c)(3). Rule 602(e) under 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).

### IV.

Based upon the representations set forth in Respondent'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

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

*Chairman Schapiro  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 9057 / July 27, 2009

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60389 / July 27, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13470

In the Matter of

CHANDRASHEKHAR  
GOPINATHAN,

Respondent.

ORDER MAKING FINDINGS, IMPOSING  
REMEDIAL SANCTIONS PURSUANT TO  
SECTION 8A OF THE SECURITIES ACT  
OF 1933 AND SECTIONS 15(b) AND 21C  
OF THE SECURITIES EXCHANGE ACT  
OF 1934, AND IMPOSING A CEASE-AND-  
DESIST ORDER

I.

On May 13, 2009, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against respondent Chandrashekhar Gopinathan ("Respondent" or "Gopinathan").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, 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, Imposing Remedial Sanctions Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

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### III.

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

#### Summary

This proceeding arises out of materially misleading statements and omissions in offering documents in connection with a private securities offering backed by a portfolio of regional aircraft manufactured by Bombardier, Inc. ("Bombardier"). RASPRO Trust 2005 ("RASPRO"), a special purpose entity created by Bombardier, sponsored the \$1.67 billion offering and Wachovia Capital Markets, LLC. ("Wachovia") served as the underwriter. On September 23, 2005 the offering closed. Within the first three months after closing, Bombardier discovered that RASPRO would have to draw on a liquidity reserve to make the first payment on one of the three tranches of securities involved in the offering, the B Notes, and that a guarantor would have to step in and purchase the B Notes in the fifth year of the 18-year transaction.

Respondent Gopinathan, a vice-president, and a junior associate served on the Commercial Aviation Team of Wachovia's Structured Asset Finance Group, and were responsible for preparing the cash flow models for the transaction. One of the purposes of the models was to show that the transaction would have sufficient liquidity to pay interest and principal when due. Gopinathan, the junior associate, and a managing director – the three members of the Commercial Aviation Team – were aware of the potential shortfalls as early as July 2005, but did not tell anyone else at Wachovia. Instead, Gopinathan and the junior associate, on the managing director's orders, manipulated certain payment assumptions in order to hide the shortfalls. As a result, the offering memorandum provided materially false and incomplete information about the liquidity of the B Note transaction.

#### Respondent

Respondent Gopinathan, age 33, currently resides in London, England. During the relevant time period, Gopinathan was a Vice-President at Wachovia on the Commercial Aviation Team in the Structured Asset Finance Group. Gopinathan assisted in the preparation of the cash flow models and payment assumptions for the RASPRO offering. While at Wachovia, Gopinathan had passed neither the Series 7 nor the Series 63 exams and was not a registered representative. Gopinathan was placed on administrative leave by Wachovia on December 22, 2005, and resigned from Wachovia on March 7, 2006. Gopinathan is currently employed by a securities firm in London, England, but is not a registered representative.

#### Other Relevant Entities

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

RASPRO is a Delaware special purpose trust organized on September 14, 2005 by Bombardier for the purpose of purchasing, leasing and owning a portfolio of 70 aircraft manufactured by Bombardier. RASPRO is located in Wilmington, Delaware and is governed by six trustees. On September 23, 2005, RASPRO issued a \$1.67 billion exempted asset-backed bond offering to "Qualified Institutional Investors" pursuant to Rule 144A and Regulation D of the Securities Act, the proceeds of which were used to purchase 70 regional aircraft from Bombardier. The offering involved three tranches of securities: (1) \$905 million in senior G Notes; (2) \$275 million in leverage lease equity; and (3) \$485 million in junior B Notes.

Wachovia, during the relevant time period, was an indirect wholly-owned subsidiary of Wachovia Corporation. On January 1, 2009, Wachovia Corporation became part of Wells Fargo & Co. Wachovia is a registered broker-dealer incorporated in Delaware and an affiliate of Wachovia Bank NA. Wachovia's principal place of business is in Charlotte, NC. Wachovia was the lead underwriter and sole lead manager of the RASPRO offering.

Bombardier is a Canadian manufacturer of aircraft and rail transportation equipment and a foreign private issuer under Section 12(g) of the Exchange Act. Its primary offices are located in Montreal, Québec, Canada, but it has U.S. offices in Vermont and Kansas.

### Background

#### The RASPRO Offering

Bombardier created RASPRO, a special purpose entity, to finance the manufacture and sale of 70 regional aircraft. Bombardier sold the 70 aircraft to RASPRO, which leased the 70 aircraft to four airline companies. To finance the purchase of the 70 aircraft from Bombardier, RASPRO issued \$1.67 billion in securities and leveraged lease equity in a private offering.

*The Asset Side of the Transaction:* Once Bombardier transferred the 70 new passenger airplanes to RASPRO, those aircraft were RASPRO's assets.<sup>2</sup> RASPRO leased the 70 aircraft to four different airline companies in return for regular lease payments. In addition to these regular lease payments, airline companies also made a one-time additional payment, payable at the same time the first regular payment was due. When RASPRO received the airline companies' payments, it placed them into a collections account. The incoming payments remained in this account for 15 days, except that the one-time additional payment stayed in the collections account longer – for a total of 105 days. While held in the collections account, the lease-payment funds earned interest.

*The Liability Side of the Transaction:* After the incoming lease payments accrued interest in the collections account, RASPRO then used these funds to pay various fees. After paying these fees, RASPRO used the incoming funds to satisfy its other liabilities, in descending order of priority, including interest payments due to the classes of note holders. The transaction included a \$41.4 million liquidity reserve that could be used in the event RASPRO did not have sufficient cash at any given time to pay the noteholders.

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<sup>2</sup> RASPRO kept ownership of some of the planes and sold-and-leased-back others.

The \$1.67 billion private placement involved three tranches. The first, and most senior, tranche consisted of \$905 million in G Notes, which were purchased by 19 investment banks and other sophisticated institutional investors. The second tranche consisted of \$275 million leveraged lease equity and was purchased by Wachovia Bank, N.A. The third, and most junior, tranche was \$485 million in B Notes. A New York commercial and investment bank purchased the B Notes. The B Notes were guaranteed by Investissement Quebec (IQ), and Financial Security Assurance Inc. (FSA).<sup>3</sup> If the incoming cash flows and liquidity reserve were insufficient to fund interest payments for the B Note holders, then IQ would make timely interest payments of up to \$48.5 million. If the \$48.5 million in interest payments were exhausted, IQ would be required to purchase the B Notes in their entirety.<sup>4</sup>

The G Notes and B Notes paid investors a monthly coupon rate (that is, the interest rate on the note) of LIBOR plus a fixed percentage.<sup>5</sup> In order to protect against fluctuations in LIBOR rates and give RASPRO and the note holders certainty about the monthly interest payment amounts, RASPRO entered into two separate interest rate swap agreements with Wachovia – one for the G Notes and one for the B Notes. In each case, RASPRO swapped the floating LIBOR interest rate income stream for a fixed rate income stream on the G Notes for the life of the transaction and on the B Notes for the first six years of the transaction. As a result of the swap agreements, RASPRO agreed to make fixed monthly payments to the G Note holders for the life of the transaction and the B Note holder for the first six years.

#### Knowledge of the Early Draw

Wachovia was the sole structuring, underwriting and placement agent for the RASPRO offering. The managing director, Gopinathan, and the junior associate, the three members of the Commercial Aviation Team, were responsible for preparing the cash flow models used in structuring the transaction. Although the models themselves were not part of the offering memorandum, the outputs (or results) from the models and the payment assumptions used in the models were included in the offering memorandum (in a section titled "Payment Assumptions"). The Commercial Aviation Team was responsible for preparing that section of the offering memorandum.

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<sup>3</sup> The B Notes were rated A1 as to timely payment of interest and principal and shadow rated B- or B3 as to timely payment of interest and principal.

<sup>4</sup> IQ had a counter-guarantee from Bombardier. If IQ were required to purchase the B Notes, it could seek reimbursement from Bombardier for 10% of the total outstanding guarantees between IQ and Bombardier, which would cover most or the entire amount owed on the B Notes. If IQ sought reimbursement under the counter-guarantee, Bombardier would likely be required to consolidate RASPRO onto its balance sheet, which would significantly increase Bombardier's debt and make it difficult for Bombardier to finance the cost of manufacturing aircraft. Bombardier hired a consultant to perform an analysis under Financial Accounting Standards Board Interpretation No. 46 ("FIN 46") to determine whether it needed to consolidate RASPRO on its balance sheet.

<sup>5</sup> "LIBOR," or the London InterBank Offered Rate, is the average interest rate charged when banks in the London interbank network lend to each other. LIBOR rates are used internationally as a benchmark for pricing, among other things, debt instruments and securities.

The Commercial Aviation Team modeled "base case" and "stress scenarios" for the offering memorandum. The "base case" cash flow model assumed that all of the airlines made their lease payments throughout the life of the transaction with no defaults. The "stress scenarios" assumed that certain airlines defaulted on their lease payments at certain times or that there were percentage reductions in the gross lease revenues received in the transaction.

The managing director, Gopinathan and the junior associate knew as early as July 2005 that there would be an early draw on the B Note guarantee in the transaction even in the base case. In July 2005, the junior associate informed the managing director that the transaction models were showing an early draw on the B Note guarantee. The managing director instructed the junior associate that the models could not show such a draw in the base case and told him to consult with Gopinathan. The managing director and the junior associate spoke separately to Gopinathan. Gopinathan suggested making changes to the payment assumptions in the offering memorandum on the liability side of the transaction because it was too complicated to make changes on the asset side of the transaction and there was time pressure on the transaction. During the relevant period, Gopinathan assisted the junior associate with making changes to the liability side of the transaction.

#### Changes to the Payment Assumptions and Transaction Model

The payment assumptions in the offering memorandum, which were used to model the transaction, did not reflect the interest rate swap agreements that modified the coupon payments to the G and B Note holders. Instead the assumptions and models assumed a fixed three-month LIBOR rate of 3.66% as the coupon rate for both notes over the life of the transaction. The effect of not modeling the swap agreements and instead using a constant 3.66% LIBOR rate was to understate the liability on the B Notes and overstate expected cash flows. The failure to model the swap agreements had the greatest impact on overstating expected cash flows. It accounted for almost 80% of the aggregate amount of the cash flow overstatement from all four changes, and overstated cash flows by over \$3.5 million during the first quarter of the transaction.

Cash flows came into the transaction in the form of airline lease payments that were deposited into a collections account. Before payments were made from the collections account to the bondholders, the proceeds in the collections account earned interest for the short reinvestment period during which the cash was in the account. The model used a 5% reinvestment rate for this period when the industry standard, and the standard used in the rating agencies' models, for short-term investments at the time, was closer to 3%. The inflated 5% reinvestment rate had the second greatest impact in overstating expected cash flows, overstating cash flows in the first quarter by \$742,000. This accounted for approximately 15.5% of the aggregate overstated cash flows in the first quarter.

The transaction was structured such that the regular incoming airline lease payments accrued interest in the collections account for a 15-day reinvestment period, except for a one-time additional up-front payment that accrued interest in the collections account for 105 days. The payment assumptions in the offering memorandum stated that a 15-day reinvestment period was modeled. However, the model reflected a 105-day reinvestment period for all incoming

lease payments instead of a 15-day reinvestment period. The 105-day reinvestment period had the third greatest impact on overstating expected cash flows. Because the first reinvestment period in the transaction was modeled correctly, the false assumption did not impact cash flows until the second quarter. Nevertheless, this false assumption overstated expected cash flows in the second quarter by \$606,000, which was approximately 13% of the total first period cash flow overstatement and approximately 12% of the aggregate cash flow overstatement for the second quarter.<sup>6</sup> Taken together, these first three alterations overstated expected cash flows by \$78 million during the first four years of the transaction (when the B Note guarantor would have been required to purchase the B Notes).

The cash flow models also reflected incorrectly the assumption that no Class B Note acceleration event would occur. Therefore, once the \$48.5 million in IQ interest payments were exhausted, the model did not show IQ stepping in to replace the original B Note investor by purchasing the B Notes in their entirety, as the transaction was structured. Instead, the model assumed a continuation of the interest shortfalls. This assumption was added at the end of August, well after the team learned that there would be a draw on the B Note guarantee.

#### The Early Draw Is Discovered by Bombardier after Closing

On September 23, 2005, the transaction closed and RASPRO issued the bond offering. Nineteen institutional investors purchased the G Notes. Wachovia Bank NA purchased the equity interest with the purpose of selling it to the public. A New York commercial and investment bank purchased the entire B Note tranche.

A few weeks after closing, Bombardier's consulting firm noticed a possible early draw on the IQ interest payments and principal. After further analysis, Bombardier learned that the transaction as structured would result in a draw on IQ's interest payments in month 13 and a draw on the IQ principal in month 63, requiring IQ to purchase the B Notes in their entirety approximately five years after the transaction closed.

In the Fall of 2005, Bombardier complained to Wachovia about the early draws that it had discovered. By January 2006, Wachovia had retained outside counsel to conduct an internal investigation. In June 2006, Wachovia agreed to restructure the transaction using corrected payment assumptions and cash flow models. As a result of the restructuring, Wachovia paid an \$87 million cash infusion into the transaction to prevent a premature draw on IQ's interest and note payments.<sup>7</sup> Wachovia also paid a \$7 million insurance premium and \$28.6 million in structuring and placement fees, as part of the restructuring.

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<sup>6</sup> The errors in conjunction with each other compound the monetary effect on the cash flows. That is, each of the percentages reflects the effect of the particular false assumption being discussed on the overall cash flows without taking into account the effects of all the false assumptions on each other. So the percentages are correct despite the fact that they exceed 100%.

<sup>7</sup> Bombardier also made a cash infusion of \$23 million in exchange for the rights to share in Wachovia's interest in the leverage lease equity.

### Respondent's Conduct

Following the managing director's instruction that the cash flow models could not show an early draw in the base case, Respondent Gopinathan suggested that changes be made to assumptions on the liability side of the transaction. Respondent assisted the junior associate in making the changes to the model. Respondent was aware that the changes were made to mask the early draw on the B Note guarantee in the base case, and he made no effort to correct the model or disclose the facts regarding the changes or the early draw in the base case to anyone outside of the Commercial Aviation Team of which he was a part. Specifically, Respondent was aware that the payment assumptions and cashflow model outputs in the offering memorandum and the cashflow model

- inaccurately reflected a lower interest rate for the G and B Note coupons;
- inaccurately reflected a higher reinvestment rate;
- inaccurately reflected a 105-day reinvestment; and
- inaccurately reflected that no Class B Note acceleration event would occur.

Regardless of this knowledge Respondent decided to incorporate these changes into the cashflow models and into the cashflow model outputs that were used in the offering memorandum.

### Legal Discussion

Section 17(a) of the Securities Act, which proscribes fraudulent conduct in the offer or sale of securities, and Section 10(b) of the Exchange Act and Rule 10b-5, which proscribe fraudulent conduct in connection with the purchase or sale of securities, prohibit essentially the same type of sales practices. *See United States v. Naftalin*, 441 U.S. 768, 773 n.4 (1979). Among other things, those provisions make it unlawful to make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, in the offer, purchase or sale of securities. Whether a fact is material depends upon the significance a reasonable investor would place on the withheld or misrepresented information in making an investment decision. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988).

By virtue of their unique position in the securities industry, underwriters are subject to liability under the antifraud provisions of the federal securities laws for materially false or misleading statements in an offering. *In the Matter of Donaldson, Lufkin & Jenrette Securities Corp.*, Securities Act Release No. 6959, Exchange Act Release No. 31,207 1992 WL 280784, at \*7 (September 22, 1992). Faulty modeling assumptions can serve as a basis for underwriter liability under the antifraud provisions of the securities laws. *See In the Matter of Michael Lissack*, Exchange Act Release No. 39,687, 1998 WL 67399, at \*2-4 (February 20, 1998) (Managing Director of broker-dealer that acted as a underwriter in a county bond offering intended to deceive

when he intentionally used faulty and inaccurate modeling assumptions to present financing structure in an artificially favorable light.).

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

#### IV.

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

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

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

B. Respondent Gopinathan be, and hereby is barred from association with any broker or dealer, with the right to reapply for association after one (1) year to the appropriate self-regulatory organization, or if there is none, to the Commission;

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

D. Respondent shall pay a civil money penalty of \$15,000, with the first installment of \$10,000 due thirty (30) days after issuance of the Order, and a second installment of \$5,000 due thirty (30) days thereafter, to the United States Treasury. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Such 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 Gopinathan 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 Cheryl J. Scarboro, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-5631.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 200 and 242**

[Release No. 34-60388; File No. S7-30-08]

**RIN 3235-AK22**

**Amendments to Regulation SHO**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission ("Commission") is finalizing amendments to Regulation SHO under the Securities Exchange Act of 1934 ("Exchange Act") by making permanent amendments contained in Interim Final Temporary Rule 204T ("temporary Rule 204T") of Regulation SHO, with some modifications to address commenters' concerns. These amendments are intended to help further our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission. In addition, these amendments are intended to help further our goal of addressing abusive "naked" short selling in all equity securities. These goals will be furthered by requiring that, subject to certain limited exceptions, if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency it must immediately purchase or borrow securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the settlement day following the day the participant incurred the fail to deliver position. Failure to comply with the close-out requirement of this final rule is a violation of the rule. In addition, a participant that does not comply with this close-out requirement, and any broker-dealer from which it receives trades for clearance and settlement, will not be able to short sell the security either for itself or for the account of another,

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unless it has previously arranged to borrow or borrowed the security, until the fail to deliver position is closed out.

**EFFECTIVE DATE:** July 31, 2009.

**FOR FURTHER INFORMATION CONTACT:** Jo Anne Swindler, Acting Associate Director; Josephine Tao, Assistant Director; Victoria Crane, Branch Chief; David Bloom and Christina M. Adams, Special Counsels; Matthew Sparkes or Katrina Wilson, Staff Attorneys, Office of Trading Practices and Processing, Division of Trading and Markets, at (202) 551-5720, at the Commission, 100 F Street, NE, Washington, DC 20549-7010.

**SUPPLEMENTARY INFORMATION:** We are adding Rule 204 of Regulation SHO [17 CFR 242.204] under the Exchange Act and removing Rule 204T of Regulation SHO [17 CFR 242.204T] under the Exchange Act.

## **I. Introduction**

In October 2008, we adopted temporary Rule 204T of Regulation SHO as an interim final temporary rule, with an expiration date of July 31, 2009.<sup>1</sup> As discussed in more detail below, temporary Rule 204T strengthens the close-out requirements of Regulation SHO for failures to deliver securities (known as “fails” or “fails to deliver”)<sup>2</sup> resulting from sales of any equity security. Our adoption of temporary Rule 204T followed a series of other steps aimed at reducing fails to deliver and addressing potentially abusive “naked” short selling.<sup>3</sup>

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<sup>1</sup> See Exchange Act Release No. 58733 (Oct. 14, 2008), 73 FR 61706 (Oct. 17, 2008) (“Rule 204T Adopting Release”).

<sup>2</sup> Fails to deliver occur when a seller fails to deliver securities to the buyer when delivery is due. See *infra* note 16 and accompanying text.

<sup>3</sup> See *infra* Section II (discussing other Commission actions aimed at reducing fails to deliver and addressing potentially abusive “naked” short selling).

In addition, at the time that we adopted temporary Rule 204T, we noted our concerns about the sudden and unexplained declines in the prices of equity securities generally and the deterioration in investor confidence in our financial markets.<sup>4</sup> Such price declines can give rise to questions about the underlying financial condition of an entity, which in turn can create a crisis of confidence even without a fundamental underlying basis.<sup>5</sup> This crisis of confidence can impair the liquidity and ultimate viability of an entity, with potentially broad market consequences.<sup>6</sup> Thus, we also adopted temporary Rule 204T to further our goal of preventing substantial disruption in the securities markets by providing a powerful disincentive to those who might otherwise engage in potentially abusive “naked” short selling.<sup>7</sup>

Preliminary results from the Commission’s Office of Economic Analysis (“OEA”) indicate that our various actions to further reduce fails to deliver and, thereby, address potentially abusive “naked” short selling are having their intended effect. For example, these preliminary results indicate a significant downward trend in the number of fails to deliver in all equity securities since, among other actions, the adoption of temporary Rule 204T.<sup>8</sup> These results provide, among other things, that in comparing a pre- to post-temporary Rule 204T adoption period,<sup>9</sup> the average daily number of fails to deliver for all equity securities has declined from 1.1

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<sup>4</sup> See Rule 204T Adopting Release, 73 FR at 61707.

<sup>5</sup> See *id.*

<sup>6</sup> See *id.*

<sup>7</sup> See *id.*

<sup>8</sup> See Memorandum from OEA Re: Impact of Recent SHO Rule Changes on Fails to Deliver, November 26, 2008 at <http://www.sec.gov/comments/s7-30-08/s73008-37.pdf>; see also Memorandum from OEA Re: Impact of Recent SHO Rule Changes on Fails to Deliver, March 20, 2009 at <http://www.sec.gov/comments/s7-30-08/s73008-107.pdf>; Memorandum from OEA Re: Impact of Recent SHO Rule Changes on Fails to Deliver, April 16, 2009 (“OEA April 2009 Memorandum”) at <http://www.sec.gov/comments/s7-30-08/s73008-121.pdf>.

<sup>9</sup> The OEA April 2009 Memorandum defined the pre-Rule period as the period from January 1, 2008 to September 22, 2008, and the post-Rule period as September 23, 2008 to March 31, 2009. The post-Rule period

billion to 478 million for a total decline of 56.6 percent. In addition, the average daily number of threshold securities declined from 480 securities to 108 securities in comparing the pre- to post-temporary Rule 204T adoption period, a decline of 77.5%.<sup>10</sup>

Due to the positive impact that temporary Rule 204T,<sup>11</sup> as well as other recent Commission actions, are having on reducing fails to deliver and after considering the comments received to temporary Rule 204T, we are adopting the provisions of that rule in a permanent rule, Rule 204 of Regulation SHO, with some limited modifications to refine provisions and address commenters' concerns.<sup>12</sup> In general, as discussed in more detail below, we are maintaining the structure of temporary Rule 204T, while making some adjustments to promote its workability.<sup>13</sup>

We believe that Rule 204 of Regulation SHO will continue to help further our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission. In addition, these amendments are intended to help further our goal of addressing potentially abusive "naked" short selling. These goals will be furthered by, among other things, requiring

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was also post elimination of the options market maker exception to Regulation SHO's close-out requirement in Rule 203(b)(3) of Regulation SHO. See OEA April 2009 Memorandum; see also infra notes 38-41 and accompanying text.

<sup>10</sup> See OEA April 2009 Memorandum.

<sup>11</sup> We note in this regard that at a public Roundtable to Examine Short Sale Price Test and Circuit Breaker Restrictions held on May 5, 2009 (the "Short Sale Price Test Roundtable"), a number of participants of the Roundtable commented on the success of temporary Rule 204T at reducing fails to deliver and urged the Commission to adopt temporary Rule 204T as a permanent rule. See, e.g., <http://www.sec.gov/spotlight/shortsales/roundtable050509/shortsalesroundtable050509-transcript.txt>

<sup>12</sup> We received approximately 120 comment letters in response to the Rule 204T Adopting Release. The comment letters are available on the Commission's Internet Web site at <http://www.sec.gov/comments/s7-30-08/s73008.shtml>. Further, as noted above, a number of participants at the Commission's Short Sale Price Test Roundtable expressed views about temporary Rule 204T. See, e.g., <http://www.sec.gov/spotlight/shortsales/roundtable050509/shortsalesroundtable050509-transcript.txt>. See also comments to the Short Sale Price Test Roundtable at <http://www.sec.gov/comments/4-581/4-581.shtml>.

<sup>13</sup> See infra Section III (discussing Rule 204 of Regulation SHO and commenters' concerns).

that securities are purchased or borrowed to close out any fail to deliver position resulting from a short sale of an equity security by no later than the beginning of regular trading hours on the settlement day following the date on which the fail to deliver position occurred. Similar to temporary Rule 204T of Regulation SHO, Rule 204 will continue to provide a disincentive to those who might otherwise engage in potentially abusive “naked” short selling.

## II. Background

Short selling involves a sale of a security that the seller does not own or a sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller.<sup>14</sup> Short sales normally are settled by the delivery of a security borrowed by or on behalf of the seller. In a “naked” short sale, however, the short seller does not borrow securities in time to make delivery to the buyer within the standard three-day settlement period.<sup>15</sup> As a result, the seller fails to deliver securities to the buyer when delivery is due.<sup>16</sup> Sellers sometimes intentionally fail to deliver securities as part of a scheme to manipulate the price of a security,<sup>17</sup> or possibly to

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<sup>14</sup> 17 CFR 242.200(a).

<sup>15</sup> See Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48009 n. 10 (Aug. 6, 2004) (“2004 Regulation SHO Adopting Release”).

<sup>16</sup> Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or “trade date plus three days”). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. The three-day settlement period applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options settle on the next settlement day following the trade (or T+1). In addition, Rule 15c6-1 prohibits broker-dealers from effecting or entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction. 17 CFR 240.15c6-1; Exchange Act Release No. 33023 (Oct. 7, 1993), 58 FR 52891 (Oct. 13, 1993). However, failure to deliver securities on T+3 does not violate Rule 15c6-1; see also Exchange Act Release No. 56212 (Aug. 7, 2007), 72 FR 45544, n. 2 (Aug. 14, 2007) (“2007 Regulation SHO Final Amendments”).

<sup>17</sup> In 2003, the Commission settled a case against certain parties relating to allegations of manipulative short selling in the stock of a corporation. The Commission alleged that the defendants profited from engaging in massive “naked” short selling that flooded the market with the stock, and depressed its price. See Rhino Advisors, Inc. and Thomas Badian, Lit. Rel. No. 18003 (Feb. 27, 2003); SEC v. Rhino Advisors, Inc. and

avoid borrowing costs associated with short sales, especially when the costs of borrowing stock are high.

We have been concerned about reducing fails to deliver and addressing “naked” short selling, in particular, potentially abusive “naked” short selling, for some time. As we have stated on several prior occasions, we believe that all sellers of securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased.<sup>18</sup> In addition, as we have stated on several prior occasions, we are concerned about the negative effect that fails to deliver may have on the markets and shareholders.<sup>19</sup>

For example, large and persistent fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending.<sup>20</sup> In addition, where a seller of securities fails to deliver securities on settlement date, in effect the seller unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently.<sup>21</sup> Moreover, sellers that fail to deliver securities on settlement date may attempt to

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Thomas Badian, Civ. Action No. 03 civ 1310 (RO) (S.D.N.Y); see also Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, 62975 (Nov. 6, 2003) (“2003 Regulation SHO Proposing Release”) (describing the alleged activity in the case involving stock of Sedona Corporation); 2004 Regulation SHO Adopting Release, 69 FR at 48016, n.76; Exchange Act Release No. 58774 (Oct. 14, 2008), 73 FR 61666 (Oct. 17, 2008) (“Anti-Fraud Rule Adopting Release”).

<sup>18</sup> See, e.g., Rule 204T Adopting Release, 73 FR at 61709; Exchange Act Release No. 57511 (Mar. 17, 2008), 73 FR 15376, 15377 (Mar. 31, 2008) (“Anti-Fraud Rule Proposing Release”).

<sup>19</sup> See, e.g., Rule 204T Adopting Release, 73 FR at 61709; 2007 Regulation SHO Final Amendments, 72 FR at 45544; Exchange Act Release No. 54154 (July 14, 2006), 71 FR 41710, 41712 (July 21, 2006) (“2006 Regulation SHO Proposed Amendments”); Exchange Act Release No. 56213 (Aug. 7, 2007), 72 FR 45558, 45558-45559 (Aug. 14, 2007) (“2007 Regulation SHO Proposed Amendments”); Anti-Fraud Rule Proposing Release, 73 FR at 15378.

<sup>20</sup> See id.

<sup>21</sup> See id.

use this additional freedom to engage in trading activities to improperly depress the price of a security. By not borrowing securities and, therefore, not making delivery within the standard three-day settlement period, the seller has additional freedom because it does not incur the costs of borrowing.

In addition, issuers and investors have repeatedly expressed concerns about fails to deliver in connection with manipulative “naked” short selling. For example, in response to proposed amendments to Regulation SHO in 2006,<sup>22</sup> which were designed to further reduce the number of persistent fails to deliver in certain equity securities by eliminating Regulation SHO’s “grandfather” exception and limit the duration of the rule’s options market maker exception, we received a number of comments that expressed concerns about “naked” short selling and extended delivery failures.<sup>23</sup> Commenters continued to express these concerns in response to proposed amendments to eliminate the options market maker exception to the close-out requirement of Regulation SHO in 2007<sup>24</sup> and in response to the Rule 204T Adopting Release.<sup>25</sup>

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<sup>22</sup> See 2006 Regulation SHO Proposed Amendments, 71 FR 41710.

<sup>23</sup> See, e.g., letter from Patrick M. Byrne, Chairman and Chief Executive Officer, Overstock.com, Inc., dated Sept. 11, 2006 (“Overstock”); letter from Daniel Behrendt, Chief Financial Officer, and Douglas Klint, General Counsel, TASER International, dated Sept. 18, 2006; letter from John Royce, dated April 30, 2007; letter from Michael Read, dated April 29, 2007; letter from Robert DeVivo, dated April 26, 2007; letter from Ahmed Akhtar, dated April 26, 2007.

<sup>24</sup> See, e.g., letter from Jack M. Wedam, dated Oct. 16, 2007; letter from Michael J. Ryan, Executive Director and Senior Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, dated Sept. 13, 2007 (“U.S. Chamber of Commerce”); letter from Robert W. Raybould, CEO Enteleke Capital Corp., dated Sept. 12, 2007 (“Raybould”); letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 12, 2007 (“NCANS”).

<sup>25</sup> See e.g., letter from Roel Campos, dated Mar. 25, 2009 (“Campos”); letter from the Risk Management Association, dated Dec. 23, 2008; letter from Professor James Angel, Ph.D, CFA, dated Dec. 17, 2008 (“Angel”); letter from Patrick Byrne, Ph.D., dated Dec. 16, 2008; letter from the American Bankers Association, dated Dec. 16, 2008 (“ABA”); letter from Fairfax Financial Holdings, Ltd., dated Oct. 16, 2008.

To the extent that fails to deliver might be part of manipulative “naked” short selling, which could be used as a tool to drive down a company’s stock price,<sup>26</sup> such fails to deliver may undermine the confidence of investors.<sup>27</sup> These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.<sup>28</sup> In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors’ negative perceptions regarding fails to deliver in the issuer’s security.<sup>29</sup> Unwarranted reputational damage caused by fails to deliver might have an adverse impact on the security’s price.<sup>30</sup>

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<sup>26</sup> See supra note 17 (discussing a case in which we alleged that the defendants profited from engaging in massive “naked” short selling that flooded the market with the company’s stock, and depressed its price); see also S.E.C. v. Gardiner, 48 S.E.C. Docket 811, No. 91 Civ. 2091 (S.D.N.Y. Mar. 27, 1991) (alleged manipulation by sales representative by directing or inducing customers to sell stock short in order to depress its price); U.S. v. Russo, 74 F.3d 1383, 1392 (2d Cir. 1996) (short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Exchange Act Section 10(b) and Rule 10b-5).

<sup>27</sup> In response to the Rule 204T Adopting Release, we received comment letters discussing the impact of fails to deliver on investor confidence. See e.g., letter from David Patch, dated Mar. 19, 2009; letter from Charles J. Greiner, dated Mar. 11, 2009. In response to the 2007 Regulation SHO Proposed Amendments, commenters discussed the impact of fails to deliver on investor confidence. See, e.g., letter from NCANS. Commenters expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Mary Helburn, Executive Director, National Coalition Against Naked Shorting, dated Sept. 30, 2006 (“NCANS (2006)”); letter from Richard Blumenthal, Attorney General, State of Connecticut, dated Sept. 19, 2006 (“Blumenthal”).

<sup>28</sup> In response to the Rule 204T Adopting Release, we received comment letters expressing concern about the impact of potential “naked” short selling on capital formation, claiming that “naked” short selling causes a drop in an issuer’s stock price and may limit the issuer’s ability to access the capital markets. See, e.g., letter from Campos (noting that “[i]n its most benign form, naked short selling is a hidden tax on equity markets, our largest wealth creation mechanism. At its worst, it is a violent force of wealth destruction that affects all market participants.”); letter from Patrick Byrne Ph.D., Chairman and Chief Executive Officer, Overstock.com Inc., dated Dec. 16, 2008 (stating that “more needs to be done to correct the problem of naked short selling and to prevent more companies from being taken down by those that use it as a tool for manipulation.”); see also letter from ABA. Commenters expressed similar concerns in response to the 2007 Regulation SHO Proposed Amendments. See, e.g., letter from Robert K. Lifton, Chairman and CEO, Medis Technologies, Inc., dated Sept. 12, 2007 (“Medis”); letter from NCANS. Commenters also expressed similar concerns in response to the 2006 Regulation SHO Proposed Amendments. See, e.g., letter from Congressman Tom Feeney - Florida, U.S. House of Representatives, dated Sept. 25, 2006 (“Feeney”); see also letter from Zix Corporation, dated Sept. 19, 2006 (“Zix”) (stating that “[m]any investors attribute the Company’s frequent re-appearances on the Regulation SHO list to manipulative short selling and frequently demand that the Company “do something” about the perceived manipulative short selling. This perception that manipulative short selling of the Company’s securities is continually occurring has undermined the confidence of many of the Company’s investors in the integrity of the market for the Company’s securities.”).

<sup>29</sup> Due in part to such concerns, some issuers have taken actions to attempt to make transfer of their securities “custody only,” (i.e., certificating the securities and prohibiting ownership by a securities intermediary) thus preventing transfer of their stock to or from securities intermediaries such as the Depository Trust Company

Although the majority of trades settle within T+3,<sup>31</sup> we adopted Regulation SHO<sup>32</sup> on July 28, 2004, in part to address problems associated with persistent fails to deliver securities and potentially abusive “naked” short selling. For example, Regulation SHO requires broker-dealers to “locate” securities that the broker-dealer reasonably believes can be delivered within the standard three-day settlement period.<sup>33</sup>

Another requirement of Regulation SHO aimed at potentially abusive “naked” short selling and reducing fails to deliver in certain equity securities is the rule’s “close-out”

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(“DTC”) or broker-dealers. See Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, at 62975 (Nov. 6, 2003). Some issuers have attempted to withdraw their issued securities on deposit at DTC in order to make the securities ineligible for book-entry transfer at a securities depository. See *id.* Withdrawing securities from DTC or requiring custody-only transfers would undermine the goal of a national clearance and settlement system designed to reduce the physical movement of certificates in the trading markets. See *id.* We note, however, that in 2003 the Commission approved a DTC rule change clarifying that its rules provide that only its participants may withdraw securities from their accounts at DTC. See Exchange Act Release No. 47978 (June 4, 2003), 68 FR 35037 (June 11, 2003).

<sup>30</sup> See 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Final Amendments, 72 FR at 45545; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558-45559; Anti-Fraud Rule Proposing Release, 73 FR at 15378; Rule 204T Adopting Release, 73 FR at 61709-61710 (providing discussion of the impact of fails to deliver on the market); see also 2003 Regulation SHO Proposing Release, 68 FR at 62975 (Nov. 6, 2003) (discussing the impact of “naked” short selling on the market).

<sup>31</sup> According to the National Securities Clearing Corporation (“NSCC”), 99% (by dollar value) of all trades settle within T+3. Thus, on an average day, only approximately 1% (by dollar value) of all trades, including equity, debt, and municipal securities fail to settle on time.

<sup>32</sup> 17 CFR 242.200. Regulation SHO became effective on January 3, 2005.

<sup>33</sup> 17 CFR 242.203(b)(1). Rule 203(b)(1) of Regulation SHO requires that, “A broker or dealer may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has: (i) Borrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) Reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) Documented compliance with this paragraph (b)(1).” This is known as the “locate” requirement. Market makers engaged in bona fide market making in the security at the time they effect the short sale are excepted from this requirement. In connection with this “locate” requirement, as well as other provisions of Regulation SHO that require a reasonableness determination (i.e., Rules 200(g)(1) and 203(a)(2)(ii)), we remind any broker-dealer subject to such provisions that they have an affirmative obligation to obtain and consider information from their own records and/or from the records of another source helpful to making the reasonableness determinations required by such rules. Such information may include, but is not limited to, information regarding a customer’s prior assurances regarding a locate source, its share ownership, or delivery of shares by settlement date. See 17 CFR 242.203(b)(1), 242.200(g)(1), 203(a)(2)(ii). See also 2004 Regulation SHO Adopting Release, 69 FR at 48014, n. 58, 48019 at n. 111.

requirement. Since Regulation SHO was adopted it has required participants<sup>34</sup> of a registered clearing agency,<sup>35</sup> which includes broker-dealers, to purchase shares to close out fails to deliver in securities with large and persistent fails to deliver, *i.e.*, "threshold securities."<sup>36</sup> Until the position is closed out, the participant responsible for the fail to deliver position and any broker-dealer from which it receives trades for clearance and settlement may not effect further short sales in that threshold security without first borrowing or arranging to borrow the security.<sup>37</sup>

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

Due to our concerns about the potentially negative market impact of large and persistent fails to deliver, and the fact that we continued to observe threshold securities with fail to deliver

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<sup>34</sup> For purposes of Regulation SHO, the term "participant" has the same meaning as in section 3(a)(24) of the Exchange Act. See 15 U.S.C. 78c(a)(24).

<sup>35</sup> The term "registered clearing agency" means a clearing agency, as defined in Section 3(a)(23)(A) of the Exchange Act, that is registered as such pursuant to Section 17A of the Exchange Act. See 15 U.S.C. 78c(a)(23)(A) and 78q-1, respectively; see also 2004 Regulation SHO Adopting Release, 69 FR at 48031. The majority of equity trades in the United States are cleared and settled through systems administered by clearing agencies registered with the Commission. The NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter market. NSCC clears and settles trades through the Continuous Net Settlement ("CNS") system, which nets the securities delivery and payment obligations of all of its members. NSCC notifies its members of their securities delivery and payment obligations daily. In addition, NSCC guarantees the completion of all transactions and interposes itself as the counterparty to both sides of the transaction. We intend to closely monitor fails to deliver resulting from trades that are not cleared and settled through the CNS system.

<sup>36</sup> Rule 203(c)(6) of Regulation SHO defines a "threshold security" as any equity security of an issuer that is registered pursuant to Section 12 of the Exchange Act (15 U.S.C. 78l) or for which the issuer is required to file reports pursuant to Section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue's total shares outstanding; and is included on a list disseminated to its members by a self-regulatory organization ("SRO"). See 17 CFR 242.203(c)(6).

<sup>37</sup> See 17 CFR 242.203(b)(3)(iv).

positions that were not being closed out under existing delivery and settlement requirements, effective on October 15, 2007, we adopted an amendment to Regulation SHO that eliminated the “grandfather” provision.<sup>38</sup>

The options market maker exception excepted any fail to deliver position in a threshold security resulting from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the underlying security became a threshold security. On September 17, 2008, we adopted and made immediately effective, as an emergency rule, an amendment to Rule 203(b)(3) of Regulation SHO to eliminate the options market maker exception to the rule’s close-out requirement.<sup>39</sup> Following the issuance of the September Emergency Order, we adopted amendments making permanent the elimination of the options market maker exception.<sup>40</sup> As we discussed in the 2008 Regulation SHO Final Amendments, we believed it was appropriate to eliminate the options market maker exception in part because substantial levels of fails to deliver continued to persist in threshold securities and it appeared that a significant number of these fails to deliver were as a result of the options market maker exception.<sup>41</sup>

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<sup>38</sup> See 2007 Regulation SHO Final Amendments, 72 FR 45544. This amendment also contained a one-time phase-in period that provided that previously-grandfathered fails to deliver in a security that was a threshold security on the effective date of the amendment must be closed out within 35 consecutive settlement days from the effective date of the amendment. The phase-in period ended on December 5, 2007.

<sup>39</sup> See Exchange Act Release No. 58572 (Sept. 17, 2008), 73 FR 54875 (Sept. 23, 2008) (“September Emergency Order”).

<sup>40</sup> See Exchange Act Release No. 58775 (Oct. 14, 2008), 73 FR 61690 (Oct. 17, 2008) (“2008 Regulation SHO Final Amendments”); see also 2007 Regulation SHO Proposed Amendments, 72 FR 45558; 2006 Regulation SHO Proposed Amendments, 71 FR 41710; Exchange Act Release No. 58107 (July 7, 2008), 73 FR 40201 (July 14, 2008) (“2008 Regulation SHO Re-Opening Release”).

<sup>41</sup> See 2008 Regulation SHO Final Amendments, 73 FR 61690; see also 2008 Regulation SHO Re-Opening Release, 73 FR 40201.

In adopting temporary Rule 204T of Regulation SHO pursuant to the September Emergency Order and subsequently pursuant to the Rule 204T Adopting Release, we strengthened further the close-out requirements of Regulation SHO by applying close-out requirements to fails to deliver resulting from sales of all equity securities and reducing the time frame within which fails to deliver must be closed out.<sup>42</sup>

As noted above, since the adoption of temporary Rule 204T and the elimination of Regulation SHO's options market maker exception, we have seen a significant reduction in the number of fails to deliver in all equity securities. To continue advancing our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive "naked" short selling, we are adopting the substance of temporary Rule 204T in a permanent rule, Rule 204. We continue to believe that strengthening the close-out requirements of Regulation SHO will further help to protect and enhance the operation, integrity, and stability of the markets; as well as help reduce potential short selling abuses.

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<sup>42</sup> In addition to these amendments to Regulation SHO, recently we have taken other actions aimed at reducing fails to deliver and addressing potentially abusive "naked" short selling. For example, in July 2008, we published an emergency order under section 12(k) of the Exchange Act (the "July Emergency Order") that temporarily restricted "naked" short selling in the publicly traded securities of nineteen financial institutions. See Exchange Act Release No. 58166 (July 15, 2008), 73 FR 55169 (July 21, 2008) (imposing borrowing and delivery requirements on short sales of the equity securities of nineteen financial companies); see also Exchange Act Release No. 58248 (July 29, 2008), 73 FR 45257 (Aug. 4, 2008) (extending the July Emergency Order such that it expired on August 12, 2008). In September 2008, we published an emergency order that temporarily banned short selling in the publicly traded securities of approximately 1,000 financial institutions (the "Short Sale Ban"). See Exchange Act Release No. 58592 (Sept. 18, 2008), 73 FR 55169 (Sept. 24, 2008); see also Exchange Act Release No. 58611 (Sept. 21, 2008), 73 FR 55556 (Sept. 25, 2008) (amending the Short Sale Ban). The Short Sale Ban expired on October 8, 2008. In addition, in the September Emergency Order, we adopted and made immediately effective a "naked" short selling anti-fraud rule, Rule 10b-21, aimed at sellers, including broker-dealers acting for their own accounts, who deceive certain specified persons about their intention or ability to deliver securities in time for settlement and that fail to deliver securities by settlement date. See September Emergency Order. Following the issuance of the September Emergency Order, we adopted final amendments making Rule 10b-21 permanent. See Anti-Fraud Rule Adopting Release, 73 FR 61666; see also Anti-Fraud Rule Proposing Release, 73 FR 15376. In addition, on April 8, 2009, we proposed amendments to Regulation SHO that, if adopted, would add a short sale price test restriction or short sale circuit breaker rule to Regulation SHO. See Exchange Act Release No. 59748 (Apr. 10, 2009), 74 FR 18042 (Apr. 20, 2009) (the "Short Sale Price Test Proposing Release").

### III. Discussion of Rule 204 of Regulation SHO

As discussed in more detail below, we are maintaining the structure of temporary Rule 204T with limited modifications to address commenters' concerns. In discussing the provisions of Rule 204, we highlight below some of the main issues, concerns, and suggestions raised by commenters.<sup>43</sup>

#### A. Rule 204's Close-Out Requirement

##### 1. Close-Out Period

In Rule 204(a), we are adopting the close-out requirements of temporary Rule 204T(a) without modification. Temporary Rule 204T(a) provides that a participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours<sup>44</sup> on the settlement day<sup>45</sup> following the settlement date (i.e., T+4), immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity.<sup>46</sup>

Under certain circumstances, temporary Rule 204T provides additional time during which fails to deliver may be closed out. Specifically, temporary Rule 204T(a)(1) and (a)(3)

<sup>43</sup> See supra note 12.

<sup>44</sup> "Regular trading hours" has the same meaning as in Rule 600(b)(64) of Regulation NMS. Rule 600(b)(64) provides that "Regular trading hours means the time between 9:30 a.m. and 4:00 p.m. Eastern Time, or such other time as is set forth in the procedures established pursuant to § 242.605(a)(2)."

<sup>45</sup> The term "settlement day" is defined in Rule 203(c)(5) of Regulation SHO as: "... any business day on which deliveries of securities and payments of money may be made through the facilities of a registered clearing agency." 17 CFR 242.203(c)(5).

<sup>46</sup> See temporary Rule 204T(a).

provide that, subject to certain conditions, fails to deliver resulting from long sales or certain bona fide market making activity must be closed out by no later than the beginning of regular trading hours on the third settlement day after settlement date (i.e., T+6).<sup>47</sup>

In response to our requests for comment, a number of commenters expressed concerns regarding the time periods within which fails to deliver must be closed out under temporary Rule 204T. Commenters expressed concern that temporary Rule 204T's requirement to close-out fails to deliver by no later than the beginning of regular trading hours can create buying pressure at the open, that may temporarily distort the price of the security.<sup>48</sup> To minimize the market impact of the close-out requirement, commenters suggested allowing participants to close out fails to deliver by the end of regular trading hours, or the close of business on the New York Stock Exchange ("NYSE"), rather than by no later than the beginning of regular trading hours.<sup>49</sup> In requesting additional time during the day to close out fails to deliver, one commenter noted that such a change "would significantly alleviate the market pressures associated with execution of potentially large purchases at the opening of trading – a time when markets are particularly susceptible to price fluctuations."<sup>50</sup> This commenter also stated that, as a practical matter,

<sup>47</sup> In addition, temporary Rule 204T(a)(2) provides that fails to deliver resulting from sales of securities pursuant to Rule 144 of the Securities Act of 1933 ("Rule 144 Securities") must be closed out by no later than the beginning of regular trading hours on the thirty-sixth consecutive settlement day following settlement date (i.e., T+39).

<sup>48</sup> See, e.g., letter from Stuart Kaswell, Executive Vice President and General Counsel, Managed Funds Association, dated Dec. 15, 2008 ("MFA"); letter from Edward J. Joyce, President and Chief Operating Officer, Chicago Board Options Exchange, dated Dec. 23, 2008 ("CBOE"); letter from Amal Aly, Managing Director and Associate General Counsel, SIFMA, dated Dec. 16, 2008 ("SIFMA"); letter from Eric Swanson, General Counsel, BATS Exchange, Inc., dated Dec. 29, 2008 ("BATS"); letter from Michael P. McAuley, Chair, RMA Committee on Securities Lending, dated Dec. 23, 2008 ("RMA"); letter from Stefan Gavell, Executive Vice President and Head of Regulatory Industry Affairs, State Street Corporation, dated Dec. 16, 2008 ("State Street").

<sup>49</sup> See, e.g., letters from SIFMA; MFA; State Street; BATS; letter from A. Peter Allman-Ward, Executive Vice President and CFO, Wedbush Morgan Securities, Inc., dated Dec. 15, 2008 ("Wedbush").

<sup>50</sup> Letter from SIFMA.

“transactions effected at market open to close-out open fail positions are no different from those effected later on in the trading session because both are part of the same clearance and settlement cycle. Thus, providing this relief would not add any delay of consequence to the close-out process.”<sup>51</sup>

Other commenters requested additional days within which to close out fails to deliver in connection with short sales. For example, some commenters requested that the Commission extend the close-out period for fails to deliver resulting from short sales to three settlement days after the fail occurs, consistent with the close-out period for fails to deliver resulting from long sales and market making activity.<sup>52</sup> Other commenters requested that the Commission extend the close-out requirement for fails to deliver resulting from all sales to five settlement days after the fail to deliver position occurs.<sup>53</sup> These commenters stated that the additional time to close out fails to deliver would allow the majority of trades to clear and settle on their own within a few days following the regular settlement date (*i.e.*, T+3).<sup>54</sup>

Some commenters expressed concerns about the effect of the close-out requirements of temporary Rule 204T on securities lending.<sup>55</sup> For example, one commenter stated that the

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<sup>51</sup> See id.

<sup>52</sup> See e.g., letter from Peter Kovac, Chief Operating Officer and Financial and Operations Principal, EWT, LLC, dated Nov. 25, 2008 (“EWT”); letter from James S. Chanos, Chairman, Coalition of Private Investment Companies, dated Dec. 16, 2008 (“Coalition of Private Investment Companies”); letters from SIFMA; MFA; State Street.

<sup>53</sup> See, e.g., letter CBOE; letter from Boston Options Exchange, Chicago Board Options Exchange, International Securities Exchange, NASDAQ Options Market, NASDAQ OMX PHLX, NYSE Alternext US, NYSE Arca, and The Options Clearing Corporation, dated Dec. 19, 2008 (“Options Exchanges”).

<sup>54</sup> See, e.g., letters from SIFMA; MFA; State Street; CBOE; Options Exchanges; Coalition of Private Investment Companies.

<sup>55</sup> As stated in the Rule 204T Adopting Release, if a person that has loaned a security to another person sells the security and a bona fide recall of the security is initiated within two business days after trade date, the person that has loaned the security will be “deemed to own” the security for purposes of Rule 200(g)(1) of Regulation SHO, and such sale will not be treated as a short sale for purposes of temporary Rule 204T. In addition, a

compressed time-frame for closing out fails to deliver under temporary Rule 204T “has generated over-buying and borrowing of securities that would otherwise settle in the normal course, thus impairing liquidity by tying up shares that would otherwise be available to natural buyers and sellers.”<sup>56</sup> This commenter also noted that in practice fails to deliver resulting from sales of securities on loan, which are considered “long” sales, are often closed out in accordance with the time-frames for fails to deliver resulting from short sales rather than long sales because temporary Rule 204T does not provide sufficient time to determine whether or not a fail to deliver position resulted from a long or short sale.<sup>57</sup> According to this commenter, such purchasing activity acts as a disincentive to lending and causes institutions to question their participation in lending programs.<sup>58</sup>

Other commenters stated that where the holder of a long position sells securities that have been financed through a securities loan, the close-out requirements of temporary Rule 204T may not provide sufficient time for the securities to be recalled and delivered in time for settlement of the sale transaction.<sup>59</sup> These commenters stated, among other things, that temporary Rule 204T’s requirement that securities be delivered by no later than the beginning of regular trading hours does not allow for the completion of the securities lending cycle, which may not occur until the

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broker-dealer may mark such orders as “long”-sales provided such marking is also in compliance with Rule 200(c) of Regulation SHO. See Rule 204T Adopting Release, 73 FR at 61713, n. 70.

<sup>56</sup> Letter from SIFMA..

<sup>57</sup> See letter from SIFMA; see also letter from RMA; letter from Heather Traeger, Assistant Counsel, Investment Company Institute, dated Dec. 16, 2008 (“ICI”).

<sup>58</sup> See letter from SIFMA; see also letter from RMA (recommending the extension of the close-out period for fails to deliver for all sales to settlement date plus three days (i.e., T+6) “to ensure that beneficial owners selling on-loan positions are not compromised by close-outs of long sales on T+4”).

<sup>59</sup> See letters from EWT; BATS; RMA; ICI; Wedbush.

close of the DTC settlement window on the third settlement day after settlement date (i.e., T+6).<sup>60</sup>

As noted above, the close-out requirements of temporary Rule 204T are advancing our goal of further reducing fails to deliver, as evidenced in part by preliminary results from OEA regarding its impact on the number of fails to deliver.<sup>61</sup> Thus, we are adopting as a permanent rule the structure of the close-out requirements of temporary Rule 204T. Specifically, Rule 204(a) provides that a participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours<sup>62</sup> on the settlement day<sup>63</sup> following the settlement date, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity.<sup>64</sup>

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<sup>60</sup> See letters from EWT; BATS; RMA; ICL. EWT stated that a recall typically occurs to assure that the securities are returned on the settlement date for the sale transaction. If the securities are not returned by that date, the lender may initiate a buy-in process designed to obtain the securities as promptly as possible. This buy-in is intended to result in delivery of the securities after three business days, such that the lender will not complete the buy-in process until the close of the DTC settlement window on the third business day following initiation of the buy-in process. Accordingly, this commenter recommended, among other things, that we should: (1) either (a) create an exception for fails to deliver where the securities are loaned but have been recalled or (b) confirm that the issuance of a bona fide loan recall notice is a valid form of close-out for a fail to deliver; or (2) extend the close-out period from settlement date plus three days (i.e., T+6), to settlement date plus six days (i.e., T+9) for fails to deliver resulting from long sales. See also letter from RMA (stating that due to operational complexity and the number of market participants involved in the sale of an "on-loan position," it is commonplace for a sale to be settled during the day on T+6).

<sup>61</sup> See supra note 8, and accompanying text.

<sup>62</sup> See supra note 44 (discussing the definition of the term "regular trading hours" for purposes of Regulation SHO).

<sup>63</sup> See supra note 45 (discussing the definition of the term "settlement day" for purposes of Regulation SHO).

<sup>64</sup> See Rule 204(a).

In addition, as discussed in more detail below, we are adopting in Rule 204(a)(1) and (a)(3) the close-out requirements of temporary Rule 204T(a)(1) and (a)(3) for fails to deliver resulting from long sales and certain bona-fide market making activity so that such fails to deliver must be closed out by no later than the beginning of regular trading hours on the close-out date (i.e., T+6) for such fails to deliver.<sup>65</sup>

Although we recognize commenters' concerns regarding the potential market impact of the close-out requirements of temporary Rule 204T, particularly at the market open, we believe that these potential effects are justified by the benefits of retaining the strict close-out requirements of temporary Rule 204T. As discussed above, since the adoption of temporary Rule 204T, and other actions taken by the Commission aimed at reducing fails to deliver, there has been a significant reduction in fails to deliver. To maintain these declines, we believe it is necessary at this time to continue to require that participants close out fails to deliver by no later than the beginning of regular trading hours on the applicable close-out date. We believe that the strict close-out requirements of the temporary rule have helped reduce fails to deliver by providing a disincentive to those who, but for the rule, may have failed to deliver securities by settlement date. In addition, we note that participants have been operating pursuant to the close-out requirements of the temporary rule, as adopted, and appear to have adjusted to its requirements.<sup>66</sup>

<sup>65</sup> In addition, as discussed in Section III.E. below, we are adopting the close-out requirements of Rule 204(a)(2) for fails to deliver resulting from sales of Rule 144 Securities so that such fails to deliver must be closed out by no later than the beginning of regular trading hours on the applicable close-out date.

<sup>66</sup> In discussing the requirement to purchase securities by no later than the beginning of regular trading hours on the applicable close-out date, some commenters discussed the ability to use, among other mechanisms, volume weighted average price ("VWAP") orders entered at the beginning of the day to more effectively manage their buy-in-risk. See, e.g., letters from Duncan L. Niederauer, CEO, NYSE Euronext and Richard G. Ketchum, NYSE Regulation, Inc., dated Dec. 16, 2008 ("NYSE"); ICI. We note that if a participant has a fail to deliver position at a registered clearing agency that it must close out in accordance with Rule 204 of Regulation SHO, the participant may satisfy the close-out requirement to purchase securities of like kind and quantity with a

We believe that continuing to require that fails to deliver be closed out on the day immediately following the day on which the fail to deliver occurs is consistent with our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing “naked” short selling and, in particular, potentially abusive “naked” short selling. Although extending the time-frames within which fails to deliver must be closed out may allow for ordinary course settlement, as several commenters contend, we believe that the close-out requirements of Rule 204 are necessary to continue to help encourage delivery by settlement date and achieve our goal of not allowing fails to deliver to persist.<sup>67</sup>

As we discussed in the Rule 204T Adopting Release, we believe that delivery on sales should be made by settlement date.<sup>68</sup> In the Rule 204T Adopting Release, we noted that the vast majority of fails to deliver are closed out within five days after T+3.<sup>69</sup> In addition, in that release we referenced a recent analysis by OEA that found that more than half of all fails to deliver and more than 70% of all fail to deliver positions are closed out within two settlement days after T+3.<sup>70</sup> We also noted in that release, however, that although this information shows that delivery

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VWAP order provided: (i) the order to purchase the equity security on a VWAP basis is irrevocable and received by no later than the beginning of regular trading hours on the applicable close-out date; and (ii) the final execution price of any such transaction is not determined until after the close of regular trading hours when the VWAP value is calculated and the execution is on an agency basis.

<sup>67</sup> See supra note 16 (discussing the standard three-day settlement cycle).

<sup>68</sup> See Rule 204T Adopting Release, 73 FR at 61712 – 61713.

<sup>69</sup> See id.

<sup>70</sup> See id. at n. 68. We note that OEA’s analysis examined the period from January to July 2008 and used the age of the fail to deliver position as reported by the NSCC. The NSCC data included only securities with at least 10,000 shares in fails to deliver. These numbers also included securities that were not subject to the close-out requirement in Rule 203(b)(3) of Regulation SHO, which applies only to “threshold securities” as defined in Rule 203(c)(6) of Regulation SHO.

is being made, it demonstrates that often delivery is not being made until several days following the standard three-day settlement cycle.

In addition, as discussed above, fails to deliver may be part of a scheme to manipulate the price of a security. We are also concerned about the negative effect that fails to deliver and potentially abusive “naked” short selling may have on the market and the broader economy, including on investor confidence.<sup>71</sup> The close-out requirements of Rule 204 help address these concerns by prohibiting the persistence of fails to deliver.

We understand, however, that fails to deliver may occur from long sales within the first two settlement days after settlement date for legitimate reasons.<sup>72</sup> For example, human or mechanical errors or processing delays can result from transferring securities in custodial or other form rather than book-entry form, thereby causing a fail to deliver on a long sale.<sup>73</sup>

Thus, in Rule 204(a)(1), we are adopting, with certain limited modifications, the provisions of temporary Rule 204T(a)(1) relating to closing out fails to deliver resulting from long sales. Specifically, Rule 204(a)(1) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security and the participant can demonstrate on its books and records that such fail to deliver position resulted from a long sale, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity.<sup>74</sup>

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<sup>71</sup> See, e.g., Anti-Fraud Rule Adopting Release, 73 FR 61666.

<sup>72</sup> See Rule 204T Adopting Release, 73 FR at 61713.

<sup>73</sup> See id.

<sup>74</sup> See Rule 204(a)(1).

In response to a request for comment, some commenters requested that we provide additional flexibility to the close-out requirements of temporary Rule 204T(a)(1) by allowing participants to borrow as well as purchase securities to close out such fails to deliver.<sup>75</sup> In temporary Rule 204T(a)(1), we required a participant to purchase securities to close out fails to deliver resulting from long sales to be consistent with the close-out requirements of Rule 203(b)(3) of Regulation SHO which require that a participant that has a fail to deliver position in a threshold security for thirteen consecutive settlement days immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity.<sup>76</sup>

Commenters stated that borrowing securities serves the same purpose as purchasing securities to close out fails to deliver.<sup>77</sup> In addition, commenters noted that allowing a borrow to close out such fails would be consistent with the close-out requirements for short sales. After considering the comments received, we provide in Rule 204(a)(1) the ability for a participant to close out a fail to deliver position resulting from a long sale by purchasing or borrowing securities.<sup>78</sup> We believe that such an amendment is consistent with our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary

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<sup>75</sup> See e.g., letters from SIFMA; EWT; MFA; State Street; BATS; Wedbush; Angel.

<sup>76</sup> See 17 CFR 242.203(b)(3). Some commenters requested clarification regarding a broker-dealer's obligations under FINRA Rule 11810 (the "FINRA Buy-In Rule") and the close-out requirements of temporary Rule 204T. See, e.g., letter from Joseph Zangri, Chief Compliance Officer, Bloomberg Tradebook, LLC (Dec. 16, 2008) ("Bloomberg"). We note that because the requirements of Rule 204 apply to broker-dealers involved in the sell-side of a transaction, whereas the FINRA Buy-In Rule sets forth procedures applicable to a purchaser that chooses to buy-in a seller, we believe that these rules apply separate and distinct obligations on market participants and, therefore, are not in conflict.

<sup>77</sup> See e.g., letter from MFA.

<sup>78</sup> See Rule 204(a)(1). Although Rule 204(a)(1) permits borrowing to close out a fail to deliver position resulting from a long sale, broker-dealers must also comply with Rule 203(a) of Regulation SHO. Rule 203(a)(1) provides that, unless an exception applies, "[i]f a broker or dealer knows or has reasonable grounds to believe that the sale of an equity security was or will be effected pursuant to an order marked "long," such broker or dealer shall not lend or arrange for the loan of any security for delivery to the purchaser's broker after the sale, or fail to deliver a security on the date delivery is due." 17 CFR 242.203(a).

Rule 204T, as well as other actions taken by the Commission, because it will provide additional flexibility to participants in closing out fail to deliver positions.<sup>79</sup> Permitting a borrow as well as a purchase will also make the close-out requirements of Rule 204(a)(1) consistent with the close-out requirements of Rule 204(a).

As we stated with respect to Rule 204T's close-out requirements, under Rule 204's close-out requirements for fails to deliver resulting from long or short sales, a participant must take affirmative action to close out a fail to deliver position by purchasing or borrowing securities.<sup>80</sup> Thus, a participant may not offset the amount of its fail to deliver position with shares that the participant receives or will receive during the applicable close-out date (i.e., during T+4 or T+6, as applicable).<sup>81</sup> In addition, as we stated in the Rule 204T Adopting Release, to meet its close-out obligation a participant also must be able to demonstrate on its books and records that on the applicable close-out date, it purchased or borrowed shares in the full quantity of its fail to deliver position and, therefore, that the participant has a net flat or net long position on its books and records on the applicable close-out date (i.e., during T+4 or T+6, as applicable).<sup>82</sup>

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<sup>79</sup> See letter from CBOE (stating that the close-out procedures under temporary Rule 204T for fails to deliver attributable to bona fide market making activity should be amended to permit borrows or purchases throughout the close-out period).

<sup>80</sup> See Rule 204T Adopting Release, 73 FR at 61710.

<sup>81</sup> In determining its close-out obligation, a participant may rely on its net delivery obligation as reflected in its notification from NSCC regarding its securities delivery and payment obligations, provided such notification is received prior to the beginning of regular trading hours on the applicable close-out date. See Rule 204T Adopting Release, 73 FR at 61711, at n. 46 (and accompanying text).

<sup>82</sup> See Rule 204T Adopting Release, 73 FR at 61711. Both temporary Rule 204T and Rule 204 require that a participant purchase or borrow shares, as applicable, to close out a fail to deliver position. Accordingly, the purchase or borrow on the applicable close-out date must be for the full quantity of the fail to deliver position that is subject to the close-out requirement. In addition, where a participant subject to the close-out requirement purchases or borrows securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant's fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement.

Consistent with temporary Rule 204T, Rule 204 defines a "settlement date" as "the business day on which delivery of a security and payment of money is to be made through the facilities of a registered clearing agency in connection with the sale of a security."<sup>83</sup> As we noted in the Rule 204T Adopting Release, this definition is consistent with Rule 15c6-1 under the Exchange Act that prohibits broker-dealers from effecting or entering into a contract for the purchase or sale of a security that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction.<sup>84</sup>

Because most transactions settle by T+3 and because delivery on all sales should be made by settlement date, participants should consider having in place policies and procedures to help ensure that delivery is being made by settlement date. As we stated in the Rule 204T Adopting Release, we intend to examine participants' policies and procedures to determine whether, among other things, such policies and procedures require broker-dealers to monitor for delivery by settlement date.<sup>85</sup>

Consistent with the existing close-out requirements of Rule 203(b)(3) of Regulation SHO and temporary Rule 204T, the close-out requirements of Rule 204 are based on a participant's fail to deliver position at a registered clearing agency. As noted above, the NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter markets. NSCC clears and settles trades through the CNS system, which nets the securities delivery and payment obligations of all of its members. NSCC notifies its members of

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<sup>83</sup> See Rule 204(g)(1); see also Rule 204T(f)(1).

<sup>84</sup> See 17 CFR 240.15c6-1; see also Rule 204T Adopting Release, 73 FR at 61711.

<sup>85</sup> See Rule 204T Adopting Release, 73 FR at 61711. Of course, broker-dealers must comply with any applicable SRO policies and procedures requirements. For example, NASD Rule 3010 contains, among other things, written procedures requirements for member firms.

their securities delivery and payment obligations daily. Because Rule 204 is based on a participant's fail to deliver position at a registered clearing agency, it is consistent with current settlement practices and procedures and with the Regulation SHO framework regarding delivery of securities.<sup>86</sup>

## 2. Application to All Equity Securities

Consistent with temporary Rule 204T, the close-out requirements of Rule 204 apply to fails to deliver in all equity securities. As discussed in the Rule 204T Adopting Release, this requirement differs from the close-out requirement of Rule 203(b)(3) of Regulation SHO that applies the close-out requirements of that rule only to those securities with a large and persistent level of fails to deliver, i.e., threshold securities.<sup>87</sup>

A purpose of Rule 204 is to help limit the use of "naked" short selling as part of a manipulative scheme. To achieve this purpose, we are applying the rule to all equity securities, regardless of the level or persistence of any fails to deliver in such securities. In addition, as discussed above, we believe that all sellers of equity securities should promptly deliver, or arrange for delivery of, securities to the respective buyer and all buyers of securities have a right to expect prompt delivery of securities purchased. We believe this should be the case for sales in all equity securities and are adopting this rule to further that goal.

We note that in the Rule 204T Adopting Release, we requested comment regarding whether temporary Rule 204T should be expanded to apply to debt as well as equity securities.

In response, commenters opposed the extension of temporary Rule 204T to debt securities.<sup>88</sup>

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<sup>86</sup> See temporary Rule 204T; see also 17 CFR 242.203(b)(3).

<sup>87</sup> See Rule 204T Adopting Release, 73 FR at 61711; see also 17 CFR 242.203(b)(3).

<sup>88</sup> See, e.g., letters from SIFMA; MFA; State Street.

One such commenter stated that the Commission has expressly carved-out debt securities from all short sale regulations, including Regulation SHO, citing in support the non-manipulative potential associated with fixed income securities.<sup>89</sup> This commenter stated that it believes that certain structured products should also be excluded from the application of temporary Rule 204T.<sup>90</sup> This commenter acknowledged, however, that the “equity” status of some structured products may not be clear and its view that it may not be feasible for the Commission to make broad-based determinations on whether categories of securities constitute debt or equity.<sup>91</sup>

After considering the comments and because all other provisions of Regulation SHO apply only to equity securities, at this time, we are not extending Rule 204 to securities other than equity securities. We note, however, for those securities for which market participants believe the “equity” status is unclear, we will consider on a case-by-case basis whether the provisions of Rule 204, and Regulation SHO more generally, apply.

Regulation SHO, as adopted in 2004, was a first step in reducing persistent fails to deliver and addressing abusive “naked” short selling. In Regulation SHO, we took a targeted approach, imposing additional delivery requirements on securities with a substantial and persistent amount of fails to deliver. As we stated in the 2004 Regulation SHO Adopting Release, we took this targeted approach at that time in an effort to address the problem but at the same time not to burden the vast majority of securities where there are not similar concerns regarding settlement.<sup>92</sup> In addition, Regulation SHO’s close-out requirement was adopted to

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<sup>89</sup> See letter from SIFMA (referring to, among other things, Securities Exchange Act Release No. 56206 (Aug. 6, 2007), 72 FR 45094 (Aug. 10, 2007)).

<sup>90</sup> See *id.*

<sup>91</sup> See *id.*

<sup>92</sup> See 2004 Regulation SHO Adopting Release, 69 FR at 48016.

address potential abuses that may occur with large, extended fails to deliver.<sup>93</sup> We also noted in the 2004 Regulation SHO Adopting Release, however, that we would pay close attention to the operation and efficacy of the provisions we were adopting at that time and would consider whether any further action was warranted.<sup>94</sup>

Because of continued concerns about the potentially negative market impact of fails to deliver, and the fact that through our monitoring of the efficacy of Regulation SHO's close-out requirement we continued to observe threshold securities with fail to deliver positions that were not being closed out, we eliminated the "grandfather" and options market maker exceptions to Regulation SHO's close-out requirements.<sup>95</sup>

However, as we stated in the Rule 204T Adopting Release, we were concerned that the close-out requirements of Regulation SHO, as adopted, had not gone far enough in reducing fails to deliver and addressing potentially abusive "naked" short selling.<sup>96</sup> In light of the recent instability and lack of investor confidence in the financial markets,<sup>97</sup> we believe that the requirements of temporary Rule 204T should be made permanent to maintain the reduced fails to deliver and to address potentially abusive "naked" short selling.

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<sup>93</sup> See *id.* at 48017.

<sup>94</sup> See *id.* at 48018.

<sup>95</sup> See *supra* Section II (discussing the elimination of Regulation SHO's "grandfather" and options market maker exceptions).

<sup>96</sup> See Rule 204T Adopting Release, 73 FR at 61711 – 61712.

<sup>97</sup> See, e.g., letter from Leland Chan, General Counsel, California Bankers Association, dated Aug. 21, 2008; letter from Eric C. Jensen, Esq., Cooley Godward Kronish L.L.P., dated Aug. 21, 2008; letter from Steven B. Boehm and Cynthia M. Krus, Sutherland Asbill Brennan LLP, dated July 31, 2008; letter from James J. Angel, Professor of Finance, Georgetown University, McDonough School of Business, dated Aug. 20, 2008; letter from Tuan Nguyen, dated Aug. 8, 2008; see also Short Sale Price Test Proposing Release, 74 FR 18042 (proposing short sale price test restrictions and short sale circuit breaker rules due to recent changes in market conditions and a deterioration in investor confidence).

We note that one commenter to the Rule 204T Adopting Release suggested eliminating temporary Rule 204T of Regulation SHO, such that only the close-out requirements of Rule 203(b)(3) would apply.<sup>98</sup> If we were to take such an approach, Regulation SHO's close-out requirements would apply only to threshold securities and fails to deliver in such securities would not have to be closed out until such fails to deliver had persisted for thirteen consecutive settlement days. As discussed above, we are applying the close-out requirements of Rule 204 to all equity securities to further our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, in both threshold and non-threshold securities and, thereby, also help continue to address abusive "naked" short selling in such securities. In the Rule 204T Adopting Release, we noted that prior to its adoption, fails to deliver in non-threshold securities averaged approximately 624 million shares or \$4.6 billion in value per day from January to July 2008.<sup>99</sup> Since adoption of the temporary rule, and in connection with other Commission actions to address fails to deliver, this number has declined significantly such that from December 2008 to March 2009, OEA estimates that fails to deliver in non-threshold securities averaged approximately 307 million shares or \$1.1 billion in value per day. We are applying Rule 204's close-out requirements to all equity securities to help maintain the benefits already achieved.

### **3. Allocation of a Fail to Deliver Position**

Temporary Rule 204T(d) provides that a participant may reasonably allocate its responsibility to close out a fail to deliver position to another broker-dealer from which the

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<sup>98</sup> See letter from CBOE.

<sup>99</sup> See Rule 204T Adopting Release, 73 FR at 61712, n. 60. We also noted these fails accounted for approximately 54.5% (56.6%) of all fail to deliver shares (by dollar value).

participant receives trades for clearance and settlement.<sup>100</sup> Consistent with temporary Rule 204T(d), Rule 204(d) provides for allocation of a fail to deliver position by a participant to a broker-dealer. Specifically, Rule 204(d) provides that if a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or from which it receives trades for settlement, based on such broker's or dealer's short position, the provisions of Rule 204(a) and (b) relating to such fail to deliver position shall apply to such registered broker or dealer that was allocated the fail to deliver position, and not to the participant.<sup>101</sup>

Thus, participants that are able to identify the accounts of broker-dealers for which they clear or from which they receive trades for settlement may allocate the responsibility to close out the fail to deliver position to the particular broker-dealer account(s) whose trading activities have caused the fail to deliver position provided the allocation is reasonable (e.g., the allocation must be timely). Absent such identification, however, the participant would remain subject to the close-out requirement.<sup>102</sup>

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<sup>100</sup> See temporary Rule 204T(d); see also 17 CFR 242.203(b)(3)(vi). Rule 203(b)(3)(vi) of Regulation SHO provides that "[i]f a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position, then the provisions of this paragraph (b)(3) relating to such fail to deliver position shall apply to the portion of such registered broker or dealer that was allocated the fail to deliver position, and not to the participant."

<sup>101</sup> See Rule 204(d).

<sup>102</sup> One commenter requested that we clarify whether an allocated broker-dealer may reasonably re-allocate to the broker-dealer from which it received the trade all or a portion of the fail to deliver position that it was allocated. This commenter stated that such re-allocation may continue until the fail position is allocated to the ultimate initiating broker-dealer. See letter from Bloomberg. We note that Rule 204(d) applies only to the allocation by a participant to a registered broker or dealer for which it clears trades or from which it receives trades for settlement. Thus, if a participant allocates all or a portion of a fail to deliver position to a broker-dealer, the close-out requirements of Rule 204 will apply to that allocated broker-dealer. This is consistent with the allocation provisions of temporary Rule 204T and Rule 203(b)(3) of Regulation SHO. Rule 204 does not, by its terms, apply to the allocation of costs by a broker-dealer in connection with meeting its close-out requirements.

If a participant allocates a fail to deliver position to a broker-dealer in accordance with Rule 204(d), such that the close-out requirements of Rule 204(a) apply to that broker-dealer, the broker-dealer to which the position was allocated must be able to demonstrate that on the applicable close-out date, it purchased or borrowed shares in the full quantity of the fail to deliver position allocated to it, and that it has a net flat or net long position on its books and records for that security on the applicable close-out date.<sup>103</sup>

In addition, as discussed above and consistent with temporary Rule 204T, the close-out requirements of Rule 204 require that the allocated broker-dealer take affirmative action to close out the fail to deliver position by purchasing or borrowing securities. Thus, a broker-dealer allocated a fail to deliver position may not offset the amount of its fail to deliver position with shares that the broker-dealer receives or will receive during the applicable close-out date (*i.e.*, during T+4 or T+6, as applicable).<sup>104</sup>

Temporary Rule 204T(d) imposes a notification requirement on a broker-dealer that has been allocated responsibility for complying with the rule's requirements. Specifically, temporary Rule 204T(d) provides that a broker-dealer that has been allocated a portion of a fail to deliver position that does not comply with the provisions of temporary Rule 204T(a) must immediately notify the participant that it has become subject to the borrowing requirements of temporary Rule 204T(b).<sup>105</sup> In the Rule 204T Adopting Release, we stated that we adopted this notification requirement so that participants would know when a broker-dealer for which they clear and settle trades has become subject to the temporary rule's borrowing requirements.<sup>106</sup>

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<sup>103</sup> See Rule 204(d); *see also supra* note 82.

<sup>104</sup> See *supra* note 81 and supporting text.

<sup>105</sup> See temporary Rule 204T(d).

<sup>106</sup> See Rule 204T Adopting Release, 73 FR at 61711.

We did not receive any comments specific to this notification requirement. We believe that the reasons for adopting this notification requirement in temporary Rule 204T(d) apply to Rule 204(d) as well. Thus, we have determined to maintain the requirement under Rule 204(d) that a broker-dealer that has been allocated a portion of a fail to deliver position that does not comply with the provisions of Rule 204(a) must immediately notify the participant that it has become subject to the borrowing requirements of Rule 204(b).<sup>107</sup>

## **B. Rule 204(b) - Borrowing Requirement**

### **1. Borrowing Requirement**

We are adopting in Rule 204(b) the requirements of temporary Rule 204T(b) without modification. If a participant does not purchase or borrow shares, as applicable, to close out a fail to deliver position in accordance with Rule 204, the participant violates the close-out requirement of the rule. Rule 204(b), like temporary Rule 204T(b), also imposes on the participant and on all broker-dealers from which that participant receives trades for clearance and settlement (including introducing and executing brokers), a requirement to borrow or arrange to borrow securities prior to accepting or effecting further short sales in that security. Specifically, Rule 204(b) provides that the participant and any broker-dealer from which it receives trades for clearance and settlement, including any market maker that is otherwise entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,<sup>108</sup> may not accept a short sale order in an equity security from another person, or effect a short sale order in such equity security for its own account, to the extent that the broker-dealer submits its short sales to that

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<sup>107</sup> See Rule 204(d).

<sup>108</sup> See 17 CFR 242.203(b)(2)(iii) (providing an exception from Regulation SHO's "locate" requirement for short sales effected by a market maker in connection with bona fide market making activities in the securities for which the exception is claimed).

participant for clearance and settlement, without first borrowing the security, or entering into a bona-fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.<sup>109</sup>

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

One commenter asked for clarification regarding whether a participant ceases to be subject to the borrow requirements of temporary Rule 204T(b) if that participant no longer has a fail to deliver position at a registered clearing agency due the participant borrowing the securities

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<sup>109</sup> See Rule 204(b). The borrow requirements of Rule 204(b) are also consistent with the requirements of Rule 203(b)(3)(iv) of Regulation SHO for a participant that has not closed out a fail to deliver position in a threshold security that has persisted for thirteen consecutive settlement days. See 17 CFR 242.203(b)(3)(iv). Rule 203(b)(3)(iv) of Regulation SHO provides that “[i]f a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a threshold security for thirteen consecutive settlement days, the participant and any broker or dealer for which it clears transactions, including any market maker that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(iii) of this section, may not accept a short sale order in the threshold security from another person, or effect a short sale in the threshold security for its own account, without borrowing the security or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity”.

or the participant receiving securities from the seller (e.g., in connection with long sales).<sup>110</sup>

Temporary Rule 204T(b) imposes short sale borrowing requirements until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency. Thus, under temporary Rule 204T regardless of whether a participant borrows or receives delivery of securities, the requirements of temporary Rule 204T(b) continue to apply until the participant purchases securities to close out the fail to deliver position and that purchase has cleared and settled at a registered clearing agency.

We have incorporated these same requirements into Rule 204(b) without modification. Rule 204(b) requires the purchase and clearance and settlement of shares purchased to help ensure that the fail to deliver position is closed out before the participant, and broker-dealers from which they receive trades for clearance and settlement, can accept or effect additional short sales without first borrowing or arranging to borrow such securities. Moreover, the provisions of Rule 204(b) are intended to act as an additional incentive to broker-dealers to deliver securities by settlement date, and to close out fail to deliver positions in accordance with the requirements of Rule 204. We believe that these goals would not be furthered absent the purchase requirement of Rule 204(b).

As discussed above in Section III.A.3, Rule 204(d) provides that a participant may reasonably allocate (e.g., the allocation must be timely) its responsibility to close out a fail to deliver position to another broker-dealer for which the participant clears or from which the participant receives trades for settlement. Thus, to the extent that the participant can identify the broker-dealer(s) that contributed to the fail to deliver position, and the participant has reasonably

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<sup>110</sup> See letter from SIFMA.

allocated the close-out obligation to the broker-dealer(s), the requirement to borrow or arrange to borrow prior to effecting further short sales in that security will apply to only those particular broker-dealer(s).

Rule 204(b), however, includes an exception from the borrowing requirements for any broker-dealer that can demonstrate that it was not responsible for any part of the fail to deliver position of the participant. We have incorporated into Rule 204(b) the language of temporary Rule 204T(b)(1), without modification. Thus, Rule 204(b) provides that a broker-dealer shall not be subject to the requirements of paragraph (b) of Rule 204 if the broker-dealer timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that the broker-dealer is in compliance with the requirements of Rule 204(e).<sup>111</sup> We have included this exception because we do not believe that a broker-dealer should be subject to the borrowing requirements of the temporary rule if the broker-dealer can demonstrate that it did not incur a fail to deliver position in the security on settlement date, or if it has taken steps, in accordance with Rule 204(e), to close out the fail to deliver position.

## **2. Notification Requirement**

In connection with the borrowing requirements of Rule 204(b), we are incorporating into Rule 204(c) the notification requirement contained in temporary Rule 204T(c), without modification. In accordance with Rule 204(c), participants must notify all broker-dealers from which they receive trades for clearance and settlement that a fail to deliver position has not been closed out in accordance with Rule 204. Specifically, Rule 204(c) provides that the participant must notify any broker-dealer from which it receives trades for clearance and settlement,

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<sup>111</sup> See Rule 204(b). Rule 204(e) is discussed in detail below in Section III.C.

including any market maker that is otherwise entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,<sup>112</sup> (a) that the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of Rule 204, and (b) when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.<sup>113</sup>

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

### C. Credit for Early Close-Outs

To encourage early close outs of fail to deliver positions, temporary Rule 204T(e) provides that a broker-dealer can satisfy the temporary rule's close-out requirement by purchasing securities in accordance with the conditions of that provision (i.e., broker-dealers will receive "pre-fail credit" for the purchase).<sup>114</sup> Encouraging early close outs of fail to deliver positions advances our goal of reducing fails to deliver. Thus, we have incorporated the conditions of temporary Rule 204T(e) into Rule 204 with some limited modifications to address commenters' concerns and to provide clarification regarding the applicability of the conditions.

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<sup>112</sup> See supra note 108.

<sup>113</sup> See Rule 204(c).

<sup>114</sup> See temporary Rule 204T(e).

Specifically, Rule 204(e) provides that even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with Rule 204(a), or has not allocated a fail to deliver position to a broker-dealer in accordance with Rule 204(d), a broker-dealer shall not be subject to the requirements of Rule 204(a) or (b) if the broker-dealer purchases or borrows<sup>115</sup> the securities, and complies with the conditions set forth in Rule 204(e)(1) through (4), as described in more detail below.

One commenter requested that we allow a broker-dealer to borrow as well as purchase shares to obtain credit for closing out a position prior to the applicable close-out date.<sup>116</sup> Temporary Rule 204T(e) provides that a broker-dealer must purchase securities to obtain credit for closing out a position prior to the applicable close-out date because under Rule 203(b)(3) of Regulation SHO, we understand that broker-dealers purchased shares to obtain credit for closing out fails to deliver in threshold securities prior to the thirteenth consecutive settlement day of having a fail to deliver position in such security. We believe, however, that allowing a broker-dealer to borrow as well as purchase securities to obtain credit for early close-outs is consistent with our goal of maintaining the benefits already achieved under temporary Rule 204T, as well as other actions by the Commission, such as the recent reduction in fails to deliver, by providing broker-dealers with additional flexibility in closing out fails to deliver. We also note that allowing a borrow is consistent with the close-out requirements of Rule 204(a) which permit a participant to close out fails to deliver on the applicable close-out date by either borrowing or purchasing securities.<sup>117</sup>

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<sup>115</sup> As discussed in more detail below, in contrast to temporary Rule 204T(c), Rule 204(e) permits a broker-dealer to borrow as well as purchase securities to close-out a fail to deliver position prior to the applicable close-out date.

<sup>116</sup> See letter from SIFMA.

<sup>117</sup> See Rule 204(a); see also *supra* Section III.A.1. (discussing the close-out requirements of Rule 204(a)).

Consistent with temporary Rule 204T(e)(1), to obtain pre-fail credit under Rule 204(e), the purchase or borrow must be "bona fide." Thus, where a broker-dealer enters into an arrangement with another person to purchase or borrow securities, and the broker-dealer knows or has reason to know that the other person will not deliver securities in settlement of the transaction, the purchase or borrow will not be "bona fide."<sup>118</sup>

Also consistent with temporary Rule 204T(e)(2), Rule 204(e)(2) provides that to obtain pre-fail credit, i.e., credit for purchases or borrows to close out fails to deliver resulting from short sales, the purchase or borrow must be executed after trade date but by no later than the end of regular trading hours on settlement date (i.e., T+3) for the transaction. Thus, the purchase or borrow must be executed on T+1, 2, or 3.

Temporary Rule 204T(e)(3) provides that the purchase must be of a quantity of securities sufficient to cover the entire amount of the broker-dealer's open short position. One commenter stated that it believes that the broker-dealer should only have to close out its open fail to deliver position, and not its open short position.<sup>119</sup> This commenter noted that a broker-dealer's open short position could far exceed its open fail to deliver position and, therefore, a requirement to purchase securities to close out the broker-dealer's entire open short position would not encourage early close outs of fail to deliver positions.<sup>120</sup>

The purpose of Rule 204(e) is to encourage broker-dealers to close out fail to deliver positions prior to the close-out date. Requiring a broker-dealer to close out its open fail to deliver position prior to the applicable close-out date is more effective at achieving that goal than

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<sup>118</sup> See infra Section III.F. (discussing bona fide purchases and borrows for purposes of the close-out requirements of Rule 204); see also 17 CFR 203(b)(3)(vii).

<sup>119</sup> See letter from SIFMA.

<sup>120</sup> See id.

requiring a broker-dealer to close out its open short position prior to the applicable close-date because a broker-dealer's open short position could far exceed its open fail to deliver position and, therefore, requiring close out of the potentially smaller fail to deliver position only is more likely to encourage broker-dealers to close out such positions early. Thus, in contrast to temporary Rule 204T(e)(3), Rule 204(e)(3) provides that a broker-dealer must purchase or borrow a quantity of securities sufficient to cover the entire amount of that broker-dealer's fail to deliver position at a registered clearing agency in that security, rather than the entire amount of the broker-dealer's open short position.<sup>121</sup>

In addition, to help ensure that broker-dealers purchase sufficient shares to close out their fail to deliver positions, Rule 204(e)(4) incorporates the condition of temporary Rule 204T(e)(4) that the broker-dealer that is purchasing or borrowing securities must be net flat or net long in that security on its books and records on the day of the purchase.<sup>122</sup> Consistent with temporary Rule 204T(e)(4), Rule 204(e)(4) requires that the broker-dealer demonstrate that it has complied with this requirement.<sup>123</sup> This requirement will enable the Commission and SROs to monitor more effectively whether or not a broker-dealer has complied with the requirements of Rule 204(e).

#### **D. Market Makers**

To allow broker-dealers that are market makers to facilitate customer orders in a fast moving market, temporary Rule 204T includes a limited exception from the temporary rule's close-out requirement for fails to deliver attributable to bona fide market making activities by

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<sup>121</sup> See Rule 204(e)(3).

<sup>122</sup> See Rule 204(e)(4).

<sup>123</sup> See *id.*

registered market makers, options market makers, or other market makers obligated to quote in the over-the-counter market. Temporary Rule 204T requires that such fails to deliver are closed out by no later than the beginning of regular trading hours on the third settlement day following the settlement date for the transaction (i.e., T+6).<sup>124</sup>

Similar to commenters' discussions regarding extending the close-out period to the end of the day for fails to deliver subject to the requirements of temporary Rule 204T(a) and (a)(1), commenters requested that we extend the market maker close-out period under temporary Rule 204T(a)(3) to the end of regular trading hours on the close-out date to help reduce buy-in risk.<sup>125</sup>

We recognize commenters' concerns regarding the market impact of temporary Rule 204T's close-out requirements, particularly at the market open. As discussed above, however, we believe, at this time, that it is appropriate to adopt temporary Rule 204T's requirement that fails to deliver, including fails to deliver resulting from market making activity, are closed out by no later than the beginning of regular trading hours on the applicable close-out date to help further our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and to maintain the benefits achieved pursuant to temporary Rule 204T. Thus, Rule 204(a)(3) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security that is attributable to bona fide market making activities by a registered market maker, options market maker, or other market

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<sup>124</sup> See temporary Rule 204T(a)(3).

<sup>125</sup> See, e.g., letters from NYSE; CBOE; The Specialist Association (discussing increased volatility at the opening of trading due to the requirement under temporary Rule 204T that fails to deliver be closed out by no later than the beginning of regular trading hours). One commenter recommended that we also extend the close-out period to five settlement days after settlement date (i.e., T+8) for fails to deliver resulting from bona fide market making activity. See letter from CBOE. For the reasons set forth in section III.A.1 above, discussing generally the close-out periods under Rule 204, we have determined not to extend the close-out period to provide additional days to close out such fails to deliver.

maker obligated to quote in the over-the-counter market, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date, immediately close out the fail to deliver position.<sup>126</sup>

In contrast to temporary Rule 204T(a)(3), however, Rule 204(a)(3) permits a participant to borrow securities to close-out a fail to deliver position. In temporary Rule 204T, we required a participant to purchase securities to close out fails to deliver attributable to bona fide market making activity to be consistent with the close-out requirements of Rule 203(b)(3) of Regulation SHO which require that a participant that has a fail to deliver position in a threshold security for thirteen consecutive settlement days immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity.<sup>127</sup>

Rule 204(a)(3) permits a borrow as well as a purchase to close out a fail to deliver position because we believe that such an amendment is consistent with our goal of maintaining the recent reduction in fails to deliver because it will provide additional flexibility to participants in closing out fail to deliver positions.<sup>128</sup> Permitting a borrow as well as a purchase will also make the close-out requirements of Rule 204(a)(3) consistent with the close-out requirements of Rule 204(a) and (a)(1).

As noted above and consistent with temporary Rule 204T, the close-out requirements of Rule 204 require that a broker-dealer take affirmative action to close out the fail to deliver position by purchasing or borrowing securities. Thus, under Rule 204(a)(3), a market maker

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<sup>126</sup> See Rule 204(a)(3).

<sup>127</sup> See 17 CFR 242.203(b)(3).

<sup>128</sup> See letter from CBOE (stating that the close-out procedures under temporary Rule 204T for fails to deliver attributable to bona fide market making activity should be amended to permit borrows or purchases throughout the close-out period).

may not offset the amount of a fail to deliver position with shares that it receives or will receive during the close-out date.<sup>129</sup>

Temporary Rule 204T(b)(2) included an exception from the borrowing requirements of temporary Rule 204T(b) for market makers that can demonstrate that they do not have an open short position in the equity security at the time of any additional short sales.<sup>130</sup> We do not believe that a similar exception is necessary under Rule 204(b) because, as with other broker-dealers, a market maker is excepted from the borrowing requirements of Rule 204(b) if it timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that it is in compliance with the requirements of Rule 204(e). Because Rule 204(b) includes an exception applicable to all broker-dealers, including market makers, we do not think it is necessary to maintain a separate exception applicable only to market makers.

#### **E. Sales of Certain Deemed to Own Securities**

Temporary Rule 204T(a)(2) includes an exception from the temporary rule's close-out requirements for sales of Rule 144 Securities.<sup>131</sup> Specifically, temporary Rule 204T(a)(2) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in an equity security sold pursuant to Rule 144 for thirty-five consecutive settlement days after the settlement date for a sale in that equity security, the participant shall, by no later than the beginning of regular trading hours on the thirty-sixth

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<sup>129</sup> See supra note 81 and supporting text.

<sup>130</sup> See temporary Rule 204T(b)(2).

<sup>131</sup> See 17 CFR 230.144.

consecutive settlement day following the settlement date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.<sup>132</sup>

Regulation SHO provides an exception from the “locate” requirement of Rule 203(b)(1) for situations where a broker-dealer effects a short sale on behalf of a customer that is deemed to own the security pursuant to Rule 200 of Regulation SHO, although, through no fault of the customer or broker-dealer, it is not reasonably expected that the security will be in the physical possession or control of the broker-dealer by settlement date and, therefore, is a “short” sale under the marking requirements of Rule 200(g). Rule 203(b)(2)(ii) of Regulation SHO provides that in such circumstances, delivery must be made on the sale as soon as all restrictions on delivery have been removed, and in any event no later than 35 days after trade date, at which time the broker-dealer that sold on behalf of the person must either borrow securities or close out the open position by purchasing securities of like kind and quantity.<sup>133</sup> In addition, in 2007 we adopted amendments to the close-out requirement of Regulation SHO to allow fails to deliver resulting from sales of threshold securities pursuant to Rule 144 to be closed out within 35 rather than 13 consecutive settlement days.<sup>134</sup>

We included in temporary Rule 204T an exception for Rule 144 Securities because these securities are formerly restricted securities that a seller is “deemed to own,” as defined by Rule 200(a) of Regulation SHO.<sup>135</sup> The securities, however, may not be capable of being delivered on

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<sup>132</sup> See temporary Rule 204T(a)(2).

<sup>133</sup> See 17 CFR 242.203(b)(2)(ii). In the 2004 Regulation SHO Adopting Release, the Commission stated that it believed that 35 calendar days is a reasonable outer limit to allow for restrictions on a security to be removed if ownership is certain. In addition, the Commission noted that Section 220.8(b)(2) of Regulation T of the Federal Reserve Board allows 35 calendar days to pay for securities delivered against payment if the delivery delay is due to the mechanics of the transactions. See 2004 Regulation SHO Adopting Release, 69 FR at 48015, n.72.

<sup>134</sup> See 2007 Regulation SHO Final Amendments, 72 FR at 45550-45551.

<sup>135</sup> See 17 CFR 242.200(a).

the settlement date due to processing delays related to removal of the restricted legend and, therefore, sales of these securities frequently result in fails to deliver. In addition, this exception is consistent with our statements in connection with our recent amendments to Rule 203(b)(3) of Regulation SHO which extended the close-out requirements of that rule for fails to deliver in threshold securities sold pursuant to Rule 144.<sup>136</sup> We limited the exception in temporary Rule 204T to Rule 144 Securities, rather than extending the exception to all formerly restricted securities that a seller is “deemed to own,” to remain consistent with Rule 203(b)(3) of Regulation SHO.

In response to a request for comment, one commenter that discussed the requirements of temporary Rule 204T(a)(2) relating to fails to deliver resulting from sales of Rule 144 Securities urged the Commission to retain the exception, and to extend it to cover sales of other securities that a person owns, but is unable to deliver on settlement date.<sup>137</sup> In particular, the commenter stated that the exception should apply to the same universe of securities to which the exception in Rule 203(b)(2)(ii) of Regulation SHO applies.<sup>138</sup> In addition, the commenter stated that for those securities subject to the close-out requirements of temporary Rule 204T(a)(2) and the delivery requirements of Rule 203(b)(2)(ii) there is confusion as to which time-frame for closing out fails to deliver resulting from sales of these securities should apply.<sup>139</sup> We note, however, that rather than changing the close-out requirement of temporary Rule 204T(a)(2), this commenter

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<sup>136</sup> See 2007 Regulation SHO Final Amendments, 72 FR at 45550-45551.

<sup>137</sup> See letter from SIFMA.

<sup>138</sup> See *id.*; see also *supra* note 133, and accompanying text.

<sup>139</sup> See letter from SIFMA.

recommended extending the delivery time-frame of Rule 203(b)(2)(ii) of Regulation SHO to 35 settlement days, rather than calendar days, from trade date.<sup>140</sup>

After considering the comments and to provide consistency between the delivery requirements of Rule 203(b)(2)(ii) of Regulation SHO and the close-out requirements of Rule 204, we are adopting in Rule 204(a)(2) the requirements of temporary Rule 204T(a)(2) with some modifications. Specifically, we are expanding the universe of securities to which Rule 204(a)(2) will apply. It will apply to fails to deliver resulting from the sale of an equity security that a person is “deemed to own” pursuant to Rule 200 of Regulation SHO and that such person intends to deliver as soon as all restrictions on delivery have been removed.<sup>141</sup> In addition, we are revising the close-out period within which a participant must close out fails to deliver resulting from sales of such securities to be consistent with the delivery period contained in Rule 203(b)(2)(ii) of Regulation SHO. Accordingly, Rule 204(a)(2) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security resulting from the sale of a security that a person is deemed to own pursuant to Rule 200 of Regulation SHO and that such person intends to deliver as soon as all restrictions on delivery have been removed, the participant shall, by no later than the beginning of regular

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<sup>140</sup> See *id.*

<sup>141</sup> Such circumstances could include the situation where a convertible security, option, or warrant has been tendered for conversion or exchange, but the underlying security is not reasonably expected to be received by settlement date. See 2004 Regulation SHO Adopting Release, 69 FR at 48015; see also 17 CFR 242.200(b) (defining when a person shall be “deemed to own” a security). Another situation could include the sale of a Rule 144 Security. See Rule 204T Adopting Release, 73 FR at 61715. In addition, we understand that sellers that own restricted equity securities that wish to sell pursuant to an effective resale registration statement under Rule 415 under the Securities Act experience similar types of potential settlement delays as sales of Rule 144 Securities. Thus, fails to deliver in such securities may be closed out in accordance with Rule 204(a)(2) if the fails to deliver resulted from sales of securities that were outstanding at the time they were sold and the sale occurred after a registration has become effective. In addition, we understand that sales pursuant to broker-assisted cashless exercises of compensatory options to purchase a company’s stock, may result in potential settlement delays and, therefore, fails to deliver. Such fails to deliver may be closed out in accordance with Rule 204(a)(2).

trading hours on the thirty-fifth consecutive calendar day following the trade date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.<sup>142</sup>

In addition to being consistent with the delivery time-frame under Rule 203(b)(2)(ii) of Regulation SHO, we believe that a close-out requirement of 35 consecutive calendar days from trade date for fails to deliver resulting from sales of such owned securities will permit the orderly settlement of such sales without the risk of causing market disruption due to unnecessary purchasing activity (particularly if the purchases are for sizable quantities of stock). Because the security being sold will be received as soon as all processing delays have been removed, this additional time will allow participants to close out fails to deliver resulting from the sale of the security with the security sold, rather than having to close out such fail to deliver position by purchasing securities in the market. In addition, we note that although a commenter requested that we maintain the close-out requirement of temporary Rule 204T(a)(2) but amend the delivery time-frame of Rule 203(b)(2)(ii) of Regulation SHO to 35 settlement rather than calendar days, we have determined not to make such an amendment because we believe that 35 calendar days from trade date should be a sufficient period of time within which delivery can be made on sales of such securities. We also note that 35 calendar days from trade date is the delivery time-frame with which broker-dealers have had to comply since the effective date of Regulation SHO in January 2005, if relying on the exception in Rule 203(b)(2)(ii) to the rule's locate requirement. We are not aware that broker-dealers have been unable to comply with this delivery requirement.

Although this amendment will provide an extended period of time within which fails to deliver resulting from sales of certain "deemed to own" securities must be closed out, we believe

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<sup>142</sup> See Rule 204(a)(2).

that such additional time is warranted and does not undermine our goal of reducing fails to deliver because these are sales of owned securities that cannot be delivered by settlement date due solely to processing delays outside the seller's or broker-dealer's control. Moreover, delivery will be made on such sales as soon as all restrictions on delivery have been removed. In addition, Rule 204(b)'s borrowing requirements will help ensure that, if a fail to deliver position is not closed out in accordance with Rule 204(a)(2), additional fails to deliver cannot occur until securities have been purchased to close out the fail to deliver position and such purchase has cleared and settled. If a participant does not close out a fail to deliver position at a registered clearing agency in accordance with Rule 204(a)(2), the rule prohibits the participant, and any broker-dealer from which it receives trades for clearance and settlement, including market makers, from accepting any short sale orders or effecting further short sales in the particular security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the entire fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.<sup>143</sup> In addition, we intend to closely monitor whether fails to deliver are being closed out in accordance with the requirements of Rule 204(a)(2).

#### **F. Sham Close-Outs**

In the Rule 204T Adopting Release, we stated that it is possible under Regulation SHO that a close out by a participant of a registered clearing agency may result in a fail to deliver position at another participant if the counterparty from which the participant purchases securities fails to deliver. We also noted, however, that Regulation SHO prohibits a participant of a registered clearing agency, or a broker-dealer for which it clears transactions, from engaging in

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<sup>143</sup> See Rule 204(b).

“sham close outs” by entering into an arrangement with a counterparty to purchase securities for purposes of closing out a fail to deliver position and the purchaser knows or has reason to know that the counterparty will not deliver the securities, and which thus creates another fail to deliver position.<sup>144</sup> Because these same concepts apply to the close-out requirements of Rule 204, we have determined to include rule text in subparagraph (f) of Rule 204 to provide that a participant of a registered clearing agency shall not be deemed to have fulfilled the requirements of Rule 204 where the participant enters into an arrangement with another person to purchase or borrow securities as required by Rule 204, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow.<sup>145</sup>

**G. De Minimis Fail to Deliver Positions**

Some commenters requested that the Commission consider including an exception from temporary Rule 204T’s close-out requirements where a participant’s fail to deliver position at a registered clearing agency is below a certain amount.<sup>146</sup> One commenter suggested that such an exception be voluntary so that firms could decide whether or not to take advantage of the exception based on their particular business model and capabilities.<sup>147</sup> Another commenter noted that de minimis fails to deliver are particularly likely to occur in connection with odd lot trading.<sup>148</sup> This commenter stated that it believes that permitting a de minimis fail to deliver,

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<sup>144</sup> See Rule 204T Adopting Release, 73 FR at 61714, n.78; see also 17 CFR 242.203(b)(3)(vii); 2004 Regulation SHO Adopting Release, 69 FR at 48018, n.96.

<sup>145</sup> See Rule 204(f).

<sup>146</sup> See, e.g., letters from SIFMA; NYSE; Wedbush; Lek Securities Corporation; CBOE; BATS; EWT; The Specialist Association.

<sup>147</sup> See letter from SIFMA.

<sup>148</sup> See, e.g., letter from NYSE (stating that by operation of NYSE and NYSE Alternext rules, odd lot executions take place automatically, with the designated market maker (“DMM”) acting as the contra-side to all odd lot trades. As a result, DMMs may sell short in a de minimis amount automatically and without prior knowledge.

particularly in less-than-round lots, would not undermine the intent of temporary Rule 204T.<sup>149</sup>

Other commenters, in discussing odd lot orders and fails to deliver, recommended a de minimis exception for fails to deliver of less than 1,000 shares.<sup>150</sup> One other commenter recommended a de minimis exception that would except a fail to deliver position from the close-out requirements if the net value of the fail in the particular security across all firm accounts is under one million dollars.<sup>151</sup>

A primary goal of Rule 204 is to continue the recent reduction in fails to deliver. We believe that an exception from Rule 204's close-out requirements that would permit certain fails to deliver to persist indefinitely could undermine this goal. Accordingly, we have determined at this time not to include a de minimis or odd-lot related exception that would permit such fails to deliver to not have to be closed out. We will continue to monitor, however, whether a de minimis or odd-lot related exception is appropriate.

#### IV. Administrative Procedure Act

Section 553(d) of the Administrative Procedure Act ("APA") provides that a substantive rule generally may not be made effective less than 30 days after notice is published in the Federal Register.<sup>152</sup> Section 553(d), however, also provides an exception to the 30-day requirement where an agency finds good cause for providing a shorter effective date.<sup>153</sup>

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This commenter further stated that if the odd lot trade occurs in hard-to-borrow or illiquid securities, the DMM may not be able to avoid failing to deliver).

<sup>149</sup> See letter from NYSE.

<sup>150</sup> See letters from The Specialist Association; Wedbush.

<sup>151</sup> See letter from EWT; see also letter from Lek Securities Corporation.

<sup>152</sup> 5 U.S.C. 553(d).

<sup>153</sup> See *id.* at 553(d)(1), (d)(3).

Temporary Rule 204T will expire on July 31, 2009. Rule 204 makes permanent the provisions of temporary Rule 204T with limited modifications to address commenters' concerns and to help ensure the workability of the rule on a permanent basis. Rule 204 is intended to help maintain the benefits achieved in part by temporary Rule 204T, such as maintaining the recent reduction in fails to deliver, and address potentially abusive "naked" short selling by strengthening the close-out requirements of Regulation SHO. A gap between the expiration of temporary Rule 204T and the effective date of Rule 204 would be contrary to these purposes and goals. Rule 204 in significant part, moreover, continues the restrictions on short selling that are currently in place, and with which participants are already familiar. In addition, the modifications that are made in Rule 204 from Rule 204T relieve participants of some of the regulatory burdens imposed by temporary Rule 204T by, for example, allowing participants to close out fail to deliver positions from long sales and market making activities by borrowing securities. Thus, the Commission finds that there is good cause for making Rule 204 effective on July 31, 2009.

**V. Amendments to Rule 30-3**

The Commission is adopting an amendment to Rule 30-3 of its Rules of Organization and Program Management governing delegations of authority to the Director of the Division of Trading and Markets (the "Director").<sup>154</sup> The amendment delegates to the Director the authority to grant by order an exemption from the provisions of Regulation SHO of the Exchange Act, under Section 36 of the Exchange Act. Such an exemption may be granted either unconditionally, or on specified conditions.

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<sup>154</sup> See 17 CFR.200.30-3

Section 36 of the Exchange Act provides that “the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this chapter or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.”<sup>155</sup>

This delegation of authority to the Director is intended to conserve Commission resources and provide market participants needed flexibility by allowing the staff, pursuant to Section 36(a) of the Exchange Act, to review and act by order on applications for exemptions from Regulation SHO. Pursuant to the amendment, the Director may consider and act upon appropriate requests for relief from the provisions of Regulation SHO, and will consider the particular facts and circumstances relevant to each such request, the potential ramifications of granting any exemptive relief, and any appropriate conditions to be imposed as part of such an exemption.

The Commission anticipates that the delegation of authority will facilitate efficient review. Nevertheless, the staff may submit matters to the Commission for consideration as it deems appropriate, and the Commission “may, in its sole discretion, decline to entertain any application for an order of exemption under this section.”<sup>156</sup>

The Commission finds, in accordance with the Administrative Procedure Act, 5 U.S.C. 553(b)(3)(A), that this amendment to Rule 30-3 relates solely to agency organization, procedure and practice and thus, notice and the opportunity for public comment before its effective date are unnecessary. In addition, because the amendment to Rule 30-3 relates solely to the internal

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<sup>155</sup> See 15 U.S.C. 78mm(a)

<sup>156</sup> See 15 U.S.C. 78mm(a)(2).

processes of the Commission with regard to the grant of exemptions from the provisions of Regulation SHO, the Commission finds, pursuant to Section 553(d)(3) of the Administrative Procedure Act, 5 U.S.C. 553(d)(3), that there is good cause for making the amendment effective upon publication in the Federal Register. For similar reasons, the amendment does not require an analysis under the Regulatory Flexibility Act or analysis of major status under the Small Business Regulatory Enforcement Fairness Act.<sup>157</sup>

## VI. Paperwork Reduction Act

Like temporary Rule 204T, several provisions under Rule 204 will impose a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("Paperwork Reduction Act").<sup>158</sup> These collections of information are mandatory. With the single exception of the elimination in Rule 204 of the exception in temporary Rule 204T(b)(2) for market makers from the borrowing requirement in Rule 204(b),<sup>159</sup> all collections of information from temporary Rule 204T have been incorporated into Rule 204 without modification. The collection of information requirements of temporary Rule 204T have not been substantively or materially modified in Rule 204; therefore, the time and cost estimates for compliance with these provisions

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<sup>157</sup> See 5 U.S.C. 601(2) (for purposes of Regulatory Flexibility Act analysis, the term "rule" means any rule for which the agency publishes a general notice of proposed rulemaking) and 5 U.S.C. 804(3)(C) (for purposes of congressional review of agency rulemaking, the term "rule" does not include any rule of agency organization, procedure, or practice that does not substantially affect the rights or obligations of non-agency parties).

<sup>158</sup> 44 U.S.C. 3501 *et seq.*

<sup>159</sup> In contrast to temporary Rule 204T(b), Rule 204(b) does not include an exception from the borrowing requirement of the Rule specific to market makers. We eliminated this exception because, as with other broker-dealers, a market maker is excepted from the borrowing requirements of Rule 204(b) if it timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at the registered clearing agency or that it is in compliance with the requirements of Rule 204(c). Market makers, like all other broker-dealers, will continue to be subject to the certification requirements under Rule 204(b). See *supra* Section III.B. (discussing Rule 204(b)).

are the same for Rule 204 as our prior time and cost estimates for temporary Rule 204T, which we incorporate by reference.<sup>160</sup>

We published a notice of our estimated time requirements for participants to comply with these collection of information provisions and requested comment on the collection of information requirements in connection with temporary Rule 204T. We submitted the collection of information to OMB for review and approval in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13.

One commenter indicated that compliance with temporary Rule 204T resulted in an increase in man-hours to monitor multiple levels of data across various system platforms and business units within a firm,<sup>161</sup> and other commenters expressed general concerns with the administrative and operational burdens on clearing firms, customers, and their regulators.<sup>162</sup> The Commission, however, did not receive any comments as to the burdens associated with the collection of information requirements in temporary Rule 204T.

The information collected under Rule 204 will continue to be retained and/or provided to other entities pursuant to the specific rule provisions and will be available to the Commission and SRO examiners upon request. The information collected will continue to aid the Commission and SROs in monitoring compliance with these requirements. In addition, the information collected will aid those subject to Rule 204 in complying with its requirements.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for

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<sup>160</sup> See Rule 204T Adopting Release, 73 FR at 61717-61722.

<sup>161</sup> See letter from SIFMA. The commenter noted that one firm indicated its operations personnel initially spent an extra 60 man-hours per day to comply with the rule, but acknowledged that time amount had tapered down through automation. The comment is addressed more directly in the cost-benefit analysis in Section VII below.

<sup>162</sup> See e.g., letters from CBOE; State Street.

the collection of information is changed from "Temporary Rule 204T" to "Rule 204" to indicate that the collection is no longer with regard to a temporary rule and the OMB control number for the collection of information is 3235-0647.

## VII. Cost-Benefit Analysis

### A. Summary

The Commission is sensitive to the costs and benefits of its rules and we have considered such with respect to the adoption of Rule 204 of Regulation SHO. We are incorporating by reference the cost-benefit discussion in the Rule 204T Adopting Release, except to the extent that we have made modifications or because we are addressing comments.

In order to assist our evaluation, we solicited comment via questions as to the costs and benefits of temporary Rule 204T, which is substantially similar to Rule 204. We address these comments as applied to permanent Rule 204 in detail below. In addition, we discuss in more detail below that we believe the benefits of adopting Rule 204 justify its costs. We also believe that the benefits of adopting Rule 204 justify forgoing benefits that might accrue if the Commission were to allow temporary Rule 204T to expire without a substantially similar replacement.<sup>163</sup>

As discussed above, preliminary results from OEA indicate that our actions to further reduce fails to deliver and, thereby, help address potentially abusive "naked" short selling are having their intended effect. For example, these preliminary results indicate a significant downward trend in the number of fails to deliver in all equity securities since, in addition to other measures, the adoption of temporary Rule 204T.<sup>164</sup>

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<sup>163</sup> Temporary Rule 204T will expire on July 31, 2009.

<sup>164</sup> See Memorandum from OEA Re: Impact of Recent SHO Rule Changes on Fails to Deliver, November 26, 2008 at <http://www.sec.gov/comments/s7-30-08/s73008-37.pdf>; see also Memorandum from OEA Re: Impact of

Due to the positive impact that temporary Rule 204T, among other actions, is having on reducing fails to deliver and after considering the comments received, we believe adopting the provisions of that rule in a permanent rule, Rule 204 of Regulation SHO, with limited modifications to promote the rule's workability and address commenters' concerns, will further the goals outlined above and below. We believe these modifications will aid compliance with Rule 204.

We believe that Rule 204 will help maintain the recent reduction in fails to deliver and address potentially abusive "naked" short selling in all equity securities by requiring that, subject to certain limited exceptions, if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency it must immediately purchase or borrow securities to close out the fail to deliver position by no later than the beginning of regular trading hours on the settlement day following the day the participant incurs the fail to deliver position. We recognize that, like temporary Rule 204T, Rule 204 may impose increased purchasing and borrowing costs beyond those that would occur if the rule was not in place and that these costs may increase the costs of legitimate short selling. We believe, however, that continuing the requirements of temporary Rule 204T by adopting them in Rule 204 is necessary to maintain the reduction in fails to deliver and to continue to address potentially abusive "naked" short selling. We believe that continuing these benefits achieved under temporary Rule 204T justifies the potential costs associated with making the requirements of that rule permanent.

Further, we believe that the benefits of making the requirements of temporary Rule 204T permanent in Rule 204 will justify forgoing any potential benefits that might accrue if the

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Recent SHO Rule Changes on Fails to Deliver, March 20, 2009 at <http://www.sec.gov/comments/s7-30-08/s73008-107.pdf>; Memorandum from OEA Re: Impact of Recent SHO Rule Changes on Fails to Deliver, April 16, 2009 at <http://www.sec.gov/comments/s7-30-08/s73008-121.pdf>.

Commission were to allow temporary Rule 204T to expire. If the Commission were to allow temporary Rule 204T to expire without replacement, there might be potential benefits. For example, some commenters noted that they believe that there has been price disruption and market volatility resulting from temporary Rule 204T's requirement that participants close out fails to deliver by no later than the beginning of regular trading hours on the applicable close-out date.<sup>165</sup> Some commenters stated that temporary Rule 204T's close-out requirements cause over-buying and over-borrowing at the market open by parties seeking to meet the close-out requirements and has unnecessarily interfered in transactions that would settle in the normal course.<sup>166</sup>

If we were to allow temporary Rule 204T to expire without adopting a substantially similar rule, the marketplace would revert back to the close-out requirements of Rule 203(b)(3) of Regulation SHO that apply only to those securities with a large and persistent level of fails to deliver, *i.e.*, threshold securities, and only to those fail to deliver positions that have persisted for thirteen consecutive settlement days.<sup>167</sup> Thus, it is plausible that a return to this pre-temporary Rule 204T close-out requirement might alleviate concerns expressed by commenters regarding potential over-buying, over-borrowing, volatility, and price disruption at the market open, be easier to comply with and, therefore, potentially reduce transaction costs to market participants. Further, according to some commenters, temporary Rule 204T may provide disincentives to lenders of securities and, thus, may cause lower liquidity levels in the market place.<sup>168</sup>

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<sup>165</sup> See *e.g.*, letters from BATS; LEK; MFA; SIFMA; State Street.

<sup>166</sup> See, *e.g.*, letter from SIFMA.

<sup>167</sup> See 17 CFR 242.203(b)(3).

<sup>168</sup> See letters from BATS; ICI; SIFMA.

In addition, if we were to allow temporary Rule 204T to expire without taking substantially similar action, participants might experience fewer costs in terms of monitoring systems platforms and notification obligations associated with complying with temporary Rule 204T<sup>169</sup> and with Rule 204. For instance, the demonstration and notification requirements of temporary Rule 204T and Rule 204 and related compliance costs in terms of personnel, recordkeeping, systems, and surveillance mechanisms would not apply. However, as noted in the temporary Rule 204T Adopting Release, we believe any potential additional costs incurred in implementing the collection of information requirements under temporary Rule 204T would be minimal. We believe the same with respect to the costs associated with Rule 204. In addition, we note that most of the infrastructure necessary to comply with Rule 204 should already be in place in order to meet the close-out requirements of Rule 203(b)(3) of Regulation SHO and, more recently, of temporary Rule 204T.

For the reasons articulated above and below, in more detail, we believe that a reversion to the pre-temporary Rule 204T close-out regime would result in a number of costs to the securities markets in the forms of an increase in the level of fails to deliver and a lack of incentive for sellers to promptly deliver securities by settlement date. Such results would undermine our goals of reducing fails to deliver and addressing potentially abusive “naked” short selling.

As previously noted, and stated in the temporary Rule 204T Adopting Release, we are concerned that the close-out requirements of Regulation SHO do not adequately address our goals of reducing fails to deliver and addressing potentially abusive “naked” short selling.<sup>170</sup> In part due to such concerns, we have taken measures to help further reduce fails to deliver in all

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<sup>169</sup> See letters from CBOE; SIFMA; State Street (noting some of the potential costs associated with complying with temporary Rule 204T’s close-out requirements).

<sup>170</sup> See, e.g., Rule 204T Adopting Release, 73 FR at 61711-61712.

equity securities. As discussed above, OEA's findings regarding the impact of temporary Rule 204T, and other Commission actions, indicate a significant reduction in the number of fails to deliver.<sup>171</sup> Thus, we believe it is necessary to adopt temporary Rule 204T's close-out requirements in a permanent rule, Rule 204, such that fails in all equity securities must be closed out within specific timeframes and, thereby, help maintain the recent reduction in fails to deliver and the benefits already achieved.

#### **B. Benefits**

By continuing to require that participants of a registered clearing agency immediately close-out a fail to deliver position on the applicable close-out date, Rule 204 will further our goals of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive "naked" short selling. This, in turn, will help to ensure that investors remain confident that trading can be conducted without the influence of illegal manipulation.<sup>172</sup> The rule also furthers the goals of helping to maintain fair and orderly markets against the threat of sudden and excessive fluctuations of securities prices and substantial disruption in the functioning of the securities markets. The rule also promotes the prompt and accurate clearance and settlement of transactions in equity securities.

In addition, by helping to further our goal of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, Rule 204, like temporary Rule 204T, will help continue to

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<sup>171</sup> See *supra* note 164.

<sup>172</sup> See 2006 Regulation SHO Proposed Amendments, 71 FR at 41712; 2007 Regulation SHO Final Amendments, 72 FR at 45545; 2007 Regulation SHO Proposed Amendments, 72 FR at 45558-45559; Anti-Fraud Rule Proposing Release, 73 FR at 15378; Rule 204T Adopting Release, 73 FR at 61709-61710 (providing discussion of the impact of fails to deliver on the market); see also 2003 Regulation SHO Proposing Release, 68 FR at 62975 (Nov. 6, 2003) (discussing the impact of "naked" short selling on the market).

address concerns that fails may create a misleading impression of the market for securities. Large and persistent fails to deliver may have a negative effect on shareholders, potentially depriving them of the benefits of ownership, such as voting and lending.<sup>173</sup> Thus, by facilitating the prompt receipt of shares, Rule 204 will help enable investors to receive the benefits associated with share ownership.

Persistent fails to deliver in a security may also be perceived by potential investors negatively and may affect their investment decisions.<sup>174</sup> Thus, providing greater assurance that securities will be delivered might help alleviate investor apprehension about investing in certain securities and increase investor confidence in the settlement process.<sup>175</sup>

#### 1. Close-out Requirements

By maintaining the close-out requirements of temporary Rule 204T we believe Rule 204 will continue to help restore, maintain, and enhance investor confidence in the securities markets. It will also help continue to limit the use of manipulative schemes involving “naked” short selling in all equity securities.<sup>176</sup> Without the requirements of Rule 204, sellers that fail to deliver securities on settlement date may attempt to engage in trading activities that deliberately depress the price of a security. Rule 204’s close-out requirements will continue the limitations on a potential means of manipulation, thereby decreasing the possibility of artificial market influences and contributing to price efficiency. Rule 204’s close-out requirements are also expected to prevent large, widespread build-ups of fails over time.

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<sup>173</sup> See supra Section II. (discussing the potential negative impact of large and persistent fail to delivers).

<sup>174</sup> See id.

<sup>175</sup> See id.

<sup>176</sup> See 204T Adopting Release, 73 FR at 61709-61710.

As in temporary Rule 204T(a), Rule 204(a) provides that a participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date or, if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity.<sup>177</sup> Similarly, consistent with temporary Rule 204T(a)(1) and (a)(3), the close-out requirements of Rule 204(a)(1) and (a)(3) for fails to deliver resulting from long sales and certain bona fide market making activity must be closed out by the beginning of regular trading hours on the close-out date for such fails to deliver (i.e., T+6).<sup>178</sup>

As discussed in Section III above, some commenters requested that we extend the close-out period for fails to deliver resulting from short sales, long sales, and bona fide market making activity from the beginning to the end of regular trading hours on the applicable close-out date. Commenters expressed concern that temporary Rule 204T's requirement to close out fails to deliver by no later than the beginning of regular trading hours can create buying pressure at the open, that may temporarily distort the price of the security.<sup>179</sup>

Other commenters requested additional days within which to close out fails to deliver in connection with short sales. For example, some commenters requested that the Commission extend the close-out period for fails to deliver resulting from short sales to three settlement days

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<sup>177</sup> See Rule 204(a).

<sup>178</sup> See Rules 204(a)(1) and 204(a)(3).

<sup>179</sup> See, e.g., letters from MFA; CBOE; SIFMA; BATS; RMA; State Street.

after the fail occurs, consistent with the close-out period for fails to deliver resulting from long sales and market making activity.<sup>180</sup> Other commenters requested that the Commission extend the close-out requirement for fails to deliver resulting from all sales to five settlement days after the fail to deliver position occurs.<sup>181</sup> These commenters stated that the additional time to close out fails to deliver would allow the majority of trades to clear and settle on their own within a few days following the regular settlement date (i.e., T+3).<sup>182</sup>

Some commenters expressed concerns about the effect of the close-out requirements of temporary Rule 204T on securities lending.<sup>183</sup> One commenter also noted that in practice fails to deliver resulting from sales of securities on loan, which are considered “long” sales, are often closed out in accordance with the time-frames for fails to deliver resulting from short sales rather than long sales because temporary Rule 204T does not provide sufficient time to determine whether or not a fail to deliver position resulted from a long or short sale.<sup>184</sup> According to this commenter, because some broker-dealers are purchasing securities by no later than the beginning of regular trading hours on the settlement date after the fail to deliver occurs, in accordance with the close-out requirements for short sales, such purchasing activity acts as a disincentive to lending and causes institutions to question their participation in lending programs.<sup>185</sup>

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<sup>180</sup> See e.g., letters from EWT; Coalition of Private Investment Companies; SIFMA; MFA; State Street.

<sup>181</sup> See e.g., letters from CBOE; Options Exchanges.

<sup>182</sup> See e.g., letters from SIFMA; MFA; State Street; CBOE; Options Exchanges; Coalition of Private Investment Companies.

<sup>183</sup> See e.g., letter from SIFMA.

<sup>184</sup> See letter from SIFMA; see also letters from RMA; ICI.

<sup>185</sup> See letter from SIFMA; see also letter from RMA (recommending the extension of the close-out period for fails to deliver for all sales to settlement date plus three days (i.e., T+6) “to ensure that beneficial owners selling on-loan positions are not compromised by close-outs of long sales on T+4”).

Other commenters stated that where the holder of a long position sells securities that have been financed through a securities loan, the close-out requirements of temporary Rule 204T may not provide sufficient time for the securities to be recalled and delivered in time for settlement of the sale transaction.<sup>186</sup> These commenters stated, among other things, that temporary Rule 204T's requirement that securities be delivered by no later than the beginning of regular trading hours does not allow for the completion of the securities lending cycle, which may not occur until the close of the DTC settlement window on the third settlement day after settlement date (i.e., T+6).<sup>187</sup>

Although we recognize commenters' concerns regarding the potential market impact of the close-out requirements of temporary Rule 204T, particularly at the market open, we believe that these potential concerns are justified by the benefits of retaining in Rule 204 the strict close-out requirements of temporary Rule 204T. As discussed above, since the adoption of temporary Rule 204T, and other actions taken by the Commission aimed at reducing fails to deliver, there has been a significant reduction in fails to deliver. To maintain this reduction, we believe it is appropriate at this time to continue to require that participants close out fails to deliver by no later than the beginning of regular trading hours on the applicable close-out date. Thus, we are adopting as a permanent rule the requirement that fails to deliver resulting from short sales, long sales, and certain bona fide market making activity must be closed out by no later than the beginning of regular trading hours on the applicable close-out date.

In addition, we believe that continuing to require that fails to deliver be closed out on the day immediately following the day on which the fail to deliver occurs is consistent with our goals of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the

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<sup>186</sup> See letters from EWT; BATS; RMA; ICI; Wedbush.

<sup>187</sup> See letters from EWT; BATS; RMA; ICI; RMA.

adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing “naked” short selling and, in particular, potentially abusive “naked” short selling. Although extending the time-frames within which fails to deliver must be closed out may allow for ordinary course settlement, as several commenters contend, we believe that the close-out requirements of Rule 204 are necessary to help encourage delivery by settlement date and achieve our goal of not allowing fails to deliver to persist.<sup>188</sup>

As we discussed in the Rule 204T Adopting Release, we believe that delivery on sales should be made by settlement date.<sup>189</sup> In the Rule 204T Adopting Release, we noted that the vast majority of fails to deliver are closed out within five days after T+3.<sup>190</sup> In addition, in that release we referenced a recent analysis by OEA that found that more than half of all fails to deliver and more than 70% of all fail to deliver positions are closed out within two settlement days after T+3.<sup>191</sup> We also noted in that release, however, that although this information shows that delivery is being made, it demonstrates that often delivery is not being made until several days following the standard three-day settlement cycle.

In addition, as discussed above, fails to deliver may be associated with a scheme to manipulate the price of a security. We are also concerned about the negative effect that fails to deliver and potentially abusive “naked” short selling may have on individual securities and the

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<sup>188</sup> See supra note 16 (discussing the standard three-day settlement cycle).

<sup>189</sup> See Rule 204T Adopting Release, 73 FR at 61712 – 61713.

<sup>190</sup> See id.

<sup>191</sup> See id. at n. 68. We note that OEA’s analysis examined the period from January to July 2008 and used the age of the fail to deliver position as reported by the NSCC. The NSCC data included only securities with at least 10,000 shares in fails to deliver. These numbers also included securities that were not subject to the close-out requirement in Rule 203(b)(3) of Regulation SHO, which applies only to “threshold securities” as defined in Rule 203(c)(6) of Regulation SHO.

broader market, including on investor confidence.<sup>192</sup> The close-out requirements of Rule 204 help address these concerns by encouraging timely settlement and not allowing fails to deliver to persist.

We understand, however, that fails to deliver may occur from long sales within the first two settlement days after settlement date for legitimate reasons. For example, human or mechanical errors or processing delays can result from transferring securities in custodial or other form rather than book-entry form, thereby causing a fail to deliver on a long sale.

Thus, in Rule 204(a)(1), we are adopting, with certain limited modifications, the provisions of temporary Rule 204T(a)(1) relating to closing out fails to deliver resulting from long sales. Specifically, Rule 204(a)(1) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security and the participant can demonstrate on its books and records that such fail to deliver position resulted from a long sale, the participant shall by no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity.<sup>193</sup>

In addition, consistent with temporary Rule 204T(a)(3), Rule 204(a)(3) extends the close-out requirement for fails to deliver attributable to certain bona fide market making activities by requiring a participant to close out the fail to deliver position attributable to such activities by no later than the beginning of regular trading hours on the third settlement day after the settlement date. We believe this exception to Rule 204(a)'s close-out requirement benefits clearing agency

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<sup>192</sup> See, e.g., Anti-Fraud Rule Adopting Release, 73 FR 61666.

<sup>193</sup> See Rule 204(a)(1).

participants because the two additional days to close-out these fail to deliver positions may reduce close-out costs for such participants.

Although we have determined at this time not to provide additional time within which fails to deliver must be closed out on the applicable close-out date, we are providing additional flexibility to the close-out requirements for fails to deliver resulting from long sales and certain bona fide market making activity by, in contrast to temporary Rule 204T(a)(1) and (a)(3), providing in Rule 204(a)(1) and (a)(3) the ability to borrow as well as purchase securities to close out a fail to deliver position. As some commenters noted, we believe that the ability to borrow a security to close-out a fail to deliver position may have less market impact than a purchase, while serving the objective of closing-out a fail position.<sup>194</sup> In addition, we believe that the additional flexibility afforded by the ability to close out a fail to deliver position either through a purchase or a borrow, will allow participants to access additional liquidity sources, thereby potentially reducing close-out costs and helping to ensure that fails to deliver are closed out on the applicable close-out date.<sup>195</sup>

Temporary Rule 204T(d) provides that a participant may reasonably allocate its responsibility to close out a fail to deliver position to another broker-dealer from which the participant receives trades for clearance and settlement.<sup>196</sup> Consistent with temporary Rule

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<sup>194</sup> See e.g., letters from SIFMA; EWT; MFA; State Street; BATS; Wedbush.

<sup>195</sup> Although Rule 204(a)(1) permits borrowing to close out a fail to deliver position resulting from a long sale, broker-dealers must also comply with Rule 203(a) of Regulation SHO. Rule 203(a)(1) provides that, unless an exception applies, “[i]f a broker or dealer knows or has reasonable grounds to believe that the sale of an equity security was or will be effected pursuant to an order marked “long,” such broker or dealer shall not lend or arrange for the loan of any security for delivery to the purchaser’s broker after the sale, or fail to deliver a security on the date delivery is due.” 17 CFR 242.203(a).

<sup>196</sup> See temporary Rule 204T(d); see also 17 CFR 242.203(b)(3)(vi). Rule 203(b)(3)(vi) of Regulation SHO provides that “[i]f a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer’s short position, then the provisions of this paragraph (b)(3) relating

204T(d), Rule 204(d) provides for allocation of a fail to deliver position by a participant to a broker-dealer. Specifically, Rule 204(d) provides that if a participant of a registered clearing agency reasonably allocates a portion of a fail to deliver position to another registered broker-dealer for which it clears trades or from which it receives trades for settlement, based on such broker-dealer's short position, the provisions of Rule 204(a) and (b) relating to such fail to deliver position shall apply to such registered broker-dealer that was allocated the fail to deliver position, and not to the participant.<sup>197</sup> This allocation provision benefits participants because if a participant can identify the accounts of broker-dealers for which they clear or from which they receive trades for settlement, the participant can allocate the responsibility to close out the fail to deliver position to the particular broker-dealer account(s) whose trading activities caused the fail to deliver position, provided the allocation is reasonable. In this way, the allocated broker-dealer rather than the participant will incur any costs associated with Rule 204's close-out requirement.

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

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

<sup>197</sup> See Rule 204(d).

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

Under Rule 204(e), even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with Rule 204(a), or has not allocated a fail to deliver position to a broker-dealer in accordance with Rule 204(d), a broker-dealer shall not be subject to the requirements of Rule 204(a) or (b) if it purchases or borrows securities, and complies with the conditions set forth in Rule 204(e)(1) through (4), as described in detail in Section III.C. above. We note that, unlike temporary Rule 204T(e), Rule 204(e) permits a broker-dealer to use a borrow, as well as a purchase, to close out a position prior to the applicable close-out date. Rule 204(e), similar to temporary Rule 204T(e), encourages early close-outs of fail to deliver positions, by providing that a broker-dealer can satisfy the rule's close-out requirements by purchasing securities prior to the applicable close-out date provided the broker-dealer complies with certain conditions. In addition, as noted above, Rule 204(e) provides more flexibility than temporary Rule 204T(e) by allowing a broker-dealer to close out a fail to deliver position prior to the applicable close-out date by borrowing, as well as purchasing securities. We believe this ability to borrow, as well as purchase, securities further encourages early close-outs of fail to deliver positions which serves the benefit of promoting our goal of maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, by facilitating the ability to close-out fails faster.

Further, Rule 204(e) is modified from temporary Rule 204T(e)(3)'s provision that the purchase must be of a quantity of securities sufficient to cover the entire amount of the broker-dealer's open short position. The purpose of Rule 204(e) is to encourage broker-dealers to close out fail to deliver positions prior to the applicable close-out date (i.e., T+4 or T+6) by reducing the costs of the early close-out. Requiring a broker-dealer to close out its open fail to deliver position prior to the applicable close-out date is more closely tailored towards achieving that goal than requiring a broker-dealer to close out its open short position prior to the applicable close-out date. Thus, in response to commenters' concerns, in Rule 204(e)(3) we have modified the requirement of temporary Rule 204T(e)(3) to provide that a broker-dealer must purchase or borrow a quantity of securities sufficient to cover the entire amount of that broker-dealer's fail to deliver position at a registered clearing agency in that security on the day of the purchase. Consequently, we believe our incorporation of the conditions of temporary Rule 204T(e), with the noted modifications, facilitates early close-outs of fail to deliver positions.<sup>198</sup>

## 2. Borrowing Requirements

Under temporary Rule 204T(b), if a participant does not purchase or borrow shares, as applicable, to close out a fail to deliver position in accordance with temporary Rule 204T, the participant violates the close-out requirements of that rule. We are adopting in Rule 204(b) the borrowing requirements of temporary Rule 204T(b), without modification. Accordingly, Rule 204(b) imposes on the participant and on all broker-dealers from which that participant receives trades for clearance and settlement (including introducing and executing brokers) a requirement to borrow or arrange to borrow securities prior to accepting or effecting further short sales in that

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<sup>198</sup> See supra Section III.C. (explaining the conditions of Rule 204(e), as well as commenters' concerns that by requiring broker-dealers to close-out their entire open short position temporary Rule 204T(e) does not encourage early close-outs).

security. We believe that this borrow requirement is beneficial in that it furthers our goals of reducing fails to deliver by helping to maintain the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive “naked” short selling, by promoting the prompt and accurate clearance and settlement of securities transactions.

Specifically, Rule 204(b) provides that the participant and any broker-dealer from which it receives trades for clearance and settlement, including any market maker that is otherwise entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,<sup>199</sup> may not accept a short sale order in an equity security from another person, or effect a short sale order in such equity security for its own account, to the extent that the broker-dealer submits its short sales to that participant for clearance and settlement, without first borrowing the security, or entering into a bona-fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.<sup>200</sup>

Rule 204, like temporary Rule 204T, is aimed at reducing fails to deliver and addressing potentially abusive “naked” short selling. To that end, we believe it is appropriate to include in the rule borrowing requirements for broker-dealers, including participants, that sell short a

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<sup>199</sup> See 17 CFR 242.203(b)(2)(iii) (providing an exception from Regulation SHO’s “locate” requirement for short sales effected by a market maker in connection with bona fide market making activities in the securities for which the exception is claimed).

<sup>200</sup> See Rule 204(b). The borrow requirements of Rule 204(b) are also consistent with the requirements of Rule 203(b)(3)(iv) of Regulation SHO for a participant that has not closed out a fail to deliver position in a threshold security that has persisted for thirteen consecutive settlement days. See 17 CFR 242.203(b)(3)(iv). Rule 203(b)(3)(iv) of Regulation SHO provides that “[i]f a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a threshold security for thirteen consecutive settlement days, the participant and any broker or dealer for which it clears transactions, including any market maker that would otherwise be entitled to rely on the exception provided in paragraph (b)(2)(iii) of this section, may not accept a short sale order in the threshold security from another person, or effect a short sale in the threshold security for its own account, without borrowing the security or entering into a bona fide arrangement to borrow the security, until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity.”

security for which a fail to deliver position has not been closed out in accordance with the requirements of the rule. We believe that the borrowing requirements of Rule 204(b) will help further our goals of reducing fails to deliver by helping to maintain the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive "naked" short selling by promoting the prompt and accurate clearance and settlement of securities transactions. In addition, we believe the rule's requirement that participants and broker-dealers from which they receive trades for clearance and settlement borrow or arrange to borrow securities prior to accepting or effecting short sales in the security that has a fail to deliver position that has not been closed out will help continue to ensure that shares will be available for delivery on any additional short sales by settlement date and, thereby, help to avoid additional fails to deliver occurring in the security.

We note that one commenter asked for clarification regarding whether a participant ceases to be subject to the borrow requirements of temporary Rule 204T(b) if a participant no longer has a fail to deliver position at a registered clearing agency due to the participant borrowing the securities or the participant receiving securities from the seller (e.g., in connection with long sales).<sup>201</sup> Temporary Rule 204T(b) imposes short sale borrowing requirements until the participant closes out the fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency. Thus, under temporary Rule 204T, regardless of whether a participant borrows or receives delivery of securities, the requirements of temporary Rule 204T(b) continue to apply until the participant purchases securities to close out the fail to deliver position and that purchase has cleared and settled at a registered clearing agency.

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<sup>201</sup> See letter from SIFMA.

We have incorporated these same requirements into Rule 204(b) without modification.

The provisions of Rule 204(b) are intended to act as an additional incentive to broker-dealers to deliver securities by settlement date, and to close out fail to deliver positions in accordance with the requirements of Rule 204. We believe that the purchase requirement of Rule 204(b) is beneficial in that it will continue to further these goals.

In connection with the borrowing requirements of Rule 204(b), we are incorporating into Rule 204(c) the notification requirement contained in temporary Rule 204T(c), without modification. In accordance with Rule 204(c), participants must notify all broker-dealers from which they receive trades for clearance and settlement that a fail to deliver position has not been closed out in accordance with Rule 204. Specifically, Rule 204(c) provides that the participant must notify any broker-dealer from which it receives trades for clearance and settlement, including any market maker that is otherwise entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,<sup>202</sup> (a) that the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of Rule 204, and (b) when the purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.<sup>203</sup>

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

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<sup>202</sup> See *supra* note 199.

<sup>203</sup> See Rule 204(c).

this notification requirement will help serve the goal of addressing potentially abusive “naked” short selling in equity securities.

As noted above, Rule 204(d) provides that a participant may reasonably allocate (e.g., the allocation must be timely) its responsibility to close out a fail to deliver position to another broker-dealer for which the participant clears or from which the participant receives trades for settlement. Thus, to the extent that the participant can identify the broker-dealer(s) that have contributed to the fail to deliver position, and the participant has reasonably allocated the close-out obligation to the broker-dealer(s), the requirement to borrow or arrange to borrow prior to effecting further short sales in that security will continue to apply to only those particular broker-dealer(s).<sup>204</sup>

Rule 204(b) includes an exception from the borrowing requirements for any broker-dealer that can demonstrate that it was not responsible for any part of the fail to deliver position of the participant. We have incorporated into Rule 204(b) the language of temporary Rule 204T(b)(1), without modification. Thus, Rule 204(b) provides that a broker-dealer shall not be subject to the requirements of paragraph (b) of Rule 204 if the broker-dealer timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that the broker-dealer is in compliance with the requirements of Rule 204(e).<sup>205</sup> We have included this exception because we continue to believe that a broker-dealer should not be subject to the borrowing requirements of the rule if the broker-dealer can

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<sup>204</sup> See Rule 204(d).

<sup>205</sup> See Rule 204(b).

demonstrate that it did not incur a fail to deliver position in the security on settlement date, or if it has taken steps, in accordance with Rule 204(e), to close out the fail to deliver position.

Temporary Rule 204T(b)(2) included an exception from the borrowing requirements of temporary Rule 204T(b) for market makers that can demonstrate that they do not have an open short position in the equity security at the time of any additional short sales.<sup>206</sup> We do not believe that a similar exception is necessary under Rule 204(b) because, as with other broker-dealers, a market maker is excepted from the borrowing requirements of Rule 204(b) if it timely certifies to the participant that it has not incurred a fail to deliver position on settlement date for a long or short sale in an equity security for which the participant has a fail to deliver position at a registered clearing agency or that it is in compliance with the requirements of Rule 204(e). Because Rule 204(b) includes an exception applicable to all broker-dealers, including market makers, we do not think it is necessary to maintain a separate exception applicable only to market makers.

### 3. Sales of Certain Deemed to Own Securities

After considering the comments and to provide consistency between the delivery requirements of Rule 203(b)(2)(ii) of Regulation SHO and the close-out requirements of Rule 204, we are adopting in Rule 204(a)(2) the requirements of temporary Rule 204T(a)(2) with some limited modifications.<sup>207</sup> Specifically, we are expanding the universe of securities to which Rule 204(a)(2) will apply. Rule 204(a)(2) will apply to fails to deliver resulting from the sale of an equity security that a person is “deemed to own” pursuant to Rule 200 of Regulation SHO and

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<sup>206</sup> See temporary Rule 204T(b)(2).

<sup>207</sup> See e.g. letter from SIFMA.

that such person intends to deliver as soon as all restrictions on delivery have been removed.<sup>208</sup>

In addition, we are revising the close-out period within which a participant must close out fails to deliver resulting from sales of such securities to be consistent with the delivery period contained in Rule 203(b)(2)(ii) of Regulation SHO.

Thus, Rule 204(a)(2) provides that if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security resulting from the sale of a security that a person is deemed to own pursuant to Rule 200 of Regulation SHO and that such person intends to deliver as soon as all restrictions on delivery have been removed, the participant shall, by no later than the beginning of regular trading hours on the thirty-fifth consecutive calendar day following the trade date for the transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity.<sup>209</sup> We believe that amending the close-out requirement to 35 consecutive calendar days from trade date for fails to deliver resulting from sales of such owned securities will better permit the orderly settlement of such sales without the risk of causing market disruption due to unnecessary purchasing activity (particularly if the purchases are for sizable quantities of stock). In addition, the amendment to the close-out period relieves an inconsistency between Rule 203(b)(2)(ii) of Regulation SHO and temporary Rule 204T(a)(2), as noted by one commenter.<sup>210</sup>

Although this amendment will provide an extended period of time within which fails to deliver resulting from sales of certain "deemed to own" securities must be closed out, we believe that such additional time is warranted and does not undermine our goal of reducing fails to deliver because these are sales of owned securities that cannot be delivered by settlement date

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<sup>208</sup> See Rule 204(a)(2).

<sup>209</sup> See *id.*

<sup>210</sup> See letter from SIFMA.

due solely to processing delays outside the seller's or broker-dealer's control. Moreover, delivery will be made on such sales as soon as all restrictions on delivery have been removed. In addition, if a fail to deliver position is not closed out in accordance with Rule 204(a)(2), the borrowing requirements of Rule 204(b) will apply. Rule 204(b)'s borrowing requirements will help ensure that additional fails to deliver cannot occur until securities have been purchased to close out the fail to deliver position and such purchase has cleared and settled.

Thus, if a participant does not close out a fail to deliver position at a registered clearing agency in accordance with Rule 204(a)(2), the rule prohibits the participant, and any broker-dealer from which it receives trades for clearance and settlement, including market makers, from accepting any short sale orders or effecting further short sales in the particular security without borrowing, or entering into a bona-fide arrangement to borrow, the security until the participant closes out the entire fail to deliver position by purchasing securities of like kind and quantity and that purchase has cleared and settled at a registered clearing agency.<sup>211</sup>

### C. Costs

We recognize that temporary Rule 204T may have resulted in increased short selling costs for participants that may have impacted legitimate short selling activities.<sup>212</sup> To the extent that the requirements of temporary Rule 204T have resulted in increased short selling costs, we do not believe that such costs will increase, and may in fact decrease, under Rule 204 because, as discussed below, among other things, we have provided additional flexibility to closing out fails to deliver under Rule 204 as compared to Rule 204T.

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<sup>211</sup> See Rule 204(b).

<sup>212</sup> See, e.g., letter from CBOE (noting its belief that legitimate short selling activity has been damaged by temporary Rule 204T).

Some commenters stated that temporary Rule 204T has imposed burdens on market participants in several areas, including on firm operations personnel.<sup>213</sup> Some industry participants have stated that lending rates increased significantly following the adoption of temporary Rule 204T and other recent Commission actions.<sup>214</sup> We note, however, that the evidence that attempts to specify the cause of any such increase in lending rates is confounded by the unusual circumstances of the continued credit crisis. In addition, we note that a recent academic study that examined borrowing costs after the September Emergency Order<sup>215</sup> found no significant increase in average lending rates.<sup>216</sup>

As discussed in more detail below, some commenters also stated that the inflexibility of temporary Rule 204T's requirement that participants purchase securities to close-out a fail to deliver position by no later than the beginning of regular trading hours on the applicable close-out date has led to increased market pressures and market volatility due to the need to execute potentially large purchases at the market open.<sup>217</sup>

To the extent that the requirements of Rule 204 result in increased costs to short selling in equity securities, it may lessen some of the benefits of legitimate short selling and, thereby, result in a reduction in short selling generally. Such a reduction may lead to a decrease in market efficiency and price discovery, less protection against upward stock price manipulations, a less

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<sup>213</sup> See letters from CBOE (stating that temporary Rule 204T has created undue burdens in trading and risk management, clearing, lending and buy-in operations and front-end trading, back-office and regulatory systems); SIFMA; State Street (noting the "additional transactional, operational and market costs which the industry had to incur").

<sup>214</sup> See *supra* notes 39-42 and accompanying text (discussing recent Commission actions in addition to the adoption of temporary Rule 204T).

<sup>215</sup> See September Emergency Order, 73 FR 54875.

<sup>216</sup> See Adam C. Kolasinski, Adam V. Reed, and Jacob R. Thornock, Prohibitions versus Constraints: The 2008 Short Sales Regulations, March 2009 working paper.

<sup>217</sup> See e.g., letters from SIFMA; MFA; Wedbush; Lek Securities; State Street.

efficient allocation of capital, an increase in trading costs, and a decrease in liquidity. We also recognize that requiring that participants close out fails to deliver in equity securities in accordance with the rule may potentially impact the willingness of participants to provide liquidity. As one commenter stated, certain aspects of the close-out process “may have an unintended impact on the securities lending market and therefore the efficient functioning of the markets.”<sup>218</sup> As a result, securities lending could become more risky and costly and, in turn, impact market liquidity and price discovery benefits of short selling.<sup>219</sup>

Although we recognize that Rule 204 may result in the continuation of some costs, as well as new costs, to certain participants, as discussed in detail below, we believe such costs will be limited and are justified by the fact that the rule will continue our efforts to achieve our goals of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive “naked” short selling and, thereby help restore, maintain, and enhance investor confidence in the markets.

#### **1. Close-Out Requirements**

Consistent with temporary Rule 204T(a), Rule 204(a) provides that a participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement date, immediately close out

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<sup>218</sup> Letter from ICI; see also letter from CBOE.

<sup>219</sup> See letters from ICI; BATS.

the fail to deliver position by borrowing or purchasing securities of like kind and quantity.<sup>220</sup>

Similarly, consistent with temporary Rule 204T(a)(1) and (a)(3), the close-out requirements of Rule 204(a)(1) and (a)(3) for fails to deliver resulting from long sales and certain bona fide market making activity must be closed out by the beginning of regular trading hours on the close-out date for such fails to deliver (i.e., T+6).<sup>221</sup>

As discussed in detail above in Section VII.B. in connection with the benefits of Rule 204, some commenters requested that we extend the close-out period for fails to deliver resulting from short sales, long sales, and bona fide market making activity from the beginning to the end of regular trading hours on the applicable close-out date due to concerns that temporary Rule 204T's requirement to close out fails to deliver by no later than the beginning of regular trading hours can create buying pressure at the open, that may temporarily distort the price of the security.<sup>222</sup> Other commenters requested additional days within which to close out fails to deliver in connection with short sales.<sup>223</sup> Commenters stated that the additional time to close out fails to deliver would allow the majority of trades to clear and settle on their own within a few days following the regular settlement date (i.e., T+3).<sup>224</sup>

Some commenters expressed concerns about the effect of the close-out requirements of temporary Rule 204T on securities lending.<sup>225</sup> One commenter also noted that in practice fails to

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<sup>220</sup> See Rule 204(a).

<sup>221</sup> See Rules 204(a)(1) and 204(a)(3).

<sup>222</sup> See, e.g., letters from MFA; CBOE; SIFMA; BATS; RMA; State Street.

<sup>223</sup> See e.g., letters from EWT; Coalition of Private Investment Companies; SIFMA; MFA; State Street; CBOE; Options Exchanges.

<sup>224</sup> See, e.g., letters from SIFMA; MFA; State Street; CBOE; Options Exchanges; Coalition of Private Investment Companies.

<sup>225</sup> See, e.g., letter from SIFMA.

deliver resulting from sales of securities on loan, which are considered “long” sales, are often closed out in accordance with the time-frames for fails to deliver resulting from short sales rather than long sales because temporary Rule 204T does not provide sufficient time to determine whether or not a fail to deliver position resulted from a long or short sale, which acts as a disincentive to lending and causes institutions to question their participation in lending programs.<sup>226</sup> Other commenters expressed concerns regarding the impact of temporary Rule 204T’s close-out requirements on the lending recall process.<sup>227</sup>

As discussed above, although we recognize commenters’ concerns regarding the potential market impact of the close-out requirements of temporary Rule 204T, such close-out requirements are furthering our goal of reducing fails to deliver, as evidenced in part by preliminary results from OEA regarding its impact on the number of fails to deliver.<sup>228</sup> To maintain this reduction, we believe it is appropriate at this time to adopt as a permanent rule the requirement that fails to deliver resulting from short sales, long sales, and certain bona fide market making activity must be closed out by no later than the beginning of regular trading hours on the applicable close-out date.

In addition, as discussed above, we believe that continuing to require that fails to deliver be closed out on the day immediately following the day on which the fail to deliver occurs is consistent with our goal of reducing fails to deliver and addressing “naked” short selling and, in particular, potentially abusive “naked” short selling. Although extending the time-frames within which fails to deliver must be closed out may allow for ordinary course settlement, as several

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<sup>226</sup> See letter from SIFMA; see also letters from RMA; ICI.

<sup>227</sup> See letters from EWT; BATS; RMA; ICI; Wedbush; RMA.

<sup>228</sup> See *supra* note 164.

commenters contend, we believe that the close-out requirements of Rule 204 are necessary to help encourage delivery by settlement date and achieve our goal of not allowing fails to deliver to persist.

We recognize that Rule 204T's close-out requirement resulted in costs for participants of a registered clearing agency in terms of systems and surveillance modifications and recordkeeping, as well as changes to processes and procedures. Because we have made limited modifications in Rule 204 to some of the requirements of temporary Rule 204T, compliance with Rule 204's requirements may result in new costs for participants in terms of systems and surveillance modifications and recordkeeping, as well as changes to processes and procedures.

We believe, however, that most of the infrastructure and personnel necessary to comply with Rule 204 is already in place to meet the requirements of Rule 203(b)(3) of Regulation SHO<sup>229</sup> and temporary Rule 204T. As temporary Rule 204T has been in effect since September 2008, and Rule 204 incorporates the substance of temporary Rule 204T with limited modifications, market participants should already have established systems and processes that should mitigate many of the costs to comply with Rule 204. Thus, we believe any additional costs incurred with respect to complying with Rule 204's close-out requirements, over those incurred with respect to complying with temporary Rule 204T, will be minimal.

In addition, we note that the close-out requirements of Rule 204 are consistent with current settlement practices and procedures and with the close-out requirements of temporary Rule 204T and Rule 203(b)(3) of Regulation SHO. For example, because most transactions settle by T+3, participants should already have had in place policies and procedures to help ensure that delivery is being made by settlement date prior to the implementation of the

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<sup>229</sup> See 17 CFR 242.203(b)(3).

requirements of temporary Rule 204T.<sup>230</sup> Nevertheless, under Rule 204, as under temporary Rule 204T, we recognize that participants will continue to incur costs for each close-out and these costs could accumulate to significant amounts over time and across participants. For example, one commenter noted that “the close-out process is manual in nature and involves intensive monitoring of multiple levels of data across various system platforms and business units within the firm.”<sup>231</sup> We believe, however, that the experience participants have gained to date in complying with temporary Rule 204T is expected to reduce the costs to participants in complying with Rule 204 from those incurred in connection with complying with Rule 204T.

Moreover, similar to the existing close-out requirements of Rule 203(b)(3) of Regulation SHO and consistent with temporary Rule 204T, the requirements of Rule 204 are based on a participant’s fail to deliver position at a registered clearing agency. As noted above, the NSCC clears and settles the majority of equity securities trades conducted on the exchanges and in the over-the-counter markets.<sup>232</sup> The NSCC clears and settles trades through the CNS system, which nets the securities delivery and payment obligations of all of its members.<sup>233</sup> The NSCC notifies its members of their securities delivery and payment obligations daily.<sup>234</sup> Because Rule 204 is based on a participant’s fail to deliver position at a registered clearing agency, it is consistent with current settlement practices and procedures and with the Regulation SHO framework regarding delivery of securities.<sup>235</sup> As such, we anticipate that most participants will already

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<sup>230</sup> See supra note 16.

<sup>231</sup> Letter from SIFMA.

<sup>232</sup> See supra note 35.

<sup>233</sup> See id.

<sup>234</sup> See id.

<sup>235</sup> See 17 CFR 242.203(b)(3).

have systems, processes and procedures in place in order to comply with Rule 204's close-out requirements and, therefore, that any additional implementation costs associated with the rule will be minimal.

In addition, to comply with Regulation SHO's close-out requirement when it became effective in January 2005, participants needed to modify their recordkeeping systems and surveillance mechanisms.<sup>236</sup> Participants also should have retained and trained the necessary personnel to ensure compliance with the Regulation SHO's close-out requirements. As we noted in the Rule 204T Adopting Release, the infrastructure necessary to comply with the requirements of that rule should already be in place.<sup>237</sup> Because Rule 204 incorporates the substance of temporary Rule 204T with limited modifications, we similarly believe that most of the infrastructure necessary to comply with Rule 204's close-out requirements will already be in place. Thus, we believe minimal modifications will be necessary to comply with Rule 204. Accordingly, we believe that any changes to personnel, computer hardware and software, recordkeeping or surveillance costs will be minimal.<sup>238</sup>

We recognize that the requirements of Rule 204(a)(1) with respect to closing out fails to deliver resulting from long sales, may impose additional costs on participants. However, we believe that these costs are consistent with those currently borne by these entities in complying with temporary Rule 204T(a)(1). Under Rule 204(a)(1), a participant of a registered clearing agency that has a fail to deliver position at a registered clearing agency in an equity security and can demonstrate on its books and records that the fail to deliver position resulted from a long sale

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<sup>236</sup> See, e.g., letter from SIFMA (indicating that their existing system for tracking and eliminating fails to deliver is based on the Regulation SHO framework).

<sup>237</sup> See Rule 204T Adopting Release, 73 FR at 61725.

<sup>238</sup> See also *supra* Section VII.B.I. (discussing benefits of the close-out requirements despite commenters' costs concerns).

will have until no later than the beginning of regular trading hours on the third consecutive settlement day following the settlement date to immediately close out the fail to deliver position by purchasing or borrowing securities of like kind and quantity.<sup>239</sup> Thus, to qualify for this additional time to close out a fail to deliver position, the rule requires the participant to demonstrate on its books and records that the fail to deliver position resulted from a long sale. This demonstration requirement may result in participants continuing to incur costs related to personnel, recordkeeping, systems, and surveillance mechanisms. However, because most of these systems have been in place since September 2008 in order for broker-dealers to comply with the requirements of temporary Rule 204T, we do not believe that the demonstration requirements of Rule 204(a)(1) will result in significant additional cost.

In addition, we recognize that the allocation notification requirement of Rule 204(d) may continue to impose costs on broker-dealers that have been allocated responsibility for the close-out requirement under the rule. As discussed above, consistent with temporary Rule 204T(d), Rule 204(d) requires a broker-dealer that has been allocated a portion of a fail to deliver position that has not complied with the close-out requirements under the rule to notify the participant that it has become subject to the borrowing requirements of Rule 204(b). This notification requirement may result in broker-dealers incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms. Again, as most of these mechanisms have been in place since the implementation of temporary Rule 204T, we believe any further implementation costs will be minimal, and the costs incurred with each notification will be similar to those incurred under temporary Rule 204T.

We also recognize that like temporary Rule 204T, the requirements of Rule 204(e) may continue to impose costs on broker-dealers. Rule 204(e) allows a broker-dealer to obtain credit if

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<sup>239</sup> See Rule 204(a)(1).

it purchases securities in accordance with the conditions specified in that provision of the rule.

Rule 204(e) requires, among other things, that a broker-dealer demonstrate that it has a net long position or net flat position on its books and records on the settlement day for which the broker-dealer is claiming credit. This demonstration requirement may continue to result in participants incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms.

However, we believe the costs associated with Rule 204(e) will be minimal because the mechanisms necessary to comply with this requirement should already be in place.

## 2. Borrowing Requirements

Consistent with temporary Rule 204T, we believe that Rule 204's borrowing requirements for fail to deliver positions that are not closed out in accordance with the rule will result in limited, if any, implementation costs – in terms of personnel, recordkeeping, systems and surveillance mechanisms – to participants of a registered clearing agency, and broker-dealers from which they receive trades for clearance and settlement. These entities have already had to comply with the borrowing requirements of Rule 203(b)(3)(iv) of Regulation SHO,<sup>240</sup> since January 2005, and temporary Rule 204T since September 2008, as applicable, if a fail to deliver position has not been closed out in accordance with those rules' mandatory close-out requirements. Accordingly, participants and broker-dealers are already required to have in place the personnel, recordkeeping, systems, and surveillance mechanisms necessary to comply with Rule 204(b)'s borrowing requirements. Nevertheless, we recognize that these borrowing requirements will impose costs on participants, broker-dealers, and investors, and these costs can accumulate to significant amounts if the borrowing requirement is triggered often. One commenter stated a concern that, “[R]equiring a borrow or arrangement to borrow securities

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<sup>240</sup> 17 CFR 242.203(b)(3)(iv).

prior to accepting or effectuating further short sales in a security that failed to deliver and has not been closed out, are overly restrictive.”<sup>241</sup> Because Rule 204 does not modify this requirement, we expect these costs to be similar to those under temporary Rule 204T.

Consistent with temporary Rule 204T, however, Rule 204 is aimed at addressing potentially abusive “naked” short selling. To that end, we believe it is appropriate to continue to include in the rule borrowing requirements for participants and broker-dealers that sell short a security for which a fail to deliver position has not been closed out in accordance with the requirements of the rule. We believe that the borrowing requirements of Rule 204(b), like those already required by temporary Rule 204T(b), will help further our goals of reducing fails to deliver by helping to maintain the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive “naked” short selling by promoting the prompt and accurate clearance and settlement of securities transactions. By continuing to require that participants and broker-dealers from which they receive trades for clearance and settlement borrow or arrange to borrow securities prior to accepting or effecting additional short sales in the security that has a fail to deliver position that has not been closed out, the rule will continue to help ensure that shares will be available for delivery on the short sale by settlement date and, thereby, will continue to help avoid additional fails to deliver occurring in the security.

Moreover, we believe any other costs incurred in connection with the borrowing requirements of Rule 204(b) will be limited because, consistent with temporary Rule 204T(b)(1), if a participant becomes subject to the borrowing requirements of Rule 204(b), a broker-dealer that clears through the participant will not also be subject to the borrowing requirements of Rule

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<sup>241</sup> Letter from MFA.

204(b) if that broker-dealer can demonstrate that it was not responsible for any part of the fail to deliver position of the participant or that it has complied with the requirement of Rule 204(e).<sup>242</sup>

The certification requirement of Rule 204(b) may impose some costs on a broker-dealer having to demonstrate that it was not responsible for any part of the fail to deliver position of the participant. As discussed above, Rule 204(b) requires a broker-dealer to timely certify to the participant that it has not incurred a fail to deliver position on settlement date in an equity security for which the participant has a fail to deliver position at a registered clearing agency or the broker-dealer is in compliance with the requirements set forth in Rule 204(e).<sup>243</sup> However, as we noted in the PRA section for temporary Rule 204T, the certification requirement's impact on broker-dealers' costs related to personnel, recordkeeping, systems, and surveillance mechanisms is expected to be limited.<sup>244</sup> We expect that Rule 204's impact on broker-dealers' costs similarly will be limited because the requirements of Rule 204(b) are consistent with the requirements of temporary Rule 204T(b)(1).

Consistent with existing requirements under temporary Rule 204T(c), the notification requirement of Rule 204(c) may continue to impose costs on participants of a registered clearing agency. Rule 204(c) requires a participant to notify any broker-dealer from which it receives trades for clearance and settlement, including any market maker that would otherwise be entitled to rely on the exception provided in Rule 203(b)(2)(iii) of Regulation SHO,<sup>245</sup> (1) that the participant has a fail to deliver position in an equity security at a registered clearing agency that has not been closed out in accordance with the requirements of Rule 204(a), and (2) when the

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<sup>242</sup> See Rule 204(b).

<sup>243</sup> See *id.*

<sup>244</sup> See Rule 204T Adopting Release, 73 FR at 61726-61727.

<sup>245</sup> See *supra* note 199.

purchase that the participant has made to close out the fail to deliver position has cleared and settled at a registered clearing agency.<sup>246</sup> This notification requirement may result in participants incurring costs related to personnel, recordkeeping, systems, and surveillance mechanisms. We believe, however, that any additional costs under Rule 204 will be minimal because participants should already have in place mechanisms necessary to comply with this requirement pursuant to temporary Rule 204T.

### 3. Sales of Certain Deemed to Own Securities

We do not believe that the modification in Rule 204(a)(2) to apply the close-out requirement to fails to deliver resulting from the sale of any equity security that a person is “deemed to own” pursuant to Rule 200 of Regulation SHO, and that such person intends to deliver as soon as all restrictions on delivery have been removed, rather than just fails to deliver resulting from sales of Rule 144 Securities as in temporary Rule 204T(a)(2), will impose any significant additional cost on participants.<sup>247</sup> In fact, this modification is responsive to issues raised by commenters and should decrease costs from those of temporary Rule 204T by providing additional time to close out fails to deliver in additional “deemed to own” securities.<sup>248</sup>

Participants may incur some costs to implement changes to their current systems to comply with the limited modifications in Rule 204(a)(2) as compared with temporary Rule 204T(a)(2). Specifically, participants will have to ensure that their systems apply the close-out requirements to all “deemed to own” securities, rather than just equity securities sold pursuant to

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<sup>246</sup> See Rule 204(c).

<sup>247</sup> See Rule 204(a)(2).

<sup>248</sup> See, e.g., letter from SIFMA.

Rule 144 of the Securities Act, as well as monitor for compliance with the 35 calendar day close-out period. However, we believe the costs for such adjustments will be minimal.

### **VIII. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation**

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine if an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.<sup>249</sup> In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition.<sup>250</sup> Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We believe Rule 204 will not materially affect the promotion of the efficiency of the capital markets. Rule 204 makes some modifications relative to temporary Rule 204T and we believe that Rule 204 will help limit disruptions due to potentially abusive “naked” short selling, but several commenters argue that temporary Rule 204T created disruptions at the open and empirical evidence suggests that fails to deliver, on average, are unrelated to stock prices.<sup>251</sup>

As discussed in the Rule 204T Adopting Release, we believe that Rule 204 will help further our goals of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the

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<sup>249</sup> 15 U.S.C. 78c(f).

<sup>250</sup> 15 U.S.C. 78w(a)(2).

<sup>251</sup> See, e.g., Fotak, Raman, and Yadav, 2009, Naked Short Selling: The Emperor’s New Clothes?, working paper, University of Oklahoma.

Commission, and addressing potentially abusive “naked” short selling without unduly burdening legitimate short selling activity. Rule 204 is intended to maintain the significant reductions in the number of fails to deliver in all equity securities since, among other actions, the adoption of temporary Rule 204T<sup>252</sup> by requiring that participants of a registered clearing agency that have a fail to deliver position, immediately close out the fail to deliver position by borrowing or purchasing securities of like kind and quantity by no later than the beginning of regular trading hours on the applicable close-out date. A participant that does not comply with Rule 204’s close-out requirements, and any broker-dealer from which it receives trades for clearance and settlement, will not be able to short sell the security either for itself or for the account of another, unless it has borrowed the security, or entered into a bona fide arrangement to borrow the security, until the fail to deliver position is closed out.

The rule is designed to help ensure that buyers of equity securities receive delivery of their shares, thereby helping to discourage persistent fails to deliver, which may have a negative effect on the securities markets and investors and also may be used to facilitate manipulative trading strategies. By requiring that participants of a registered clearing agency borrow or purchase securities to close out a fail to deliver position by no later than the beginning of regular trading hours on the applicable close-out date, Rule 204 will promote the prompt clearance and settlement of securities transactions. By doing so, the rule will help further our goals of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive “naked” short selling and, thereby, will help ensure that investors remain confident that trading can be conducted without the illegal influence of manipulation. A loss of

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<sup>252</sup> See *supra* note 164.

confidence in the market for these securities can lead to panic selling, which may be further exacerbated by potentially abusive “naked” short selling.

We sought comment regarding whether the rule may adversely impact liquidity, disrupt markets, or unnecessarily increase risks or costs to participants of a registered clearing agency. We are incorporating by reference the discussion in the Rule 204T Adopting Release regarding the burden on competition and promotion of efficiency, competition, and capital formation,<sup>253</sup> except to the extent that we have made modifications or because we are addressing comments.

Several commenters suggested that temporary Rule 204T has had a negative impact, particularly at the market open.<sup>254</sup> Although we recognize commenters’ concerns regarding the potential market impact of the close-out requirements of temporary Rule 204T, we believe that these potential concerns are justified by the benefits of retaining the strict close-out requirements of temporary Rule 204T. In addition, we note that the close-out provisions of Rule 204 provide additional flexibility in 204(a)(1) and (a)(3) by allowing a participant to close out a fail to deliver position resulting from a long sale or certain bona fide market making activity by borrowing as well as purchasing securities. In addition, as discussed above, in contrast to temporary Rule 204T, participants may satisfy the close-out requirement to purchase securities of like kind and quantity with a VWAP order.<sup>255</sup> This increased flexibility in Rule 204, as compared with temporary Rule 204T, is expected to reduce the possibility of the increased volatility and market disruptions potentially caused by temporary Rule 204T by potentially providing additional sources of liquidity from which to obtain shares to close out fail to deliver positions.

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<sup>253</sup> See Rule 204T Adopting Release, 73 FR at 61728-61729.

<sup>254</sup> See *supra* Section III (discussing commenters’ concerns regarding the market impact of temporary Rule 204T).

<sup>255</sup> See *supra* note 66.

We believe that the rule will promote capital formation. Issuers and investors have repeatedly expressed concerns about fails to deliver in connection with potentially manipulative “naked” short selling.<sup>256</sup> The perception that potentially abusive “naked” short selling is occurring in securities could undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct.<sup>257</sup> To the extent that “naked” short selling and fails to deliver result in an unwarranted decline in investor confidence about a security, the rule will improve investor confidence about the security. As previously noted, preliminary results from OEA indicate that the Commission’s various recent actions with respect to further reducing fails to deliver, including the adoption of temporary Rule 204T, have contributed to a significant reduction in the number of fails to deliver.<sup>258</sup> In addition, the rule may lead to a greater certainty in the settlement of these securities which is expected to strengthen investor confidence in the settlement process. Therefore, we believe maintaining the substance of temporary Rule 204T in permanent Rule 204 will help achieve the Commission’s goals of preventing substantial disruption in the securities markets, reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and helping to prevent potentially abusive “naked” short-selling.

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<sup>256</sup> See, e.g., 2008 Regulation SHO Final Amendments, 73 FR 61690.

<sup>257</sup> See *supra* note 28 (discussing comments in response to the Rule 204T Adopting Release expressing concern about the impact of potential “naked” short selling on capital formation, claiming that “naked” short selling causes a drop in an issuer’s stock price and may limit the issuer’s ability to access the capital markets). In connection with prior proposed amendments to Regulation SHO aimed at reducing fails to deliver and addressing potentially abusive “naked” short selling, such as the 2007 Regulation SHO Proposed Amendments, we sought comment on whether such proposed amendments would promote capital formation, including whether the proposed increased short sale restrictions would affect investors’ decisions to invest in certain equity securities. In response, commenters expressed concern about the potential impact of “naked” short selling on capital formation claiming that “naked” short selling causes a drop in an issuer’s stock price that may limit the issuer’s ability to access the capital markets. See, e.g., letters from Medis; NCANS.

<sup>258</sup> See *supra* note 164.

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

#### **IX. Final Regulatory Flexibility Analysis**

The Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with 5 U.S.C. 604. This FRFA relates to the adoption of Rule 204 to Regulation SHO.<sup>259</sup>

##### **A. Need for and Objectives of the Rule**

Sections I through VI of this release describe the reasons for and objectives of Rule 204.

As previously stated in the temporary Rule 204T Adopting Release,<sup>260</sup> we are concerned that the close-out requirements of Regulation SHO have not gone far enough in reducing fails to deliver

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<sup>259</sup> Although the requirements of the Regulatory Flexibility Act are not applicable to rules adopted under the Administrative Procedure Act's "good cause" exception, see 5 U.S.C. 601(2) (defining "rule" and notice requirements under the Administrative Procedures Act), we nevertheless prepared an FRFA.

<sup>260</sup> See Rule 204T Adopting Release, 73 FR at 61712.

and addressing potentially abusive “naked” short selling. Thus, we are incorporating the requirements of temporary Rule 204T with limited modification into Rule 204 to help maintain the recent reductions in fails to deliver resulting from the implementation of temporary Rule 204T and other Commission actions. We believe the adoption of Rule 204 is appropriate to continue our goals of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, addressing potentially abusive “naked” short selling, and providing an incentive for sellers to promptly deliver securities by settlement date.

**B. Small Entities Affected by the Rule**

The entities covered by the rule will include small entities that are participants of a registered clearing agency and small broker-dealers from which participants receive trades for clearance and settlement. In addition, the entities covered by the rule will include small entities that are market participants that effect sales subject to the requirements of Regulation SHO. Although it is impossible to quantify every type of small entity covered by the rule, Paragraph (c)(1) of Rule 0-10 under the Exchange Act<sup>261</sup> states that the term “small business” or “small organization,” when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to §240.17a-5(d); and is not affiliated with any person (other than a natural person) that is not a small business or small organization. We estimate that as of 2008 there were approximately 915 broker-dealers that qualified as small entities as defined above.<sup>262</sup>

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<sup>261</sup> 17 CFR 240.0-10(c)(1).

<sup>262</sup> These numbers are based on OEA’s review of 2008 FOCUS Report filings reflecting registered broker-dealers. This number does not include broker-dealers that are delinquent on FOCUS Report filings.

As noted above, the entities covered by the rule will include small entities that are participants of a registered clearing agency. As of May 30, 2009, approximately 89% of participants of the NSCC, the primary registered clearing agency responsible for clearing U.S. transactions, were registered as broker-dealers. Participants not registered as broker-dealers include such entities as banks, U.S.-registered exchanges, and clearing agencies. Although these entities are participants of a registered clearing agency, generally these entities do not engage in the types of activities that would implicate the close-out requirements of Regulation SHO.

The federal securities laws do not define what is a "small business" or "small organization" when referring to a bank. The Small Business Administration regulations define "small entities" to include banks and savings associations with total assets of \$175 million or less.<sup>263</sup> As of May 30, 2009, no bank that was a participant of the NSCC was a "small entity" because none met that criteria.

Paragraph (e) of Rule 0-10 under the Exchange Act<sup>264</sup> states that the term "small business" or "small organization," when referring to an exchange, means any exchange that: (1) has been exempted from the reporting requirements of Rule 601 under the Exchange Act; and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined by Rule 0-10. No U.S. registered exchange is a small entity because none meets these criteria.

Paragraph (d) of Rule 0-10 under the Exchange Act<sup>265</sup> states that the term "small business" or "small organization," when referring to a clearing agency, means a clearing agency

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<sup>263</sup> See 13 CFR 121.201.

<sup>264</sup> 17 CFR 240.0-10(e).

<sup>265</sup> 17 CFR 240.0-10(d).

that: (1) compared, cleared and settled less than \$500 million in securities transactions during the preceding fiscal year (or in the time that it has been in business, if shorter); (2) had less than \$200 million in funds and securities in its custody or control at all times during the preceding fiscal year (or in the time that it has been in business, if shorter); and (3) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined by Rule 0-10. No clearing agency that is subject to the requirements of Regulation SHO is a small entity because none meets these criteria.

**C. Projected Reporting, Recordkeeping and Other Compliance Requirements**

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

**D. Agency Action to Minimize Effect on Small Entities**

As required by the Regulatory Flexibility Act, we have considered alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. Rule 204 is not expected to adversely affect small entities because it imposes minimal reporting, record keeping, or compliance requirements, many of which were previously required of small entities pursuant to the implementation of Regulation SHO and, more recently, temporary Rule 204T. Moreover, it is not appropriate to develop separate requirements for small entities because we believe that to accomplish the Commission's stated goals, all broker-dealers, regardless of size, should be subject to the same enhanced delivery requirements imposed by the rule.

### **E. Duplicative, Overlapping, or Conflicting Federal Rules**

The Commission believes that there are no rules that duplicate, overlap, or conflict with Rule 204. The Commission has designed the rule so that it is consistent with the close-out requirements of Rule 203(b)(3) of Regulation SHO. In addition, with limited modifications to address commenters' concerns, Rule 204 incorporates the substance and maintains most of the components of temporary Rule 204T of Regulation SHO and will become effective on July 31, 2009, the expiration date for temporary Rule 204T.

### **F. Significant Alternatives**

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.<sup>266</sup> In connection with the rule, we considered the following alternatives: (1) establishing different compliance or reporting standards or timetable that take into account the resources available to small entities; (2) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (3) using performance rather than design standards; and (4) exempting small entities from coverage of the rule, or any part of the rule.

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

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<sup>266</sup> See 5 U.S.C. 603(c).

The rule should not adversely affect small entities because the rule will impose only minimal compliance requirements, many of which were previously required of small entities pursuant to the implementation of Regulation SHO and, more recently, temporary Rule 204T. Moreover, it is not appropriate to develop different compliance requirements for small entities with respect to the rule because we believe all entities, including small entities, should be subject to the requirements of the rule. We believe that imposing different compliance requirements, and possibly a different timetable for implementing compliance requirements, for small entities would undermine the Commission's goals of reducing fails to deliver by maintaining the reductions in fails to deliver achieved by the adoption of temporary Rule 204T, as well as other actions taken by the Commission, and addressing potentially abusive "naked" short selling. We have concluded similarly that it is not consistent with the goal of the rule to further clarify, consolidate or simplify the rule for small entities. The Commission also believes that it is inconsistent with the purposes of the Exchange Act to exempt small entities from having to comply with the rule.

#### **X. Statutory Authority**

Pursuant to the Exchange Act and, particularly, Sections 2, 9(h), 10, 11A, 15, 17, 17A, and 23(a) thereof, 15 U.S.C. 78b, 78i(h), 78j, 78k-1, 78o, 78q, 78q-1, and 78w(a), the Commission is amending Regulation SHO to adopt Rule 204.

#### **XI. Text of Amendments**

##### **List of Subjects**

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies).

17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

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

**PART 200 – ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS**

1. The authority citation for Part 200, Subpart A, continues to read in part as follows:

**Authority:** 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

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2. Section 200.30-3 is amended by adding paragraph (a)(11) to read as follows:

**§ 200.30-3 Delegation of authority to Director of Division of Trading and Markets.**

\*\*\*\*\*

(a) \*\*\*

(11) Upon written application or upon its own motion, either unconditionally or on specified terms and conditions, to grant or deny by order an exemption from the requirements of Regulation SHO (§242.200 of this chapter) under the Act pursuant to Section 36 of the Act (15 U.S.C. 78mm).

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

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

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

4. Section 242.204 is added to read as follows:

**§ 242.204 Close-out requirement.**

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

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

(2) If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security resulting from a sale of a security that a person is deemed to own pursuant to § 242.200 and that such person intends to deliver as soon as all restrictions on delivery have been removed, the participant shall, by no later than the beginning of regular trading hours on the thirty-fifth consecutive calendar day following the trade date for the

transaction, immediately close out the fail to deliver position by purchasing securities of like kind and quantity; or

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

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

deliver position at a registered clearing agency or that the broker or dealer is in compliance with paragraph (e) of this section.

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

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

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

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

(e) Even if a participant of a registered clearing agency has not closed out a fail to deliver position at a registered clearing agency in accordance with paragraph (a) of this section, or has not allocated a fail to deliver position to a broker or dealer in accordance with paragraph (d) of this section, a broker or dealer shall not be subject to the requirements of paragraph (a) or (b) of this section if the broker or dealer purchases or borrows the securities, and if:

- (1) The purchase or borrow is bona fide;
- (2) The purchase or borrow is executed after trade date but by no later than the end of regular trading hours on settlement date for the transaction;
- (3) The purchase or borrow is of a quantity of securities sufficient to cover the entire amount of that broker's or dealer's fail to deliver position at a registered clearing agency in that security; and
- (4) The broker or dealer can demonstrate that it has a net flat or net long position on its books and records on the day of the purchase.

(f) A participant of a registered clearing agency shall not be deemed to have fulfilled the requirements of this section where the participant enters into an arrangement with another person to purchase or borrow securities as required by this section, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow.

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

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

By the Commission.



Elizabeth M. Murphy  
Secretary

Dated: July 27, 2009

*Chairman Schapiro  
not participating  
Commissioner Paredes  
Disapproved*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60393 / July 28, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3021 / July 28, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13564

In the Matter of

EVERY DENNISON  
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 Avery Dennison Corporation ("Avery" or "Respondent").

II.

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

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Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.<sup>1</sup>

### III.

On the basis of this Order and Respondent’s Offer, the Commission finds<sup>2</sup> that:

#### Summary

1. This matter involves Avery’s violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act (“FCPA”) through its indirect subsidiary Avery (China) Co. Ltd. (“Avery China”), as well as certain potential violations Avery uncovered at entities it acquired after Avery’s initial self-disclosure to the Commission.

2. From 2002 through 2005, Avery China’s Reflectives Division paid or authorized the payments of several kickbacks, sightseeing trips, and gifts to Chinese government officials. The amount of illegal payments actually paid amounted to approximately \$30,000. These payments and the promises to pay were made with the purpose and effect of improperly influencing decisions by foreign officials to assist Avery China to obtain or retain business.

3. In addition, after Avery acquired a company in June 2007, employees of the acquired company continued their pre-acquisition practice of making illegal petty cash payments to customs or other officials in several foreign countries. The amount of illegal payments actually paid after the June 2007 acquisition amounted to approximately \$51,000.

4. Avery failed to accurately record these payments and gifts in the company’s books and records, and failed to implement or maintain a system of internal accounting controls sufficient to detect and prevent such illegal payments or promises of illegal payments.

#### Respondent

5. Avery is a Delaware corporation headquartered in Pasadena, California. It operates in over sixty countries and develops, manufactures and markets a wide range of products, including self-adhesive materials, office products, labels and graphics imaging media. Its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

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<sup>1</sup> The Commission has contemporaneously filed a complaint in the United States District Court for the Central District of California against Avery alleging violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and seeking a civil penalty. Without admitting or denying the Commission’s allegations, Avery has consented to the entry of a final judgment by the Court that requires the company to pay a \$200,000 civil penalty. *See SEC v. Avery Dennison Corporation*, No. CV09-5493 DSF (CWx).

<sup>2</sup> The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

## Other Related Entity

6. Avery China is a wholly-owned subsidiary of Avery headquartered in Shanghai, China. It is incorporated under the laws of China and wholly owned by Avery Dennison Hong Kong BV, which is in turn wholly owned by Avery Dennison Group Danmark ApS, which is in turn wholly owned by Avery Dennison Corporation. The Reflectives Division is part of Avery China and is currently part of Avery's Graphics Division. Avery China is overseen by Avery's Asia Pacific Group, an unincorporated group based in Hong Kong within the Avery Dennison Hong Kong BV entity.

## Facts

### A. Payments and Promises of Payments by Avery China's Reflectives Division

#### *Promises of Payments to Wuxi Institute Officials*

7. Avery China sells reflective materials through the Reflectives Division. Reflective materials are commonly used in printing, road signs and emergency vehicle markings. In China, the Ministry of Public Security requires that all products used in road communications and safety meet certain requirements as certified by an authorized government entity. One such entity is called the Traffic Management Research Institute under the Ministry of Public Security located in Wuxi, Jiangsu Province ("Wuxi Institute"). The Wuxi Institute helps formulate project plans, draft product and project specifications, and tests pilot projects, and as such could play an important role in awarding government contracts. From early 2004, Avery China's then-national manager for the Reflectives Division ("Reflectives China National Manager") sought to obtain business through the Wuxi Institute. As part of that effort, in January 2004, an Avery China sales manager accompanied four Wuxi Institute officials to a meeting and bought each a pair of shoes with a combined value of approximately \$500.

8. In May 2004, Avery China hired a former Wuxi Institute official as a sales manager for the Reflectives Division, because his wife was also an official at the Wuxi Institute who was in charge of two projects that Avery China wanted to pursue: a "digital license plate" project for which Avery China had previously bid unsuccessfully, and a pilot project to develop a new graphic design for police cars.

9. In August 2004, Avery China was awarded two government contracts through the Wuxi Institute to install new graphics on approximately 15,400 police cars for two Chinese government entities. The Reflectives China National Manager obtained these contracts by agreeing to artificially increase the sales price and then refund that amount back to the Wuxi Institute as a "consulting fee." In doing so, he understood at least a portion of that refunded amount would be for the benefit of Wuxi Institute officials. The total sales under the two contracts were \$677,494, and Avery China profited by approximately \$363,953. However, Avery's Asia Pacific Group discovered the kickback scheme before any illegal payment was made. The

attempted illegal payments would have amounted to approximately \$41,138, or 6% of the total sales.

2002 Sightseeing Trip

10. In December 2002, another Reflectives Division salesman proposed, and the Reflectives China National Manager approved, hosting a sightseeing trip for five government officials with a budget of about RMB 35,000, or \$4,227. Two reimbursement requests were used to conceal the expenses for the trip (one of which was altered at some point in time).

Attempted Kickback to Project Manager at State-owned Entity

11. In August 2004, the Reflectives China National Manager approved a kickback payment to an official at Henan Luqiao, a state-owned enterprise, to secure a sales contract. The total sales under this contract were approximately \$106,562, and Avery China profited by \$61,381. However, Avery China discovered the kickback arrangement and never made the promised payment to the official at Henan Luqiao, which would have amounted to approximately \$2,415.

Kickback Arranged through Product Distributor (Hefei Anchang)

12. From May to June 2005, a Reflectives Division sales manager negotiated a sale to a state-owned end user. To secure the sale, the sales manager agreed to pay a commission to a project manager at the end user. He then asked a distributor to fill the order and fund the agreed upon commission out of what ordinarily would have been the distributor's profit. The transaction was booked as a sale to the distributor, rather than to the end-user. The distributor claimed to have paid the project manager approximately \$24,752 out of its own profit margin. The total sales in the transaction were \$466,162, and Avery China profited by \$273,213.

2005 Sightseeing Trip

13. In late 2005, during a sales conference that Avery China sponsored in a famous Chinese tourist destination, the successor to the Reflectives China National Manager paid for sightseeing trips for at least four government officials. The manager later attempted to cover up both his role in planning the trip and the sightseeing during the conference. He asked his secretary to alter the conference invoice by reallocating the sightseeing expenses to other expense categories, and have the travel agency submit the changed invoice to Avery China for payment. The changed invoice did not contain any sightseeing expenses; rather, they were buried in expenses for rooms, meals, and transportation. The total cost for the conference (which had more than 40 attendees overall) was approximately \$15,500.

14. After discovering the arrangement with the Wuxi Institute in September 2004, Avery conducted an internal review of the Reflectives Division and another division of Avery China. Avery voluntarily approached Commission staff regarding the possible improper payments.

**B. Improper Payments by Employees of Acquired Companies**

15. After its initial disclosure to Commission staff in August 2005, Avery discovered two additional instances of possible improper payments by acquired companies.

16. The first involved illegal payments to customs officials in Indonesia. In 2005, Avery integrated the operations of an Indonesia contractor it had acquired. The contractor operated out of a bonded zone in Indonesia, and had a practice of paying approximately \$100 each to three customs officials who regularly visited its warehouse to inspect goods. The contractor continued the practice after the acquisition. To obtain cash for the payments, an employee of the acquired subsidiary obtained \$10 petty cash on a daily basis for the \$300 needed each month, and the accounting entry reflected \$10 of travel expense each day for the employee.

17. The second instance involved illegal petty cash payments to customs officials by employees of Paxar Corporation, a NYSE listed company that Avery acquired in June 2007. In September 2007, through a whistleblower, Avery discovered that Paxar employees in Indonesia made illegal payments to customs and tax officials to obtain bonded zone licenses and to overlook bonded zone regulatory violations, and that the former general manager of Paxar Indonesia directed employees to fabricate fake invoices to conceal illegal payments. An internal audit review also uncovered payments to customs officials in Pakistan made by Paxar Pakistan through its customs broker. In April 2008, Avery commenced a global trade compliance review in twenty-seven countries, which included an FCPA review. In July 2008, Avery commenced a more comprehensive FCPA review in ten high risk countries, including China. Beyond the illicit payments identified at Paxar Indonesia and Paxar Pakistan, the ten country review has also identified problematic payments in Paxar China. In all three locations, illicit payments were made both before and after the acquisition, with the latest illicit payment occurring in January 2008. The post-acquisition payments amount to \$5,000, \$30,000 and \$16,000 at Paxar Indonesia, Paxar Pakistan, and Paxar China, respectively.

**Violations**

18. The FCPA, enacted in 1977, added Exchange Act Section 13(b)(2)(A) to require public companies to make and keep books, records and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer, and added Exchange Act Section 13(b)(2)(B) to require such companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets. 15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B).

19. As detailed above, Avery's books, records, and accounts did not properly reflect the illicit payments, sightseeing trips and gifts that Avery China made or provided to government officials, and the illicit payments made to customs officials in several countries by employees of the acquired subsidiaries. As a result, Avery violated Exchange Act Section 13(b)(2)(A).

20. Avery also failed to devise or maintain sufficient internal controls to provide reasonable assurance that Avery China and the acquired subsidiaries complied with the FCPA and that payments, gifts or sightseeing expenses they provided to foreign officials were accurately reflected on its books and records. As a result, Avery violated Exchange Act Section 13(b)(2)(B).

**Avery's Remedial Efforts**

In determining to accept the Offer, the Commission considered remedial acts undertaken by Avery 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 Avery's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Avery cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

B. Respondent Avery shall, within ten business days of the entry of this Order, pay disgorgement of \$273,213 and prejudgment interest of \$45,257 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Avery 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 Andrew Petillon, Associate Regional Director, Los Angeles Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11<sup>th</sup> Floor, Los Angeles, California 90036.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 232**

[Release Nos. 33-9058; 34-60390; 39-2466; IC-28838]

**Adoption of Updated EDGAR Filer Manual**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission (the Commission) is adopting revisions to the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) Filer Manual to reflect updates to the EDGAR system. The revisions were made primarily to support the 2009 US GAAP Taxonomy, the Schedule of Investments (SOI) Taxonomy and to communicate a change in the Filer Support hours to 9:00 a.m. to 5:30 p.m. The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 7 (July 2009) and Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 12 (July 2009). The updated manual will be incorporated by reference into the Code of Federal Regulations.

**DATES:** Effective Date: [Insert date of publication in the Federal Register.] The incorporation by reference of the EDGAR Filer Manual is approved by the Director of the Federal Register as of [Insert date of publication in the Federal Register].

**FOR FURTHER INFORMATION CONTACT:** In the Office of Information Technology, contact Rick Heroux, at (202) 551-8800; in the Office of Interactive Disclosure for questions concerning the 2009 US GAAP Taxonomy and the Schedule of Investments Taxonomy contact Jeffrey Naumann, Assistant Director of the Office of Interactive Disclosure, at (202) 551-5352; in the Division of Corporation Finance, for questions on the change in filer support hours of

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operation, the Form D entity type description requirement or the requirement to provide additional information on the authentication documentation for Update Passphrase and Convert Paper Filer to Electronic Filer requests contact Cecile Peters, Chief, Office of Information Technology, at (202) 551-3600; and in the Division of Investment Management for questions on changing investment company type contact Ruth Armfield Sanders, Senior Special Counsel, Office of Legal and Disclosure, at (202) 551-6989

**SUPPLEMENTARY INFORMATION:** We are adopting an updated EDGAR Filer Manual, Volume I and Volume II. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.<sup>1</sup> It also describes the requirements for filing using EDGARLink<sup>2</sup> and the Online Forms/XML Web site.

The Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Filers must comply with the applicable provisions of the Filer Manual in order to assure the timely acceptance and processing of filings made in electronic format.<sup>3</sup> Filers may consult the Filer Manual in conjunction with our rules governing mandated electronic filing when preparing documents for electronic submission.<sup>4</sup>

The EDGAR system will be upgraded to Release 9.16 on July 20, 2009 will introduce the following changes: Interactive Data/XBRL Changes: The existing US GAAP Taxonomy will be upgraded to the 2009 US GAAP Taxonomy; the US GAAP Beta 2.0 Taxonomy will no longer be

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<sup>1</sup> We originally adopted the Filer Manual on April 1, 1993, with an effective date of April 26, 1993. Release No. 33-6986 (April 1, 1993) [58 FR 18638]. We implemented the most recent update to the Filer Manual on April 23, 2009. See Release No.33-9027 (April 16, 2009) [74 FR 18465].

<sup>2</sup> This is the filer assistance software we provide filers filing on the EDGAR system.

<sup>3</sup> See Rule 301 of Regulation S-T (17 CFR 232.301).

<sup>4</sup> See Release No. 33-9027 (April 16, 2009) [74 FR 18465] in which we implemented EDGAR Release 9.15.1. For a complete history of Filer Manual rules, please see the cites therein.

supported; and, the system will support the Schedule of Investments Taxonomy 2008. Taxonomy details can be found on the SEC public website's "EDGAR Standard Taxonomies" web page (<http://www.sec.gov/info/edgar/edgartaxonomies.shtml>). Chapter 6 (Interactive Data) of the EDGAR Filer Manual, Volume II: "EDGAR Filing" has been updated to make minor clarifications to the instructions on XBRL/Interactive Data Tagging.

**New Filer Support Hours:** The updated EDGAR Filer Manual makes the business hours for all EDGAR Filer Support branches uniform and conforms them to the Commission's official business hours of 9:00 a.m. to 5:30 p.m. Eastern Time. The manual notes that for the first time filers may leave voice mail for calls placed outside of the official business hours.

**Filer Management:** Filers will be required to provide the printed name and title or position of the authorized person signing on both the Update Passphrase and Convert Paper Only Filer to Electronic Filer requests, which are faxed to the SEC.

A new fax line will be added for submitting Form ID notarized authentication documentation. The new fax line number will be (703) 813-6961.

The EDGAR Filing Website will be updated to allow filers to change their investment company type (ICT) from the "Enter Series and Classes (Contracts) Information" option under the Retrieve/Edit Data menu.

Minor description changes were made to submission form types DEFM14A and PREM14A.

Along with adoption of the Filer Manual, we are amending Rule 301 of Regulation S-T to provide for the incorporation by reference into the Code of Federal Regulations of today's revisions. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51.

You may obtain paper copies of the updated Filer Manual at the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1520, Washington DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. We will post electronic format copies on the Commission's Web site; the address for the Filer Manual is <http://www.sec.gov/info/edgar.shtml>.

Since the Filer Manual relates solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedure Act (APA)<sup>5</sup>. It follows that the requirements of the Regulatory Flexibility Act<sup>6</sup> do not apply.

The effective date for the updated Filer Manual and the rule amendments is [Insert date of publication in the Federal Register]. In accordance with the APA<sup>7</sup>, we find that there is good cause to establish an effective date less than 30 days after publication of these rules. The EDGAR system upgrade to Release 9.16 is scheduled to be available on July 20, 2009. The Commission believes that establishing an effective date less than 30 days after publication of these rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

#### Statutory Basis

We are adopting the amendments to Regulation S-T under Sections 6, 7, 8, 10, and 19(a) of the Securities Act of 1933,<sup>8</sup> Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange Act

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<sup>5</sup> 5 U.S.C. 553(b).

<sup>6</sup> 5 U.S.C. 601- 612.

<sup>7</sup> 5 U.S.C. 553(d)(3).

<sup>8</sup> 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

of 1934,<sup>9</sup> Section 319 of the Trust Indenture Act of 1939,<sup>10</sup> and Sections 8, 30, 31, and 38 of the Investment Company Act of 1940.<sup>11</sup>

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENT

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

**PART 232 - REGULATION S-T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS**

1. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 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

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2. Section 232.301 is revised to read as follows:

**§232.301 EDGAR Filer Manual.**

Filers must prepare electronic filings in the manner prescribed by the EDGAR Filer Manual, promulgated by the Commission, which sets out the technical formatting requirements for electronic submissions. The requirements for becoming an EDGAR Filer and updating company data are set forth in the updated EDGAR Filer Manual, Volume I: "General Information," Version

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<sup>9</sup> 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

<sup>10</sup> 15 U.S.C. 77sss.

<sup>11</sup> 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

7 (July 2009). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 12(July 2009). Additional provisions applicable to Form N-SAR filers are set forth in the EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 1 (September 2005). All of these provisions have been incorporated by reference into the Code of Federal Regulations, which action was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. You must comply with these requirements in order for documents to be timely received and accepted. You can obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1520, Washington, DC 20549, or call (202) 551-5850, on official business days between the hours of 10:00 am and 3:00 pm. Electronic copies are available on the Commission's Web site. The address for the Filer Manual is <http://www.sec.gov/info/edgar.shtml>. You can also inspect the document at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202-741-6030, or go to: [http://www.archives.gov/federal\\_register/code\\_of\\_federal\\_regulations/ibr\\_locations.html](http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html).

By the Commission.



Elizabeth M. Murphy  
Secretary

July 28, 2009

*Chairman Schapiro  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60400 / July 30, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3026 / July 30, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13565

In the Matter of  
  
HELMERICH & PAYNE,  
INC.,  
  
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 Helmerich & Payne, Inc. ("H&P" or "Respondent").

II.

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

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### III.

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

#### Summary

1. This recommendation concerns violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") by H&P, through two of its second-tier wholly-owned subsidiaries, Helmerich & Payne (Argentina) Drilling Company and Helmerich & Payne de Venezuela, C.A. From 2003 through 2008, H&P Argentina and H&P Venezuela made approximately \$185,673 in improper payments directly – or indirectly through third-party customs brokers – to foreign customs authorities in connection with the international passage of drilling equipment parts into and out of Latin American drilling sites. These payments were made with the purpose and effect of avoiding potential delays typically associated with the international transport of drilling parts. H&P avoided costs in the estimated amount of approximately \$320,604, as a direct result of the improper payments by its subsidiaries. None of the improper payments was accurately reflected in H&P's books and records, nor was H&P's system of internal accounting controls adequate at the time to prevent and detect the improper payments.

#### Respondent

2. H&P is a Delaware corporation headquartered in Tulsa, Oklahoma. H&P is the holding company for Helmerich & Payne International Drilling Co., an international drilling contractor with land and offshore operations primarily in the United States and South America. H&P's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act, and is listed on the New York Stock Exchange. H&P, through its subsidiaries, provided oil drilling rigs, equipment, and personnel on a contract basis to international and national oil companies, primarily in the United States and South America.

#### Other Relevant Entities

3. Helmerich & Payne (Argentina) Drilling Company ("H&P Argentina"), a wholly-owned second-tier subsidiary of H&P, was incorporated in Oklahoma and has its principal administrative office in Buenos Aires, Argentina. H&P Argentina operates drilling rigs in Argentina. H&P Argentina's financial results are components of the consolidated financial statements included in H&P's filings with the Commission.

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

4. Helmerich & Payne de Venezuela, C.A. ("H&P Venezuela"), a wholly-owned second-tier subsidiary of H&P, was incorporated in Venezuela and has its principal administrative office in Anaco, Venezuela. H&P Venezuela operates drilling rigs in Venezuela. H&P Venezuela's financial results are components of the consolidated financial statements included in H&P's filings with the Commission.

### Facts

#### **A. Payments to Argentine Customs Officials**

5. In connection with the operation of its oil rigs in Argentina, H&P, through its operating subsidiaries, imported and exported equipment and materials related to the operation of the rigs. Such equipment and materials were inspected by the Argentine customs service and were subject to duties owed under the laws of Argentina. From 2004 through 2008, H&P Argentina paid Argentine customs officials approximately \$166,000 to permit the importation and exportation of equipment and materials without required certifications, to expedite the importation of equipment and materials, and to allow the importation of materials that could not be imported under Argentine law.

6. H&P Argentina made most of these improper payments indirectly through customs brokers. After having made the improper payments on behalf of H&P Argentina, the customs brokers invoiced H&P Argentina for their brokerage services, including as part of the invoiced amount the improper payments to the Argentine customs officials. The improper payments were falsely, or at least misleadingly, described as attributable to, for instance, "additional assessments," "extra costs," or "extraordinary expenses." By making these improper payments to Argentine government officials, H&P, through H&P Argentina, avoided more than an estimated \$186,000 in expenses it would have otherwise incurred if it had properly imported and exported the equipment and materials.

#### **B. Payments to Venezuelan Customs Officials**

7. In connection with the operation of its oil rigs in Venezuela, H&P, through its operating subsidiaries, imported and exported equipment and materials related to the operation of the rigs and support of its personnel. Such equipment and materials were inspected by the Venezuelan customs service and were subject to duties owed under the laws of Venezuela. From 2003 through 2008, H&P Venezuela paid Venezuelan customs officials approximately \$19,673 either to permit the importation and exportation of equipment and materials that were not in compliance with Venezuelan importation and exportation regulations or to secure a partial inspection, rather than a full inspection, of the goods being imported.

8. H&P Venezuela made the improper payments indirectly through customs brokers. After having made the improper payments on behalf of H&P Venezuela, the customs brokers invoiced H&P Venezuela for their brokerage services, including as part of the invoiced amount the improper payments to the Venezuelan customs officials. The improper payments were falsely, or at least misleadingly, described as attributable to, for

instance, "urgent processing," "urgent dispatch," or "customs processing." By making these improper payments to Venezuelan government officials, H&P, through H&P Venezuela, avoided more than an estimated \$134,000 in expenses it would have otherwise incurred if it had properly imported and exported the equipment and materials.

### C. Discovery of Improper Payments and Internal Investigation

9. In early 2008, as part of an effort to improve compliance with the FCPA, H&P designed and implemented a stand-alone set of FCPA policies and procedures.<sup>2</sup> In conjunction with this effort, H&P also designed and conducted worldwide FCPA training for its key employees. At one such training session in May 2008, an employee voluntarily disclosed that potentially improper payments had been made by H&P Argentina, through a customs broker, to Argentine customs officials. This information was relayed to H&P's corporate headquarters in Oklahoma, and came to the attention of H&P's general counsel in July 2008. In response, H&P hired outside FCPA counsel and independent forensic accountants to conduct an internal investigation of its subsidiaries' customs payment practices in a number of Latin American countries.

10. The internal investigation uncovered fifty improper payments to government customs officials in Argentina and Venezuela from 2003 through 2008, totaling approximately \$185,673. In Argentina, the nature of the improper payments was disguised in invoices by using vague-sounding line items such as "additional assessments," "extra costs," and "extraordinary expenses," without any additional documentation to support the descriptions. Similarly, in Venezuela, the nature of the improper payments was disguised in invoices by using descriptions such as "urgent processing," "urgent dispatch," or "customs processing." In October 2008, H&P voluntarily reported its initial findings to the staff.

### Legal Analysis

11. The FCPA, enacted in 1977, added Exchange Act Section 13(b)(2)(A) to require public companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer, and added Exchange Act Section 13(b)(2)(B) to require such companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets. 15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B).

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<sup>2</sup> H&P's Corporate Code of Business Ethics historically had contained anti-bribery provisions, but H&P decided as part of its focus on FCPA compliance to draft and implement a stand-alone set of policies and procedures regarding the FCPA.

12. As detailed above, H&P's books, records, and accounts did not properly reflect the improper payments made by H&P Argentina and H&P Venezuela to customs officials. As a result, H&P violated Exchange Act Section 13(b)(2)(A).

13. H&P also failed to devise or maintain sufficient internal controls to ensure that H&P Argentina and H&P Venezuela complied with the FCPA and to ensure that the payments those subsidiaries made to foreign officials were accurately reflected on its books and records. As a result, H&P violated Exchange Act Section 13(b)(2)(B).

#### H&P's Remedial Efforts and Cooperation

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent, Respondent's voluntary disclosure of these matters to the Commission, 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 H&P's Offer.

Accordingly, it is hereby ORDERED that:

- (i) Pursuant to Section 21C of the Exchange Act, Respondent H&P cease and desist from committing or causing any violations and any future violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B);
- (ii) Respondent shall, within ten days of the entry of this Order, pay disgorgement of \$320,604 and prejudgment interest of \$55,077.22 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover of a letter that identifies Helmerich & Payne, Inc. 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 Cheryl J. Scarboro, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Casey  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60401 / July 30, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13566

In the Matter of

INTEGRAL SYSTEMS, INC.

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 Integral Systems, Inc. ("Integral Systems" 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.

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### III.

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

#### Summary

These proceedings arise out of Integral Systems's failure to disclose to its shareholders for over seven years that Gary A. Prince ("Prince"), who had previously been convicted of conspiracy to commit securities and bank fraud and enjoined from committing securities fraud in a civil action brought by the Commission, was an executive officer of the Company. Integral Systems failed to disclose Prince's role at the company and his securities fraud background in its periodic reports and proxy statements filed from 1999 through August 8, 2006.

#### Respondent

1. **Integral Systems** is a Maryland corporation headquartered in Lanham, Maryland. It makes and sells satellite ground systems, including satellite communications systems and commercial off-the-shelf software products for satellite command and control. Its stock is registered under Exchange Act Section 12(b) and trades on the NASDAQ Global Select Market.

#### Background

2. From 1982 until 1995, Prince provided accounting and other services for Integral Systems on a part-time basis, and was the Company's Chief Financial Officer ("CFO") for much of that time. When Integral Systems's Chief Executive Officer ("CEO") Steven Chamberlain founded the Company in 1982, he hired Gary Prince as a vice president and appointed him a director. Prince's responsibilities included setting up the Company's accounting system and providing the Company with accounting and bookkeeping services as a part-time consultant. Prince performed these tasks for over a decade, during which time Chamberlain and he became close colleagues. In 1992, Prince was named CFO of Integral Systems.

3. While providing Integral Systems with accounting services on a part-time basis, Prince also served as the CFO of another public company, Financial News Network. Prior to 1992, Prince participated in a financial fraud at Financial News Network, involving improper recognition of revenue.

4. As a result of the financial fraud at Financial News Network, on August 18, 1994, Prince was permanently enjoined in an SEC action from violating the antifraud and lying-to-auditors provisions of the Exchange Act. [15 U.S.C. § 78j(b), 17 C.F.R. §240.10b-5, 17 C.F.R. §

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

240.13b2-2]. In 1995, in connection with the same conduct, Prince pleaded guilty to conspiracy to commit securities and bank fraud and to making false statements to SEC staff. He cooperated with investigators following his criminal plea, and was sentenced in 1997 to two months of incarceration, two months of home detention, and two years of probation.<sup>2</sup> On June 24, 1997, in an administrative proceeding instituted pursuant to Rule 102(e) of the Commission's Rules of Practice then in effect, [17 C.F.R. § 201.2(e)], the Commission permanently denied Prince the privilege of appearing or practicing before the Commission as an accountant.

#### PRINCE'S ROLE AT INTEGRAL SYSTEMS AS A DE FACTO OFFICER

5. After Prince served a short prison term in 1998, Integral Systems's founder and then-CEO Steven Chamberlain re-hired Prince as a *de facto* officer of the Company, giving him broad authority and responsibility within the Company. Chamberlain, however, was careful not to give Prince a title that would raise questions about his status as an officer, fearing that Prince's criminal background would have to be disclosed to investors if Prince was perceived as an officer of the Company.

6. Notwithstanding his concerns about disclosing Prince's criminal background, Chamberlain immediately gave Prince substantial responsibility and authority within the Company. Chamberlain included Prince in a policy-setting group of the most senior officers of the Company, known at various times as the "G-6" and "G-7." Prince was a member of this group from 1998 until his termination in 2007. By early 2002, all G-6 members except for Prince had titles of "Executive Vice President" or higher. Like the executive vice presidents in the group, Prince reported directly to Chamberlain, appeared at the executive vice president level on internal organizational charts, and had his office in the senior corporate officers's executive suite. Prince also was recognized throughout the Company as one of Chamberlain's closest advisors.

7. From his 1998 hiring to his 2007 termination, Prince directed the Company's mergers and acquisitions program. He evaluated potential acquisitions and worked with outside lawyers and accountants to complete acquisition due diligence and close transactions. Prince oversaw the acquired companies after they became subsidiaries and each acquired Company's former CEO reported to Prince. He made operational decisions for the subsidiaries about spending, hiring, and firing. Prince was a director of the Integral Systems acquisition vehicle, ISI Merger Corp. and was chairman of the board of one subsidiary, Newpoint Technology.

8. Prince also trained and supported the inexperienced CFOs who succeeded him. Prince had access to the Company's financial databases and often suggested how accounting entries should be handled. Prince prepared the Company's quarterly financial forecasts. He drafted the MD&A sections of periodic filings, and he also reviewed and edited the entirety of each filed periodic report.

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<sup>2</sup> See, *U.S. v. Prince*, No. CR 95-771 (Central District of Cal.); see also, *SEC v. Bolen*, 93 Civ. No. 93-1331 (D.D.C.). Prince's judgment of conviction was entered on September 22, 1997.

9. In August 2005, Prince became head of the contracts department—a responsibility that formerly belonged to the CFO. All major contracts were reviewed by Prince and required either CEO Chamberlain's or his approval. Major Company expenditures also required either Prince's or Chamberlain's approval.

10. Starting in at least 2000 and continuing through 2006, Prince attended board of directors meetings and regularly gave presentations to the board, including regular presentations involving potential acquisitions or the Company's previously-acquired subsidiaries, and less regular presentations on the Company's financial forecasts. The only other officers that gave regular board presentations were Chairman and CEO Chamberlain and CFO Elaine M. Brown. Prince also recommended to Chamberlain salary increases and bonuses for all senior managers.

11. Prince's compensation was equal to that of the top named officers. Prince was the fourth highest compensated employee in 1999 and 2000, and the fifth highest compensated employee in 2001, 2004, and 2005. In some years he was paid more than other G-6 members, including the CFO. Like other officers, Prince was awarded stock option grants. Prince received options grants for at least 29,000 shares beginning as early as 2000.

#### INTEGRAL SYSTEMS'S CONCEALMENT OF PRINCE

12. Integral Systems made some disclosures about Prince's legal problems in the mid-1990s as they occurred. The Company filed a Form 8-K on July 9, 1993 stating that the SEC had charged Prince with securities fraud. In its Form 10-KSB for 1994, the Company disclosed that Prince had settled with the SEC. In 1995, when Prince signed a plea agreement, the Company announced that he had resigned his titles for personal reasons, but made no mention of the plea agreement. However, all disclosures about Prince's status as an officer and his criminal background stopped after 1995 and did not occur again until August 2006 when Integral Systems disclosed in a Form 8-K that Prince was an Executive Vice President and Managing Director of Operations and also disclosed his criminal background.

13. From calendar year 1999 through mid-2006, Integral Systems filed seven annual reports on Forms 10-K or 10-KSB. The annual reports listed executive officers, but did not list Prince. The annual reports listed highly compensated officers and employees, but did not list Prince. The annual reports stated that all officers were current in filing required disclosures regarding their holdings and transactions in Company shares—or explained why certain officers were not current—but failed to disclose that Prince had not filed such disclosures.

14. From 2000 through mid-2006, Integral Systems filed seven proxy statements to give notice of its annual meetings and to solicit for the election of directors. The proxy statements listed executive officers and highly compensated persons "serving as officers," and represented that certain officers had complied with the disclosure provisions regarding officers' stock holdings and transactions. The proxy statements, however, made no mention of Prince. The proxy statements also incorporated the Company's annual filings from 1999 through 2005.

15. Integral Systems failed to disclose Prince's *de facto* executive officer status and his securities fraud background in its annual reports filed for the fiscal years 1999 through 2005, and in its Schedule 14A Proxy Statements filed from 1999 through 2006.

16. As a result of the conduct described above, Integral Systems violated Section 13(a) of the Exchange Act and Rules 13a-1 and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents and annual reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

17. Also as a result of the conduct described above, Integral Systems violated Section 14(a) of the Exchange Act and Rule 14a-9 thereunder, which make it unlawful for any person to solicit any proxy, consent or authorization, in respect of any security registered pursuant to Section 12 of the Exchange Act, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, and which mandate that no solicitation shall be made by means of a proxy statement containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading.

#### RESPONDENT'S REMEDIAL EFFORTS

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

#### IV.

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

Accordingly, it is hereby ORDERED that:

Pursuant to Section 21C of the Exchange Act, Respondent Integral Systems cease and desist from committing or causing any violations and any future violations of Sections 13(a) and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, and 14a-9 thereunder.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Watter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60403 / July 30, 2009

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In the Matters of :

Bear Wagner Specialists LLC :

Admin. Proc. File No. 3-11445 :

Fleet Specialist, Inc. :

Admin. Proc. File No. 3-11446 :

LaBranche & Co. LLC :

Admin. Proc. File No. 3-11447 :

Spear, Leeds & Kellogg Specialists LLC :

Admin. Proc. File No. 3-11448 :

Van der Moolen Specialists USA, LLC :

Admin. Proc. File No. 3-11449 :

Performance Specialist Group LLC :

Admin. Proc. File No. 3-11558 :

SIG Specialists, Inc. :

Admin. Proc. File No. 3-11559 :

Respondents. :

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**NOTICE OF CLOSING OF THE  
DISTRIBUTION FUNDS AND  
OPPORTUNITY FOR  
COMMENT AS TO USE OF  
REMAINING FUNDS**

Notice is hereby given, pursuant to Rule 1103 of the Securities and Exchange Commission's ("Commission") Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103, that (i) Heffler Radetich & Saitta L.L.P. ("Heffler"), the Fund Administrator in the above-captioned matters, has determined to close the Distribution Funds established with respect to the Respondents following a sixth and final distribution, and has recommended that the Commission seek public comments on the use of the remaining funds left after all the payments to injured customers and for administrative expenses have been made, in accordance with the Commission's May 17, 2006 Order (the "May 2006 Order"), Exchange Act Rel. No. 53823, and (ii) the Division of Enforcement has recommended that the Commission publish a Notice of Closing of the Distribution Funds and Opportunity for Comment as to Use of Remaining Funds.

On March 30, 2004, and July 26, 2004, the Commission issued Orders Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 (collectively, the "Specialist Firm Orders") against Bear Wagner

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Specialists LLC, Fleet Specialist, Inc. (now Banc of America Specialist, Inc.), LaBranche & Co. LLC, Spear, Leeds & Kellogg Specialists LLC, Van der Moolen Specialists USA, LLC, Performance Specialist Group LLC, and SIG Specialists, Inc. (collectively, the "Specialist Firms"). See Exchange Act Rel. Nos. 49498 – 49502 and Nos. 50075 – 50076. Among other things, the Specialist Firm Orders directed the Specialist Firms to pay disgorgement and civil penalties totaling \$247,028,778, and provided for the settlement funds to be used to reimburse injured customers for their loss, pay prejudgment interest to the injured customers, and pay the costs of administering the distribution plan ("Plan") implemented by Heffler. The Plan, as adopted by the May 2006 Order, included the payment of post-judgment interest to the injured customers as well. To date, Heffler has made five distributions under the Plan, totaling, in the aggregate, more than \$123 million, comprised of over \$96 million in disgorgement and over \$26 million in pre- and post-judgment interest. The distributions have involved the issuance of more than 348,000 checks to injured customers.

The Plan provides that when Heffler determines that "efforts to identify the Injured Customers have been exhausted," it will submit a final report to the Commission recommending that the matter be closed. Heffler views its efforts to identify the injured customers as having been exhausted, and has recommended that the Commission notify the public of Heffler's position. By Order dated July 30, 2009, the Commission has so notified the public and has identified the steps to be taken by Heffler in making a sixth and final distribution, following which distribution the above-captioned matters, as pertains to identifying injured customers and making distributions, will be considered closed by the Commission, and Heffler will begin the process of closing out the Distribution Funds pursuant to the Plan. See Exchange Act Rel. No. 34-60402.

The Specialist Firm Orders also provided that "[t]he Commission shall determine the appropriate use for the benefit of investors of any funds left" after all contemplated payments to injured customers and for administrative expenses have been made. The May 2006 Order adopting the Plan provided that "[t]he Commission believes that the determination of what to do with any Remaining Funds left . . . should be made by the Commission at a later date, after further public notice and comment." Heffler has considered the appropriate use of the remaining funds and has determined that the remaining funds should be transferred to the United States Treasury. However, in light of the May 2006 Order, which calls for further public notice and comment prior to the Commission making its determination, Heffler has recommended, and the Division of Enforcement concurs, that the Commission publish a notice seeking public comments as to the use of the remaining funds in these matters. In Heffler's estimate, there will be approximately \$135 million of remaining funds left in the Distribution Funds after all the payments to the injured customers and for administrative expenses have been made. If no public comments are received pursuant to this Notice, the Commission shall issue an order to transmit the Remaining Funds to the United States Treasury.

### **OPPORTUNITY FOR COMMENT**

Pursuant to this Notice, all interested parties are advised that the Plan may be obtained by visiting <http://www.sec.gov/litigation/admin/34-53025-pdp.pdf> or [www.hrsclaimsadministration.com](http://www.hrsclaimsadministration.com), or by submitting a written request to Ronald A. Bertino, c/o

Heffler, Radetich & Saitta, LLP, 1515 Market Street, Suite 1700, Philadelphia, PA 19102. Further, all persons desiring to comment on the use to be made of any remaining funds left after the contemplated payments have been made, may submit their comments, in writing, no later than August 31, 2009:

1. to the Office of the Secretary, United States Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090;
2. by using the Commission's Internet comment form (<http://www.sec.gov/litigation/admin.shtml>); or
3. by sending an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov).

Comments submitted by email or via the Commission's website should include the appropriate Administrative Proceeding File Number(s) in the subject line. Comments received will be available to the public. Persons should only submit information that they wish to make publicly available.

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. 60402 / July 30, 2009

In the Matters of

Bear Wagner Specialists LLC

Admin. Proc. File No. 3-11445

Fleet Specialist, Inc.

Admin. Proc. File No. 3-11446

LaBranche & Co. LLC

Admin. Proc. File No. 3-11447

Spear, Leeds & Kellogg Specialists LLC

Admin. Proc. File No. 3-11448

Van der Moolen Specialists USA, LLC

Admin. Proc. File No. 3-11449

Performance Specialist Group LLC

Admin. Proc. File No. 3-11558

SIG Specialists, Inc.

Admin. Proc. File No. 3-11559

Respondents.

ORDER APPROVING AUDIT  
REPORTS, ANNOUNCING THE  
DECISION TO CLOSE THE  
DISTRIBUTION FUNDS  
FOLLOWING A FINAL  
DISTRIBUTION, APPROVING  
PUBLICATION OF A NOTICE  
SEEKING COMMENTS ON THE  
USE OF THE REMAINING FUNDS,  
MODIFYING PRIOR ORDER AND  
MODIFYING DISTRIBUTION PLAN

I.

FACTS

1. In March and July 2004, the Commission entered into settlements with the seven specialist firms operating on the New York Stock Exchange. The Commission's orders (Securities Exchange Act Release Nos. 49498 – 49502 and Nos. 50075 – 50076) (the "Settlement Orders") provided, among other things, for payment of disgorgement and civil penalties totaling, in the aggregate, over \$247 million. The Settlement Orders further provided that the disgorgement and civil penalties were to be placed in seven Fair Funds (the "Distribution Funds") to be distributed pursuant to a distribution plan (the "Plan") drawn up by a fund administrator. Heffler, Radetich & Saitta L.L.P. ("Heffler") was appointed the fund administrator in October 2004.

2. On May 17, 2006, the Commission issued an order (the "May 2006 Order") approving Heffler's Plan. See Securities Exchange Act Release No. 53823. Pursuant to the Plan, Heffler must identify the customers who were injured as a result of the previously identified

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violative trades, calculate each injured customer's distribution amount – which is the sum of the disgorgement amount, and the prejudgment and post-judgment interest thereon – and make distributions to the injured customers. The distributions are to be made on a rolling basis. The May 2006 Order and the Plan were modified by Commission orders dated June 15, 2007 and June 26, 2008, which cumulatively extended the initial termination date of the Distribution Funds from December 31, 2006 to June 30, 2009. See Securities Exchange Act Release Nos. 55915 and 58035.

3. Pursuant to previous Commission orders, Heffler has thus far made five distributions under the Plan, totaling, in the aggregate, over \$123 million.

a. The initial distribution was made on July 19, 2006, pursuant to a Commission Order dated July 5, 2006. See Securities Exchange Act Release No. 54102. This initial distribution involved a total disbursement of \$52,732,921.43, which was comprised of \$42,082,144.95 in disgorgement, \$6,101,253.76 in prejudgment interest, and \$4,549,522.72 in post-judgment interest.

b. On November 30, 2006, Heffler made a second rolling distribution under the Plan, pursuant to a Commission Order dated November 24, 2006. See Securities Exchange Act Release No. 54815. This second distribution involved a total disbursement of \$42,765,263.59, which was comprised of \$33,548,991.43 in disgorgement, \$4,942,721.04 in prejudgment interest, and \$4,273,551.12 in post-judgment interest.

c. On June 19, 2007, Heffler made a third rolling distribution under the Plan, pursuant to a Commission Order dated June 15, 2007. See Securities Exchange Act Release No. 55915. This third distribution involved a total disbursement of \$14,305,053.02, which was comprised of \$10,923,205.08 in disgorgement, \$1,606,357.24 in prejudgment interest, and \$1,775,490.70 in post-judgment interest.

d. On December 19, 2007, Heffler made a fourth rolling distribution under the Plan, pursuant to a Commission Order dated December 12, 2007. See Securities Exchange Act Release No. 56944. This fourth distribution involved a total disbursement of \$10,733,490.40, which was comprised of \$7,935,062.94 in disgorgement, \$1,267,325.27 in prejudgment interest, and \$1,531,102.19 in post-judgment interest.

e. On June 30, 2008, Heffler made a fifth rolling distribution under the Plan, pursuant to a Commission Order dated June 26, 2008. See Securities Exchange Act Release No. 58035. This fifth distribution involved a total disbursement of \$2,885,895.39, which was comprised of \$2,069,722.41 in disgorgement, \$354,784.94 in prejudgment interest, and \$461,388.04 in post-judgment interest.

#### **The Independent Auditor's Reports**

4. The Plan provides that the Distribution Funds shall each be subject to an independent audit if the funds have not been entirely distributed by June 30, 2007 or such other

date as ordered by the Commission, and that the independent auditor's report shall be delivered to the Office of the Secretary, for approval by the Commission.

5. Pursuant to the Plan, Heffler selected the audit firm of Parente Randolph LLC (the "Independent Auditor") to perform an independent audit of the financial statements of the Distribution Funds for the period November 30, 2004 (the Funds' inception date) to March 31, 2008. The audit was completed in October 2008 and the financial statements of each of the Distribution Funds received an unqualified opinion; that is, in the opinion of the Independent Auditor, the financial statements of each Distribution Fund present fairly, in all material respects, the financial position of such Distribution Fund. The Independent Auditor's audit reports were delivered to the Office of the Secretary in accordance with the Plan, for approval by the Commission.

#### **Proposed Closing of the Distribution Funds Following a Final Distribution**

6. The Plan further provides that Heffler will continue to work with the clearing member firms and nominees to identify the injured customers, and when Heffler determines that "efforts to identify the Injured Customers have been exhausted," Heffler will inform the Commission of its position and recommend that the matter be closed. Heffler has informed the Commission staff that Heffler views its efforts to identify the injured customers as having been exhausted, and that it is Heffler's recommendation that the Commission issue an order notifying the public of Heffler's position and informing the clearing member firms and nominees that they shall have 60 days from the date of such Order (the "Deadline") to submit responses to any prior outstanding requests made by Heffler of such entities to identify the injured customers.

7. Any injured customers identified on or before the Deadline, and found eligible by Heffler to receive a distribution amount shall be entitled to participate in a sixth and final distribution, following which distribution the matter, as pertains to identifying injured customers and making distributions, will be considered closed by the Commission, and Heffler will begin the process of closing out the Distribution Funds pursuant to the Plan.

#### **Use of the Remaining Funds**

8. The Settlement Orders provide that "the Commission shall determine the appropriate use for the benefit of investors of any funds left in the Distribution Fund" after the contemplated payments to injured customers and for administrative expenses have been made. The May 2006 Order adopting the Plan provides that "[t]he Commission believes that the determination of what to do with any Remaining Funds left . . . should be made by the Commission at a later date, after further public notice and comment." See Securities Exchange Act Release No. 53823.

9. In Heffler's estimate, there will be approximately \$135 million of remaining funds (the "Remaining Funds") left in the Distribution Funds after all the payments to the injured customers and for administrative expenses have been made. Heffler has considered the appropriate use of the remaining funds and has determined that the remaining funds should be transferred to the United States Treasury. However, in light of the May 2006 Order, which calls

for further public notice and comment prior to the Commission making its determination, it is Heffler's recommendation that the Commission issue an Order approving the publication of notice, pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans ("Fair Fund Rules"), and Section 200.30-7(a)(11) of the Commission's Rules on Organization and Program Management, seeking public comment on the use of the remaining funds, in accordance with the May 2006 Order. If no public comments are received pursuant to the notice, the Commission shall issue an order to transmit the Remaining Funds to the United States Treasury.

### **Proposed Extension of Termination Date of Distribution Funds Under the Plan**

10. In the Plan, as previously modified by the Commission's June 15, 2007 and June 26, 2008 Orders (See Securities Exchange Act Release Nos. 55915 and 58035), Heffler proposed June 30, 2009, as the termination date of the Distribution Funds, with the proviso that "such date may be subsequently amended in light of Heffler's recommendation for periodic distributions, which is based on future responses received from Clearing Members and Nominees." The Plan provides that Heffler will continue to work with the clearing member firms and nominees to identify the injured customers, and when Heffler determines that "efforts to identify the Injured Customers have been exhausted," it will submit a final report to the Commission recommending that the Distribution Funds be terminated.

11. Heffler has informed the staff that while Heffler's efforts to reach out to the clearing member firms and nominees to identify the injured customers have been exhausted, there still remains a final distribution to be made, which will likely take place around August 2009. In addition, pursuant to the Plan, injured customers receiving a check as part of the final distribution will have 180 days from the date of issuance, or until February 2010, to negotiate the same. Moreover, the Plan provides a procedure for the reissuance of checks that have been returned as undeliverable, and, pursuant to that process, checks that are reissued may be negotiated within 180 days of the date of such reissuance. Finally, Heffler has informed the staff that Heffler will require a certain amount of time to finalize and close out the Distribution Funds after all the payments have been made. Accordingly, Heffler has requested that the Commission further modify the May 2006 Order and the Plan to extend Heffler's proposed date of termination of the Distribution Funds to September 30, 2010, or such other date as ordered by the Commission.

## **II.**

In view of the foregoing, it is ORDERED that:

1. The audit reports issued by the Independent Auditor are hereby approved.
2. There shall be a sixth and final distribution in this matter in accordance with the procedures set forth in Sections I.6. and I.7. of this Order, following which distribution the matter, as pertains to identifying injured customers and making distributions, will be considered closed by the Commission, and Heffler will begin the process of closing out the Distribution Funds pursuant to the Plan.

3. A notice be published, pursuant to Rule 1103 of the Commission's Fair Fund Rules, and Section 200.30-7(a)(11) of the Commission's Rules on Organization and Program Management, as of the date hereof seeking public comment on the use of the Remaining Funds.

4. The May 2006 Order and the Plan are hereby further modified to extend Heffler's proposed date of termination of the Distribution Funds to September 30, 2010, or such other date as may be further ordered by the Commission.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60405; File No. 4-546)

July 30, 2009

Joint Industry Plan; Order Approving the National Market System Plan Relating to Options Order Protection and Locked/Crossed Markets Submitted by the Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NYSE Amex LLC, and NYSE Arca, Inc.

I. Introduction

The proposed Options Order Protection and Locked/Crossed Market Plan ("Proposed Plan") was filed jointly, pursuant to Rule 608 of Regulation NMS under the Securities Exchange Act of 1934 ("Act") ("Regulation NMS") ("Rule 608"),<sup>1</sup> by the International Securities Exchange, LLC ("ISE") and NYSE Arca, Inc. ("NYSE Arca") on September 13, 2007 and September 18, 2007, respectively, with the Securities and Exchange Commission ("Commission").<sup>2</sup> On December 11, 2007, ISE and NYSE Arca separately filed Amendment No. 1 to the Proposed Plan.<sup>3</sup> On April 24, 2008, and April 17, 2008, ISE and NYSE Arca, respectively, filed Amendment No. 2 to the Proposed Plan.<sup>4</sup> On November 10, 2008 and October 31, 2008, ISE and NYSE Arca, respectively, filed Amendment No. 3 to the Proposed

<sup>1</sup> 17 CFR 242.608.

<sup>2</sup> See letter from Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated September 12, 2007 ("ISE Letter 1"); and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated September 14, 2007 ("NYSE Arca Letter 1").

<sup>3</sup> See letter from Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated December 10, 2007; and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated December 10, 2007.

<sup>4</sup> Amendment No. 2 superseded Amendment No. 1 and replaced it in its entirety. See letter from Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated April 16, 2008; and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated April 16, 2008.

Plan.<sup>5</sup> On April 30, 2008, May 8, 2008, June 18, 2008, June 18, 2008, and July 9, 2008, respectively, Chicago Board Options Exchange, Incorporated (“CBOE”), The NASDAQ Stock Market LLC (“Nasdaq”), American Stock Exchange LLC (“Amex”) (f/k/a NYSE Alternext US LLC, “NYSE Alternext,” n/k/a NYSE Amex LLC, “NYSE Amex”), Philadelphia Stock Exchange, Incorporated (n/k/a NASDAQ OMX PHLX, Inc., “Phlx”), and Boston Stock Exchange, Inc. (“BSE”) (n/k/a NASDAQ OMX BX, Inc., “BX” and together with ISE, NYSE Arca, CBOE, Nasdaq, Amex, and Phlx, the “Proposing Exchanges”) filed with the Commission the Proposed Plan.<sup>6</sup> On November 25, 2008, November 26, 2008, December 2, 2008, December 4, 2008, and December 5, 2008, CBOE, NYSE Alternext, BSE, Phlx, and Nasdaq, respectively, filed Amendment No. 1 to the Proposed Plan.<sup>7</sup> On April 2, 2009, a detailed summary of the Proposed Plan was published for comment in the Federal Register.<sup>8</sup>

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<sup>5</sup> See letter from Michael J. Simon, General Counsel, ISE, to Florence Harmon, Acting Secretary, Commission, dated November 7, 2008 (“ISE Letter 2”); and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Florence Harmon, Acting Secretary, Commission, dated October 30, 2008 (“NYSE Arca Letter 2”).

<sup>6</sup> In their respective filings of the Proposed Plan, Amex, BSE, CBOE, Nasdaq, and Phlx incorporated the changes made by ISE and NYSE Arca in Amendment No. 2. See letters from Jeffrey P. Burns, Vice President and Associate General Counsel, Amex, to Nancy M. Morris, Secretary, Commission, dated June 17, 2008 (“Amex Letter 1”); Bruce Goodhue, Chief Regulatory Officer, BSE, to Florence Harmon, Acting Secretary, Commission, dated July 8, 2008 (“BSE Letter 1”); Edward J. Joyce, President and Chief Operating Officer, CBOE, to Nancy M. Morris, Secretary, Commission, dated April 29, 2008 (“CBOE Letter 1”); Jeffrey S. Davis, Vice President and Deputy General Counsel, The NASDAQ OMX Group, Inc., to Nancy M. Morris, Secretary, Commission, dated May 7, 2008 (“Nasdaq Letter 1”); and Richard S. Rudolph, Vice President and Counsel, Phlx, to Nancy M. Morris, Secretary, Commission, dated June 17, 2008 (“Phlx Letter 1”).

<sup>7</sup> In their respective Amendment No. 1 to the Proposed Plan, BSE, CBOE, NYSE Alternext, Phlx, and Nasdaq made changes identical to those made by ISE and NYSE Arca in Amendment No. 3. See letters from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Florence Harmon, Acting Secretary, Commission, dated November 25, 2008 (“CBOE Letter 2”); Jeffrey P. Burns, Managing Director, NYSE Alternext, to Florence Harmon, Acting Secretary, Commission, dated November 25, 2008 (“Amex Letter 2”); John Katovich, Vice President, BSE, to Florence Harmon, Acting Secretary, Commission, dated December 1, 2008 (“BSE Letter 2”); Richard S.

The Commission received one comment on the Proposed Plan.<sup>9</sup>

This order approves the Proposed Plan, with changes as the Commission deems necessary or appropriate, thus authorizing CBOE, ISE, Nasdaq, BX, Phlx, Amex, and NYSE Arca to act jointly to implement the Proposed Plan, as modified herein, as a means of facilitating a national market system in accordance with the requirements of Section 11A of the Act.<sup>10</sup>

## II. Background

### A. Section 11A of the Act

In 1975, Congress directed the Commission, through the enactment of Section 11A of the Act,<sup>11</sup> to facilitate the establishment of a national market system to link together the individual markets that trade securities. Congress found the development of a national market system to be in the public interest and appropriate for the protection of investors and the maintenance of fair

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Rudolph, Vice President and Counsel, Phlx, to Florence Harmon, Acting Secretary, Commission, dated December 3, 2008 ("Phlx Letter 2"); and Jeffrey S. Davis, Vice President and Deputy General Counsel, The NASDAQ OMX Group, Inc., to Florence Harmon, Acting Secretary, Commission, dated December 4, 2008 ("Nasdaq Letter 2").

<sup>8</sup> Securities Exchange Act Release No. 59647 (March 30, 2009), 74 FR 15010 (File No. 4-546) ("Proposed Plan Notice"). The full text of the Proposed Plan submitted by the Proposing Exchanges, is available on the Commission's Web site at <http://sec.gov/rules/sro/nms/nmsarchive/nms2007.shtml#4-546>, at each Proposing Exchange, and at the Commission's Public Reference Room.

<sup>9</sup> Letter from John C. Nagel, Managing Director & Deputy General Counsel, Citadel Investment Group L.L.C. ("Citadel") to Nancy M. Morris, Secretary, Commission, dated July 18, 2008 ("Citadel Letter"). The Citadel Letter cited to Citadel's comments made in a letter from John C. Nagel, Managing Director & Deputy General Counsel, Citadel to Nancy M. Morris, Secretary, Commission, dated July 15, 2008 (Petition for Rulemaking to Address Excessive Access Fees in the Options Markets) ("Petition for Rulemaking").

<sup>10</sup> 15 U.S.C. 78k-1. See also 17 CFR 242.608(b)(2). The approved Options Order Protection and Locked/Crossed Market Plan, which incorporates the changes the Commission deems necessary or appropriate, is attached here as Appendix A and is referred to herein as the "Options Linkage Plan."

<sup>11</sup> 15 U.S.C. 78k-1.

and orderly markets to assure fair competition among the exchange markets.<sup>12</sup> Section 11A(a)(3)(B) of the Act directs the Commission, “by rule or order, to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under this title in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities.”<sup>13</sup> The Commission’s approval of a national market system plan is conditioned upon a finding that the proposed plan is “necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanism of, a national market system, or otherwise in furtherance of the purposes of the Act.”<sup>14</sup>

B. Current Plan

Currently, the Proposing Exchanges are signatories to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Current Plan”). The Current Plan is a national market system plan linking its participants. The Commission approved the Current Plan on July 28, 2000.<sup>15</sup> Subsequently, both Pacific Exchange, Inc. (n/k/a “NYSE Arca”) and Phlx submitted proposed amendments to the Current Plan to become participants to the Current Plan. These proposed amendments were approved on November 16, 2000.<sup>16</sup> On February 5, 2004,

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<sup>12</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>13</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>14</sup> 17 CFR 242.608(b)(2).

<sup>15</sup> See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (File No. 4-429).

<sup>16</sup> See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) (File No. 4-429) and 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000) (File No. 4-429).

BSE's proposed amendment to become a participant to the Current Plan became effective.<sup>17</sup> Further, Nasdaq's proposed amendment to become a participant to the Current Plan became effective on March 21, 2008.<sup>18</sup>

The Current Plan requires its participants to avoid, absent reasonable justification and during normal market conditions, trading at a price inferior to that displayed on another market ("trade-through").<sup>19</sup> The Current Plan provides for several exceptions to trade-through liability, including, among other things, systems malfunction, failure of the receiving market to respond to an incoming order within 30 seconds, failure of the market traded through to complain within the specified time period, complex trades, trading rotations, and non-firm quotations on the market that was traded through.<sup>20</sup> The Current Plan also provides a mechanism by which a member of a participating exchange could seek satisfaction if a customer order is traded through.<sup>21</sup>

Under the Current Plan, its participants agree that the dissemination of "locked" or "crossed" markets should be avoided, and, if their members lock or cross a market, they should take remedial actions to unlock or uncross such market.<sup>22</sup> Further, the Current Plan contains provisions to address trade comparison, clearing, trading halts, non-firm quotations, and administration of the Current Plan.<sup>23</sup> Except with respect to the addition of new participants and

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<sup>17</sup> See Securities Exchange Act Release No. 49198 (February 5, 2004), 69 FR 7029 (February 12, 2004) (File No. 4-429).

<sup>18</sup> See Securities Exchange Act Release No. 57545 (March 21, 2008), 73 FR 16394 (March 27, 2008) (File No. 4-429).

<sup>19</sup> Section 8(c) of the Current Plan.

<sup>20</sup> Section 8(c)(iii) of the Current Plan.

<sup>21</sup> Section 8(c)(ii) of the Current Plan.

<sup>22</sup> Section 7(a)(i)(C) of the Current Plan.

<sup>23</sup> Sections 5, 9, and 10 of the Current Plan.

the withdrawal of current participants, any proposed change to the Current Plan must be approved unanimously by its participants.<sup>24</sup>

The participating exchanges comply with the requirements of the Current Plan, including the prohibition against trade-throughs, by utilizing a stand alone system ("Linkage Hub") to send and receive specific order types. The Linkage Hub is a centralized data communications network that electronically links the options exchanges to one another. The Options Clearing Corporation ("OCC") operates the Linkage Hub.<sup>25</sup>

There are three defined order types under the Current Plan that its participants could route through the Linkage Hub to limit trade-throughs: orders represented by eligible market makers on behalf of customers ("Principal Acting as Agent Orders" or "P/A Orders");<sup>26</sup> orders for the principal accounts of market makers and specialists ("Principal Orders");<sup>27</sup> and orders intended to satisfy trade-through liabilities ("Satisfaction Orders").<sup>28</sup> Non-market-maker broker-dealers do not have access to the Linkage Hub.

C. Proposed Plan

The Proposing Exchanges are now seeking approval of an alternative linkage plan, the Proposed Plan. As described in more detail below, the Proposed Plan would not require a central linkage mechanism akin to the Current Plan's Linkage Hub, and would introduce certain new features to linkages between options markets, including an Intermarket Sweep Order ("ISO")

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<sup>24</sup> Section 5(c)(i) of the Current Plan.

<sup>25</sup> See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

<sup>26</sup> Sections 2(16)(a) and 7(a)(ii)(A), (B) of the Current Plan.

<sup>27</sup> Sections 2(16)(b) and 7(a)(ii)(C) of the Current Plan.

<sup>28</sup> Sections 2(16)(c) and 7(a)(ii)(D) of the Current Plan.

similar to that available for NMS stocks under Regulation NMS.<sup>29</sup>

### III. Discussion

As discussed above, in 1975, Congress directed the Commission, through the enactment of Section 11A of the Act,<sup>30</sup> to facilitate the development of a national market system consistent with the objectives of the Act. In particular, Section 11A(a)(3)(B) of the Act<sup>31</sup> authorizes the Commission “by rule or order, to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under this title in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities.” Rule 608 establishes the procedures for filing, amending, and approving a national market system plan. Approval of such a plan is conditioned upon a finding that the proposed plan “is necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Act.”<sup>32</sup>

After careful review, the Commission has determined to approve the Proposed Plan, pursuant to Section 11A(a)(3)(B) of the Act<sup>33</sup> and Rule 608 thereunder,<sup>34</sup> with changes set forth herein as the Commission has deemed necessary and appropriate.<sup>35</sup> Specifically, the

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<sup>29</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (File No. S7-10-04) (“NMS Release”); 17 CFR 242.600 et seq.

<sup>30</sup> 15 U.S.C. 78k-1.

<sup>31</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>32</sup> 17 CFR 242.608.

<sup>33</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>34</sup> 17 CFR 242.608.

<sup>35</sup> The Commission has modified the Proposed Plan to amend Section 7 of the Proposed Plan relating to the implementation date of the plan (see infra notes 140-143 and accompanying text).

Commission finds that changes to the Proposed Plan set forth herein are necessary and appropriate in the public interest. The Commission further finds that the Options Linkage Plan is in furtherance of the purposes of the Act in that it requires the protection of the best priced displayed quotes and avoidance and reconciliation of locked and crossed markets, and thus is necessary and appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system.<sup>36</sup>

The Commission believes that Proposed Plan's decentralized structure will allow the Proposing Exchanges to take advantage of new technology that allow for efficient routing and executions. The Proposed Plan will give the Proposing Exchanges greater flexibility for order handling as it would allow the exchanges to utilize private linkages, instead of requiring each Proposing Exchange to connect to, and participate in the maintenance of, a centralized hub. In addition, the Proposed Plan would permit the use of ISOs in the options markets. As such, the Proposed Plan would allow the Proposing Exchanges to move towards the market structure approved by the Commission for NMS stocks under Regulation NMS.<sup>37</sup> The Commission believes that the Options Linkage Plan will allow the Proposing Exchanges to update the way in which they accomplish effective quote protection and locked and crossed market reconciliation. For the reasons described above, the Commission believes that these provisions of the Options Linkage Plan will provide benefits to the options markets, including the Proposing Exchanges and market participants generally.

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<sup>36</sup> 17 CFR 242.608(b)(2).

<sup>37</sup> See supra note 29.

In its comment letter on the Proposed Plan, Citadel referenced the comments it made with regard to access fees in the options markets in its Petition for Rulemaking.<sup>38</sup> There, Citadel encouraged the Commission to institute a rulemaking proceeding to limit the fees that options exchanges may charge non-members to obtain access to quotations.<sup>39</sup> Commission staff is currently considering Citadel's petition.

A. Order Protection

1. Requirement of Reasonable Policies and Procedures

The Options Linkage Plan requires each Participant<sup>40</sup> to establish, maintain, and enforce written policies and procedures as approved by the Commission that are reasonably designed to prevent Trade-Throughs in that Participant's market in Eligible Options Classes.<sup>41</sup> A "Trade-Through"<sup>42</sup> is defined as a transaction in an option series, either as principal or agent, at a price that is lower than a Protected Bid or higher than a Protected Offer. A "Protected Bid" or a

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<sup>38</sup> See Citadel Letter, supra note 9.

<sup>39</sup> See Petition for Rulemaking, supra note 9.

<sup>40</sup> The Options Linkage Plan defines "Participant" to mean an Eligible Exchange whose participation in the plan has become effective pursuant to Section 3(c) of the Options Linkage Plan. See Section 2(15) of the Options Linkage Plan. The Options Linkage Plan defines "Eligible Exchange" to mean a national securities exchange registered with the Commission in accordance with Section 6(a) of the Act that, among other things, is a Participant Exchange in OCC (as that term is defined in Section VII of the OCC by-laws) and is a party to the OPRA Plan (as that term is described in Section I of the OPRA Plan). "OPRA Plan" means the plan filed by the Options Price Reporting Authority with the Commission pursuant to Section 11A(a)(1)(C)(iii) of the Act and approved by the Commission and declared effective as of January 22, 1976, as from time to time amended. See Section 2(14) of the Options Linkage Plan. For the definitions of "Trade-Through," "Best Bid" or "Best Offer," "Locked Market," and "Crossed Market," see infra notes 42, 44, and 119 and accompanying texts.

<sup>41</sup> Section 5(a)(i) of the Options Linkage Plan.

<sup>42</sup> Section 2(21) of the Options Linkage Plan.

“Protected Offer”<sup>43</sup> means a bid or offer in an option series that is displayed by an Eligible Exchange, is disseminated pursuant to the OPRA Plan, and is the Best Bid or Best Offer of an Eligible Exchange. A “Best Bid” or “Best Offer”<sup>44</sup> means the highest bid price or the lowest offer price communicated by a member of an Eligible Exchange to any broker-dealer or to any customer at which such member is willing to buy or sell, either as principal or agent.

The Options Linkage Plan also requires each Participant to agree to conduct surveillance of its market on a regular basis to ascertain the effectiveness of the policies and procedures to prevent Trade-Throughs and to take prompt action to remedy deficiencies in such policies and procedures.<sup>45</sup>

As is the case currently for NMS stocks under Regulation NMS,<sup>46</sup> the Commission believes the Options Linkage Plan’s policies and procedures-based approach to preventing Trade-Throughs in options is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets, and is consistent with Section 11A(a)(1)(C) of the Act.<sup>47</sup> The requirement in Section 5(a)(i) of the Options Linkage Plan is virtually identical to the requirement in Rule 611(a) of Regulation NMS. The Commission expects the Participants in the Options Linkage Plan will establish, maintain, and enforce written policies and procedures comparable to those established, maintained and enforced by the market centers subject to Rule 611(a). The Commission believes that a policies and procedures-based approach to preventing

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<sup>43</sup> Section 2(17) of the Options Linkage Plan. Protected Bid and Protected Offer, together are referred to herein as “Protected Quotation.” See Section 2(18) of the Options Linkage Plan.

<sup>44</sup> Sections 2(1) and 2(2) of the Options Linkage Plan.

<sup>45</sup> Section 5(a)(ii) of the Options Linkage Plan.

<sup>46</sup> See Rule 611(a) of Regulation NMS (17 CFR 242.611(a)).

<sup>47</sup> 15 U.S.C. 78k-1(a)(1)(C).

Trade-Throughs in options is reasonable given the increasingly high volume of trading in options, and the latencies and other discrepancies in the delivery and receipt of quotation data. The requirement of written policies and procedures, as well as the responsibility assigned to Participants to regularly surveil to ascertain the effectiveness of their procedures and take prompt remedial steps, is designed to achieve the objective of eliminating all Trade-Throughs that reasonably can be prevented, while also recognizing the inherent difficulties of eliminating Trade-Through transactions that, despite a Participant's reasonable efforts, may occur.

The Commission believes that each Participant's policies and procedures must enable it to monitor, on a real-time basis, the Protected Quotations displayed by Eligible Exchanges so as to determine the prices at which the Participant can and cannot execute trades. In addition, the Commission believes that a Participant's policies and procedures must establish objective standards and parameters governing its use of the exceptions set forth in Section 5(b) of the Options Linkage Plan, discussed below, and expects each Participant's order-handling and trading systems to be programmed in accordance with these policies and procedures. Finally, the Participant must take such steps as are necessary to enable it to enforce its policies and procedures effectively. For example, the Commission believes that Participants will need to establish procedures such as regular exception reports to evaluate their trading and order-routing practices. The Commission believes that each Participant Exchange will need to examine such reports to affirm that its policies and procedures have been followed by its personnel and properly coded into its systems and, if not, to promptly identify the reasons and take remedial action.<sup>48</sup>

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<sup>48</sup> See NMS Release at 37535, *supra* note 29.

Participants' obligations under the Options Linkage Plan to maintain and enforce policies and procedures reasonably designed to prevent Trade-Throughs is reinforced by the Options Linkage Plan's explicit assignment of responsibility to Participants to surveil to ascertain the effectiveness of their policies and procedures. Participants cannot merely establish policies and procedures that may be reasonable when created and assume that such policies and procedures continue to satisfy the requirements of the Options Linkage Plan. Rather, the Commission believes that Participants must regularly assess the continuing effectiveness of their procedures and take prompt action when needed to remedy deficiencies. In particular, Participants must engage in regular surveillance to determine whether Trade-Throughs are occurring without an applicable exception and whether they have failed to implement and maintain policies and procedures that would have reasonably prevented such Trade-Throughs. Further, this requirement is an important element of a Participant's obligations under Rule 608(c) of Regulation NMS, which require that each self-regulatory organization, absent reasonable justification or excuse, enforce compliance with any national market system plan by its members and persons associated with its members.<sup>49</sup>

## 2. Exceptions to Trade-Throughs

The Options Linkage Plan provides exceptions for certain transactions from the prohibition against Trade-Throughs.<sup>50</sup> The Options Linkage Plan also provides that, if a Participant relies on an exception, it would be required to establish, maintain, and enforce written policies and procedures reasonably designed to assure compliance with the terms of the

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<sup>49</sup> 17 CFR 242.608(c).

<sup>50</sup> See Proposed Plan Notice at 15012, supra note 8, for a more detailed description of the proposed Trade-Through exceptions.

exception.<sup>51</sup> Except for the proposed exception for stopped orders and price improvement,<sup>52</sup> the exceptions in the Options Linkage Plan correspond to trade-through exceptions found in either the Current Plan or in Regulation NMS.<sup>53</sup> The Options Linkage Plan includes the following exceptions from the prohibition against Trade-Throughs: system issues;<sup>54</sup> trading rotations;<sup>55</sup> crossed markets;<sup>56</sup> intermarket sweep orders;<sup>57</sup> quote flickering;<sup>58</sup> non-firm quotes;<sup>59</sup> complex trades;<sup>60</sup> customer stopped orders;<sup>61</sup> stopped orders and price improvement,<sup>62</sup> and benchmark trades.<sup>63</sup>

The Commission believes these exceptions will permit a workable intermarket price protection structure for the options market, and are consistent with the principle of price protection. As discussed below, the Commission finds that each of these exceptions is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly

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<sup>51</sup> Section 5(a)(i) of the Options Linkage Plan.

<sup>52</sup> Section 5(b)(x) of the Options Linkage Plan.

<sup>53</sup> Rule 611 of Regulation NMS, known also as the Order Protection Rule, governs trade-through liability for NMS Stocks. See 17 CFR 242.611.

<sup>54</sup> Section 5(b)(i) of the Options Linkage Plan.

<sup>55</sup> Section 5(b)(ii) of the Options Linkage Plan.

<sup>56</sup> Section 5(b)(iii) of the Options Linkage Plan. For the definition of a "Crossed Market," see *infra* note 119 and accompanying text.

<sup>57</sup> Section 5(b)(iv)-(v) of the Options Linkage Plan.

<sup>58</sup> Section 5(b)(vi) of the Options Linkage Plan.

<sup>59</sup> Section 5(b)(vii) of the Options Linkage Plan.

<sup>60</sup> Section 5(b)(viii) of the Options Linkage Plan.

<sup>61</sup> Section 5(b)(ix) of the Options Linkage Plan.

<sup>62</sup> Section 5(b)(x) of the Options Linkage Plan.

<sup>63</sup> Section 5(b)(xi) of the Options Linkage Plan.

markets,<sup>64</sup> and believes each assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>65</sup>

System Issues:<sup>66</sup> This exception, similar to an exception in the Current Plan, permits a Participant to trade through a Protected Quotation if the Eligible Exchange displaying the Protected Quotation that was traded through was experiencing a failure, material delay, or malfunction of its systems or equipment when the Trade-Through occurred. This exception gives Participants a “self-help” remedy if another Eligible Exchange repeatedly fails to provide an immediate response to incoming orders attempting to access its quotes. As the Commission stated in approving a parallel exception for stocks under Regulation NMS, the Eligible Exchange receiving an order can only be held responsible for its own turnaround time (*i.e.*, from the time it first received an order to the time it transmits a response to the order). Accordingly, the routing exchange will be required to develop policies and procedures that allow for any potential delays in transmission not attributable to the receiving exchange. This exception also covers any failure or malfunction of an Eligible Exchange’s systems or equipment, as well as any material delay.<sup>67</sup>

Participants will need to establish specific objective parameters governing their use of this “self-help” exemption as part of their reasonable policies and procedures. The Commission believes, for example, a single failure to respond within one second generally will not justify future bypassing of another Eligible Exchange’s quotations. Many failures to respond within one second in a short time period, in contrast, clearly will warrant use of the exception. The Commission believes that a Participant making use of this exception must notify the non-

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<sup>64</sup> 17 CFR 242.608(b)(2).

<sup>65</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>66</sup> Section 5(b)(i) of the Options Linkage Plan.

<sup>67</sup> See NMS Release at 37535, *supra* note 29.

responding Eligible Exchange immediately after (or at the same time as) electing this exception pursuant to reasonable and objective standards contained in its policies and procedures in order to alert the non-responding Eligible Exchange that the Participant intends to make use of this exception with respect to the non-responding Eligible Exchange's quotes.<sup>68</sup>

The Commission believes that a Participant should be entitled to bypass an away market's quotations if that market fails to respond to incoming orders attempting to access a displayed quote. The Commission believes that this exception will provide Participants with the necessary flexibility for dealing with problems that occur on an away market during the trading day. Further, the Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>69</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>70</sup>

Trading Rotations:<sup>71</sup> This exception, which is carried over from the Current Plan<sup>72</sup> and similar to an exception available for NMS stocks under Regulation NMS,<sup>73</sup> permits a Participant to trade through a Protected Quotation disseminated by an Eligible Exchange during a trading rotation. Options exchanges use a trading rotation to open an option for trading or reopen an option after a trading halt.

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<sup>68</sup> Id.

<sup>69</sup> 17 CFR 242.608(b)(2).

<sup>70</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>71</sup> Section 5(b)(ii) of the Options Linkage Plan.

<sup>72</sup> See Section 8(c)(iii)(E) of the Current Plan.

<sup>73</sup> See Rule 611(b)(3) of Regulation NMS under the Act (17 CFR 242.611(b)(3)).

As noted by the Participants, the trading rotation is effectively a single price auction to price the option,<sup>74</sup> and there are no practical means to include prices on other exchanges in that auction.<sup>75</sup> As such, the Commission emphasizes that the exception will not permit a Participant to declare a trading halt merely to be able to circumvent the operation of the Options Linkage Plan's Trade-Through provisions upon reopening; instead, the Commission believes a Participant must conduct, pursuant to its rules, a formalized and transparent process for executing orders during reopening after a trading halt that involves the queuing and ultimate execution of multiple orders at a single equilibrium price. In addition, a Participant must have formally declared a trading halt pursuant to its rules. Therefore, the Commission finds that it is reasonable to include this as an exception to the general prohibition on Trade-Throughs as it is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>76</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>77</sup>

Crossed Markets:<sup>78</sup> This exception permits a Participant to trade through a Protected Quotation when the market is crossed, and corresponds to an exception for NMS stocks under Regulation NMS.<sup>79</sup> A Crossed Market occurs when a Protected Bid is higher than a Protected Offer in a given options class. The Commission believes that it is appropriate to permit executions without regard to Trade-Throughs in a Crossed Market because allowing such

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<sup>74</sup> See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

<sup>75</sup> See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

<sup>76</sup> 17 CFR 242.608(b)(2).

<sup>77</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>78</sup> Section 5(b)(iii) of the Options Linkage Plan.

<sup>79</sup> See Rule 611(b)(4) of Regulation NMS (17 CFR 242.611(b)(4)).

transactions should permit the market to quickly resolve any unintentional crosses. For the foregoing reasons, the Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>80</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>81</sup>

Intermarket Sweep Orders:<sup>82</sup> The Options Linkage Plan includes two exceptions from the prohibition against Trade-Throughs for certain transactions involving ISOs. These two exceptions correspond to the exceptions relating to ISOs for NMS stocks under Regulation NMS.<sup>83</sup> First, the Options Linkage Plan permits a Participant to execute orders marked as ISOs even when the Participant is not at the national best bid or offer (“NBBO”). Second, a Participant is permitted to execute a transaction when such transaction is not at the NBBO, provided it simultaneously “sweeps” all better priced Protected Quotations by routing an ISO to execute against the full displayed size of any Protected Quotation that was traded through.

An ISO is defined as a limit order for an options series that, when routed to an Eligible Exchange, is identified as an Intermarket Sweep Order and, simultaneously with the routing of the order, one or more additional orders, as necessary, are routed to execute against the full displayed size of any Protected Bid, in the case of a limit order to sell, or any Protected Offer, in the case of a limit order to buy, for the options series with a price that is superior to the limit price of the order.<sup>84</sup> Any such additional orders would also be marked as ISOs.

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<sup>80</sup> 17 CFR 242.608(b)(2).

<sup>81</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>82</sup> Section 5(b)(iv) and (v) of the Options Linkage Plan.

<sup>83</sup> See Rule 611(b)(5) and (6) of Regulation NMS (17 CFR 242.611(b)(5) and (6)).

<sup>84</sup> Section 2(9) of the Options Linkage Plan.

The availability of ISOs will allow the Participants to access multiple price levels simultaneously displayed on the same or multiple markets, without violating the prohibition against Trade-Throughs. As the Commission stated with respect to ISOs for stocks under Regulation NMS, the Commission believes that allowing a Participant to immediately execute an order identified as an ISO when that exchange is not at the NBBO is fully consistent with the principle of protecting the best displayed prices because the exception is premised on the condition that the market participant sending the ISO has already attempted to access all better-priced Protected Quotations up to their displayed size. Consequently, there is no reason why a Participant that receives an ISO while displaying an inferior-priced quotation should be required to delay an execution of the order.<sup>85</sup> This exception should help to ensure more efficient and faster executions.

The second ISO Trade-Through exception, under subparagraph (b)(v) of Section 5 of the Options Linkage Plan, should benefit market participants in their ability to handle orders efficiently. For example, market participants should be able to use this exception to more efficiently execute block trades one or more minimum price increments away from the NBBO. So long as ISOs are simultaneously routed to execute against better-priced Protected Quotation on other markets, the block order could be executed contemporaneously with the routing of the ISOs.

The Commission notes that Section 5(c) of the Options Linkage Plan requires Participants to take reasonable steps to establish that ISOs are properly routed in an attempt to execute against all applicable Protected Quotations.

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<sup>85</sup> See NMS Release at 37523, supra note 29.

For the reasons stated above, the Commission finds that the exception from Trade-Through liability when an exchange or market participants sends an ISO is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>86</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>87</sup>

Quote Flickering.<sup>88</sup> Subparagraph (b)(vi) of Section 5 of the Options Linkage Plan sets forth an exception for flickering quotations, and corresponds to an exception for NMS stocks under Regulation NMS.<sup>89</sup> It excepts a transaction if the Eligible Exchange displaying the Protected Quotation that was traded through had displayed, within one second prior to execution of the Trade-Through, a Best Bid or Best Offer, as applicable, for the options series with a price that was equal or inferior to the price of the Trade-Through transaction.

As the Commission stated with respect to the similar exception for stocks under Regulation NMS,<sup>90</sup> this exception thereby provides a “window” to address false indications of Trade-Throughs that in actuality are attributable to rapidly moving quotations. It should also reduce the number of instances in which a Participant must alter its normal trading procedures and route orders to other trading centers to comply with the Options Linkage Plan. The exception is thereby intended to promote more workable intermarket price protection. The Commission finds it is in the public interest, appropriate for the protection of investors and the

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<sup>86</sup> 17 CFR 242.608(b)(2).

<sup>87</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>88</sup> Section 5(b)(vi) of the Options Linkage Plan.

<sup>89</sup> See Rule 611(b)(8) of Regulation NMS (17 CFR 242.611(b)(8)).

<sup>90</sup> See NMS Release at 37536, supra note 29.

maintenance of fair and orderly markets,<sup>91</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>92</sup>

Non-Firm Quotes:<sup>93</sup> This exception, which is carried over from the Current Plan,<sup>94</sup> permits a Participant to trade through a Protected Quotation that was “Non-Firm.”<sup>95</sup> “Non-Firm” is defined to mean, with respect to Quotations in an Eligible Options Class, that members of a Participant are relieved of their obligations under that Participant’s firm quote rule in that Eligible Options Class.<sup>96</sup>

The Commission believes that Participants should not be required to protect the price of an away market when that market identifies its quotes as “Non-Firm.” The Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>97</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>98</sup>

Complex Trades:<sup>99</sup> This exception carries forward the complex trade exception in Section 8(c)(iii)(G) of the Current Plan<sup>100</sup> and permits a Participant to trade through a Protected

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<sup>91</sup> 17 CFR 242.608(b)(2).

<sup>92</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>93</sup> Section 5(b)(vii) of the Options Linkage Plan.

<sup>94</sup> See Section 8(c)(iii)(C) of the Current Plan.

<sup>95</sup> See Section 2(11) of the Options Linkage Plan.

<sup>96</sup> The Commission notes that, when quotations in an Eligible Options Class are Non-Firm, exchange rules require the exchange to provide notice that its quotations are Non-Firm by appending an indicator to its quotations. See, e.g., CBOE Rule 43.14(b) and NYSE Arca Rule 6.86(d)(1)(C).

<sup>97</sup> 17 CFR 242.608(b)(2).

<sup>98</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>99</sup> Section 5(b)(viii) of the Options Linkage Plan.

<sup>100</sup> Section 8(c)(iii)(G) of the Current Plan.

Quotation if the transaction was part of a “complex trade.” The definition of “complex trade” would be implemented through rules adopted by the Participants, which would be subject to notice, comment, and Commission review pursuant to the Section 19(b) rule filing process.

Complex trades, such as those submitted by market participants under the Proposing Exchanges complex order mechanisms,<sup>101</sup> are composed of multiple transactions effected at a net price. As the Proposing Exchanges state,<sup>102</sup> it is not always practical to require each leg to be transacted at a price that does not constitute a Trade-Through, and the Commission believes that permitting an exception for transactions effected as a portion of a complex trade is appropriate. By narrowly crafting the definition of complex trades in each Participants’ rules,<sup>103</sup> the Commission believes that this exception will not undercut the general Trade-Through protections of the Options Linkage Plan, and finds it is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>104</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>105</sup>

Customer Stopped Orders:<sup>106</sup> This exception permits a Participant to trade through a Protected Quotation if the trade executed a “stopped order.” The exception requires that the “stopped order” be for the account of a Customer,<sup>107</sup> that the Customer agreed to the specified

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<sup>101</sup> See, e.g., ISE Rule 722.

<sup>102</sup> See ISE Letter 2 and NYSE Arca Letter 2, *supra* note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, *supra* note 7.

<sup>103</sup> All changes to rules of national securities exchanges are subject to notice, comment and Commission review pursuant to Section 19(b) of the Act. 15 U.S.C. 78s(b).

<sup>104</sup> 17 CFR 242.608(b)(2).

<sup>105</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>106</sup> Section 5(b)(ix) of the Options Linkage Plan.

<sup>107</sup> “Customer” would be defined to mean an individual or organization that is not a “Broker/Dealer.” See Section 2(5) of the Options Linkage Plan.

price on an order-by-order basis; and that the price of the Trade-Through was, for a stopped buy order, lower than the national Best Bid in the options series at the time of execution, or, for a stopped sell order, higher than the national Best Offer in the options series at the time of execution. This exception corresponds to the customer stopped order exception under Regulation NMS.<sup>108</sup>

The Commission recognizes that the use of stopped orders is a valuable tool, particularly for the execution of large orders.<sup>109</sup> The Commission believes that this narrowly-drawn exception would give market participants the ability to execute large Customer orders over time at a price agreed upon by a Customer, even though the price of the option may change before the order is executed in its entirety, without undermining the general principles of price protection under the Options Linkage Plan. For these reasons, the Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>110</sup> and assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>111</sup>

Stopped Orders and Price Improvement:<sup>112</sup> This exception permits a Participant to trade through a Protected Quotation if the transaction that constituted the Trade-Through was the execution by a Participant of an order that is stopped at a price that did not constitute a Trade-Through at the time of the stop. This exception allows a Participant to seek price improvement for an order, even if the market moves in the interim, and the transaction ultimately is effected at

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<sup>108</sup> See Rule 611(b)(9) of Regulation NMS (17 CFR 242.611(b)(9)).

<sup>109</sup> See NMS Release at 37527, supra note 29.

<sup>110</sup> 17 CFR 242.608(b)(2).

<sup>111</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>112</sup> Section 5(b)(x) of the Options Linkage Plan.

a price that would trade through the then currently-displayed market. The rules of several of the Proposing Exchanges currently contain provisions relating to price improvement mechanisms.<sup>113</sup>

These price improvement mechanisms offer price improvement to orders received by the exchange during a specified period of time ("auction"). During this auction period, the NBBO could move from where it was when the order was received. However, the exchange is only required to guarantee a price no worse than the NBBO at the time the order was received. Thus, following the auction, an execution could result in a Trade-Through if the NBBO improves from the time the order was received although, had the order been executed at the time of receipt, the execution would not have resulted in a Trade-Through.

This exception would allow a Participant to seek price improvement for an order, even if the market moves in the interim, and the transaction ultimately is effected at a price that would trade through the then currently-displayed market. By allowing this exception, the Commission expects that Participants would be able to continue to use price improvement mechanisms, thereby offering market participants potentially better-priced executions. The Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>114</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>115</sup>

Benchmark Trades:<sup>116</sup> This exception permits a Participant to trade through a Protected Quotation if the trade was executed at a price not based directly or indirectly on the quoted price

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<sup>113</sup> See, e.g., Securities Exchange Act Release No. 50819 (December 8, 2004), 69 FR 75093 (December 15, 2004) (SR-ISE-2003-06) (approving rules implementing ISE's Price Improvement Mechanism under ISE Rule 723).

<sup>114</sup> 17 CFR 242.608(b)(2).

<sup>115</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>116</sup> Section 5(b)(xi) of the Options Linkage Plan.

of an options series at the time of execution and for which the material terms were not reasonably determinable at the time of the commitment to make the trade.

This exception allows a “benchmark order” and corresponds to an exception for NMS stocks under Rule 611 of Regulation NMS.<sup>117</sup> A common example of a benchmark order for NMS stocks is a volume-weighted average price, or “VWAP,” order. The Commission notes that none of the Proposing Exchanges currently permit these types of options trades, and any Participant seeking to make use of this exception would be required to submit a proposed rule change which would be subject to notice, comment and Commission review under Section 19(b) of the Act. The Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets, and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>118</sup>

B. Locked and Crossed Markets

The Options Linkage Plan also addresses Locked and Crossed Markets.<sup>119</sup> The requirements in the Options Linkage Plan relating to Locked and Crossed Markets are virtually identical to those applicable to market centers for NMS stock under Regulation NMS.<sup>120</sup>

Specifically, the Options Linkage Plan requires each Participant to establish, maintain, and enforce written rules that require their members reasonably to avoid displaying Locked and

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<sup>117</sup> See Rule 611(b)(7) of Regulation NMS (17 CFR 242.611(b)(7)).

<sup>118</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>119</sup> Section 6 of the Options Linkage Plan. A “Locked Market” is defined as a quoted market in which a Protected Bid is equal to a Protected Offer in a series of an Eligible Options Class. See Section 2(10) of the Options Linkage Plan. A “Crossed Market” is defined as a quoted market in which a Protected Bid is higher than a Protected Offer in a series of an Eligible Options Class. See Section 2(4) of the Options Linkage Plan.

<sup>120</sup> See Rule 610(d) of Regulation NMS (17 CFR 242.610(d)).

Crossed Markets.<sup>121</sup> Participants would also be required to establish, maintain, and enforce written rules reasonably designed to assure the reconciliation of Locked and Crossed Markets.<sup>122</sup> Finally, the Options Linkage Plan would provide that Participants must establish, maintain, and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying Locked and Crossed Markets, subject to exceptions as may be contained in the Participants' rules, as approved by the Commission.<sup>123</sup>

The Commission recognizes that Section 6 of the Options Linkage Plan, by restricting Locked Markets, can prohibit the display of an order that would otherwise have been displayed and reduced the quoted spread to zero. However, as the Commission stated with respect to locked markets for stocks under Regulation NMS, the Commission believes that Locked Markets may not actually represent two market participants willing to buy and sell at the same price. Instead, a locking market participant may not truly be willing to trade at the displayed locking price, but chooses to lock rather than execute against the already-displayed quotation to receive a liquidity rebate. The Commission believes that giving priority to the first-displayed Protected Bid or Protected Offer, particularly when it includes a public customer's order, will encourage price discovery and contribute to fair and orderly markets.<sup>124</sup>

The Options Linkage Plan is designed to ensure that the display of locked and crossed markets would be restricted, while also recognizing that locked and crossed markets do occur accidentally and cannot always be avoided. Thus, the Options Linkage Plan requires that the

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<sup>121</sup> Section 6(a) of the Options Linkage Plan.

<sup>122</sup> Section 6(b) of the Options Linkage Plan.

<sup>123</sup> Section 6(c) of the Options Linkage Plan. The Commission notes that the proposed rule changes relating to all necessary implementing rules of the Participants, including those required by Section 6 of the Options Linkage Plan, would be subject to notice, comment, and Commission review pursuant to Section 19(b) of the Act.

<sup>124</sup> See NMS Release at 37547, *supra* note 29.

Participants have written rules that are reasonably designed to assure the reconciliation of any lock or cross. Further, the Options Linkage Plan expressly prohibits a pattern or practice of locking or crossing away markets.

In addition, the Options Linkage Plan would allow exceptions to its general Locked and Crossed Markets provision as might be contained in a given Participant's rules. As with all proposed rule changes of national securities exchanges, such rule changes would be subject to notice, comment and Commission review under Section 19(b)(1) of the Act.<sup>125</sup> The Commission believes that these provisions are designed to ensure that the display of Locked and Crossed Markets will be limited and that any such display will be promptly reconciled.

For the reasons stated above, the Commission finds that the Options Linkage Plan's provisions relating to Locked and Crossed Markets are in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>126</sup> and believes they assure fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>127</sup>

C. Joining the Proposed Plan

Any national securities exchange would be eligible to become a Participant by executing a copy of the Options Linkage Plan and providing each Participant with a copy of such executed Options Linkage Plan<sup>128</sup> if it is: (1) registered with the Commission in accordance with Section 6(a) of the Act; (2) a Participant Exchange in OCC;<sup>129</sup> and (3) a party to the OPRA Plan.<sup>130</sup>

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<sup>125</sup> 15 U.S.C. 78s(b)(1).

<sup>126</sup> 17 CFR 242.608(b)(2).

<sup>127</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>128</sup> Section 3(c) of the Options Linkage Plan.

<sup>129</sup> For a definition of a "Participant Exchange," see Section VII of the OCC by-laws.

<sup>130</sup> For more information on who is a party to the OPRA Plan, see Section I of the OPRA Plan.

Further, any such national securities exchange wishing to become a Participant would be required to file an amendment to the Options Linkage Plan by executing a copy of the Options Linkage Plan and filing such executed Options Linkage Plan to the Commission.<sup>131</sup> Such amendment would be effective when the amendment is approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder.<sup>132</sup> The Commission finds that this process for joining the Options Linkage Plan is in the public interest,<sup>133</sup> and believes it is consistent with Section 11A(a)(1)(C) because it is designed to ensure that reasonable procedures are in place to permit additional exchanges to also participate in the Options Linkage Plan.<sup>134</sup>

D. Withdrawal from the Proposed Plan

Any Participant would be able to withdraw from the Options Linkage Plan at any time by providing not less than 30 days' prior written notice to each of the other Participants of such intent to withdraw.<sup>135</sup> To withdraw, such Participant also would be required to effect an amendment to the Options Linkage Plan by submitting such amended Options Linkage Plan to the Commission for approval.<sup>136</sup> In submitting the amended Options Linkage Plan to the Commission, the Participant proposing to withdraw from the Options Linkage Plan would be required to state how the Participant plans to accomplish, by alternate means, the goal of the

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<sup>131</sup> Section 4(b) of the Options Linkage Plan.

<sup>132</sup> Id. These requirements are identical to those contained in the Current Plan. See Sections 4(c)(i) and 5(c) of the Current Plan. The Current Plan also requires that an eligible exchange pay a fee to join the Current Plan. See Section 4(c)(i)(iv) of the Current Plan. The Options Linkage Plan does not require an Eligible Exchange to pay a fee to join the Options Linkage Plan.

<sup>133</sup> 17 CFR 242.608(b)(2).

<sup>134</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>135</sup> Section 3(d) of the Options Linkage Plan.

<sup>136</sup> Section 4(c) of the Options Linkage Plan.

Options Linkage Plan regarding limiting Trade-Throughs of prices on other exchanges trading the same options classes.<sup>137</sup> Such withdrawal from the Options Linkage Plan would be effective when the amendment is approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder. Upon the effectiveness of such withdrawal, the withdrawing Participant would have no further rights or obligations under the Options Linkage Plan.

The Commission finds that these requirements for withdrawal from the Options Linkage Plan are in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>138</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>139</sup>

E. Implementation

The Proposed Plan states that the “[Participants] shall implement [the plan]...no later than February 27, 2009; provided that, unless the [Commission] otherwise authorizes, the [Participants] shall not implement [the plan] until all Eligible Exchanges either (1) have become parties to [the plan] and the [Commission] has approved all necessary implementing rules or (2) have developed the ability to accept and execute incoming Intermarket Sweep Orders.”<sup>140</sup>

To provide clarity to market participants regarding the implementation date of the plan, the Commission, after consultation with the Proposing Exchanges, has modified the Proposed Plan to change the implementation date in Section 7 from February 27, 2009 to August 31, 2009.

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<sup>137</sup> Id. These requirements are identical to those contained in the Current Plan. See Sections 4(d) and 5(c)(iii) of the Current Plan.

<sup>138</sup> 17 CFR 242.608(b)(2).

<sup>139</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>140</sup> See Section 7 of the Proposed Plan.

In addition, the Commission notes that all seven options exchanges<sup>141</sup> have joined in filing the Proposed Plan with the Commission, and each has submitted proposed rule changes pursuant to Section 19(b) of the Act to modify its rules to comply with the Options Linkage Plan.<sup>142</sup> The Commission believes that the provision that would permit the plan to be implemented if an Eligible Exchange “developed the ability to accept and execute incoming Intermarket Sweep Orders,” even if such exchange had not become a party to the plan is no longer necessary because all seven options exchanges have joined the Options Linkage Plan and therefore will, upon implementation of the Options Linkage Plan, accept and execute ISOs.

The Commission finds that these modifications to Section 7 of the Proposed Plan are necessary and appropriate and will further the purposes of the Act by providing clarity to market participants regarding the implementation of the plan while providing appropriate time to self-regulatory organizations to prepare for implementation.

With these modifications, unless the Commission otherwise authorizes, the plan may only be implemented by the Proposing Exchanges when all Proposing Exchanges’ proposed rule changes containing the necessary implementing rules<sup>143</sup> have been approved by the Commission.

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<sup>141</sup> That is, CBOE, ISE, Nasdaq, BX, Phlx, Amex and NYSE Arca.

<sup>142</sup> See, e.g., Securities Exchange Act Release Nos. 60014 (June 1, 2009); and 74 FR 27224 (June 8, 2009) (SR-ISE-2009-27) and 60015 (June 1, 2009); 74 FR 27375 (June 9, 2009) (SR-NYSEAmex-2009-19) which propose rules such as provisions that contain relevant definitions, an order protection rule, and a locked and crossed market rule, which correspond to the provisions in the Options Linkage Plan.

<sup>143</sup> See *id.*

IV. Conclusion

IT IS HEREBY ORDERED, that pursuant to Section 11A(a)(3)(B) of the Act<sup>144</sup> and Rule 608 thereunder,<sup>145</sup> that the Proposed Plan submitted by CBOE, ISE, Nasdaq, BX, Phlx, Amex, and NYSE Arca, as modified herein, is approved and declared effective,<sup>146</sup> and that CBOE, ISE, Nasdaq, BX, Phlx, Amex, and NYSE Arca are authorized to act jointly to implement the Options Order Protection and Locked/Crossed Market Plan as a means of facilitating a national market system.

By the Commission.

Elizabeth M. Murphy  
Secretary

By: Florence E. Harmon  
Deputy Secretary

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<sup>144</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>145</sup> 17 CFR 242.608.

<sup>146</sup> The approved Plan is attached here as Appendix A.

## Appendix A

### OPTIONS ORDER PROTECTION AND LOCKED/CROSSED MARKET PLAN

#### Section 1 – Preamble

The Participants submit to the SEC this Plan providing a framework for order protection and addressing Locked and Crossed Markets in Eligible Options Classes. The purpose of the Plan is to enable the Participants to act jointly in establishing a framework for providing order protection and addressing Locked and Crossed Markets in Eligible Options Classes. In addition, the Plan provides for a non-exclusive method for achieving order protection and addressing Locked and Crossed Markets. The Participants will submit to the SEC for approval their respective rules that will implement the framework of the Plan. The Participants request that the SEC issue an order pursuant to Section 11A(a)(3)(B) of the Exchange Act and Rule 608 thereunder evidencing its approval of the Plan.

#### Section 2 - Definitions

- 1) "Best Bid" and "Best Offer" mean the highest priced Bid and the lowest priced Offer.
- 2) "Bid" or "Offer" means the bid price or the offer price communicated by a member of an Eligible Exchange to any Broker/Dealer, or to any customer, at which it is willing to buy or sell, as either principal or agent, but shall not include indications of interest.
- 3) "Broker/Dealer" means an individual or organization registered with the SEC in accordance with Section 15(b)(1) of the Exchange Act or a foreign broker or dealer exempt from such registration pursuant to Rule 15a-6 under the Exchange Act.
- 4) "Crossed Market" means a quoted market in which a Protected Bid is higher than a Protected Offer in a series of an Eligible Class.
- 5) "Customer" means an individual or organization that is not a Broker/Dealer.
- 6) "Eligible Exchange" means a national securities exchange registered with the SEC in accordance with Section 6(a) of the Exchange Act that: (a) is a Participant Exchange in OCC (as that term is defined in Section VII of the OCC by-laws); (b) is a party to the OPRA Plan (as that term is described in Section I of the OPRA Plan); and (c) if the national securities exchange chooses not to become a party to this Plan, is a participant in another plan approved

by the Commission providing for comparable Trade-Through and Locked and Crossed Market protection.

- 7) "Eligible Options Class" means all option series overlying a security (as that term is defined in Section 3(a)(10) of the Exchange Act) or group of securities, including both put options and call options, which class is available for trading on two or more Eligible Exchange.
- 8) "Exchange Act" means the Securities Exchange Act of 1934, as amended.
- 9) "Intermarket Sweep Order (ISO)" means a limit order for an options series that meets the following requirements:
  - (a) When routed to an Eligible Exchange, the order is identified as an ISO;
  - (b) Simultaneously with the routing of the order, one or more additional ISOs, as necessary, are routed to execute against the full displayed size of any Protected Bid, in the case of a limit order to sell, or any Protected Offer, in the case of a limit order to buy, for the options series with a price that is superior to the limit price of the ISO, with such additional orders also marked as ISOs.
- 10) "Locked Market" means a quoted market in which a Protected Bid is equal to a Protected Offer in a series of an Eligible Options Class.
- 11) "Non-Firm" means, with respect to Quotations in an Eligible Options Class, that members of a Participant are relieved of their obligations under that Participant's firm quote rule in that Eligible Options Class.
- 12) "OCC" means The Options Clearing Corporation.
- 13) "OPRA" means the Options Price Reporting Authority.
- 14) "OPRA Plan" means the plan filed with the SEC pursuant to Section 11Aa(1)(C)(iii) of the Exchange Act, approved by the SEC and declared effective as of January 22, 1976, as from time to time amended.
- 15) "Participant" means an Eligible Exchange whose participation in the Plan has become effective pursuant to Section 3(c) of the Plan.

- 16) "Plan" means the plan amended and restated in this instrument as from time to time amended in accordance with its provisions.
- 17) "Protected Bid" or "Protected Offer" means a Bid or Offer in an options series, respectively, that:
- a. Is displayed by an Eligible Exchange;
  - b. Is disseminated pursuant to the OPRA Plan; and
  - c. Is the Best Bid or Best Offer, respectively, of an Eligible Exchange.
- 18) "Protected Quotation" means a Protected Bid or Protected Offer.
- 19) "Quotation" means a Bid or Offer.
- 20) "SEC" means the United States Securities and Exchange Commission.
- 21) "Trade-Through" means a transaction in an options series, either as principal or agent, at a price that is lower than a Protected Bid or higher than a Protected Offer.

### **Section 3 – Parties to the Plan**

(a) List of Parties

The parties to the Plan are as follows:

Boston Stock Exchange, Inc., registered as a national securities exchange under the Exchange Act and having its principal place of business at 100 Franklin Street, Boston, Massachusetts 02110.

Chicago Board Options Exchange, Incorporated, registered as a national securities exchange under the Exchange Act and having its principal place of business at 400 South LaSalle Street, Chicago, Illinois 60605.

International Securities Exchange, LLC, registered as a national securities exchange under the Exchange Act and having its principal place of business at 60 Broad Street, New York, New York 10004.

The NASDAQ Stock Market LLC, registered as a national securities exchange under the Exchange Act and having its principal place of business at One Liberty Plaza, 50<sup>th</sup> Floor, New York, New York 10006.

NASDAQ OMX PHLX, Inc., registered as a national securities exchange under the Exchange Act and having its principal place of business at 1900 Market Street, Philadelphia, Pennsylvania 19103.

NYSE Alternext US LLC, registered as a national securities exchange under the Exchange Act and having its principal place of business at 11 Wall Street, New York, NY 10005.

NYSE Arca, Inc., registered as a national securities exchange under the Exchange Act and having its principal place of business at 100 South Wacker Drive, Suite 1800, Chicago, IL 60606.

(b) Compliance Undertaking

By subscribing to and submitting the Plan for filing with the SEC, each Participant agrees to enforce compliance by its members with the provisions of the Plan.

(c) Entry of New Participants

The Participants agree that any other Eligible Exchange may become a Participant by: (i) executing a copy of the Plan, as then in effect; (ii) providing each then-current Participant with a copy of such executed Plan; and (iii) effecting an amendment to the Plan as specified in Section 4(b) of the Plan.

(d) Withdrawal from the Plan

Any Participant may withdraw from the Plan at any time by: (i) providing not less than 30 days' prior written notice to each of the other Participants of such intent to withdraw; and (ii) effecting an amendment to the Plan as specified in Section 4(c) of the Plan. Upon the effectiveness of such withdrawal the withdrawing Participant shall have no further rights or obligations whatsoever under the Plan.

**Section 4 – Amendments to the Plan**

(a) General Amendment Authority

Except with respect to:

- (i) the addition of new Participants to the Plan; and

(ii) the withdrawal of a Plan Participant, any proposed change in, addition to, or deletion from the Plan may be effected only by means of a written amendment to the Plan that is unanimously approved by the Participants and that: (A) sets forth the change, addition or deletion; (B) is executed on behalf of each Participant; and (C) is approved by the SEC or otherwise becomes effective pursuant to Section 11A of the Exchange Act and Rule 608 thereunder.

(b) New Participants

With respect to new Participants, an amendment to the Plan may be effected by a new Eligible Exchange executing a copy of the Plan, as then in effect (with the only change being the addition of the new Participant's name in Section 3(a) of the Plan), and submitting such executed Plan to the SEC. Such amendment will be effective when the amendment is approved by the SEC or otherwise becomes effective pursuant to Section 11A of the Exchange Act and Rule 608 thereunder.

(c) Withdrawal from the Plan

A Participant seeking to withdraw from the Plan shall effect an amendment to the Plan as then in effect (with the only change being the deletion of the Participant's name in Section 3(a) of the Plan) by submitting such amended Plan to the SEC for approval. In submitting the amended Plan to the SEC, the Participant proposing to withdraw from the Plan shall state how the Participant plans to accomplish, by alternate means, the goal of the Plan regarding limiting Trade-Throughs of prices on other exchanges trading the same options classes. Such withdrawal from the Plan shall be effective when the amendment is approved by the SEC or otherwise becomes effective pursuant to Section 11A of the Exchange Act and Rule 608 thereunder.

**Section 5 – Order Protection**

(a) Order Protection

(i) Prevention of Trade-Throughs. Each Participant agrees that it shall establish, maintain and enforce written policies and procedures as approved by the SEC that are reasonably designed to prevent Trade-Throughs in that Participant's market in Eligible Options Classes that do not fall within an exception set forth in paragraph (b) below, and, if relying on such exception, that are reasonably designed to assure compliance with the terms of the exception.

(ii) Surveillance. Each Participant agrees to conduct surveillance of its market on a regular basis to ascertain the effectiveness of the policies and procedures required by paragraph (a)(1) of this section, and to take prompt action to remedy deficiencies in such policies and procedures.

(b) Exceptions.

(i) The transaction that constituted the Trade-Through was effected when the Eligible Exchange displaying the Protected Quotation that was traded through was experiencing a failure, material delay, or malfunction in its systems or equipment;

(ii) The transaction traded through a Protected Quotation being disseminated by an Eligible Exchange during a trading rotation;

(iii) The transaction that constituted the Trade-Through occurred when there was a Crossed Market;

(iv) The transaction that constituted the Trade-Through was the execution of an order identified as an Intermarket Sweep Order;

(v) The transaction that constituted the Trade-Through was effected by a Participant that simultaneously routed an Intermarket Sweep Order to execute against the full displayed size of any Protected Quotation that was traded through;

(vi) The Eligible Exchange displaying the Protected Quotation that was traded through had displayed, within one second prior to execution of the Trade-Through, a Best bid or Best offer, as applicable, for the options series with a price that was equal or inferior to the price of the Trade-Through transaction;

(vii) The Protected Quotation traded through was being disseminated from an Eligible Exchange whose Quotations were Non-Firm with respect to such options series;

(viii) The transaction that constituted the Trade-Through was effected as a portion of a "complex trade," as defined in the rules of a Participant;

(ix) The transaction that constituted the Trade-Through was the execution by a Participant of an order for which, at the time of receipt of the order, a member of the Participant had guaranteed an execution at no worse than a specified price (a "stopped order"), where:

- (A) the stopped order was for the account of a Customer;
- (B) the Customer agreed to the specified price on an order-by-order basis; and
- (C) the price of the Trade-Through was, for a stopped buy order, lower than the national Best Bid in the options series at the time of execution, or, for a stopped sell order, higher than the national Best Offer in the options series at the time of execution;

(x) The transaction that constituted the Trade-Through was the execution by a Participant of an order which was stopped at a price that did not Trade-Through another Eligible Exchange at the time of the stop; or

(xi) The transaction that constituted the Trade-Through was the execution of an order at a price that was not based, directly or indirectly, on the quoted price of the options series at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made.

(c) Intermarket Sweep Orders. Participants shall take reasonable steps to establish that Intermarket Sweep Orders meet the requirements of Section 2(9) of the Plan.

**Section 6 – Locked and Crossed Markets**

The Participants agree that they shall establish, maintain and enforce written rules that:

- (a) Require their members reasonably to avoid displaying Locked and Crossed Markets;
- (b) Are reasonably designed to assure the reconciliation of Locked and Crossed Markets; and
- (c) Prohibit its members from engaging in a pattern or practice of displaying Locked and Crossed Markets;

in all cases subject to such exceptions as may be contained in the rules of a Participant approved by the Commission.

**Section 7 – Implementation**

The Parties shall implement this Plan on a date upon which all Parties agree, but no later than August 31, 2009; provided that, unless the SEC otherwise authorizes, the Parties shall not implement this Plan unless all Eligible Exchanges have become parties to this Plan and the SEC has approved all necessary implementing rules.

**Section 8 – Counterparts and Signatures**

The Plan may be executed in any number of counterparts, no one of which need contain all signatures of all Participants, and as many of such counterparts as shall together contain all such signatures shall constitute one and the same instrument.

IN WITNESS WHEREOF, this Plan has been executed as of the \_\_\_\_\_ 2009 by each of the parties hereto.

CHICAGO BOARD OPTIONS EXCHANGE,  
INCORPORATED

By: \_\_\_\_\_

Date: \_\_\_\_\_

INTERNATIONAL SECURITIES EXCHANGE, LLC

By: \_\_\_\_\_

Date: \_\_\_\_\_

The NASDAQ STOCK MARKET LLC

By: \_\_\_\_\_

Date: \_\_\_\_\_

NASDAQ OMX BX, INC.

By: \_\_\_\_\_

Date: \_\_\_\_\_

NASDAQ OMX PHLX, Inc.

By: \_\_\_\_\_

Date: \_\_\_\_\_

NYSE AMEX LLC

By: \_\_\_\_\_

Date: \_\_\_\_\_

NYSE ARCA, INC.

By: \_\_\_\_\_

Date: \_\_\_\_\_

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 60415 / July 31, 2009

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3027 / July 31, 2009

ADMINISTRATIVE PROCEEDING  
File No. 3-13567

In the Matter of

FRANK S. LAFORGIA, CPA,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Frank S. LaForgia, CPA ("Respondent" or "LaForgia") pursuant to Sections 4C<sup>1</sup> and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.<sup>2</sup>

<sup>1</sup> Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

<sup>2</sup> Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

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## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

## III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>3</sup> that:

### A. SUMMARY

1. These proceedings concern the improper professional conduct of LaForgia, a certified public accountant ("CPA"), who conducted improper audits and reviews of Certified Services, Inc.'s ("Certified") financial statements for the years ended December 31, 2002 and December 31, 2003 and the first three quarters of 2004 (the "engagements"). LaForgia's departure from the applicable professional standards while acting as the engagement partner caused the accounting firm, Rosenberg, Rich, Baker, Berman & Company, PA ("Rosenberg Rich"), to issue unqualified audit and review reports despite the fact that Certified's financial statements were not presented in accordance with generally accepted accounting principles ("GAAP").

2. Certified was a publicly held company located in Fort Lauderdale, Florida. Certified and its subsidiaries operated a professional employee leasing organization ("PEO") business. PEOs provide small and medium-size businesses with a variety of human resource services by acting as a co-employer of those businesses' employees. Among other things, Certified assumed some or all of its clients' responsibilities and risks related to workers' compensation insurance coverage. Beginning in 2002, Certified retained Rosenberg Rich to audit its financial statements and quarterly filings.

3. On March 6, 2008 the Commission filed a complaint in U.S. District Court for the Southern District of Florida (the "Complaint"), alleging, among other things, that Certified's management engaged in financial fraud from approximately 2001 through 2004.<sup>4</sup> The Commission alleged that Certified's officers artificially and materially inflated the company's

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<sup>3</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>4</sup> SEC v. W. Anthony Huff et al., 08-60315-CIV-ZLOCH (S. D. Fla.).

financial condition in its Commission filings by including at its high point almost \$47 million in bogus letters of credit ("LOCs") as assets on its balance sheet and omitting liabilities that reached a high of approximately \$65 million. The Commission also alleged that the company failed adequately to disclose material related party relationships and related party transactions.

4. LaForgia was Rosenberg Rich's engagement partner on the audits and reviews at issue. LaForgia should have known that Certified's financial statements for the years ended 2002 and 2003 as well as the first three quarters of 2004 were misleading and not presented in accordance with GAAP. As the engagement partner, LaForgia was a cause of Certified issuing misstated financial statements by ignoring significant evidence that indicated heightened audit risk and by failing to conduct Certified's audits and reviews in accordance with generally accepted auditing standards ("GAAS"). Additionally, LaForgia should have known that Rosenberg Rich's unqualified audit reports were false because they represented that the audits were conducted in accordance with GAAS, when they were not.

5. LaForgia thereby was a cause of Certified's violations of Sections 10(b), 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1 and 13a-13 thereunder, and engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice ("Rule 102(e)(1)(ii)").

## **B. RESPONDENT**

LaForgia, CPA, age 61, resides in White House Station, New Jersey. LaForgia is a CPA licensed in New Jersey since 1975. From 2002 through 2005, LaForgia was Rosenberg Rich's engagement partner for Certified. LaForgia currently works for a private company.

## **C. FACTS**

### Certified

1. In July 2001, Danny L. Pixler and W. Anthony Huff formed Midwest Merger Management ("Midwest") as a holding company, capitalized it with \$500, and listed Pixler's wife and Huff's ex-wife as the primary shareholders. In November 2001, Midwest acquired a majority ownership interest in Certified, an inactive public shell company. Certified and its subsidiaries operated a PEO business. Through a series of acquisitions, Certified grew from a shell company with minimal assets to a company with approximately \$78 million in revenues and \$107 million in assets in 2003. Pixler was Certified's president and Huff, who was affiliated with Midwest, was also an undisclosed control person of Certified.

### Certified Improperly Recorded LOCs as Assets

2. Beginning in July 2002, Certified's insurer required one of Certified's subsidiaries to post more collateral due to Certified's rapidly expanding PEO business. Certified relied primarily on another entity Pixler and Huff controlled through a business associate, to obtain the

collateral for its insurer. That entity provided this collateral in the form of LOCs which were due to expire in one year.<sup>5</sup> Midwest played a role in obtaining the LOCs.

3. In December 2002, Midwest entered into an agreement with Certified to purchase shares of Certified's preferred stock ("Subscription Agreement"). The Subscription Agreement specifically provided that the subscriber could use various forms of consideration to subscribe to the offering, including cash or LOCs. Midwest used the very same LOCs which it had procured for Certified's subsidiary as consideration for the subscription. Beginning with its 2002 annual report, Certified reported these LOCs as assets. Certified relied on the fact that the LOCs were used as consideration under the Subscription Agreement as a factor in justifying their treatment as assets. By Certified's second quarter 2003 filing it was reporting \$47 million in LOCs as assets on its financial statements. The LOCs were discovered to be bogus by Certified's insurer during Certified's third quarter of 2003. However, as discussed below, it was improper for Certified to record the LOCs as assets even if they had been legitimate.

#### **Certified Improperly Omitted its Workers' Compensation Liabilities**

4. Certified improperly omitted substantial workers' compensation liabilities from its balance sheets. As Certified's PEO business expanded in 2002 and 2003, Certified assumed increasing amounts of workers' compensation liabilities as part of the normal operation of its PEO business. Midwest and Certified entered into a Risk Allocation Agreement ("Risk Agreement"), purportedly to enable Midwest to manage Certified's workers' compensation program and to protect against the exposure that Certified would face from large claims. Certified used the Risk Agreement to justify omitting its workers' compensation liabilities from its financials asserting that those liabilities were assumed by Midwest under the Risk Agreement.

5. In reality though, Midwest did not assume any of Certified's workers' compensation liabilities under the Risk Agreement. The Risk Agreement provided that Midwest would "assume responsibility for and promptly make all required payments *in excess of the applicable deductibles...*" (emphasis added). However, Certified already had re-insurance that protected it against having to make payments in excess of the applicable deductible (\$1 million per claim). Certified's risk was its liability for deductibles, which the Risk Agreement did not transfer. Even if the terms of the Risk Agreement had purportedly provided any real economic protection, it is unlikely that Midwest would have been able to honor those terms based on the fact that Midwest had negative equity for 2001-2003 and only one employee.

#### **Certified Failed to Disclose its Related Party Transactions**

6. In its financial statements, Certified acknowledged its relationship with Midwest but omitted required information. Certified disclosed that Midwest was a "related party," however Certified did not disclose that Pixler was a co-manager of Midwest. Certified also failed to

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<sup>5</sup> A LOC is an instrument under which the issuer, usually a bank, at a customer's request, agrees to honor a draft or other demand for payment made by a third party, as long as the draft or demand complies with specified conditions, and regardless of whether any underlying agreement between the customer and the beneficiary is satisfied.

disclose until its Form 10-Q for the period ending September 30, 2004 that Pixler had received payments from Midwest. Additionally, Certified failed to disclose that Pixler's wife owned at least a 40% stake in Midwest.

### **Auditor Violations of Professional Standards**

7. LaForgia's GAAS failures during the engagements facilitated Certified's ability to report \$47 million of bogus assets, omit \$65 million of liabilities and not fully disclose its related party relationships and transactions. LaForgia failed to: staff and plan adequately; obtain sufficient competent evidential matter regarding assets and liabilities; exercise due professional care and professional skepticism; and issue accurate audit reports and review reports. Based on his violations of professional standards, LaForgia was a cause of Certified issuing misstated financial statements by ignoring significant evidence that indicated heightened audit risk and by failing to conduct Certified's audits and reviews in accordance with GAAS. Additionally, LaForgia should have known that Rosenberg Rich's unqualified audit reports were false because they incorrectly represented that the audits were conducted in accordance with GAAS, and that Certified's financial statements conformed with GAAP. Furthermore, LaForgia also caused Rosenberg Rich to improperly issue seven unqualified review reports for Certified's quarterly filings from the third quarter of 2002 through the third quarter of 2004.

### **Failure Adequately to Staff and Plan the Engagements**

8. LaForgia failed adequately to staff the engagements. GAAS requires audits to be performed by a person or persons having adequate technical training and proficiency as an auditor. (AU § 150.02, Generally Accepted Auditing Standards) The auditor, having ultimate authority for the audit, should "know, at a minimum, the relevant professional accounting and auditing standards and should be knowledgeable about the client." (AU § 230.06, Due Professional Care in the Performance of Work) The auditor "with final responsibility is responsible for the assignment of tasks to, and supervision of, assistants." (AU § 230.06) LaForgia did not have any prior experience auditing LOCs before accepting the Certified engagement. Despite his lack of experience with LOCs, and the complexity of Certified's business and financial relationships, LaForgia staffed the engagements with an audit manager who had limited experience auditing LOCs and no experience auditing PEO's. LaForgia's own inexperience auditing LOCs and his decision to select an inexperienced audit manager negatively impacted LaForgia's ability to conduct the audits and reviews in accordance with GAAS. The two most senior accountants on the engagement had little or no experience auditing the largest category of assets on Certified's balance sheets.

9. LaForgia failed to plan and develop audit programs tailored to address issues unique to Certified. GAAS requires that the auditor plan the audit "to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." (AU § 316.01, Consideration of Fraud in a Financial Statement Audit) The risk assessment process should "be ongoing throughout the audit" and should consider whether the "nature of audit procedures performed may need to be changed to obtain evidence that is more reliable or to obtain additional corroborative information." (AU § 316.52) LaForgia was aware

that Certified had rapidly grown from a shell company to a company with approximately \$78 million in revenues. LaForgia also knew the LOCs comprised 45% of Certified's assets. Further, LaForgia was aware of Certified's treatment of its workers' compensation liabilities which were purportedly being assumed by its controlling shareholder, Midwest. Despite this knowledge, LaForgia did not plan and develop an adequate audit program particular to Certified and these issues.

10. Further, LaForgia failed adequately to plan, develop and adjust his audit programs or procedures when he was confronted with significant indications of increased fraud risk. Auditors must consider potential fraud factors when planning and performing the audit. GAAS states that the assessment of the risk of material misstatement due to fraud is a cumulative process and one that should be ongoing throughout the audit. (See § AU 316) LaForgia had researched Huff's background while conducting the engagements and knew that Huff had previously been criminally indicted.<sup>6</sup> Also, LaForgia identified concerns in a November 11, 2002 letter to Certified. LaForgia stated that he was "distressed" to learn that Certified incorrectly recorded \$8 million worth of LOCs as cash on its balance sheet. Further, in a November 19, 2002 letter to Certified, LaForgia identified additional concerns, namely "a lack of total candor" by Certified's executives regarding the auditors' inquiries, and Certified's penchant for "managing earnings," among other things. LaForgia's observations show that he was aware of heightened audit risks yet he did not adequately tailor the audit program specifically to address the risks suggested by these facts that were both specific to Certified and critical to the audit of its financial statements.

#### **Failure to Obtain Sufficient Competent Evidential Matter Regarding Assets and Liabilities**

11. Auditors must obtain sufficient competent evidence to afford a basis for an opinion regarding the financial statements under audit. (AU § 326.01, Audit Evidence) The validity and sufficiency of required evidence depends on the circumstances and the auditors' judgment, but should be "persuasive" though it need not be "conclusive." (AU § 326.13) With respect to such judgment, an auditor must maintain an attitude of professional skepticism and assess the risk that errors and irregularities may cause the financial statements to contain a material misstatement. (AU § 316.13) An assessment of higher risk may cause the auditor to expand the extent of procedures applied or modify the nature and/or the timing of procedures to obtain more persuasive evidence.

#### **Failure to Audit LOCs Included in the Financial Statements**

12. Certified's LOCs represented its single largest asset for its 2002 financial statements and each subsequent quarter up to, and including, the quarter ended September 30,

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<sup>6</sup> In 1998, the State of Kentucky revoked Huff's insurance license in connection with an \$113,000 insurance premium theft while he was associated with U.S. Trucking, Inc. ("U.S. Trucking") as a significant shareholder. In 2000, Huff was indicted by the United States Attorney's Office for the Western District of Kentucky, for his involvement in a multi-million dollar insurance fraud with U.S. Trucking. In 2004, he pled guilty to three counts of mail fraud in that case, served 12 months probation and paid restitution of approximately \$180,000.

2003.<sup>7</sup> LaForgia accepted the position that Certified properly recorded the LOCs as assets because they were given in consideration for the Subscription Agreement and were analogous to a note, or alternatively a promise to pay. However, LaForgia's conclusion was unreasonable. Emerging Issues Task Force 85-1, Classifying Notes Received for Capital Stock, (1985) ("EITF 85-1") states that "[t]he SEC requires that public companies report notes received in payment for the enterprise's stock as a deduction from shareholders' equity." Midwest provided the LOCs, which LaForgia equated to a note, as consideration in exchange for Certified's preferred stock. Therefore, LaForgia's conclusion was inconsistent with EITF 85-1.

13. Further, LaForgia failed to obtain sufficient competent evidence to conclude that the LOCs were properly recorded as assets. Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, provides that:

An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

14. The LOCs did not and could not provide Certified with future cash flows. The LOCs were not cash equivalents but instead a promise to pay cash to Certified's insurance provider on behalf of one of Certified's subsidiaries, upon the insurer's demand. However the LOCs' future economic benefits were limited in duration because the fees paid to use the LOCs were made for a fixed period of time, usually one year. Therefore any future benefit ended after one year unless the LOCs were renewed or replaced. Midwest, not Certified, was obliged to replace the LOCs if they were not renewed by the issuing bank upon expiration. Certified's future economic benefit from the LOCs would have only extended beyond one year if Midwest had the financial capabilities to renew or replace the LOCs after their expiration. LaForgia did not obtain sufficient competent evidence regarding Midwest's financial capabilities to renew or replace the LOCs, and evidence shows that Midwest did not have such capabilities.

15. The LOCs also failed to meet the second criteria of an asset. Certified did not own or control the LOCs and could not pledge, assign or transfer them. This fact also renders moot the third characteristic of an asset, since Certified did not control the benefit of the LOCs. In addition, Certified did not provide collateral for the LOCs. Therefore, LaForgia did not obtain sufficient evidence to overcome these factors which collectively demonstrate that the LOCs were not assets.

#### **Failure Adequately to Audit the Risk Agreement and Workers' Compensation Liabilities**

16. Certified asserted that under the Risk Agreement its workers' compensation liabilities were assumed by Midwest, even though it is clear under the Risk Agreement's terms

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<sup>7</sup> Certified reported \$18.7 million of LOCs as assets for 2002 and \$47.5 million of LOCs as assets in the second quarter of 2003.

that Midwest did not assume those liabilities. LaForgia failed adequately to audit and review the key terms of the Risk Agreement. LaForgia instead relied on Certified's representations that pursuant to the Risk Agreement, Certified's workers' compensation liabilities were assumed by Midwest and could be omitted from Certified's financial statements. GAAS requires that "[d]uring an audit, management makes many representations to the auditor, both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the audit evidence the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." (AU § 333.02, Management Representations) LaForgia had a general understanding about how the parties operated under the Risk Agreement, but had little information concerning Midwest's business. LaForgia did not take sufficient steps independently to test Certified's reliance on the Risk Agreement as a basis for its decision to omit the liabilities.

17. Aside from his reliance on the Risk Agreement, LaForgia failed to obtain other sufficient competent evidence to support his position that Certified properly omitted the workers' compensation liabilities from its financial statements. Certified maintained a contractual relationship with its insurer and even if the Risk Agreement was consistent with LaForgia's belief, Certified would still be obligated to pay the deductible amount for claims in the event that Midwest did not fulfill its promises under the Risk Agreement. Further, GAAS requires that "[w]ith respect to material uncollected balances, guarantees, and other obligations, [auditors should] obtain information about the financial capability of the other party or parties to the transaction." (AU § 334.10e, Related Parties) LaForgia did not have, or require, adequate assurance that Midwest had the financial resources to satisfy the workers' compensation liabilities and he did not do adequate work to satisfy himself of Midwest's ability to pay. LaForgia failed to obtain sufficient competent evidence to provide a basis for his opinion that the workers' compensation liabilities could be omitted from Certified's financial statements.

18. Additionally, LaForgia was also confronted with facts that should have raised his professional skepticism with regards to the Risk Agreement. For example, Certified's filings included inconsistent versions of the Risk Agreement. Specifically, the language in the text of Certified's filings materially contradicted the language of the Risk Agreement that was attached to the filing. The two versions of the Risk Agreement language were contradictory regarding which party was responsible for paying claims above or below the \$1 million deductible - a critical aspect of the Risk Agreement. Also, the Risk Agreement was purportedly signed by Certified's president. This individual was not even associated with Certified at that time. These facts, in addition to those previously mentioned regarding Certified's growth and fraud risks, should have further caused LaForgia's increased skepticism. Instead, he failed to obtain sufficient competent evidence and unreasonably relied on management's representations about the Risk Agreement and why the workers' compensation liabilities were being omitted.

#### **Failure to Control the LOC Confirmation Process**

19. LaForgia was confronted with numerous facts that should have caused him to heighten his skepticism during the LOC confirmation process. For example, he was aware of

Certified's rapid growth, the increase in the LOCs as a proportion of Certified's assets, LaForgia's documented concerns regarding Certified's management and his knowledge of Huff's criminal background. Significantly, LaForgia also knew that Certified did not maintain accounts with the financial institution that purportedly issued the LOCs. Despite these facts, and in contravention of AU § 330.15, (AU § 330, The Confirmation Process) LaForgia did not exhibit an appropriate level of professional skepticism.

20. LaForgia's review of the LOCs and the process LaForgia directed and conducted to confirm the LOCs were insufficient. GAAS requires that "[d]uring the performance of confirmation procedures, the auditor should maintain control over the confirmation requests and responses. Maintaining control means establishing direct communication between the intended recipient and the auditor to minimize the possibility that the results will be biased because of interception and alteration of the confirmation requests or responses." (AU § 330.28) GAAS also instructs that "[t]he auditor should direct the confirmation request to a third party who the auditor believes is knowledgeable about the information to be confirmed. For example, to confirm a client's oral and written guarantees with a financial institution, the auditor should direct the request to a financial institution official who is responsible for the financial institution's relationship with the client or is knowledgeable about the transactions or arrangements." (AU § 330.26) LaForgia and his team did not control the LOC confirmation process. Rather than independently obtaining the address of the issuing bank, LaForgia and his team of auditors relied on Certified to supply the contact information. The address they found in Certified's documents was not actually connected with the bank but instead was the address of a retail mail service store.

21. LaForgia and his team also failed to reasonably evaluate a purported confirmation response from the issuing bank. LaForgia did not question why a standard client authorization for release of information letter directed to Certified and received by the auditors was signed by a purported bank employee rather than someone from Certified. Additionally, LaForgia and his team requested certain information concerning LOCs issued on behalf of Certified's subsidiary, however the issuing bank response listed Certified, not the subsidiary as the beneficiary of the LOCs. Despite LaForgia's receipt of this document he failed adequately to analyze this one-page confirmation and did not notice the discrepancy. This discrepancy should have increased LaForgia's skepticism for two reasons. First, Certified was never mentioned in the auditors' authorization letter. Second, neither Certified nor its subsidiary ever had a banking relationship with that bank. Further, LaForgia and his team requested that the issuing bank identify the source of the LOCs' collateral, but the response failed to address this issue and LaForgia did not further pursue it. Finally, Certified did not have any other bank documents to support the issuance of the LOCs and the auditors did not obtain any evidence of cash disbursements backing the LOCs. The totality of these facts should have raised LaForgia's skepticism regarding the validity of the LOCs, particularly since they comprised such a large part of Certified's assets.

#### **Failure to Identify and Examine Properly Related Party Transactions**

22. LaForgia failed to perform adequate procedures to identify related parties, and the related party transactions in the engagements. GAAS states that "[t]he auditor should place

emphasis on testing material transactions with parties he knows are related to the reporting entity.” (AU § 334.07) Further, AU Section 334.11 provides that “[t]he auditor should consider whether he has obtained sufficient competent evidential matter to understand the relationship of the parties and, for related party transactions, the effects of the transaction on the financial statements.” Certified failed to fully describe its relationship with Midwest in its Commission filings. Certified disclosed that Midwest was a “related party” because it was Certified’s largest shareholder and as part of its disclosures relating to the Risk Agreement. Yet, Certified did not disclose that in addition to being Certified’s largest shareholder, Midwest was a related party to Certified because Pixler was a co-manager of Midwest; Pixler received payments from Midwest; and Pixler’s wife owned at least a 40% stake in Midwest.<sup>8</sup> LaForgia testified that he knew, during the 2002 audit, that Pixler’s wife and Huff’s ex-wife were the owners of Midwest. Yet LaForgia did not object to Certified’s failure to disclose Pixler’s wife’s ownership of Midwest (nor that of Huff’s ex-wife, since LaForgia knew, or should have known, that Huff was an undisclosed control person of Certified). Additionally, during the 2003 audit, LaForgia also learned that Pixler was an “owner/controller” of Midwest. Yet again, LaForgia did not object to Certified’s failure to disclose Pixler’s overlapping management roles. Furthermore, LaForgia failed to take adequate steps to investigate and determine the full extent as to why Midwest was a related party when he was confronted with these additional facts evidencing the intertwined relationship. LaForgia’s failure to obtain competent evidential matter regarding Certified’s related party transactions in accordance with GAAS, and failure to address Certified’s inadequate disclosure of known intercompany relationships, caused Certified to issue financial statements that provided inadequate disclosures.

#### **Failure to Exercise Due Professional Care and Professional Skepticism**

23. GAAS required LaForgia to exercise due professional care in performing the engagements and in the preparation of the audit and review reports. (AU § 230.01) Due care required LaForgia to exercise professional skepticism in planning auditing and review procedures and in assessing audit evidence and to obtain sufficient competent evidential matter through inspection, observation, inquiries, and confirmations to afford a reasonable basis for the opinion regarding Certified’s financial statements. (AU § 230.07-.08) “In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.” (AU § 230.09) Exercise of professional skepticism requires auditors to demonstrate a questioning mind and to critically assess audit evidence. (AU § 230.07; see also AU § 316.13) LaForgia had a responsibility not only to plan and perform the engagements to provide reasonable assurances of detecting material errors or irregularities in the financial statements, but to exercise sufficient professional skepticism to achieve reasonable assurance that material errors or irregularities would be detected. As described above, LaForgia’s lack of skepticism resulted in the audit and review failures.

#### **Failure to Issue Accurate Audit Reports and Review Reports**

24. In auditing Certified’s financial statements, and reviewing Certified’s quarterly filings, LaForgia acted unreasonably in rendering audit reports and review reports containing

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<sup>8</sup> Certified did not disclose that Pixler received payments from Midwest until filing its Form 10-Q for the period ending September 30, 2004.

unqualified opinions. GAAS requires that the auditor's report contain an opinion on the financial statements taken as a whole and contain a clear indication of the character of the auditor's work. (AU § 508.04, Reports on Audited Financial Statements) The auditor can determine that he is able to issue an audit report containing an unqualified opinion only if he has conducted his audit in accordance with GAAS and the financial statements were presented in accordance with GAAP. (AU §§ 508.07 & .22) LaForgia signed Rosenberg Rich's audit reports and review reports on Certified's financial statements and quarterly filings even though those statements and quarterly filings were not presented in accordance with GAAP and that LaForgia did not conduct the audits in accordance with GAAS. Nevertheless, LaForgia issued audit reports containing unqualified opinions that falsely stated that Certified's financial statements were presented in accordance with GAAP and that he and the auditors he directed had conducted the audits in accordance with GAAS.

### Violations

1. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit a person, in connection with the purchase or sale of a security, from making an untrue statement of a material fact or from omitting to state a material fact necessary to make statements made, in light of the circumstances under which they were made, not misleading. To violate Section 10(b) or Rule 10b-5, a defendant must act with scienter, *Aaron v. SEC*, 446 U.S. 680, 695, 701-02 (1980), which the Supreme Court has defined as "a mental state embracing intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Certified violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by filing with the Commission quarterly and annual reports that were materially misstated and that misrepresented Certified's financial condition and results of operations.

2. Under Section 21C of the Exchange Act the Commission may "enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation." Exchange Act, 15 USCS § 78u-3. As a result of his actions described above LaForgia was a cause of Certified's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

3. Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers with securities registered under Section 12 of the Exchange Act to file quarterly and annual reports with the Commission and to keep this information current. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Rule 12b-20 requires disclosure of such additional information as may be necessary to make the required statements not misleading. Implicit in these provisions is the requirement that the information reported be true, correct and complete. *See SEC v. IMC International, Inc.*, 384 F.Supp. 889, 893 (N.D. Texas), *aff'd mem.*, 505 F.2d 733 (5<sup>th</sup> Cir. 1974), *cert. denied sub nom.*

4. As discussed above, LaForgia's actions were a cause of Certified filing false and misleading annual and quarterly reports with the Commission that misrepresented Certified's financial results. By his conduct described above, LaForgia caused Certified's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

5. Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of their assets.

6. As a result of the actions taken by LaForgia as described above, LaForgia was a cause of Certified's violations of Section 13(b)(2)(A) of the Exchange Act.

7. Under Rule 102(e)(1)(iv), the term "improper professional conduct" means, in part, "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission."

8. As a result of the actions described above, LaForgia engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

### Undertakings

1. Ongoing Cooperation by LaForgia. LaForgia undertakes to cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order. In connection with such cooperation, LaForgia has undertaken:

A. To produce, without service of a notice or subpoena, any and all documents and other information reasonably requested by the Commission's staff;

B. To be interviewed by the Commission's staff at such times as the staff may reasonably request and to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and

C. That in connection with any testimony of LaForgia to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, LaForgia:

i. Agrees that any such notice or subpoena for his appearance and testimony may be served by regular mail on his counsel, R. Scott Thompson, Esq., Lowenstein Sandler PC, 65 Livingston Avenue, Roseland, New Jersey 07068; and

ii. Agrees that any such notice or subpoena for his appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

## Findings

1. Based on the foregoing, the Commission finds that LaForgia engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

2. Based on the foregoing, the Commission finds that LaForgia was a cause of Certified's violations of Sections 10(b), 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1 and 13a-13 promulgated thereunder.

## IV.

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

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

A. LaForgia 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 promulgated thereunder; and from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Rules 12b-20, 13a-1 and 13a-13 promulgated thereunder;

B. LaForgia is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After five (5) years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

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

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he/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 his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Florence E. Harmon  
Deputy Secretary

*Chairman Schapiro  
not participating*

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. IA-2909]

**Approval of Investment Adviser Registration Depository Filing Fees**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Order.

**SUMMARY:** The Securities and Exchange Commission (“Commission” or “SEC”) is, for five months, waiving Investment Adviser Registration Depository annual and initial filing fees for investment advisers.

**EFFECTIVE DATE:** The order will become effective on August 1, 2009.

**FOR FURTHER INFORMATION CONTACT:** Keith Kanyan, IARD System Manager, at 202-551-6737, Daniel S. Kahl, Branch Chief, at 202-551-6730, or [Iarules@sec.gov](mailto:Iarules@sec.gov), Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-8549.

**SUPPLEMENTARY INFORMATION:**

Section 204(b) of the Investment Advisers Act of 1940 (“Advisers Act”) authorizes the Commission to require investment advisers to file applications and other documents through an entity designated by the Commission, and to pay reasonable costs associated with such filings.<sup>1</sup> In 2000, the Commission designated the Financial Industry Regulatory Authority Regulation (“FINRA”) as the operator of the Investment Adviser Registration Depository (“IARD”) system. At the same time, the Commission approved,

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<sup>1</sup> 15 U.S.C. 80b-4(b).

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as reasonable, filing fees.<sup>2</sup> The Commission later required advisers registered or registering with the SEC to file Form ADV through the IARD.<sup>3</sup> Over 11,000 advisers now use the IARD to register with the SEC and make state notice filings electronically through the Internet.

Commission staff, representatives of the North American Securities Administrators Association, Inc. ("NASAA"),<sup>4</sup> and representatives of FINRA periodically hold discussions on IARD system finances. In the early years of operations, SEC-associated IARD revenues exceeded projections while SEC-associated IARD expenses were lower than estimated, resulting in a surplus. In 2005, FINRA wrote a letter to SEC staff recommending a waiver of annual fees for a one-year period. The Commission concluded that this was appropriate and waived the annual fees.<sup>5</sup> In 2006 and 2008, FINRA wrote to the staff again, this time recommending a two-year waiver and a nine-month waiver, respectively, of all fees to continue to reduce the surplus. The Commission agreed and issued another two orders waiving all IARD fees.<sup>6</sup> As a result of

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<sup>2</sup> Designation of NASD Regulation, Inc., to Establish and Maintain the Investment Adviser Registration Depository; Approval of IARD Fees, Investment Advisers Act Release No. 1888 (July 28, 2000) [65 FR 47807 (Aug. 3, 2000)]. FINRA was formerly known as the National Association of Securities Dealers, Inc.

<sup>3</sup> Electronic Filing by Investment Advisers; Amendments to Form ADV, Investment Advisers Act Release No. 1897 (Sept. 12, 2000) [65 FR 57438 (Sept. 22, 2000)].

<sup>4</sup> The IARD system is used by both advisers registering or registered with the SEC and advisers registered or registering with one or more state securities authorities. NASAA represents the state securities administrators in setting IARD filing fees for state-registered advisers.

<sup>5</sup> Approval of Investment Adviser Registration Depository Filing Fees, Investment Advisers Act Release No. 2439 (Oct. 7, 2005) [70 FR 59789 (Oct. 13, 2005)].

<sup>6</sup> Approval of Investment Adviser Registration Depository Filing Fees, Investment Advisers Act Release Nos. 2564 (Oct. 26, 2006) and 2806 (Oct. 30, 2008) [73 FR 65900 (Nov. 5, 2008)].

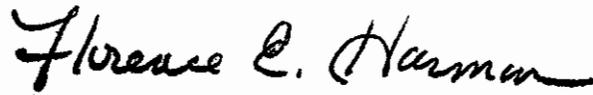
these three waivers, the surplus was reduced from \$9 million in 2005 to approximately \$3 million today.

FINRA has again written to Commission staff, recommending that the waiver of annual IARD fees and the waiver of initial IARD filing fees for SEC-registered advisers be extended for an additional five months to December 31, 2009. Based on projections of expected SEC-associated IARD revenues and SEC-associated IARD expenses for the next five months, the Commission believes that the current SEC-associated surplus exceeds the amount needed for operations and system enhancements during this period, and accordingly believes that an extension of the current waiver of both annual and initial filing fees through December 31, 2009 is appropriate in order to continue reducing the SEC-associated surplus. This action is expected to waive approximately \$300,000 in IARD system fees that SEC-registered advisers would incur, and should reduce the SEC-associated surplus to approximately \$2 million. The fee waiver will apply to all annual updating amendments filed by SEC-registered advisers from August 1, 2009 through December 31, 2009 and to all initial applications for registration filed by advisers applying for SEC registration from August 1, 2009 through December 31, 2009.

IT IS THEREFORE ORDERED, pursuant to sections 204(b) and 206(A) of the Investment Advisers Act of 1940, that:

For annual updating amendments to Form ADV filed from August 1, 2009 through December 31, 2009, the fee otherwise due from SEC-registered advisers is waived, and for initial applications to register as an investment adviser with the SEC filed from August 1, 2009 through December 31, 2009, the fee otherwise due from the applicant is waived.

By the Commission.



Florence E. Harmon  
Deputy Secretary

Dated: July 31, 2009