

*Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61307 / January 7, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3099 / January 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13740

In the Matter of

DAVID C. MAYFIELD, CPA,

Respondent.

ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 4C OF THE
SECURITIES EXCHANGE ACT OF 1934
AND 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 that public administrative proceedings be, and hereby are, instituted against David C. Mayfield, CPA ("Respondent") pursuant to Section 4C¹ of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.²

¹ 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.

² 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.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and 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 finds³ that:

RESPONDENT

David C. Mayfield is a certified public accountant licensed by the state of Oklahoma. During the period at issue here, he was a partner in Eide Bailly LLP, an accounting firm registered with the Public Company Accounting Oversight Board (the "PCAOB").

FACTS

1. Jerry D. Cash, the former Chief Executive Officer and chairman of Quest Resource Corporation ("Quest Resource") and the general partner of Quest Energy Partners, L.P. ("Quest Energy" and, together with Quest Resource, "Quest"), with the aid of David E. Grose, Quest's former Chief Financial Officer, misappropriated millions from Quest through insider loans that were also undisclosed related party transactions. Between 2005 and August, 2008, Cash embezzled \$10 million from Quest by transferring funds between Quest-related entities and companies he owned and controlled. As a result of Cash's and Grose's activities, Quest failed to disclose, or inadequately disclosed, the related party transactions in periodic filings, registration statements, and proxy statements.⁴

2. Respondent acted as the senior manager on Eide Bailly's review of Quest Resource and Quest Energy's respective financial statements for the quarter ended June 30, 2008, which were included in the companies' second quarter 2008 Forms 10-Q, filed August 11, 2008 and August 12, 2008, respectively.

3. While performing these professional services, Respondent learned that Quest had engaged in a circular series of funds transfers to and from Rockport Energy LLC, a company Cash

³ 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.

⁴ See *SEC v. Jerry D. Cash, et al.*, Lit. Rel. No. 21087 (June 17, 2009)

controlled, totaling \$10 million by the second quarter of 2008. As a result of these transfers, which were described to Respondent as "loans," \$10 million was outstanding at the time of Eide Bailly's review of Quest's second quarter 2008 financial statements.

4. In the course of providing these professional services, Respondent failed to undertake adequate procedures to determine whether the transfers to Rockport were properly recorded in Quest's financial statements for that period and properly disclosed in Quest's second quarter 2008 Forms 10-Q. Among other things, Respondent failed to undertake adequate procedures to ascertain the terms and other details of the transactions; to determine whether the transactions were authorized by Quest's board of directors; or whether Quest had properly accounted for the transactions, including whether it had established appropriate reserves against Rockport's inability to repay the amounts.

5. Respondent also failed to adequately consider whether the transfers to Rockport may constitute fraud or an illegal act. *See PCAOB Standards and Related Rules*, AU §§ 316 and 722.32. Furthermore, Respondent failed to adequately consider whether the transfers to Rockport violated Section 13(k) of the Securities Exchange Act of 1934, which prohibits any issuer to make, directly or indirectly, "personal loans" to any executive officer.

Violations

Section 4C of the Exchange Act and Rule 102(e)(1)(ii) provide that the Commission may temporarily or permanently deny an accountant the privilege of appearing or practicing before it if it finds, after notice and opportunity for hearing, that the accountant engaged in "improper professional conduct." In relevant part, Section 4C(b) and Rule 102(e)(1)(iv) define "improper professional conduct" to include either of the following two types of negligent conduct:

- (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant, or a person associated with a registered public accounting firm, knows, or should know, that heightened scrutiny is warranted, or
- (2) 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.

Findings

Based on the foregoing, the Commission finds that Respondent engaged in improper professional conduct pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(ii) 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 Respondent's Offer.

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

A. Respondent is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After three years from the date of this Order, Respondent may request that the Commission consider his reinstatement by submitting an application (Attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of a 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 PCAOB 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 PCAOB and that inspection did not identify any criticisms of or potential defects in Respondent's or the firm's quality control system that would indicate that Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (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 PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of

accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Aquilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61306 / January 7, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3098 / January 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13739

In the Matter of

JOHN W. JACOBSEN, CPA,

Respondent.

ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 4C OF THE
SECURITIES EXCHANGE ACT OF 1934
AND 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 that public administrative proceedings be, and hereby are, instituted against John W. Jacobsen, CPA ("Respondent") pursuant to Section 4C¹ of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.²

¹ 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.

² 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.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and 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 finds³ that:

RESPONDENT

John W. Jacobsen is a certified public accountant licensed by the state of Montana. During the period at issue here, he was a partner in Eide Bailly LLP, an accounting firm registered with the Public Company Accounting Oversight Board (the "PCAOB").

FACTS

1. Jerry D. Cash, the former Chief Executive Officer and chairman of Quest Resource Corporation ("Quest Resource") and the general partner of Quest Energy Partners, L.P. ("Quest Energy" and, together with Quest Resource, "Quest"), with the aid of David E. Grose, Quest's former Chief Financial Officer, misappropriated millions from Quest through insider loans that were also undisclosed related party transactions. Between 2005 and August, 2008, Cash embezzled \$10 million from Quest by transferring funds between Quest-related entities and companies he owned and controlled. As a result of Cash's and Grose's activities, Quest failed to disclose, or inadequately disclosed, the related party transactions in periodic filings, registration statements, and proxy statements.⁴

2. Respondent acted as the audit partner on Eide Bailly's review of Quest Resource and Quest Energy's respective financial statements for the quarter ended June 30, 2008, which were included in the companies' second quarter 2008 Forms 10-Q, filed August 11, 2008 and August 12, 2008, respectively.

3. While performing these professional services, Respondent learned that Quest had engaged in a circular series of funds transfers to and from Rockport Energy LLC, a company Cash

³ 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.

⁴ See *SEC v. Jerry D. Cash, et al.*, Lit. Rel. No. 21087 (June 17, 2009)

controlled, totaling \$10 million by the second quarter of 2008. As a result of these transfers, which were described to Respondent as "loans," \$10 million was outstanding at the time of Eide Bailly's review of Quest's second quarter 2008 financial statements.

4. In the course of providing these professional services, Respondent failed to undertake adequate procedures to determine whether the transfers to Rockport were properly recorded in Quest's financial statements for that period and properly disclosed in Quest's second quarter 2008 Forms 10-Q. Among other things, Respondent failed to undertake adequate procedures to ascertain the terms and other details of the transactions; to determine whether the transactions were authorized by Quest's board of directors; or whether Quest had properly accounted for the transactions, including whether it had established appropriate reserves against Rockport's inability to repay the amounts.

5. Respondent also failed to adequately consider whether the transfers to Rockport may constitute fraud or an illegal act. *See PCAOB Standards and Related Rules*, AU §§ 316 and 722.32. Furthermore, Respondent failed to adequately consider whether the transfers to Rockport violated Section 13(k) of the Securities Exchange Act of 1934, which prohibits any issuer to make, directly or indirectly, "personal loans" to any executive officer.

Violations

Section 4C of the Exchange Act and Rule 102(e)(1)(ii) provide that the Commission may temporarily or permanently deny an accountant the privilege of appearing or practicing before it if it finds, after notice and opportunity for hearing, that the accountant engaged in "improper professional conduct." In relevant part, Section 4C(b) and Rule 102(e)(1)(iv) define 'improper professional conduct' to include either of the following two types of negligent conduct:

- (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant, or a person associated with a registered public accounting firm, knows, or should know, that heightened scrutiny is warranted, or
- (2) 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.

Findings

Based on the foregoing, the Commission finds that Respondent engaged in improper professional conduct pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(ii) 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 Respondent's Offer.

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

A. Respondent is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After three years from the date of this Order, Respondent may request that the Commission consider his reinstatement by submitting an application (Attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of a 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 PCAOB 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 PCAOB and that inspection did not identify any criticisms of or potential defects in Respondent's or the firm's quality control system that would indicate that Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (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 PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of

accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61315 / January 7, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3100 / January 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13489

In the Matter of

POLLARD KELLEY
AUDITING SERVICES,
INC. and TERANCE
KELLEY, CPA,

Respondents.

ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
PURSUANT TO RULE 102(e) OF THE
COMMISSION'S RULES OF
PRACTICE

I.

On May 27, 2009, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings against Pollard Kelley Auditing Services, Inc. ("Pollard-Kelley") and Terance Kelley, CPA ("Kelley") (together, "Respondents"), pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.¹

¹ Rule 102(e)(1) provides, in pertinent part: "The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct."

With respect to persons licensed to practice as accountants, Rule 102(e)(1)(iv) provides that "improper professional conduct" means:

- (A) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or (B) either of the following two types of negligent conduct: (1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted. (2) repeated instances of

II.

The Respondents have submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding 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 Making Findings and Imposing Remedial Sanctions Pursuant to Rule 102(e) of the Commission's Rules of Practice ("Order"), as set forth below.

III.

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

Summary

1. These proceedings arise out of a deficiency in Respondents' 2006 audit of Pegasus Wireless Corporation's financial statements. During the 2006 audit, Respondents violated numerous professional standards by failing to obtain written representations from Pegasus' management and failing to exercise due care and professional skepticism. In early 2008, nearly one year after completing the audit and after being sued by Pegasus investors for securities fraud, Respondents added additional workpapers to their audit documentation, which masked deficiencies in the audit. By adding workpapers after the fact and adding them to their audit documentation, without identifying the date they were added or the reason for adding them, Respondents violated Public Company Accounting Oversight Board ("PCAOB") Auditing Standard No. 3. Respondents' conduct, as further described below, constituted improper professional conduct within the meaning of Rule 102(e)(1)(ii) and (iv).

Respondents

2. Pollard Kelley Auditing Services, Inc. is a Colorado corporation licensed to do business in Colorado and Ohio. Pollard-Kelley is a public accounting firm registered with the PCAOB. According to corporate filings, its principal place of business is Kelley's Colorado home. Pollard-Kelley has five employees, including Kelley. The firm served as Pegasus' independent auditor from mid-2005 through approximately November 2007. As auditor, Pollard-Kelley opined that Pegasus' 2005 and 2006 financial statements were prepared in conformity with Generally Accepted Accounting Principles ("GAAP") and that Pollard-Kelley had conducted audits in accordance with the PCAOB's standards.

3. Terance Kelley, CPA, age 62, resides in Lake City, Colorado. He formed Pollard-Kelley and is its vice president of audit services. He performs the vast majority of

unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

the firm's audits and performed the audits of Pegasus' 2005 and 2006 financial statements, as well as quarterly reviews of Pegasus financial statements through approximately November 2007. He is licensed as a certified public accountant in Ohio.

Related Party

4. Pegasus Wireless Corporation is a Nevada corporation formed in 2000. After several failed enterprises, it became a shell company by 2003. In June 2005, through a series of reverse mergers, it acquired OTC Wireless, Inc., a private company incorporated in California that designs wireless networking devices. Pegasus had headquarters in Fremont, California, until about January 2007. It currently maintains a mailbox in Palm Beach, Florida. During the relevant period, its securities were registered pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act"). Its shares most recently traded on the OTC Bulletin Board and briefly traded on NASDAQ in 2006. Pegasus filed for bankruptcy in January 2008.

Respondents' Improper Professional Conduct

Pegasus' Fraud Scheme

5. From 2006 through 2008, Pegasus officers defrauded investors by creating backdated promissory notes memorializing a phony debt, which they used to issue unrestricted shares of Pegasus stock to individuals and entities they controlled. Pegasus issued nearly 480 million shares – 75% of its outstanding shares – based on the fake, backdated promissory notes, resulting in massive dilution of the existing shareholders' ownership interest. The individuals and entities who received shares dumped the stock on the open market and funneled many millions in proceeds to Pegasus officers.

6. Pegasus misled investors about why it issued the shares. For example, in the financial statements included in its quarterly report on Form 10-QSB for the quarter ended September 30, 2006, Pegasus stated: "During the third quarter the Company issued 5,276,016 shares to satisfy \$263,800 debt [sic] owed by the Company from prior to the change in control [in 2005]." Similarly, in the financial statements in its annual report on Form 10-KSB for the year ended December 31, 2006, Pegasus represented:

During 2006 the Company issued 7,376,016 shares of common stock to satisfy \$368,532 debt [sic] owed by the Company from prior to the change in control. . . . The Company is obligated on notes payable amounting to \$145,000 remaining balance which were undisclosed when current management took control of the shell company. These notes were entered into at various times in 2003 and were 2 year notes, all of which have matured. The notes . . . are convertible into common stock of the parent company at the discretion of the holder. Management two steps back

failed to disclose these notes to subsequent management, thus current management was unaware of their existence.

In truth, Pegasus officers in 2006 concocted the debt as a means to enrich themselves.

Respondents' Deficient 2006 Audit

7. From mid-2005 through approximately October 2007, Respondents served as Pegasus' independent auditor, auditing the company's 2005 and 2006 financial statements and reviewing its quarterly statements through the second quarter of 2007.

8. In March 2007, during field work for the 2006 audit, Respondents noted Pegasus' disclosures that it had issued stock to pay previously undisclosed debt. The alleged debt described in the September 30, 2006 10-QSB had grown from \$263,800 to \$368,532 at year-end, as had the number of shares issued. (Pegasus had additional debt, which had been previously disclosed, on its balance sheet.) Moreover, the number of shares issued by year-end based on the alleged debt (7,376,016) equaled more than one third of Pegasus' then-outstanding shares.

9. Respondents advised Pegasus in writing that they needed copies of "all agreements in connection with the conversion of \$368,532 of debt into common stock." Pegasus' CFO agreed to provide the information. Respondents also sent additional emails seeking this information.

10. Respondents also requested Pegasus to explain the "basis for the 7,376,016 shares of common stock issued to satisfy \$368,532 of debt." On March 28, 2007, Pegasus' CFO replied in writing: "Huh? isn't that rather obvious." Kelley's contemporaneous notes reflect that he continued to have questions about the item.

11. Pegasus failed to provide the promised information or other substantiation or explanation for the alleged debt. Pegasus also failed to provide additional requested information to Respondents, including detail for prepaid expenses; a cash summary, bank reconciliations, and bank statements; supporting invoices for research and development purchases; a breakdown of the goodwill balance; and a copy of an acquisition agreement. Despite these open items, Respondents rendered an unqualified opinion on Pegasus' 2006 financial statements and affirmed its audit was in accordance with the PCAOB's standards. Pegasus included the opinion in its 2006 annual report on Form 10-KSB filed April 3, 2007.

12. Respondents also failed to obtain a signed management representation letter from Pegasus for the 2006 audit.

13. PCAOB auditing standards require auditors to exercise reasonable diligence and due professional care in performing an audit. "Due professional care requires the auditor to exercise professional skepticism. . . . [i.e.,] an attitude that includes a questioning mind and a critical assessment of audit evidence." AICPA Codification of

Statements on Auditing Standards, "*Due Professional Care in the Performance of Work*," AU § 230.07. "The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. 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. Moreover, an auditor must obtain "sufficient competent evidential matter" to provide "a reasonable basis for forming an opinion." AU § 326.22.

14. In addition, PCAOB auditing standards establish a requirement that the auditor obtain written representations from management as part of an audit. AU § 333.01. The specific representations an auditor should obtain relate to, among other things, management's acknowledgement of its responsibility for the financial statements; its belief that the financial statements are fairly presented in conformity with GAAP, and the completeness of information provided. AU § 333.06. Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause an auditor to disclaim an opinion or withdraw from the engagement. AU § 333.13.

15. Respondents departed from the standards described above by failing to obtain competent evidential matter for the alleged debt and other matters and failing to exercise professional skepticism.

16. Respondents further departed from these standards by failing to obtain a written management representation letter from Pegasus for the 2006 audit.

17. During reviews of Pegasus' quarterly financial statements for the quarters ended March 31, 2007, and June 30, 2007, Respondents continued to request information about the alleged debt and other items, but received nothing regarding the debt or other items.

Respondents Added Documents to Their Audit Work Papers After the Audit

18. In late 2007, a Pegasus investor, seeking to represent a class of injured shareholders, sued Pollard-Kelley and others for securities fraud. Pollard-Kelley was served with the complaint on December 29, 2007.

19. On January 1, 2008, Kelley e-mailed the Pegasus CFO and CEO, stating: "We have been named defendants in [a lawsuit] against Pegasus, et al. Please give me a call and bring me up to date concerning this matter." The e-mail further stated: "ALSO, THIS IS THE TIME TO GET THE FINAL SCHEDULES NEEDED FOR THE 2006 AUDIT TO ME!!!!!!!"

20. On February 19, 2008, in connection with its investigation relating to Pegasus, SEC staff requested Pollard-Kelley to produce documents, including documents relating to Pegasus' disclosures about how and why it issued shares to pay the purported convertible debt.

21. In early 2008, having received notice of a shareholder suit involving Pegasus, Respondents added an unsigned, written management representation letter to the audit work papers. The letter purported to reflect the CEO and CFO's confirmation that the 2006 financial statements are fairly presented in conformity with GAAP; that they made available to Pollard-Kelley all financial records and related data; and that they had no knowledge of fraud involving management. The letter was not signed by Pegasus' CEO or CFO. Rather, Kelley made a handwritten note on the last page of the letter: "Verbally acknowledged & confirmed . . . by [Pegasus' CFO] over the phone. Hard copy to follow."

22. Kelley, however, testified that he added the workpaper to the audit documentation in 2008.

23. In addition to adding the written management representation letter to the audit documentation, Respondents added an undated memo to explain why they opined on Pegasus' 2006 financial statements despite numerous open items. The memo states:

At the time [Pegasus filed its 10-KSB] a request for additional information and support was made to the client . . . [W]e were told the materials requested would be provided. The 45 day period of wrapping up audit documentation passed on May 13, 2007 without the receipt of the requested materials.

At that time the firm considered what it should do. Provisions of AU 390 were considered. The firm knew of no reason to suspect the accuracy of the filed financial statements. [The] CFO is a knowledgeable, competent experiences [sic] accountant, with many years experience. Past audits have shown a consistent accuracy of the Company's records under [the CFO's] leadership. We did not know or have any reason to believe the statements as filed were misleading

We concluded that even with the omitted procedures our audit work papers still supported our opinion. However, we will continue to try to obtain the information requested the complete the additional audit procedures for the items requested on [the 10-KSB filing date].

24. When Kelley created the document in early 2008 and added it, he was still being told by the CFO of Pegasus that documentation was forthcoming, but he was suspicious whether the CFO would ever provide the requested documents.

25. PCAOB Auditing Standard No. 3 provides that "[a] complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date" (i.e., the "date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements").

¶¶ 14-15. Although the standard recognizes that “[c]ircumstances may require additions to audit documentation after the report release date,” it states that “[a]ny documentation added must indicate the date information was added, the name of the person who prepared the additional documentation, and the reason for adding it.” ¶ 16.

26. Respondents departed from this standard by adding the written management representation to the audit documentation in early 2008 without indicating when it was added or the reason for adding it.

27. Respondents further departed from this standard by adding the undated memo to the audit documentation without indicating when it was added.

Violations

28. Rule 102(e)(1) provides, in pertinent part: “The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct.” With respect to persons licensed to practice as accountants, Rule 102(e)(1)(iv) provides that “improper professional conduct” means:

(A) Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or (B) Either of the following two types of negligent conduct:

(1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.

(2) 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.

Findings

29. Based on the foregoing, the Commission finds that Respondents engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) 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 Respondents’ Offer.

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

A. Respondents are each denied the privilege of appearing or practicing before the Commission as an accountant.

B. After five years from the date of this order, Respondents may each request that the Commission consider his or its 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. If submitted by Kelley, such an application must satisfy the Commission that Kelley'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

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondents, or the public accounting firm with which Kelley is associated, are 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) Respondents, or the registered public accounting firm with which Kelley is associated, have been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Kelley's or the firm's quality control system that would indicate that Kelley will not receive appropriate supervision;

(c) Respondents have resolved all disciplinary issues with the Board, and each has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondents each acknowledge his or its responsibility, as long as either 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 either Respondent to resume appearing or practicing before the Commission provided that his or its state CPA license is current and he or it 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 either Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

III.

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

Summary

1. In this Foreign Corrupt Practices Act case, TEST Automation & Controls, Inc. ("TEST"), a wholly owned subsidiary of oil field services provider NATCO Group Inc., created and accepted false documents while paying extorted immigration fines and obtaining immigration visas in the Republic of Kazakhstan. NATCO's system of internal accounting controls failed to ensure that TEST recorded the true purpose of the payments, and NATCO's consolidated books and records did not accurately reflect these payments.

Respondent

2. NATCO Group Inc., a Delaware corporation with its headquarters in Houston, Texas, designs, manufactures, and markets oil and gas production equipment and systems that are used worldwide. At the time of the events discussed in this Order, NATCO's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and was listed on the New York Stock Exchange.²

Other Relevant Entities

3. TEST Automation & Controls, Inc. is a Louisiana corporation and, at all relevant times, was headquartered in Harvey, Louisiana. TEST is a wholly-owned subsidiary of NATCO.³ TEST fabricates and sells control panels and packaged automation systems, as well as providing field services associated with repair, maintenance, inspection and testing of onshore and offshore control systems. TEST, at all relevant times, maintained a branch office in Kazakhstan ("TEST Kazakhstan").

Facts

A. Background

4. In June 2005, TEST Kazakhstan won a contract to provide instrumentation and electrical services in Kazakhstan. To perform the services, TEST Kazakhstan hired both expatriates and local Kazakh workers. Kazakhstan law required TEST to obtain immigration

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

² The registration of NATCO's common stock, and its listing on the NYSE, ended on November 18, 2009, when NATCO became a subsidiary of Cameron International Corporation ("Cameron"), a publicly held reporting corporation listed on the NYSE.

³ TEST also became a subsidiary of Cameron, following NATCO's acquisition by Cameron.

documentation before an expatriate worker entered the country. Kazakhstan immigration authorities periodically audited immigration documentation of TEST Kazakhstan and other companies operating in Kazakhstan for compliance with local law.

B. Cash Payments to Kazakh Immigration Prosecutor

5. In February 2007 and September 2007, Kazakh immigration prosecutors conducted audits and claimed that TEST Kazakhstan's expatriate workers were working without proper immigration documentation. The prosecutors threatened to fine, jail or deport the workers if TEST Kazakhstan did not pay cash fines.

6. Believing the prosecutor's threats to be genuine, employees with TEST Kazakhstan sought guidance from TEST's senior management in Harvey, Louisiana, who authorized making the payments. TEST Kazakhstan employees used personal funds to pay the prosecutors \$25,000 in February and \$20,000 in September, and then obtained reimbursement from TEST.

7. For the February 2007 payment, TEST made a \$25,000 wire transfer to the affected employee. TEST inaccurately described the transfer as "an advance against his [the paying employee's] bonus payable in March." Moreover, the email noted the bonus would be "substantial," to further disguise the true reason for the transfer. In addition, TEST's letter to the bank providing the wire instructions inaccurately described the payment as a "Payroll Advance." After the wire transfer was transmitted, TEST inaccurately recorded the payment in its books and records as a salary advance.

8. TEST made a \$20,000 wire transfer to reimburse the September 2007 payment. The wire transfer and journal entry in TEST's books described the purpose of the transfer as "visa fines."

C. Inaccurate Consultant Invoices for Visa Services

9. TEST Kazakhstan used consultants to assist it in obtaining immigration documentation for its expatriate employees. One of these consultants did not have a license to perform visa services, but maintained close ties to an employee working at the Kazakh Ministry of Labor, the entity issuing the visas. On two instances, the consultant requested cash from TEST Kazakhstan to help him obtain the visas. Because Kazakh law requires companies seeking to withdraw cash from commercial bank accounts to submit supporting invoices, the consultant provided TEST Kazakhstan bogus invoices for "cable" from third-party entities he controlled. TEST Kazakhstan knew these invoices were false, but nonetheless presented them to Kazakh banks to withdraw the requested cash.⁴ TEST Kazakhstan later submitted the false invoices – which totaled in excess of \$80,000 – to TEST for reimbursement. TEST reimbursed these requests despite knowing the invoices mischaracterized the true purpose of the services rendered.

⁴ It is not known how the consultant used these funds, or to whom they were paid.

D. Discovery of Payments, Internal Investigation, and Remediation

10. During a routine internal audit review in late 2007, NATCO discovered potential issues involving payments at TEST. NATCO conducted an internal investigation, and voluntarily disclosed the results to Commission staff. NATCO undertook numerous remedial measures, including employee termination and disciplinary actions. The company also created a revised form document for agent agreements and established new due diligence procedures regarding the vetting and retention of third-party intermediaries; increased staffing in its global compliance department, including the appointment of a full-time Chief Compliance Officer; joined a non-profit association specializing in anti-bribery due diligence that, among other things, screens potential partners and other third parties that work with multinational corporations; improved its FCPA compliance training worldwide, investing heavily in software to assist in enhancing internal controls and compliance; and restructured its internal audit function and enhanced its monitoring and auditing process for the compliance program.

11. In light of the weaknesses uncovered at TEST, the company expanded its investigation to examine TEST's other worldwide operations, including Nigeria, Angola and China, geographic locations with historic FCPA concerns. NATCO's expanded internal investigation of TEST uncovered no wrongdoing.

E. Legal Discussion

12. 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).

13. As detailed above, NATCO's books, records, and accounts did not properly reflect TEST's reimbursement of payments to the Kazakhstan immigration prosecutor or the immigration consultant. As a result, NATCO violated Exchange Act Section 13(b)(2)(A).

14. In addition, NATCO failed to devise or maintain sufficient internal controls to ensure that TEST complied with the books and records provisions of the FCPA and to ensure that the payments TEST made were accurately reflected on its books and records. As a result, NATCO violated Exchange Act Section 13(b)(2)(B).⁵

⁵ NATCO also has agreed to pay a \$65,000 civil monetary penalty.

NATCO's Remedial Efforts

In determining to accept the Offer, the Commission considered the remedial efforts undertaken by NATCO and the cooperation afforded the Commission Staff.

IV.

In view of the foregoing, the Commission deems it appropriate to accept the Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that NATCO 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.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Aquilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2975 / January 11, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13741

In the Matter of

**JULIE M. JARVIS, and
CROSSROADS FINANCIAL
PLANNING, INC.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTIONS 203(e) and
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 Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Julie M. Jarvis ("Jarvis") and Crossroads Financial Planning, Inc. ("CFP").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and with admitting the findings herein, Respondents consent to the entry of this Order Instituting Administrative Proceedings Pursuant to Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

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

1. Julie M. Jarvis, age 50, was an investment adviser and an associated person with a registered investment adviser at the relevant times. Jarvis was the president and chief executive officer of Crossroads Financial Planning, Inc. ("CFP"), 5001 Horizons Dr., Upper Arlington, Ohio, a registered investment adviser and an entity incorporated in the State of Ohio. From approximately 1995 to February 2009, Jarvis, though CFP, acted as an investment adviser to certain individuals and entities.

2. On April 8, 2009, the Commission filed a Complaint alleging that Jarvis and CFP misappropriated at least \$2.3 million from clients in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 206(1) and 206(2) of the Advisers Act, before the United States District Court for the Southern District of Ohio, in S.E.C. v. Julie Jarvis and Crossroads Financial Planning, Inc., No. 2:09cv269 (Marbley, J./Able, MJ). The Complaint alleged that Jarvis, through CFP, misappropriated funds from two elderly clients, concealed the nature of the withdrawals and securities transactions and then converted the funds to pay her personal expenses or otherwise use for her benefit. On April 22, 2009, Judge Marbley issued a preliminary injunction, enjoining Jarvis from committing further violations and freezing Jarvis and CFP's assets.

3. On May 13, 2009, Jarvis pled guilty to Count I of an Information alleging mail fraud in connection with a scheme to defraud investors in violation of Section 1341, Title 18, United States Code, before the United States District Court for the Southern District of Ohio, in United States v. Julie M. Jarvis, No. 2:09cr103 (Frost, J.). The count of the Information to which Jarvis pled guilty alleged that Jarvis, while purporting to provide financial advice to her clients, willfully and knowingly devised a scheme and artifice to defraud; defrauded her clients by use of the means and instrumentalities of interstate commerce and of the mails, directly and indirectly; and that she engaged in transactions, practices, and courses of business operating to defraud and deceive those clients.

4. On October 22, 2009, the Commission filed an Amended Complaint restating the allegations against Jarvis and CFP, but adding John Simpson as a Relief Defendant.

5. On November 6, 2009, Defendants Jarvis and CFP executed Consents in this case, admitting the facts alleged in the Amended Complaint, and, on December 28, 2009, the Court entered a permanent injunction against violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 204, 206(1) and 206(2) of the Advisers Act, and Rule 204-2 thereunder.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(e) of the Advisers Act, Respondent CFP's registration is hereby revoked and, pursuant to Section 203(f) of the Advisers Act, Respondent Jarvis is hereby barred from association with any investment adviser.

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61328 / January 11, 2010

In the Matter of	:	ORDER PURSUANT TO SECTIONS
Full Value Advisors, LLC	:	13(f)(3) and 13(f)(4) OF THE SECURITIES
	:	EXCHANGE ACT OF 1934 DENYING
	:	REQUESTS FOR CONFIDENTIAL
	:	TREATMENT OF INFORMATION
	:	REQUIRED TO BE FILED PURSUANT
	:	TO SECTION 13(f)(1) OF THE
	:	SECURITIES EXCHANGE ACT OF 1934

Full Value Advisors, LLC ("Full Value") is a Delaware limited liability company and an investment adviser to certain private investment companies. By letters dated February 7, 2007 and May 8, 2007, Full Value submitted written requests ("February CT Request" and "May CT Request," respectively, and together, "Full Value CT Requests") pursuant to section 13(f)(3) of the Securities Exchange Act ("Exchange Act") and rule 24b-2 under the Exchange Act seeking confidential treatment of information that Full Value otherwise was required to disclose on Forms 13F pursuant to section 13(f)(1) of the Exchange Act and rule 13f-1 thereunder for the quarters ending December 31, 2006 and March 31, 2007.¹

The Commission has considered the Full Value CT Requests. The Commission deems it appropriate in the public interest and for the protection of investors pursuant to sections 13(f)(3) and 13(f)(4) of the Exchange Act to deny the Full Value CT Requests.

Background

Section 13(f)(1) of the Exchange Act and rule 13f-1 thereunder require every "institutional investment manager," as defined in section 13(f)(5)(A) of the Exchange Act, that exercises investment discretion with respect to "section 13(f) securities," as defined in rule 13f-1, having an aggregate fair market value of at least \$100 million ("Institutional Manager," and the securities, "Reportable Securities"), to file with the Commission quarterly reports on Form 13F setting forth each Reportable Security's name, CUSIP number, the number of shares held, and the market value of the position. Form 13F must be filed within 45 days of the end of the calendar year during which the \$100 million threshold was satisfied and within 45 days of the end of the first three calendar quarters that follow.

¹ Full Value also submitted a letter, dated February 13, 2008, correcting a statement in the February CT Request.

Under section 13(f)(3) of the Exchange Act, information filed on Form 13F must be made publicly available, "except that the Commission, as it determines to be necessary or appropriate in the public interest or for the protection of investors, may delay or prevent public disclosure of any such information in accordance with [the Freedom of Information Act]." Under section 13(f)(4), "[i]n exercising its authority under this subsection, the Commission shall determine (and so state) that its action is necessary or appropriate in the public interest and for the protection of investors or to maintain fair and orderly markets."

Rule 200.80(b)(4) of the Commission's Freedom of Information Act rules provides that the Commission generally will not publish or make available to any person matters that "[d]isclose trade secrets and commercial or financial information obtained from a person and privileged or confidential." An Institutional Manager seeking to delay or prevent public disclosure of any such information provided on Form 13F must submit a written confidential treatment request following the procedures set forth in rule 24b-2 under the Exchange Act and the Commission's Instructions to Form 13F ("Instructions").

Rule 24b-2(b)(2)(ii) under the Exchange Act requires that a request for confidential treatment of Form 13F information contain, among other things, "a statement of the grounds of objection referring to, and containing an analysis of, the applicable exemption(s) from disclosure under the Commission's rules and regulations adopted under the Freedom of Information Act." Rule 24b-2(b)(2)(ii) also requires that a request for confidential treatment of Form 13F information contain "a justification of the period of time for which confidential treatment is sought."

The Instructions state that an Institutional Manager "requesting confidential treatment must provide enough factual support for its request to enable the Commission to make an informed judgment as to the merits of the request" and must "address all pertinent factors." The Instructions also require that a request based on a claim that the subject information is confidential commercial or financial information must provide supporting information in five specific areas: (1) a description of the investment strategy, including the extent of any program of acquisition or disposition; (2) an explanation of why disclosure of the securities would be likely to reveal the strategy; (3) a demonstration that the revelation of the investment strategy would be premature; (4) a demonstration that failure to grant the request for confidential treatment would be likely to cause substantial harm to the Institutional Manager's competitive position; and (5) a statement of the period of time for which confidential treatment is requested. The Instructions also provide that an Institutional Manager may discuss each of the five areas listed above with respect to a class of holdings rather than with respect to each individual holding if the Institutional Manager "can identify a class or classes of holdings as to which the nature of the factual circumstances and the legal analysis are substantially the same."

Full Value CT Requests

Full Value came under the definition of Institutional Manager in March 2006, and was required to file Forms 13F beginning with calendar quarter ended December 31, 2006. On October 24, 2006, Full Value filed an application pursuant to section 13(f)(2) of the Exchange Act seeking an exemption from rule 13f-1 under the Exchange Act ("Exemptive Application"). On February 8, 2007 and May 10, 2007, Full Value submitted the February CT Request and the May CT Request, respectively. The Exemptive Application and the Full Value CT Requests do not identify Full Value's Reportable Securities. The Full Value CT Requests request confidential treatment "until our administrative remedies have been exhausted with respect to the Exemptive Application."

The February CT Request states that Full Value "are activist investors. We seek to acquire meaningful stakes in small publicly traded companies that we have concluded, after extensive research, are undervalued and to take action to increase their stock price." The February CT Request further states that if Full Value "are required to prematurely disclose our [Reportable Securities], it is likely that their prices will rise due to the expectation by investors that we may act sooner or later to unlock their value. Such price increases may be harmful to our clients because they might otherwise have been able to acquire additional shares of their stocks at lower prices." The February CT Request "incorporate[d] the Exemptive Application." According to the February CT Request, the Exemptive Application "essentially argues that our [Reportable Securities] are trade secrets and that involuntary compliance with the filing requirement of rule 13f-1 would, by requiring us to publicly disclose them, constitute a 'taking' of our trade secrets without just compensation in violation of the Fifth Amendment to the Constitution."

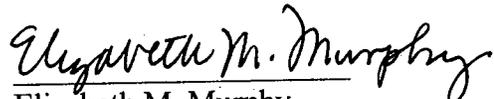
The May CT Request "incorporate[d] the Exemptive Application as well as the February [CT Request]." The May CT Request also discussed "an additional but related constitutional argument for exemptive relief that we were unaware of when we submitted the Exemptive Application. Involuntary compliance with the filing requirement of rule 13f-1 constitutes 'compelled speech.'"

The Commission's Findings

We have carefully reviewed the Full Value CT Requests. Full Value has not identified the Reportable Securities for which it seeks confidential treatment and otherwise failed to provide the factual and analytical support necessary for the Commission to make an informed judgment as to the merits of the Full Value CT Requests. Full Value has failed to address both the status and the expected duration of its purported acquisition program in the Reportable Securities as required by rule 24b-2 and the Instructions. Full Value has not provided sufficient facts or analysis about its Reportable Securities to demonstrate that disclosure of its position in any Reportable Security would likely cause substantial harm to Full Value's competitive position. Full Value also has failed to justify any period of confidential treatment, as required by the Instructions.

Accordingly, IT IS ORDERED that, pursuant to sections 13(f)(3) and 13(f)(4) of the Exchange Act, the Full Value CT Requests are denied.

By the Commission.


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61327 / January 11, 2010

_____	:	ORDER PURSUANT TO
In the Matter of	:	SECTIONS 13(f)(2), 13(f)(4) AND
	:	36 OF THE SECURITIES
Full Value Advisors, LLC	:	EXCHANGE ACT OF 1934
	:	DENYING APPLICATION FOR
	:	EXEMPTION FROM RULE
_____	:	13f-1 UNDER THE SECURITIES
	:	EXCHANGE ACT OF 1934

Full Value Advisors, LLC ("Full Value"), a Delaware limited liability company and an investment adviser to certain private investment companies, filed an application on October 24, 2006, pursuant to section 13(f)(2) of the Securities Exchange Act of 1934 ("Exchange Act") seeking an exemption from rule 13f-1 under the Exchange Act ("Exemptive Application"). By letters dated February 7, 2007 and May 8, 2007, Full Value submitted written requests ("February CT Request" and "May CT Request," respectively, and together, "Full Value CT Requests") pursuant to section 13(f)(3) of the Exchange Act and rule 24b-2 under the Exchange Act seeking confidential treatment of information that Full Value otherwise was required to disclose on Forms 13F for the quarters ending December 31, 2006 and March 31, 2007, respectively.¹ The May CT Request also set forth "an additional but related constitutional argument for exemptive relief that [Full Value was] unaware of when [Full Value] submitted the Exemptive Application" ("Additional Argument"). The Exemptive Application and the Full Value CT Requests did not identify Full Value's Reportable Securities.

The Commission has considered the Exemptive Application, including the Additional Argument. The Commission finds that the standard for an exemption from section 13(f)(1) of the Exchange Act and rule 13f-1 thereunder, set forth in section 13(f)(4) of the Exchange Act, has not been met. Separately, the Commission is issuing an order denying the Full Value CT Requests ("CT Denial Order") for failure to provide the factual support necessary for the Commission to make an informed judgment as to the merits of the CT Requests.

¹ Full Value also submitted a letter, dated February 13, 2008, correcting a statement in the February CT Request.

Background

Section 13(f)(1) of the Exchange Act and rule 13f-1 thereunder require every "institutional investment manager," as defined in section 13(f)(5)(A) of the Exchange Act, that exercises investment discretion with respect to "section 13(f) securities," as defined in rule 13f-1, having an aggregate fair market value of at least \$100 million ("Institutional Manager," and the securities, "Reportable Securities"), to file with the Commission quarterly reports on Form 13F setting forth each Reportable Security's name, CUSIP number, the number of shares held, and the market value of the position. Form 13F must be filed within 45 days of the end of the calendar year during which the \$100 million threshold was satisfied and within 45 days of the end of the first three calendar quarters that follow.

Congress enacted section 13(f) in order to make publicly available information about Institutional Managers' holdings of Reportable Securities, and to create with the Commission a central depository of historical and current data about these holdings.² The legislative history of section 13(f) suggests that the provision was designed to further regulatory and policymaking uses of the information, as well as to contribute to the transparency and integrity of, and investor confidence in, the U.S. equity markets.³

Under section 13(f)(3) of the Exchange Act, information filed on Form 13F must be made publicly available, "except that the Commission, as it determines to be necessary or appropriate in the public interest or for the protection of investors, may delay or prevent public disclosure of any such information in accordance with [the Freedom of Information Act]." Rule 200.80(b)(4) of the Commission's Freedom of Information Act rules provides that the Commission generally will not publish or make available to any person matters that "[d]isclose trade secrets and commercial or financial information obtained from a person and privileged or confidential." An Institutional Manager seeking to delay or prevent public disclosure of any such information provided on Form 13F must submit a written confidential treatment request ("CT Request") following the procedures set forth in rule 24b-2 under the Exchange Act and the Commission's Instructions to Form 13F ("Instructions").

Under section 13(f)(2) of the Exchange Act, in relevant part, the Commission may by order exempt an Institutional Manager from section 13(f)(1) of the Exchange Act or the rules thereunder. Pursuant to Section 13(f)(4) of the Exchange Act, the Commission must determine that any such exemption is consistent with the protection of investors and the purposes of section 13(f). Under section 36 of the Exchange Act, in relevant part, the Commission may by order exempt any person from any provision of the Exchange Act or any rule or regulation thereunder. Rule 0-12 under the Exchange Act sets forth Commission procedures for applications for orders under section 36 of the Exchange Act.

² See Report of Senate Comm. On Banking, Housing and Urban Affairs, S.Rep.No. 75, 94th Cong., 1st Sess. 83 (1975) at 79-82, 85-87.

³ See *id.* at 80-84.

The Commission has not established separate procedures for applications under section 13(f)(2), and therefore follows the procedures set forth in rule 0-12 for issuing this order.

The Exemptive Application

Full Value came under the definition of Institutional Manager in March 2006, and was required to file Forms 13F beginning with calendar quarter ended December 31, 2006. In October 2006, Full Value filed the Exemptive Application seeking an exemption from rule 13f-1 pursuant to section 13(f)(2). On February 8, 2007 and May 10, 2007, Full Value submitted the February CT Request and the May CT Request, respectively.

The Exemptive Application stated that Full Value was an activist investor that "seek[s] to acquire meaningful stakes in publicly-traded companies whose stocks [it has] concluded, after extensive research, are undervalued and to influence management to take action to increase the stock prices." The Exemptive Application further stated that "[t]he Applicants generally do not publicly disclose their investments" and "[t]he Applicants' equity holdings are trade secrets that are protected by the Taking Clause of the Fifth Amendment [to the Constitution]" ("Fifth Amendment Argument"). The Exemptive Application argued that "the investors in an entity advised by the Applicants may be harmed if the Applicants' trade secrets are accessed by other investors with whom it competes." The Exemptive Application also argued that "unless an exemption from rule 13f-1 is granted, the Applicants' trade secrets will be taken for public use without compensation in violation of the Fifth Amendment."⁴

The May CT Request stated "[p]lease be advised that there is an additional but related constitutional argument for exemptive relief that we were unaware of when we submitted the Exemptive Application. Involuntary compliance with the filing requirement of rule 13f-1 constitutes 'compelled speech.' A regulation that compels commercial speech must pass a four-part test set forth in *Central Hudson Gas & Elec. Corp. v. Public Serv. Com'r*, 447 U.S. 557, 562-63 (1980) . . ." The May CT Request went on to argue that the two Congressional purposes behind section 13(f) -- that the collected information find regulatory or policy uses and contribute to public confidence in the U.S. securities markets -- have not been fulfilled, and that section 13(f)(1) therefore violates the First Amendment to the Constitution.

The Commission's Findings

The Commission has considered the Fifth Amendment Argument set forth in the Exemptive Application. We note that Congress, in section 13(f)(3) of the Exchange Act,

⁴ The February CT Request stated that "If the order requested in the Exemptive Application is denied we would likely seek a judicial determination that [section] 13(f) is unconstitutional. In light of these novel circumstances, we request to be excused from complying with certain instructions that are applicable to routine confidential treatment requests made pursuant to section 13(f)(3) and rule 24b-2." By telephone conversation and a letter, dated March 9, 2007, which attached the Instructions, Form 13F, and a staff letter to Institutional Managers, dated June 17, 1998, providing guidance on the CT Request process, the staff informed Full Value about the requirements applicable to CT Requests.

specifically provided protection from public disclosure for an Institutional Manager's trade secrets and similar sensitive business information. The Commission has established an administrative process, detailed in rule 24b-2 under the Exchange Act and the Instructions, for Institutional Managers to submit CT Requests to protect such information from public disclosure. The CT Request process is tailored to protect certain specific information upon a demonstration of substantial harm, while ensuring that other information required by Form 13F is publicly disclosed consistent with section 13(f)(1). We do not believe that Congress generally intended for the Commission to exempt an Institutional Manager from disclosing its Reportable Securities pursuant to section 13(f)(2) when the Commission's authority to delay or prevent public disclosure of certain Reportable Securities pursuant to section 13(f)(3) can adequately protect the proprietary interests of an Institutional Manager. Therefore, absent extraordinary circumstances, an Institutional Manager seeking protection on grounds provided for under section 13(f)(3) must make a good faith effort to obtain that protection through the CT Request process. Because the Fifth Amendment Argument in the Exemptive Application seeks to protect from public disclosure information that is trade secrets, such protection is more properly addressed pursuant to the CT Request process. Full Value's failure to provide the factual support necessary for the Commission to make an informed judgment as to the merits of its CT Requests is addressed separately in the CT Denial Order.

The Commission also has considered the Additional Argument alleging that section 13(f) violates the First Amendment to the Constitution. The Additional Argument is a type of facial challenge to the constitutionality of a law administered by the Commission upon which the Commission generally declines to pass. Therefore, the Commission proceeds on the presumption that section 13(f) is constitutional.

The Commission also disagrees with the assertion in the Exemptive Application and the Additional Argument that the information collected pursuant to section 13(f) has not been used for the purposes intended by Congress. The information collected on Forms 13F has been and continues to be used by U.S. regulators, academics, the media and financial information distributors, and investors and other U.S. equity markets participants, as intended by Congress. The Commission's staff use Form 13F information for a variety of research, oversight, and enforcement purposes. The Commission's staff also use Form 13F-based academic research, for example, to analyze the Commission's rulemaking initiatives under the federal securities laws.⁵ As the primary source of data about institutional equity holdings, Form 13F information is monitored, analyzed, and distributed by market data services for use by investors and other participants in the U.S. equity markets. The information reported on Form 13F can be used for commercial and academic purposes, for example, to identify and locate large holders of an issuer's publicly-traded stock, measure investment performance, and characterize trading

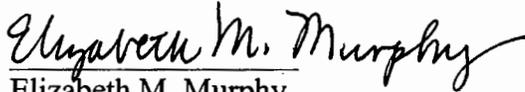
⁵ Form 13F information from an Institutional Manager that is a bank whose deposits are insured under the Federal Deposit Insurance Act also is required to be filed, for example, with the Federal Reserve Board and the Office of the Comptroller of the Currency. See section 13(f)(4) of the Exchange Act (requiring such Institutional Manager to file a copy of its Form 13F with the "appropriate regulatory agency"). See also section 3(a)(34)(D) of the Exchange Act (defining the "appropriate regulatory agency").

patterns. We believe that the availability of information provided on Forms 13F to the public has contributed to the transparency and integrity of the U.S. equity markets and thereby to investor confidence, as intended by Congress.

Having considered the Exemptive Application and the Additional Argument, the Commission finds that Full Value has failed to demonstrate that exempting it from rule 13f-1 under the Exchange Act would be consistent with the protection of investors and the purposes of section 13(f), as required by section 13(f)(4).

Accordingly, IT IS ORDERED, pursuant to sections 13(f)(2), 13(f)(4) and 36 of the Exchange Act, that Full Value's Exemptive Application is denied.

By the Commission.


Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[RELEASE NO. 34-61335; File No. S7-12-09]

RIN 3235-AK31

SHAREHOLDER APPROVAL OF EXECUTIVE COMPENSATION OF TARP RECIPIENTS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting 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 amendments are intended to help implement this requirement by specifying and clarifying it in the context of the federal proxy rules.

EFFECTIVE DATE: [Insert date 30 days after publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: John Harrington, Attorney-Adviser, or N. Sean Harrison, Special Counsel, Division of Corporation Finance, at (202) 551-3430, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

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SUPPLEMENTARY INFORMATION: We are adopting new Rule 14a-20 and amendments to Schedule 14A¹ and Rule 14a-6² under the Securities Exchange Act of 1934 (“Exchange Act”).³

I. BACKGROUND

In July 2009, we published for public comment⁴ proposed amendments to the proxy rules under the Exchange Act to set forth certain requirements for U.S. registrants subject to Section 111(e) of the Emergency Economic Stabilization Act of 2008 (“EESA”).⁵

Section 111(e) of the EESA, as amended by Section 7001 of the American Recovery and Reinvestment Act of 2009⁶ on February 17, 2009, requires any entity that is a recipient of 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

¹ 17 CFR 240.14a-101.

² 17 CFR 240.14a-6.

³ 15 U.S.C. 78a *et seq.*

⁴ Shareholder Approval of Executive Compensation of TARP Recipients, Release No. 34-60218 (July 1, 2009) [74 FR 32474] (hereinafter, the “Proposing Release”).

⁵ 12 U.S.C. 5221(e). 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.

⁶ Pub. L. No. 111-5, 123 Stat. 115 (2009).

compensation disclosure rules of the Commission (which disclosure shall include the compensation discussion and analysis, the compensation tables, and any related material).⁷

Companies that have received financial assistance under the TARP are required to provide this separate shareholder vote during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding.⁸ 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.⁹ 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.¹⁰

⁷ 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.

⁸ Section 111 of the EESA defines this period not to 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).

⁹ Section 111(e)(2) of the EESA [12 U.S.C. 5221(e)(2)].

¹⁰ *Id.* 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)] (the exclusion for proposals that directly conflict with one of the company's own proposals) or Rule 14a-8(i)(10) [17 CFR 240.14a-8(i)(10)] (the exclusion for proposals that have been substantially implemented) 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/corpfin/cf-noaction/2009_14a-8.shtml).

We received approximately 50 comment letters in response to the proposed amendments.¹¹ The respondents included business organizations, law firms and attorneys, investment firms, investor groups and many individuals. Most commenters expressed general support for the proposed amendments.¹² A few of these commenters expressed general support for the amendments, but also suggested certain changes or improvements on specific issues, as discussed more fully below.¹³ Several other commenters only addressed specific aspects of the proposed amendments, such as the requirement to file a preliminary proxy statement as a consequence of the required vote, but did not express a viewpoint on the overall proposals.¹⁴ One commenter argued that we should revise our proposals so that TARP recipients are not required to provide a mandatory annual advisory shareholder vote on executive compensation.¹⁵

More generally, many commenters expressed support for a requirement that all public companies permit an annual advisory vote on executive compensation.¹⁶ Other commenters expressed opposition to mandatory “say on pay” for all public companies.¹⁷ While we note these comments, the purpose of this rulemaking is limited to helping to implement the requirements of

¹¹ The public comments we received are available online at <http://www.sec.gov/comments/s7-12-09/s71209.shtml>.

¹² See, e.g., letters from California Public Employees’ Retirement System (“CalPERS”), Calvert Group, Ltd. (“Calvert”), General Board of Pension and Health Benefits of the United Methodist Church (“UMC”), Northwest & Ethical Investments L.P., Sisters of Saint Francis of Philadelphia, United Brotherhood of Carpenters and Joiners of America (“UBCJA”) and Walden Asset Management (“Walden”).

¹³ See, e.g., letters from CalPERS, UBCJA and Pax World Management Corp.

¹⁴ See, e.g., letters from Cleary Gottlieb Steen & Hamilton LLP (“Cleary”), Mary K. Blasy, Esq. (“Blasy”), and Sullivan & Cromwell LLP (“S&C”).

¹⁵ See letter from Center for Capital Markets Competitiveness, U.S. Chamber of Commerce (“CCMC”). CCMC advocated a triennial vote with an opt-out provision for small and mid-size companies. However, as discussed below, Section 111(e)(1) of the EESA requires an annual vote and does not include opt-out provisions.

¹⁶ See, e.g., letters from CalPERS, Calvert, Midwest Coalition for Responsible Investments and Walden.

¹⁷ See, e.g., letters from The Center on Executive Compensation and UBCJA.

Section 111(e) of the EESA with respect to TARP recipients. Therefore, these comments are beyond the scope of this rulemaking.

We have carefully considered the comments we received regarding the proposed amendments and are adopting new Rule 14a-20 and an amendment to Item 20 of Schedule 14A substantially as proposed with slight modifications to provide further clarity. In response to comments we received, we are also amending Rule 14a-6(a) under the Exchange Act so that TARP recipients required to provide a separate shareholder vote on executive compensation pursuant to Section 111(e)(1) of the EESA will not be required to file a preliminary proxy statement as a consequence of providing the required vote.

II. DISCUSSION OF THE AMENDMENTS

We are adopting substantially as proposed new Rule 14a-20 under the Exchange Act to help implement Section 111(e) of the EESA. Under Rule 14a-20, registrants that are “TARP recipients”¹⁸ will be required to provide the separate shareholder vote to approve the compensation of executives, as required by Section 111(e)(1) of the EESA, in proxies solicited during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding. Rule 14a-20 clarifies that the separate shareholder vote required by Section 111(e)(1) of the EESA will 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.¹⁹

¹⁸ 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).

¹⁹ As noted in the Proposing Release, 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

We are making one modification to the proposed instruction to Rule 14a-20 in order to clarify its meaning. The purpose of the instruction remains, as proposed, to clarify that smaller reporting companies will not be required to provide a compensation discussion and analysis in order to comply with the requirements of Rule 14a-20.²⁰ As proposed, the instruction referenced the compensation of executives as disclosed pursuant to Item 402(m) through (r) of Regulation S-K.²¹ Items 402(m) through (r) are the entire scaled compensation disclosure applicable to smaller reporting companies. However, paragraph (r) refers only to director compensation. As suggested by one commenter, we are revising the instruction to eliminate the reference to paragraph (r) in order to avoid the implication that the required vote relates to director compensation.²² Other than this modification, we are adopting the instruction as proposed.

We are also adopting substantially as proposed an amendment to Item 20 of Schedule 14A that will 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 Rule 14a-20. Pursuant to this amendment, such registrants will be required to disclose in the

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." Rule 14a-20 is intended to result in TARP recipients conducting the required advisory vote annually in connection with the election of directors, with respect to which our rules call for disclosure of executive compensation.

²⁰ Several commenters expressed support for the proposed instruction clarifying that smaller reporting companies that are TARP recipients are not obligated to provide a compensation discussion and analysis. *See, e.g.*, letters from Calvert, UBCJA and Ursuline Sisters of Tildonk. One commenter did not believe smaller reporting companies in general should be entitled to provide scaled compensation disclosure. *See* letter from CalPERS. Another commenter believed smaller reporting companies that are TARP recipients should provide a limited compensation discussion and analysis of at least 100 words. *See* letter from Phil Nicholas ("Nicholas"). As described above, we do not believe the EESA alters the disclosure obligations of smaller reporting companies pursuant to our existing rules regarding scaled disclosure. *See* note 7 above.

²¹ 17 CFR 229.402(m) - (r).

²² *See* letter from S&C.

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. In response to a comment we received requesting clarification, we are adding the phrase “such as whether the vote is non-binding” to the end of the text of the amended Item 20 in order to provide an example of a type of disclosure that is required.²³

As adopted, Item 20 will not require any additional disclosures by TARP recipients beyond those discussed above. Although a few commenters advocated additional disclosure requirements,²⁴ we believe the existing compensation disclosure requirements of Item 402 of Regulation S-K should result in sufficient disclosure about TARP recipients’ compensation policies and decisions to enable an informed vote on the compensation of executives.²⁵ We note in this connection that, under our existing rules, a TARP recipient must consider various disclosures regarding its participation in TARP. For example, a TARP recipient must consider whether the impact of TARP participation on compensation is required to be discussed in its CD&A in order to provide investors with material information that is necessary to an

²³ See letter from Davis Polk & Wardwell LLP (“Davis Polk”).

²⁴ See letters from CalPERS (suggesting that TARP recipients should detail in the CD&A how receipt of TARP funds will affect executive compensation), The Value Alliance (“Value Alliance”) (suggesting that required disclosures should include information on how receipt of TARP funds impacted compensation policies), Blasy (advocating for disclosure requirements related to EESA incentive compensation claw-back provisions), Jonathan Graf (commenting that CD&A should discuss key financial and risk decisions) and Jasim Haider (also expressing the view that CD&A should discuss significant financial and risk decisions).

²⁵ We also note that, on December 16, 2009, we approved certain amendments intended to improve our proxy disclosure requirements. See Proxy Disclosure Enhancements, Release No. 33-9089 (December 16, 2009). As part of this rulemaking, we approved amendments accelerating the reporting of shareholder vote results by moving the reporting requirement from the Exchange Act periodic reports to Form 8-K [17 CFR 249.308]. These amendments will apply to reporting results of the vote required by Section 111(e) of the EESA. This will help to address the concerns of commenters who stressed the importance of timely reporting of the shareholder vote on executive compensation. See, e.g., letter from CalPERS.

understanding of the company's compensation policies and decisions regarding named executive officers.²⁶

As we indicated in the Proposing Release, we believe Rule 14a-20 and the amendment to Schedule 14A will afford registrants that are TARP recipients adequate flexibility to meet their obligations under Section 111(e) of the EESA.²⁷ At the same time, the amendments, by helping to implement the requirements of Section 111(e) of the EESA in our proxy rules, should 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 this disclosure will provide investors with information that will help them to make informed voting decisions.

In the Proposing Release, we solicited comment on whether we should amend Rule 14a-6(a) under the Exchange Act so that registrants that are TARP recipients would not be required to file a preliminary proxy statement as a consequence of providing the required shareholder vote on executive compensation. In response to comments received and after further consideration of

²⁶ See Item 402(b), (e) and (o) of Regulation S-K [17 CFR 229.402(b), (e) and (o)].

²⁷ Several commenters expressed support for the flexibility provided by the proposed rules and did not believe we should designate the specific language to be used by TARP recipients when presenting the required vote to shareholders. See, e.g., letters from Blasy, Davis Polk, UMC, UBCJA and Walden. On the other hand, two commenters suggested that we mandate the specific language to be used. See letters from S&C (proposing a standard form of resolution) and Value Alliance.

Consistent with the proposal, we are not requiring registrants to use any specific language or form of resolution in order to afford registrants that are TARP recipients some flexibility in how they present the required vote. 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)." As we indicated in the Proposing Release, 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 Rule 14a-20.

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 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 Rule 14a-20. See also note 10 above.

this issue, we are adopting an amendment to Rule 14a-6(a) under the Exchange Act to add the vote required for TARP recipients to the list of items that do not trigger a preliminary filing requirement.

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 shareholders, unless the items included for a shareholder vote in the proxy statement are limited to matters specified in the rule.²⁸ 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 are 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.

We noted in the Proposing Release that, in light of the early stage of development of disclosures and the special policy considerations related to this required vote for TARP recipients, we thought it would be appropriate to provide the staff with the opportunity to comment on the disclosure before final proxy materials were filed. Some commenters agreed with that approach.²⁹ Other commenters who were opposed to a preliminary filing requirement generally argued that the burdens to TARP recipients and Commission staff would not be justified by the benefits of a preliminary filing requirement.³⁰ These commenters noted that a

²⁸ 17 CFR 240.14a-6(a).

²⁹ See letters from CalPERS, Calvert and Nicholas. See also letter from UMC (acknowledging that a preliminary filing may be beneficial to staff and some investors, but noting that a preliminary filing would be of limited value to the commenter).

³⁰ See letters from Cleary, Davis Polk and S&C. See also letter from UBCJA.

preliminary filing requirement would be unduly burdensome and amplify the already difficult timing and scheduling issues surrounding annual meetings. According to the commenters, the need to make a preliminary filing would require accelerated timelines and result in additional costs. Commenters also noted additional timing difficulties related to “notice and access” requirements under Rule 14a-16.³¹ At the same time, the commenters argued that the disclosure provided in response to Item 20 of Schedule 14A as amended would be straightforward and unlikely to require staff intervention.³² Therefore, these commenters asserted, the benefits to investors of a preliminary filing requirement would be limited. Overall, these commenters noted, an advisory vote on executive compensation of TARP recipients is similar to the other items specified in Rule 14a-6(a) that routinely arise at annual meetings and therefore should not trigger a preliminary filing requirement.³³

After further consideration of this issue, we agree that a preliminary filing requirement is not necessary and are adopting an amendment to Rule 14a-6 accordingly. We agree with commenters that this item is similar to the other items specified in Rule 14a-6(a) that do not require a preliminary filing, and that the burdens of requiring a preliminary filing outweigh the potential benefits in this context. We note also that the staff is not precluded from providing an issuer with comments on the disclosure in a proxy statement after it has been filed in definitive form if the staff determines that to be appropriate in the circumstances.

³¹ 17 CFR 240.14a-16. See letters from Cleary and Davis Polk.

³² See letter from Cleary.

³³ See letters from Davis Polk and S&C.

III. PAPERWORK REDUCTION ACT

A. Background

The final amendments contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).³⁴ As discussed in the Proposing Release, we submitted the proposed amendments to the Office of Management and Budget (“OMB”) for review in accordance with the PRA.³⁵ 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 amendments by affected U.S. issuers will be mandatory. Responses to the information collections will not be kept confidential and there will be no mandatory retention period for the information disclosed.

As discussed in more detail above, we are adopting a new Rule 14a-20 under the Exchange Act and an amendment to Item 20 of Schedule 14A. Rule 14a-20 will 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 amendment to Item 20 of Schedule 14A, registrants required to provide a separate shareholder vote pursuant to Section 111(e) of the

³⁴ 44 U.S.C. 3501 et seq.

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

EESA and new Rule 14a-20 will be required to disclose the EESA requirement to provide such a vote and the general effect of the vote. In addition, we are adopting an amendment to Rule 14a-6(a) under the Exchange Act so that TARP recipients will not be required to file a preliminary proxy statement as a consequence of providing the required vote on executive compensation.

We published a notice requesting comment on the collection of information requirements in the Proposing Release and submitted these requirements to OMB for review in accordance with the PRA. Although we received many comment letters on the proposed rule amendments, no commenter specifically mentioned the estimated effects of these proposed amendments on the collection of information requirements.³⁶

Since we are adopting Rule 14a-20 and the amendment to Item 20 of Schedule 14A substantially as proposed, we are not changing the PRA burden estimates originally submitted to OMB. In addition, for the reasons discussed below, we are not revising our PRA burden estimates as a result of the amendment to Rule 14a-6(a).

B. Burden and Cost Estimates Related to the Amendments

We believe that Rule 14a-20 and the amendment 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 was already in effect during the 2009 proxy season. Our amendments address the EESA requirement in the context of the federal proxy rules, thereby creating only an incremental increase in the burdens

³⁶ We note that one commenter indicated that the additional burdens of a preliminary filing far outweigh any potential benefit of prior staff review. See letter from Cleary. As discussed above, we are amending Rule 14a-6 and, therefore, a TARP recipient will not be required to file a preliminary proxy statement as a consequence of providing the required vote.

and costs for such registrants. We believe the amendments will remove uncertainty while still providing registrants that are TARP recipients adequate flexibility in complying with Section 111(e) of the EESA. For purposes of this analysis, we estimate the burden of disclosing the general effect of the vote pursuant to Item 20 of Schedule 14A and ensuring conformity with Rule 14a-20 when complying with Section 111(e)(1) of the EESA will be approximately one hour per year per registrant that is a TARP recipient. We do not believe the minor modifications that we are making to the proposed Rule 14a-20 and amendment Item 20 of Schedule 14A in response to comments will impact this estimated burden.

However, as a result of our amendment to Rule 14a-6(a), TARP recipients will no longer be required to file a preliminary proxy statement as a consequence of providing the required vote. The amendment to Rule 14a-6(a) does not change the substance of the information that must be collected and disclosed in Schedule 14A, but it does eliminate an additional filing requirement. As discussed in greater detail below in the Cost-Benefit Analysis, we believe this amendment will benefit many TARP recipients, primarily by easing some of the timing challenges that can result from a requirement to prepare and file preliminary proxy materials in connection with an annual meeting. However, we do not believe the average paperwork burden will change as a result of the amendment to Rule 14a-6(a).

A requirement to file a preliminary proxy statement accelerates the time in which registrants must complete a Schedule 14A and creates the possibility that the filing could be subject to staff review before a definitive filing is made. A filer may incur additional paperwork burden if it changes its disclosure in the definitive proxy statement in response to staff comments. However, the staff does not review every preliminary proxy statement that is filed with the Commission and is not precluded from commenting on proxy materials filed in

definitive form if the staff deems that to be appropriate under the circumstances. In addition, the amendment to Rule 14a-6(a) that we are adopting today does not necessarily eliminate the potential burdens associated with a preliminary filing requirement because any TARP recipient that presents an additional proposal to shareholders in its proxy materials that is not among the matters enumerated in Rule 14a-6(a) as amended will still be required to file a preliminary proxy statement. On balance, therefore, we do not believe that eliminating the requirement to file a preliminary proxy statement is likely to change the overall disclosure provided by TARP recipients with respect to the required vote on executive compensation, so we are not reducing our average PRA burden estimate.

We estimate there are approximately 275 registrants that are TARP recipients with outstanding obligations that would be subject to the final amendments.³⁷ Since we estimate that the rules we are adopting will result in an increased burden of one hour per year for each registrant that is a TARP recipient, the total annual PRA burden increase attributable to the final 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 the company to review corporate disclosure at an average cost of \$400 per hour.³⁸ 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

³⁷ 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 as of November 6, 2009.

³⁸ We estimate an hourly rate of \$400 as the average cost for the service of outside professionals that assist in preparing and filing proxy statements and related disclosures with the Commission.

compliance burdens resulting from the final 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 final amendments, the total annual burden hours and cost of Schedule 14A will be approximately 555,889.5 hours and \$63,737,487.

IV. COST-BENEFIT ANALYSIS

We are sensitive to the costs and benefits of our rules. In this section, we examine the benefits and costs of the final amendments we are adopting today.³⁹

In the Proposing Release, we requested that commenters provide views, supporting information and estimates on the benefits and costs that may result from adoption of the proposed amendments. No commenter expressly addressed the cost-benefit analysis in the Proposing Release. Some commenters cited certain benefits and costs of the proposed amendments in the course of making a variety of suggestions and observations. We discuss these comments throughout the release as applicable.

A. Benefits

We are adopting 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

³⁹ The cost-benefit analysis in this section addresses the costs and benefits of the 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 amendments set forth the manner in which registrants that are TARP recipients must 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 amendments.

shareholder vote to approve the compensation of executives. Under the amendments, this separate shareholder vote will 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 will 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 are also amending Rule 14a-6(a) under the Exchange Act so that TARP recipients are not required to file a preliminary proxy statement as a consequence of providing the required vote on executive compensation.

We believe the 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 amendments eliminate uncertainty that may have existed 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 amendments allow TARP recipients adequate flexibility under the proxy rules to comply with the requirements of the EESA. By providing clarity while maintaining adequate flexibility, we believe the amendments will 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 should benefit TARP recipients and their shareholders.

The amendment to Rule 14a-6(a) will also benefit many TARP recipients. During the 2009 proxy season, TARP recipients were required to file preliminary proxy statements because

the vote on executive compensation required by the EESA was not among the matters enumerated in Rule 14a-6(a) that do not trigger a preliminary filing requirement. Because a preliminary proxy statement must be filed at least 10 days prior to the date definitive copies are first sent or given to shareholders, registrants subject to a preliminary filing requirement must complete their materials on an accelerated basis. This can create costs and burdens, especially in conjunction with the scheduling and timing issues surrounding annual meetings. In addition, a preliminary filing requirement may make it more difficult for a registrant to achieve the cost savings possible under the "notice and access" model because a registrant must send shareholders a Notice of Internet Availability of Proxy Materials (and those materials must be available) at least 40 days prior to the meeting date unless the registrant relies on the "full set delivery" option.⁴⁰ By amending Rule 14a-6 so that TARP recipients are not required to file a preliminary proxy statement as a consequence of providing the required vote, we believe these costs may be avoided or lessened and thus the amendment will benefit many TARP recipients.

We believe the 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, Rule 14a-20 specifies and clarifies that requirement in the context of the federal proxy rules. By doing so, we believe Rule 14a-20 should 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 amendment to Schedule 14A requires disclosure about the EESA requirement to provide a separate shareholder vote and the general effects of such a vote.

Together, the amendments are intended to provide useful, comparable and consistent information

⁴⁰ 17 CFR 240.14a-16.

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 Rule 14a-20 will 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 amendments will not add any significant costs for TARP recipients to those already created by the requirements of Section 111(e)(1) of the EESA and our proxy rules. The amendments are intended to help implement the existing substantive EESA requirement in the context of the federal proxy rules. While our amendment to Schedule 14A would require certain disclosures not explicitly required by EESA, we believe any incremental costs imposed by our amendments would be minimal. For purposes of the PRA, we estimated the total annual increase in incremental burden as a result of the amendments to be 275 hours.

There may be some costs to investors as a result of our amendment to Rule 14a-6(a). Because TARP recipients will no longer be required to file a preliminary proxy statement as a consequence of providing the required vote on executive compensation, Commission staff may not have the opportunity to review preliminary proxy materials before TARP recipients make definitive copies of these materials available to shareholders. Staff review of preliminary materials can benefit shareholders by helping to ensure that registrants comply with the federal proxy rules and provide appropriate disclosure to shareholders. However, we do not believe the amendment to Rule 14a-6(a) will deprive investors of significant benefits. We believe that the rules we are adopting today, Rule 14a-20 and the amendment to Item 20 of Schedule 14A, provide clear guidance to TARP recipients regarding their obligations under the federal proxy

rules when subject to the requirements of Section 111(e) of the EESA. In addition, the staff does not review every preliminary proxy statement that is filed with the Commission and is not precluded from commenting on proxy materials filed in definitive form if the staff deems that to be appropriate under the circumstances.

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 Act⁴¹ 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)⁴² 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 final amendments will 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 final amendments also will 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. The amendment to Rule 14a-6(a)

⁴¹ 15 U.S.C. 78w(a).

⁴² 15 U.S.C. 78c(f).

will benefit many TARP recipients by reducing the burdens associated with a preliminary filing requirement. As discussed in greater detail above, we believe these benefits will be achieved without imposing any significant additional burdens on registrants that are TARP recipients or costs to their shareholders. We do not anticipate any effect on competition or capital formation. We do believe the rules will make compliance with EESA more efficient.

In the Proposing Release, we requested comment on whether the proposed amendments, if adopted, would impose a burden on competition. We also requested comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. We did not receive any comments directly responding to these requests.

VI. REGULATORY FLEXIBILITY ACT CERTIFICATION

In Part VII of the Proposing Release, the Commission certified pursuant to Section 605(b) of the Regulatory Flexibility Act⁴³ that the proposed amendments to the federal proxy rules would not have a significant economic impact on a substantial number of small entities. While the Commission encouraged written comments regarding this certification, no commenters responded to this request or indicated that the amendments as adopted would have a significant economic impact on a substantial number of small entities.

VII. STATUTORY AUTHORITY AND TEXT OF THE FINAL AMENDMENTS

The amendments described in this release are being adopted 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 Exchange Act (15 U.S.C. 78n(a) and 78w(a)).

List of Subjects

17 CFR Part 240

⁴³ 5 U.S.C. 605(b).

Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENTS

For the reasons set out in the preamble, the Commission hereby amends 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. Amend §240.14a-6 by:

a. Removing “and/or” from the end of paragraph (a)(5);

b. Removing the period from the end of paragraph (a)(6) and in its place adding “; and/or”; and

c. Adding paragraph (a)(7).

The addition reads as follows:

§240.14a-6 Filing requirements.

(a) * * *

(7) A vote to approve the compensation of executives as required 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.

* * * * *

3. 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 (q) of Regulation S-K.

4. 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, such as whether the vote is non-binding.

* * * * *

By the Commission.



Florence E. Harmon
Deputy Secretary

January 12, 2010

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940

Release No. 29110 / January 12, 2010

In the Matter of)

Investools Inc.)

13947 S. Minuteman Dr.)

Draper, UT 84020)

Amerivest Investment Management, LLC)

1005 North Ameritrade Place)

Bellevue, NE 68005)

TDAM USA Inc.)

161 Bay Street)

35th Floor, TD Canada Trust Tower)

Toronto, Ontario)

Canada M5J 2T2)

(812-13728))

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

Investools Inc. ("Investools"), Amerivest Investment Management, LLC, and TDAM USA Inc. (collectively, "Applicants") filed an application on December 11, 2009, and amendments to the application on December 11, 2009 and December 16, 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 Investools is or hereafter becomes an affiliated person within the meaning of section 2(a)(3) of the Act (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 District of Columbia on December 16, 2009.

On December 16, 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 December 16, 2009 until the Commission takes final action on the application for a permanent order (Investment Company Act Release No. 29093). 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 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 Investools et al. (File No. 812-13728), 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 District of Columbia on December 16, 2009.

By the Commission.

Elizabeth M. Murphy
Secretary



By: Florence E. Harmon
Deputy Secretary

*Commissioner Casey and
Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 13, 2010

In the Matter of

East Delta Resources Corp.,

File No. 500-1

ORDER OF SUSPENSION
OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of East Delta Resources Corp. ("East Delta") because it has not filed any periodic reports since the period ended September 30, 2008.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of East Delta.

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of East Delta is suspended for the period from 9:30 a.m. EST on January 13, 2010, through 11:59 p.m. EST on January 27, 2010.

By the Commission.

Elizabeth M. Murphy
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 202

[Release No. 34-61340]

Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions

AGENCY: Securities and Exchange Commission.

ACTION: Policy statement.

SUMMARY: The Securities and Exchange Commission is issuing a policy statement announcing the analytical framework it uses to evaluate cooperation by individuals.

EFFECTIVE DATE: [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: Joan McKown, Chief Counsel, (202) 551-4933; or Jordan A. Thomas, Assistant Chief Litigation Counsel, (202) 551-4475.

SUPPLEMENTARY INFORMATION:

The Securities and Exchange Commission is issuing a policy statement announcing the analytical framework it uses to evaluate cooperation by individuals. This framework serves two important purposes: it promotes the fair and effective exercise of discretion by the Commission, and it enhances confidence on the part of the public and cooperating individuals that decisions regarding cooperation in the Commission's investigations and related enforcement actions will be made in an appropriate and consistent manner.

The provisions of the Administrative Procedure Act ("APA"), 5 U.S.C. 553, regarding notice of proposed rulemaking, opportunities for public comment, and prior publication are not applicable to general statements of policy, such as this policy

statement. Similarly, the provisions of the Regulatory Flexibility Act, 5 U.S.C. 601-602, apply only when notice and comment are required by the APA or another statute and are therefore not applicable.

LIST OF SUBJECTS IN 17 CFR PART 202

Administrative practice and procedure.

TEXT OF AMENDMENT:

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

PART 202—INFORMAL AND OTHER PROCEDURES

1. The authority citation for Part 202 continues to read, in part, as follows:

Authority: 15 U.S.C. 77s, 77t, 77sss, 77uuu, 78d-1, 78u, 78w, 78ll(d), 80a-37, 80a-41, 80b-9, 80b-11, 7202 and 7211 et seq., unless otherwise noted.

* * * * *

2. Add § 202.12 to read as follows:

§ 202.12 Policy statement concerning cooperation by individuals in its investigations and related enforcement actions.

Cooperation by individuals and entities in the Commission's investigations and related enforcement actions can contribute significantly to the success of the agency's mission. Cooperation can enhance the Commission's ability to detect violations of the federal securities laws, increase the effectiveness and efficiency of the Commission's investigations, and provide important evidence for the Commission's enforcement actions. There is a wide spectrum of tools available to the Commission and its staff for

facilitating and rewarding cooperation by individuals, ranging from taking no enforcement action to pursuing reduced charges and sanctions in connection with enforcement actions. As with any cooperation program, there exists some tension between the objectives of holding individuals fully accountable for their misconduct and providing incentives for individuals to cooperate with law enforcement authorities. This policy statement sets forth the analytical framework employed by the Commission and its staff for resolving this tension in a manner that ensures that potential cooperation arrangements maximize the Commission's law enforcement interests. Although the evaluation of cooperation requires a case-by-case analysis of the specific circumstances presented, as described in greater detail below, the Commission's general approach is to determine whether, how much, and in what manner to credit cooperation by individuals by evaluating four considerations: the assistance provided by the cooperating individual in the Commission's investigation or related enforcement actions ("Investigation"); the importance of the underlying matter in which the individual cooperated; the societal interest in ensuring that the cooperating individual is held accountable for his or her misconduct; and the appropriateness of cooperation credit based upon the profile of the cooperating individual. In the end, the goal of the Commission's analysis is to protect the investing public by determining whether the public interest in facilitating and rewarding an individual's cooperation in order to advance the Commission's law enforcement interests justifies the credit awarded to the individual for his or her cooperation.

(a) Assistance provided by the individual. The Commission assesses the assistance provided by the cooperating individual in the Investigation by considering, among other things:

(1) The value of the individual's cooperation to the Investigation including, but not limited to:

(i) Whether the individual's cooperation resulted in substantial assistance to the Investigation;

(ii) The timeliness of the individual's cooperation, including whether the individual was first to report the misconduct to the Commission or to offer his or her cooperation in the Investigation, and whether the cooperation was provided before he or she had any knowledge of a pending investigation or related action;

(iii) Whether the Investigation was initiated based on information or other cooperation provided by the individual;

(iv) The quality of cooperation provided by the individual, including whether the cooperation was truthful, complete, and reliable; and

(v) The time and resources conserved as a result of the individual's cooperation in the Investigation.

(2) The nature of the individual's cooperation in the Investigation including, but not limited to:

(i) Whether the individual's cooperation was voluntary or required by the terms of an agreement with another law enforcement or regulatory organization;

(ii) The types of assistance the individual provided to the Commission;

(iii) Whether the individual provided non-privileged information, which information was not requested by the staff or otherwise might not have been discovered;

(iv) Whether the individual encouraged or authorized others to assist the staff who might not have otherwise participated in the Investigation; and

(v) Any unique circumstances in which the individual provided the cooperation.

(b) Importance of the underlying matter. The Commission assesses the importance of the Investigation in which the individual cooperated by considering, among other things:

(1) The character of the Investigation including, but not limited to:

- (i) Whether the subject matter of the Investigation is a Commission priority;
- (ii) The type of securities violations;
- (iii) The age and duration of the misconduct;
- (iv) The number of violations; and
- (v) The isolated or repetitive nature of the violations.

(2) The dangers to investors or others presented by the underlying violations involved in the Investigation including, but not limited to:

(i) The amount of harm or potential harm caused by the underlying violations;

(ii) The type of harm resulting from or threatened by the underlying violations; and

(iii) The number of individuals or entities harmed.¹

(c) Interest in holding the individual accountable. The Commission assesses the societal interest in holding the cooperating individual fully accountable for his or her misconduct by considering, among other things:

¹ Cooperation in Investigations that involve priority matters or serious, ongoing, or widespread violations will be viewed most favorably.

(1) The severity of the individual's misconduct assessed by the nature of the violations and in the context of the individual's knowledge, education, training, experience, and position of responsibility at the time the violations occurred;

(2) The culpability of the individual, including, but not limited to, whether the individual acted with scienter, both generally and in relation to others who participated in the misconduct;

(3) The degree to which the individual tolerated illegal activity including, but not limited to, whether he or she took steps to prevent the violations from occurring or continuing, such as notifying the Commission or other appropriate law enforcement agency of the misconduct or, in the case of a violation involving a business organization, by notifying members of management not involved in the misconduct, the board of directors or the equivalent body not involved in the misconduct, or the auditors of such business organization of the misconduct;

(4) The efforts undertaken by the individual to remediate the harm caused by the violations including, but not limited to, whether he or she paid or agreed to pay disgorgement to injured investors and other victims or assisted these victims and the authorities in the recovery of the fruits and instrumentalities of the violations; and

(5) The sanctions imposed on the individual by other federal or state authorities and industry organizations for the violations involved in the Investigation.

(d) Profile of the individual. The Commission assesses whether, how much, and in what manner it is in the public interest to award credit for cooperation, in part, based upon the cooperating individual's personal and professional profile by considering, among other things:

- (1) The individual's history of lawfulness, including complying with securities laws or regulations;
- (2) The degree to which the individual has demonstrated an acceptance of responsibility for his or her past misconduct; and
- (3) The degree to which the individual will have an opportunity to commit future violations of the federal securities laws in light of his or her occupation -- including, but not limited to, whether he or she serves as: a licensed individual, such as an attorney or accountant; an associated person of a regulated entity, such as a broker or dealer; a fiduciary for other individuals or entities regarding financial matters; an officer or director of public companies; or a member of senior management -- together with any existing or proposed safeguards based upon the individual's particular circumstances.

Note to § 202.12. Before the Commission evaluates an individual's cooperation, it analyzes the unique facts and circumstances of the case. The above principles are not listed in order of importance nor are they intended to be all-inclusive or to require a specific determination in any particular case. Furthermore, depending upon the facts and circumstances of each case, some of the principles may not be applicable or may deserve greater weight than others. Finally, neither this statement, nor the principles set forth herein creates or recognizes any legally enforceable rights for any person.

By the Commission.



Elizabeth M. Murphy
Secretary

Date: January 13, 2010

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 200

[Release No. 34-61339]

Delegations of Authority to the Director of its Division of Enforcement

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is amending its rules to delegate authority to the Director of the Division of Enforcement ("Division") to submit witness immunity order requests to the Department of Justice for witnesses who have provided or have the potential to provide substantial assistance in the Commission's investigations and related enforcement actions. This delegation is intended to conserve Commission resources, enhance the Division's ability to detect violations of the federal securities laws, increase the effectiveness and efficiency of the Division's investigations, and improve the success of the Commission's enforcement actions.

EFFECTIVE DATE: [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: Joan McKown, Chief Counsel, (202) 551-4933; or Jordan A. Thomas, Assistant Chief Litigation Counsel, (202) 551-4475.

SUPPLEMENTARY INFORMATION:

The Commission today is amending its rules governing delegations of authority to the Director of the Division of Enforcement. The amendment to Rule 30-4 (17 CFR 200.30-4) authorize the Director of the Division of Enforcement ("Director") to submit

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witness immunity order requests to the Department of Justice for witnesses who have provided or have the potential to provide substantial assistance in the Commission's investigations and related enforcement actions. This delegation is intended to conserve Commission resources, enhance the Division's ability to detect violations of the federal securities laws, increase the effectiveness and efficiency of the Division's investigations, and improve the success of the Commission's enforcement actions.

Nevertheless, the Division may submit matters to the Commission for consideration, as it deems appropriate.

The Commission finds, in accordance with the Administrative Procedure Act ("APA") (5 U.S.C. 553(b)(3)(A)), that this revision relates solely to agency organization, procedures, or practices. It is therefore not subject to the provisions of the APA requiring notice and opportunity for comment. Accordingly, it is effective [insert date of publication in the Federal Register].

LIST OF SUBJECTS IN 17 CFR PART 200

Administrative practice and procedure, Authority delegations (Government agencies).

TEXT OF AMENDMENT:

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, 77d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

* * * * *

2. Section 200.30-4 is amended by adding paragraph (a)(14) to read as follows:

§ 200.30-4 Delegation of authority to Director of Division of Enforcement.

* * * * *

(a) * * *

(14) To submit witness immunity requests to the U.S. Attorney General for approval to seek an order compelling an individual to give testimony or provide other information pursuant to a subpoena that may be necessary to the public interest in connection with investigations and related enforcement actions pursuant to section 22(b) of the Securities Act of 1933 (15 U.S.C. 77v(b)), section 21(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(c)), section 42(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-41(c)) and section 209(c) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-9(c)).

* * * * *

By the Commission.



Elizabeth M. Murphy
Secretary

Date: January 13, 2010

*Commissioner Watter
not participating*

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

**SECURITIES EXCHANGE ACT OF 1934
Release No. 61362 / January 14, 2010**

**ADMINISTRATIVE PROCEEDING
File No. 3-13749**

In the Matter of

ADNAN S. ZAMAN,

Respondent.

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

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, 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. Zaman, 30 years old, is a resident of San Jose, California.
2. From July 2001 through March 2009, Zaman was employed as a registered representative at Lazard Frères & Co. LLC ("Lazard"), which is a broker-dealer registered with the Commission.
3. On January 12, 2010, a final judgment was entered by consent against Zaman, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 14(e) of the Exchange Act and Rule 14e-3 thereunder, in the civil action entitled Securities and Exchange Commission v. Vinayak S. Gowrish, et al., Civil Action No.09-CV-5883, in the United States District Court for the Northern District of California.
4. The Commission's complaint alleged, *inter alia*, that Zaman, as a Lazard investment banker, was privy to highly confidential acquisition information involving Lazard clients. In breach of his fiduciary and other duties of trust and confidence owed to Lazard and its clients, Zaman misappropriated and illegally tipped material, nonpublic acquisition information to two friends who traded stock and options on the basis of the tipped information. The complaint further alleged that, in exchange for tipping the information, Zaman received kickbacks in the form of cash, free rent, and other items of value.

IV.

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

Accordingly, it is hereby ORDERED:

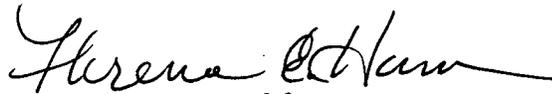
Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Zaman be, and hereby is, barred from association with any broker or dealer.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary


By: Florence E. Harmon
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 242

[Release No. 34-61358; File No. S7-02-10]

RIN 3235-AK47

Concept Release on Equity Market Structure

AGENCY: Securities and Exchange Commission.

ACTION: Concept release; request for comments.

SUMMARY: The Securities and Exchange Commission (“Commission”) is conducting a broad review of the current equity market structure. The review includes an evaluation of equity market structure performance in recent years and an assessment of whether market structure rules have kept pace with, among other things, changes in trading technology and practices. To help further its review, the Commission is publishing this concept release to invite public comment on a wide range of market structure issues, including high frequency trading, order routing, market data linkages, and undisplayed, or “dark,” liquidity. The Commission intends to use the public’s comments to help determine whether regulatory initiatives to improve the current equity market structure are needed and, if so, the specific nature of such initiatives.

DATES: Comments should be received on or before [insert date 90 days after date of publication in Federal Register]

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

Electronic Comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or

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- Send an e-mail to rule-comments@sec.gov. Please include File No. S7-02-10 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. S7-02-10. 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: Arisa Tinaves, Special Counsel, at (202) 551-5676, Gary M. Rubin, Attorney, at (202) 551-5669, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

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I. Introduction

The secondary market for U.S.-listed equities has changed dramatically in recent years. In large part, the change reflects the culmination of a decades-long trend from a market structure with primarily manual trading to a market structure with primarily automated trading. When

Congress mandated the establishment of a national market system for securities in 1975, trading in U.S.-listed equities was dominated by exchanges with manual trading floors. Trading equities today is no longer as straightforward as sending an order to the floor of a single exchange on which a stock is listed. As discussed in section III below, the current market structure can be described as dispersed and complex: (1) trading volume is dispersed among many highly automated trading centers that compete for order flow in the same stocks; and (2) trading centers offer a wide range of services that are designed to attract different types of market participants with varying trading needs.

A primary driver and enabler of this transformation of equity trading has been the continual evolution of technologies for generating, routing, and executing orders. These technologies have dramatically improved the speed, capacity, and sophistication of the trading functions that are available to market participants. Changes in market structure also reflect the markets' response to regulatory actions such as Regulation NMS, adopted in 2005,¹ the Order Handling Rules, adopted in 1996,² as well as enforcement actions, such as those addressing anti-competitive behavior by market makers in NASDAQ stocks.³

The transformation of equity trading has encompassed all types of U.S.-listed stocks. In recent years, however, it is perhaps most apparent in stocks listed on the New York Stock Exchange ("NYSE"), which constitute nearly 80% of the capitalization of the U.S. equity

¹ Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) ("Regulation NMS Release").

² Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) ("Order Handling Rules Release").

³ See, e.g., In the Matter of National Association of Securities Dealers, Inc., Administrative Proceeding File No. 3-9056, Securities Exchange Act Release No. 37538 (August 8, 1996).

markets.⁴ In contrast to stocks listed on the NASDAQ Stock Market LLC (“NASDAQ”), which for more than a decade have been traded in a highly automated fashion at many different trading centers,⁵ NYSE-listed stocks were traded primarily on the floor of the NYSE in a manual fashion until October 2006. At that time, NYSE began to offer fully automated access to its displayed quotations.⁶ An important impetus for this change was the Commission’s adoption of Regulation NMS in 2005, which eliminated the trade-through protection for manual quotations that nearly all commenters believed was seriously outdated.⁷

The changes in the nature of trading for NYSE-listed stocks have been extraordinary, as indicated by the comparisons of trading in 2005 and 2009 in Figures 1 through 5 below:

⁴ In November 2009, for example, NYSE-listed stocks represented approximately 78% of the market capitalization of the Wilshire 5000 Total Market Index. Wilshire Associates, <http://wilshire.com/Indexes/Broad/Wilshire5000/Characteristics.html> (November 17, 2009).

⁵ NASDAQ itself offered limited automated execution functionality until the introduction of SuperMontage in 2002. See Securities Exchange Act Release No. 46429 (August 29, 2002), 67 FR 56862 (September 5, 2002) (Order with Respect to the Implementation of NASDAQ’s SuperMontage Facility). Prior to 2002, however, many electronic communication networks (“ECNs”) and market makers trading NASDAQ stocks provided predominantly automated executions.

⁶ See Securities Exchange Act Release No. 53539 (March 22, 2006), 71 FR 16353 (March 31, 2006) (File No. SR-NYSE-2004-05) (approving proposal to create a “Hybrid Market” by, among other things, increasing the availability of automated executions); Pierre Paulden, Keep the Change, Institutional Investor (December 19, 2006) (“Friday, October 6, was a momentous day for the New York Stock Exchange. That morning the Big Board broke with 214 years of tradition when it began phasing in a new hybrid market structure that can execute trades electronically, bypassing face-to-face auctions on its famed floor.”). Prior to the Hybrid Market, NYSE offered limited automated executions.

⁷ Regulation NMS Release, 70 FR at 37505 n. 55 (“Nearly all commenters, both those supporting and opposing the need for an intermarket trade-through rule, agreed that the current ITS trade-through provisions are seriously outdated and in need of reform. They particularly focused on the problems created by affording equal protection against trade-throughs to both automated and manual quotations.”).

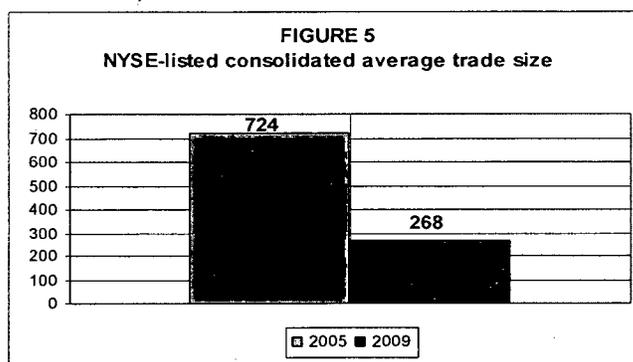
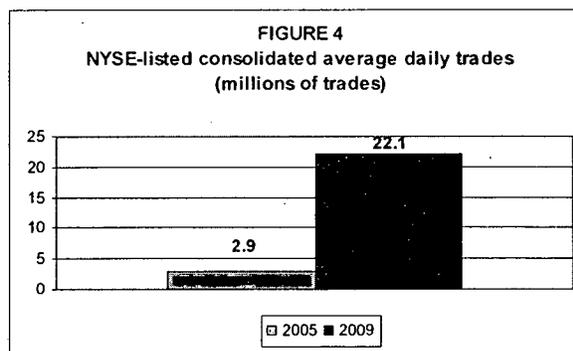
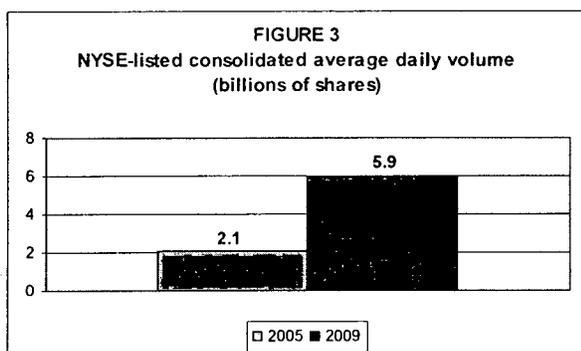
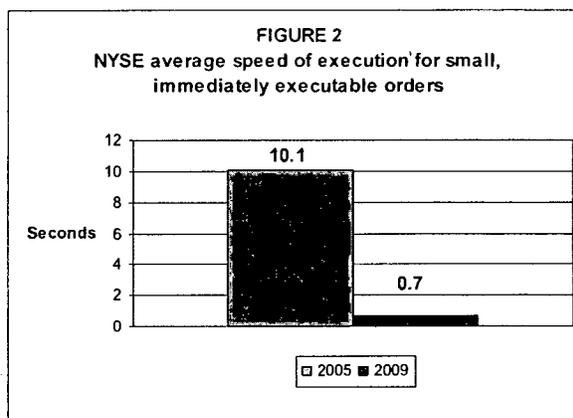
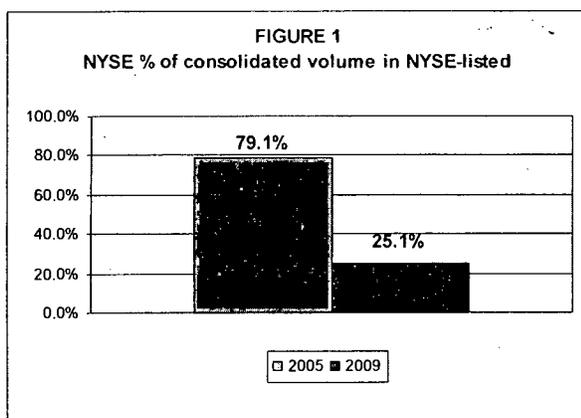


Figure 1 – NYSE executed approximately 79.1% of the consolidated share volume in its listed stocks in January 2005, compared to 25.1% in October 2009.⁸

⁸ NYSE Euronext, “NYSE Euronext Announces Trading Volumes for October 2009 (November 6, 2009) (“Tape A matched market share for NYSE was 25.1% in October 2009, above the 24.5% market share reported in October 2008”) (available at <http://www.nyse.com/press/125741917814.html>); Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770, 74782 (December 9, 2008) (File No. SR-NYSEArca-2006-21) (“Given the competitive pressures that currently characterize the U.S. equity markets, no exchange can afford to take its market share percentages for

Figure 2 – NYSE’s average speed of execution for small, immediately executable (marketable) orders was 10.1 seconds in January 2005, compared to 0.7 seconds in October 2009.⁹

Figure 3 – consolidated average daily share volume in NYSE-listed stocks was 2.1 billion shares in 2005, compared to 5.9 billion shares (an increase of 181%) in January through October 2009.¹⁰

Figure 4 – consolidated average daily trades in NYSE-listed stocks was 2.9 million trades in 2005, compared to 22.1 million trades (an increase of 662%) in January through October 2009.¹¹

Figure 5 – consolidated average trade size in NYSE-listed stocks was 724 shares in 2005, compared to 268 shares in January through October 2009.¹²

The foregoing statistics for NYSE-listed stocks are intended solely to illustrate the sweeping changes that are characteristic of trading in all U.S.-listed equities, including NASDAQ-listed stocks and other equities such as exchange-traded funds (“ETFs”). They are not intended to indicate whether these changes have led to a market structure that is better or

granted – they can change significantly over time, either up or down. . . . For example, the NYSE’s reported market share of trading in NYSE-listed stocks declined from 79.1% in January 2005 to 30.6% in June 2008.”) (citations omitted).

⁹ NYSE Euronext, Rule 605 Reports for January 2005 and October 2009 (available at <http://www.nyse.com/equities/nyseequities/1201780422054.html>) (NYSE average speed of execution for small (100-499 shares) market orders and marketable limit orders was 10.1 seconds in January 2005 and 0.7 seconds in October 2009).

¹⁰ NYSE Euronext, Consolidated Volume in NYSE Listed Issues 2000-2009 (available at <http://www.nyxdata.com/nysedata/NYSE/FactsFigures/tabid/115/Default.aspx>).

¹¹ NYSE Euronext, Consolidated Volume in NYSE Listed Issues 2000-2009 (available at <http://www.nyxdata.com/nysedata/NYSE/FactsFigures/tabid/115/Default.aspx>).

¹² NYSE Euronext, Consolidated Volume in NYSE Listed Issues 2000-2009 (available at <http://www.nyxdata.com/nysedata/NYSE/FactsFigures/tabid/115/Default.aspx>).

worse for long-term investors – an important issue on which comment is requested in section IV.A.1 below. Rather, the statistics for NYSE-listed stocks provide a useful illustration simply because the changes occurred both more rapidly and more recently for NYSE-listed stocks than other types of U.S.-listed equities.

To more fully understand the effects of these and other changes in equity trading, the Commission is conducting a comprehensive review of equity market structure. It is assessing whether market structure rules have kept pace with, among other things, changes in trading technology and practices. The review already has led to several rulemaking proposals that address particular issues and that are intended primarily to preserve the integrity of longstanding market structure principles. One proposal would eliminate the exception for flash orders from the Securities Exchange Act of 1934 (“Exchange Act”) quoting requirements.¹³ Another would address certain practices associated with non-public trading interest, including dark pools of liquidity.¹⁴ In addition, the Commission today is proposing for public comment an additional market structure initiative to address the risk management controls of broker-dealers with market access.¹⁵

The Commission is continuing its review. It recognizes that market structure issues are complex and require a broad understanding of statutory requirements, economic principles, and practical trading considerations. Given this complexity, the Commission believes that its review would be greatly assisted by receiving the benefit of public comment on a broad range of market structure issues. It particularly is interested in hearing the views of all types of investors and

¹³ Securities Exchange Act Release No. 60684 (September 18, 2009), 74 FR 48632 (September 23, 2009) (“Flash Order Release”).

¹⁴ Securities Exchange Act Release No. 60997 (November 13, 2009), 74 FR 61208 (November 23, 2009) (“Non-Public Trading Interest Release”).

¹⁵ Securities Exchange Act Release No.[citation unavailable] (“Market Access Release”).

other market participants and in receiving as much data and analysis as possible in support of commenters' views.

Commenters' views on both the strengths and weaknesses of the current market structure are sought. Views on both strengths and weaknesses can help identify new initiatives that would enhance the strengths or improve on the weaknesses, avoid changes that would unintentionally cause more harm than good, and suggest whether any current rules are no longer necessary or are counterproductive to the objectives of the Exchange Act. As discussed in section II below, Congress mandated that the national market system should achieve a range of objectives – efficient execution of transactions, fair competition among markets, price transparency, best execution of investor orders, and the interaction of investor orders when consistent with efficiency and best execution. Additionally, the Commission's mission includes the protection of investors and the facilitation of capital formation. Appropriately achieving each of these objectives requires a balanced market structure that can accommodate a wide range of participants and trading strategies.

This release is intended to facilitate public comment by first giving a basic overview of the legal and factual elements of the current equity market structure and then presenting a wide range of issues for comment. The Commission cautions that it has not reached any final conclusions on the issues presented for comment. The discussion and questions in this release should not be interpreted as slanted in any particular way on any particular issue. The Commission intends to consider carefully all comments and to complete its review in a timely fashion. At that point, it will determine whether there are any problems that require a regulatory initiative and, if so, the nature of that initiative. Moreover, a new regulatory requirement would

first be published in the form of a proposal that would give the public an opportunity to comment on the specifics of the proposal prior to adoption.

II. Exchange Act Requirements for a National Market System

In Section 11A of the Exchange Act,¹⁶ Congress directed the Commission to facilitate the establishment of a national market system in accordance with specified findings and objectives. The initial Congressional findings were that the securities markets are an important national asset that must be preserved and strengthened, and that new data processing and communications techniques create the opportunity for more efficient and effective market operations. Congress then proceeded to mandate a national market system composed of multiple competing markets that are linked through technology. In particular, Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure five objectives:

- (1) economically efficient execution of securities transactions;
- (2) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets;
- (3) the availability to brokers, dealers, and investors of information with respect to quotations and transactions in securities;
- (4) the practicability of brokers executing investors' orders in the best market; and
- (5) an opportunity, consistent with efficiency and best execution, for investors' orders to be executed without the participation of a dealer.

The final Congressional finding was that these five objectives would be fostered by the linking of all markets for qualified securities through communication and data processing

¹⁶ 15 U.S.C. 78k-1.

facilities. Specifically, Congress found that such linkages would foster efficiency; enhance competition; increase the information available to brokers, dealers, and investors; facilitate the offsetting (matching) of investors' orders; and contribute to the best execution of investors' orders.

Over the years, these findings and objectives have guided the Commission as it has sought to keep market structure rules up-to-date with continually changing economic conditions and technology advances. This task has presented certain challenges because, as noted previously by the Commission, the five objectives set forth in Section 11A can, at times, be difficult to reconcile.¹⁷ In particular, the objective of matching investor orders, or "order interaction," can be difficult to reconcile with the objective of promoting competition among markets. Order interaction promotes a system that "maximizes the opportunities for the most willing seller to meet the most willing buyer."¹⁸ When many trading centers compete for order flow in the same stock, however, such competition can lead to the fragmentation of order flow in that stock. Fragmentation can inhibit the interaction of investor orders and thereby impair certain efficiencies and the best execution of investors' orders. Competition among trading centers to provide specialized services for investors also can lead to practices that may detract from public price transparency. On the other hand, mandating the consolidation of order flow in a single venue would create a monopoly and thereby lose the important benefits of competition among markets. The benefits of such competition include incentives for trading centers to create

¹⁷ See, e.g., Securities Exchange Act Release No. 42450 (February 3, 2000), 65 FR 10577, 10580 (February 28, 2000) ("Fragmentation Concept Release") ("[A]lthough the objectives of vigorous competition on price and fair market center competition may not always be entirely congruous, they both serve to further the interests of investors and therefore must be reconciled in the structure of the national market system.").

¹⁸ H.R. Rep. 94-123, 94th Cong., 1st Sess. 50 (1975).

new products, provide high quality trading services that meet the needs of investors, and keep trading fees low.

The Commission's task has been to facilitate an appropriately balanced market structure that promotes competition among markets, while minimizing the potentially adverse effects of fragmentation on efficiency, price transparency, best execution of investor orders, and order interaction.¹⁹ An appropriately balanced market structure also must provide for strong investor protection and enable businesses to raise the capital they need to grow and to benefit the overall economy. Given the complexity of this task, there clearly is room for reasonable disagreement as to whether the market structure at any particular time is, in fact, achieving an appropriate balance of these multiple objectives. Accordingly, the Commission believes it is important to monitor these issues and, periodically, give the public, including the full range of investors and other market participants, an opportunity to submit their views on the matter. This concept release is intended to provide such an opportunity.

III. Overview of Current Market Structure

This section provides a brief overview of the current equity market structure. It first describes the various types of trading centers that compete for order flow in NMS stocks²⁰ and

¹⁹ See S. Rep. 94-75, 94th Cong., 1st Sess. 2 (1975) ("S. 249 would lay the foundation for a new and more competitive market system, vesting in the SEC power to eliminate all unnecessary or inappropriate burdens on competition while at the same time granting to that agency complete and effective powers to pursue the goal of centralized trading of securities in the interest of both efficiency and investor protection."); Regulation NMS Release, 70 FR at 37499 ("Since Congress mandated the establishment of an NMS in 1975, the Commission frequently has resisted suggestions that it adopt an approach focusing on a single form of competition that, while perhaps easier to administer, would forfeit the distinct, but equally vital, benefits associated with both competition among markets and competition among orders.").

²⁰ Rule 600(b)(47) of Regulation NMS defines "NMS stock" to mean any NMS security other than an option. Rule 600(b)(46) defines "NMS security" to mean any security for

among which liquidity is dispersed. It then describes the primary types of linkages between or involving these trading centers that are designed to enable market participants to trade effectively. This section attempts to highlight the features of the current equity market structure that may be most salient in presenting issues for public comment and is not intended to serve as a full description of the U.S. equity markets.

A. Trading Centers

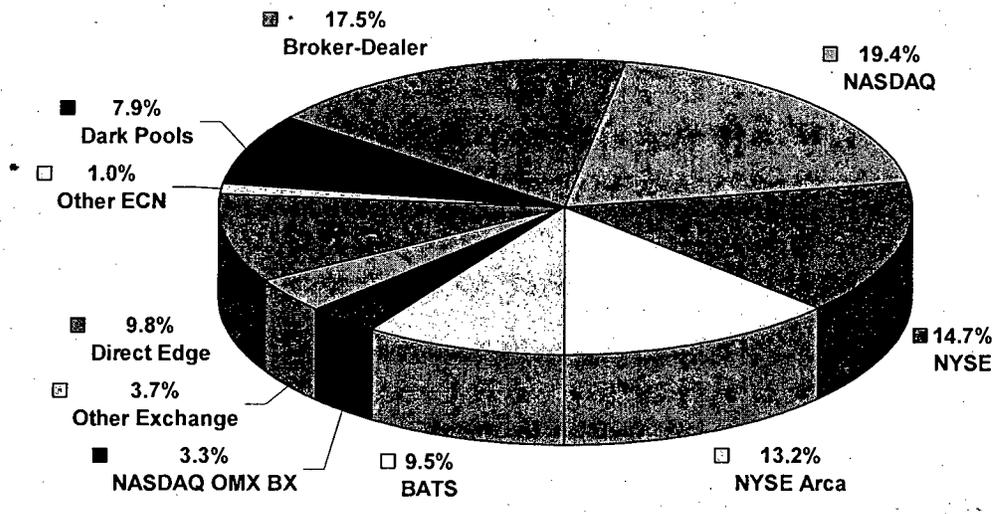
A good place to start in describing the current market structure is by identifying the major types of trading centers and giving a sense of their current share of trading volume in NMS stocks. Figure 6 below provides this information with estimates of trading volume in September 2009.²¹

Figure 6

**Trading Centers and Estimated % of Share Volume in NMS Stocks
September 2009**

which trade reports are made available pursuant to an effective transaction reporting plan. In general, NMS stocks are those that are listed on a national securities exchange.

²¹ Sources of estimated trading volume percentages: NASDAQ; NYSE Group; BATS; Direct Edge; data compiled from Forms ATS for 3d quarter 2009.



■ NASDAQ	■ NYSE	■ NYSE Arca
■ BATS	■ NASDAQ OMX BX	■ Other Registered Exchange
■ ECN: 2 Direct Edge	■ ECN: 3 Others	■ Dark Pools Approximately 32
■ Broker-Dealer Internalization More than 200		

Registered exchanges:

NASDAQ	19.4%
NYSE	14.7%
NYSE Arca	13.2%
BATS	9.5%
NASDAQ OMX BX	3.3%
Other	3.7%
Total Exchange	63.8%

ECNs:

2 Direct Edge	9.8%
3 Others	1.0%
Total ECN	10.8%

Total Displayed Trading Center 74.6%

Dark Pools:

Approximately 32²² 7.9%

Broker-Dealer Internalization:

More than 200²³ 17.5%

Total Undisplayed Trading Center 25.4%

Figure 6 identifies two types of trading centers that display quotations in the consolidated quotation data that is widely distributed to the public – registered exchanges and ECNs.²⁴ These displayed trading centers execute approximately 74.6% of share volume. Figure 6 also identifies two types of undisplayed trading centers – dark pools and broker-dealers that execute trades internally – that execute approximately 25.4% of share volume. These four types of trading centers are described below.

1. Registered Exchanges

²² Data compiled from Forms ATS submitted to Commission for 3d quarter 2009.

²³ More than 200 broker-dealers (excluding ATSS) have identified themselves to FINRA as market centers that must provide monthly reports on order execution quality under Rule 605 of Regulation NMS (list available at <http://apps.finra.org/datadirectory/1/marketmaker.aspx>).

²⁴ Consolidated quotation data is described in section III.B.1. below.

Registered exchanges collectively execute approximately 63.8% of share volume in NMS stocks, with no single exchange executing more than 19.4%. Registered exchanges must undertake self-regulatory responsibility for their members and file their proposed rule changes for approval with the Commission. These proposed rule changes publicly disclose, among other things, the trading services and fees of exchanges.

The registered exchanges all have adopted highly automated trading systems that can offer extremely high-speed, or “low-latency,” order responses and executions. Published average response times at some exchanges, for example, have been reduced to less than 1 millisecond.²⁵ Many exchanges offer individual data feeds that deliver information concerning their orders and trades directly to customers. To further reduce latency in transmitting market data and order messages, many exchanges also offer co-location services that enable exchange customers to place their servers in close proximity to the exchange’s matching engine. Exchange data feeds and co-location services are discussed further in section IV.B.2. below.

Registered exchanges typically offer a wide range of order types for trading on their automated systems. Some of their order types are displayable in full if they are not executed immediately. Others are undisplayed, in full or in part. For example, a reserve order type will display part of the size of an order at a particular price, while holding the balance of the order in reserve and refreshing the displayed size as needed. In general, displayed orders are given

²⁵ See, e.g., BATS Exchange, Inc., http://batstrading.com/resources/features/bats_exchange_Latency.pdf (June 2009) (average latency (time to accept, process, and acknowledge or fill order) of 320 microseconds; NASDAQ, <http://www.nasdaqtrader.com/trader.aspx?id=inet> (December 12, 2009) (average latency (time to accept, process, and acknowledge or fill order) of 294 microseconds).

execution priority at any given price over fully undisplayed orders and the undisplayed size of reserve orders.²⁶

In addition, many exchanges have adopted a “maker-taker” pricing model in an effort to attract liquidity providers. Under this model, non-marketable, resting orders that offer (make) liquidity at a particular price receive a liquidity rebate if they are executed, while incoming orders that execute against (take) the liquidity of resting orders are charged an access fee. Rule 610(c) of Regulation NMS caps the amount of the access fee for executions against the best displayed prices of an exchange at 0.3 cents per share. Exchanges typically charge a somewhat higher access fee than the amount of their liquidity rebates, and retain the difference as compensation. Sometimes, however, exchanges have offered “inverted” pricing and pay a liquidity rebate that exceeds the access fee.

Highly automated exchange systems and liquidity rebates have helped establish a business model for a new type of professional liquidity provider that is distinct from the more traditional exchange specialist and over-the-counter (“OTC”) market maker. In particular, proprietary trading firms and the proprietary trading desks of multi-service broker-dealers now take advantage of low-latency systems and liquidity rebates by submitting large numbers of non-marketable orders (often cancelling a very high percentage of them), which provide liquidity to the market electronically. As discussed in section IV.B. below, these proprietary traders often

²⁶ See, e.g., BATS Exchange, Inc., Rule 11.12 (equally priced trading interest executed in time priority in the following order: (1) displayed size of limit orders; (2) non-displayed limit orders; (3) pegged orders; (4) mid-point peg orders; (5) reserve size of orders; and (6) discretionary portion of discretionary orders); NASDAQ Rule 4757(a)(1) (book processing algorithm executes trading interest in the following order: (1) displayed orders; (2) non-displayed orders and the reserve portion of quotes and reserve orders (in price/time priority among such interest); and (3) the discretionary portion of discretionary orders).

are labeled high-frequency traders, though the term does not have a settled definition and may encompass a variety of strategies in addition to passive market making.

2. ECNs

The five ECNs that actively trade NMS stocks collectively execute approximately 10.8% of share volume. Almost all ECN volume is executed by two ECNs operated by Direct Edge, which has submitted applications for registration of its two trading platforms as exchanges.²⁷

ECNs are regulated as alternative trading systems ("ATs"). Regulation of ATs is discussed in the next section below in connection with dark pools, which also are ATs. The key characteristic of an ECN is that it provides its best-priced orders for inclusion in the consolidated quotation data, whether voluntarily or as required by Rule 301(b)(3) of Regulation ATS. In general, ECNs offer trading services (such as displayed and undisplayed order types, maker-taker pricing, and data feeds) that are analogous to those of registered exchanges.

3. Dark Pools

Dark pools are ATs that, in contrast to ECNs, do not provide their best-priced orders for inclusion in the consolidated quotation data. In general, dark pools offer trading services to institutional investors and others that seek to execute large trading interest in a manner that will minimize the movement of prices against the trading interest and thereby reduce trading costs.²⁸

There are approximately 32 dark pools that actively trade NMS stocks, and they executed approximately 7.9% of share volume in NMS stocks in the third quarter of 2009.²⁹ ATs, both

²⁷ Securities Exchange Act Release No. 60651 (September 11, 2009), 74 FR 47827 (September 17, 2009) (Notice of filing of applications for registration as national securities exchanges by EDGX Exchange, Inc. and EDGA Exchange, Inc.).

²⁸ See Non-Public Trading Interest Release, 74 FR at 61208-61209.

²⁹ Data compiled from Forms ATS submitted to Commission for 3d quarter 2009. Some OTC market makers offer dark liquidity primarily in a principal capacity and do not operate as ATs. For purposes of this release, these trading centers are not defined as

dark pools and ECNs, fall within the statutory definition of an exchange, but are exempted if they comply with Regulation ATS. Regulation ATS requires ATSS to be registered as broker-dealers with the Commission, which entails becoming a member of the Financial Industry Regulatory Authority (“FINRA”) and fully complying with the broker-dealer regulatory regime. Unlike a registered exchange, an ATS is not required to file proposed rule changes with the Commission or otherwise publicly disclose its trading services and fees. ATSS also do not have any self-regulatory responsibilities, such as market surveillance. The regulatory differences between registered exchanges and ATSS are addressed further in section IV.C.3. below.

Dark pools can vary quite widely in the services they offer their customers. For example, some dark pools, such as block crossing networks, offer specialized size discovery mechanisms that attempt to bring large buyers and sellers in the same NMS stock together anonymously and to facilitate a trade between them. The average trade size of these block crossing networks can be as high as 50,000 shares.³⁰ Most dark pools, though they may handle large orders, primarily execute trades with small sizes that are more comparable to the average size of trades in the public markets, which was less than 300 shares in July 2009.³¹ These dark pools that primarily match smaller orders (though the matched orders may be “child” orders of much larger “parent”

dark pools because they are not ATSS. These trading centers may, however, offer electronic dark liquidity services that are analogous to those offered by dark pools.

³⁰ See, e.g., <http://www.liquidnet.com/about/liquidStats.html> (average U.S. execution size in July 2009 was 49,638 shares for manually negotiated trades via Liquidnet’s negotiation product); <http://www.pipelinetrading.com/AboutPipeline/CompanyInfo.aspx> (average trade size of 50,000 shares in Pipeline).

³¹ See, e.g., <http://www.nasdaqtrader.com/trader.aspx?id=marketshare> (average size of NASDAQ matched trades in July 2009 was 228 shares); <http://nyxdata.com/nysedata/asp/factbook> (NYSE Group average trade size in all stocks traded in July 2009 was 267 shares).

orders) execute more than 90% of dark pool trading volume.³² The majority of this volume is executed by dark pools that are sponsored by multi-service broker-dealers. These broker-dealers also offer order routing services, trade as principal in the sponsored ATS, or both.

4. Broker-Dealer Internalization

The other type of undisplayed trading center is a non-ATS broker-dealer that internally executes trades, whether as agent or principal. Notably, many broker-dealers may submit orders to exchanges or ECNs, which then are included in the consolidated quotation data. The internalized executions of broker-dealers, however, primarily reflect liquidity that is not included in the consolidated quotation data. Broker-dealer internalization accordingly should be classified as undisplayed liquidity. There are a large number of broker-dealers that execute trades internally in NMS stocks – more than 200 publish execution quality statistics under Rule 605 of Regulation NMS.³³ Broker-dealer internalization accounts for approximately 17.5% of share volume in NMS stocks.

Broker-dealers that internalize executions generally fall into two categories – OTC market makers and block positioners. An OTC market maker is defined in Rule 600(b)(52) of Regulation NMS as “any dealer that holds itself out as being willing to buy and sell to its customers, or others, in the United States, an NMS stock for its own account on a regular or continuous basis otherwise than on a national securities exchange in amounts of less than block size.” “Block size” is defined in Rule 600(b)(9) as an order of at least 10,000 shares or for a quantity of stock having a market value of at least \$200,000. A block positioner generally means any broker-dealer in the business of executing, as principal or agent, block size trades for its

³² Data compiled from Forms ATS submitted to Commission for 3d quarter 2009.

³³ See supra note 23.

customers. To facilitate trades, block positioners often commit their own capital to trade as principal with at least some part of the customer's block order.

Broker-dealers that act as OTC market makers and block positioners conduct their business primarily by directly negotiating with customers or with other broker-dealers representing customer orders. OTC market makers, for example, appear to handle a very large percentage of marketable (immediately executable) order flow of individual investors that is routed by retail brokerage firms. A review of the order routing disclosures required by Rule 606 of Regulation NMS of eight broker-dealers with significant retail customer accounts reveals that nearly 100% of their customer market orders are routed to OTC market makers.³⁴ The review also indicates that most of these retail brokers either receive payment for order flow in connection with the routing of orders or are affiliated with an OTC market maker that executes the orders. The Rule 606 Reports disclose that the amount of payment for order flow generally is 0.1 cent per share or less.³⁵

B. Linkages

Given the dispersal of liquidity across a large number of trading centers of different types, an important question is whether trading centers are sufficiently linked together in a unified national market system. Thus far in this release, the term "dispersed" has been used to describe the current market structure rather than "fragmented." The term "fragmentation" connotes a negative judgment that the linkages among competing trading centers are insufficient to achieve the Exchange Act objectives of efficiency, price transparency, best execution, and order interaction. Whether fragmentation is in fact a problem in the current market structure is a

³⁴ Review of Rule 606 Reports for 2d quarter 2009 of eight broker-dealers with substantial number of retail customer accounts.

³⁵ Id.

critically important issue on which comment is requested in section IV below in a variety of

contexts. This section will give an overview of the primary types of linkages that operate in the current market structure – consolidated market data, trade-through protection, and broker routing services.

1. Consolidated Market Data

When Congress mandated a national market system in 1975, it emphasized that the systems for collecting and distributing consolidated market data would “form the heart of the national market system.”³⁶ As described further below, consolidated market data includes both: (1) pre-trade transparency – real-time information on the best-priced quotations at which trades may be executed in the future (“consolidated quotation data”); and (2) post-trade transparency – real-time reports of trades as they are executed (“consolidated trade data”). As a result, the public has ready access to a comprehensive, accurate, and reliable source of information for the prices and volume of any NMS stock at any time during the trading day. This information serves an essential linkage function by helping assure that the public is aware of the best displayed prices for a stock, no matter where they may arise in the national market system. It also enables investors to monitor the prices at which their orders are executed and assess whether their orders received best execution.

Consolidated market data is collected and distributed pursuant to a variety of Exchange Act rules and joint-industry plans. With respect to pre-trade transparency, Rule 602 of Regulation NMS requires exchange members and certain OTC market makers that exceed a 1% trading volume threshold to provide their best-priced quotations to their respective exchanges or FINRA, and these self-regulatory organizations (“SROs”), in turn, are required to make this

³⁶ H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 93 (1975).

information available to vendors. Rule 604 of Regulation NMS requires exchange specialists and OTC market makers to display certain customer limit orders in their best-priced quotations provided under Rule 602. In addition, Rule 301(b)(3) of Regulation ATS requires an ATS that displays orders to more than one person in the ATS and exceeds a 5% trading volume threshold to provide its best-priced orders for inclusion in the quotation data made available under Rule 602.³⁷

Importantly, the Commission's rules do not require the display of a customer limit order if the customer does not wish the order to be displayed.³⁸ Customers have the freedom to display or not display depending on their trading objectives. On the other hand, the selective display of orders generally is prohibited in order to prevent the creation of significant private markets and two-tiered access to pricing information.³⁹ Accordingly, the display of orders to some market participants generally will require that the order be included in the consolidated quotation data that is widely available to the public.

With respect to post-trade transparency, Rule 601 of Regulation NMS requires the equity exchanges and FINRA to file a transaction reporting plan regarding transactions in listed equity securities. The members of these SROs are required to comply with the relevant SRO rules for

³⁷ The Commission has proposed lowering the trading volume threshold for order display obligations from 5% to 0.25%. Non-Public Trading Interest Release, 74 FR at 61213.

³⁸ Rule 604 of Regulation NMS, for example, explicitly recognizes the ability of customers to control whether their limit orders are displayed to the public. Rule 604(b)(2) provides an exception from the limit order display requirement for orders that are placed by customers who expressly request that the order not be displayed. Rule 604(b)(4) provides an exception for all block size orders unless the customer requests that the order be displayed.

³⁹ See, e.g., Rule 301(b)(3) of Regulation ATS; Rule 602(a)(1) of Regulation NMS; Order Handling Rules Release, 61 FR at 48307 ("Although offering benefits to some market participants, widespread participation in these hidden markets has reduced the completeness and value of publicly available quotations contrary to the purposes of the NMS.").

trade reporting. FINRA's trade reporting requirements apply to all ATSS that trade NMS stocks, both ECNs and dark pools, as well as to broker-dealers that internalize. FINRA currently requires members to report their trades as soon as practicable, but no later than 90 seconds.⁴⁰ FINRA has proposed to reduce the reporting time period to 30 seconds, noting that more than 99.9% of transactions are reported to FINRA in 30 seconds or less.⁴¹

Finally, Rule 603(b) of Regulation NMS requires the equity exchanges and FINRA to act jointly pursuant to one or more effective national market system plans to disseminate consolidated information, including an NBBO, on quotations for and transactions in NMS stocks. It also requires that consolidated information for each NMS stock be disseminated through a single plan processor.

To comply with these requirements, the equity exchanges and FINRA participate in three joint-industry plans ("Plans").⁴² Pursuant to the Plans, three separate networks distribute consolidated market data for NMS stocks: (1) Network A for securities with their primary listing on the NYSE; (2) Network B for securities with their primary listing on exchanges other than the

⁴⁰ Securities Exchange Act Release No. 60960 (November 6, 2009), 74 FR 59272, 59273 (November 17, 2009) (File No. SR-FINRA-2009-061) (in its description of the proposed rule change, FINRA stated that "[a]lthough members would have 30 seconds to report, FINRA reiterates that – as is the case today – members must report trades as soon as practical and cannot withhold trade reports, e.g., by programming their systems to delay reporting until the last permissible second").

⁴¹ *Id.* (from February 23, 2009 through February 27, 2009, 99.90% of trades submitted to a FINRA Facility for public reporting were reported in 30 seconds or less).

⁴² The three joint-industry plans are: (1) the CTA Plan, which is operated by the Consolidated Tape Association and disseminates transaction information for securities with their primary listing on exchanges other than NASDAQ; (2) the CQ Plan, which disseminates consolidated quotation information for securities with their primary listing on exchanges other than NASDAQ; and (3) the NASDAQ UTP Plan, which disseminates consolidated transaction and quotation information for securities with their primary listing on NASDAQ. The CTA Plan and CQ Plan are available at <http://www.nyxdata.com/nysedata/default.aspx?tabid=227>. The NASDAQ UTP Plan is available at <http://www.utpplan.com>.

NYSE or NASDAQ; and (3) Network C for securities with their primary listing on NASDAQ.

The three Networks establish fees for the data, which must be filed for Commission approval.

The three Networks collect the applicable fees and, after deduction of Network expenses (which do not include the costs incurred by SROs to generate market data and provide such data to the Networks), allocate the remaining revenues to the SROs. The revenues, expenses, and allocations for each of the three Networks are set forth in Table 1 below.⁴³

Table 1

2008 Financial Information for Networks A, B, and C

	Network A	Network B	Network C	Total
Revenues	\$209,218,000	\$119,876,000	\$134,861,000	463,955,000
Expenses	6,078,000	3,066,000	5,729,000	14,873,000
Net Income	203,140,000	116,810,000	129,132,000	449,082,000
Allocations:				
NASDAQ	47,845,000	34,885,000	60,614,000	143,343,000
NYSE Arca	37,080,000	38,235,000	26,307,000	101,622,000
NYSE	68,391,000	0	0	68,391,000
FINRA	24,325,000	16,458,000	20,772,000	61,555,000
NSX	7,100,000	11,575,000	17,123,000	35,798,000
ISE	15,260,000	1,477,000	1,883,000	18,620,000
NYSE Amex	1,000	9,760,000	14,000	9,775,000
BATS	2,356,000	2,770,000	1,538,000	6,664,000
CBOE	80,000	1,046,000	433,000	1,559,000
CHX	565,000	574,000	298,000	1,437,000
Phlx	134,000	30,000	146,000	310,000
BSE	3,000		4,000	7,000

In addition to providing quotation and trade information to the three Networks for distribution in consolidated data, many exchanges and ECNs offer individual data feeds directly to customers that include information that is provided in consolidated data. The individual data feeds of exchanges and ECNs also can include a variety of other types of information, such as

⁴³ The Network financial information for 2008 is preliminary and unaudited.

~~“depth-of-book” quotations at prices inferior to their best-priced quotations. Rule 603(a) of~~

Regulation NMS requires all exchanges, ATSS, and other broker-dealers that offer individual data feeds to make the data available on terms that are fair and reasonable and not unreasonably discriminatory. Exchanges, ATSS, and other broker-dealers are prohibited from providing their data directly to customers any sooner than they provide their data to the plan processors for the Networks.⁴⁴ The fact that trading center data feeds do not need to go through the extra step of consolidation at a plan processor, however, means that such data feeds can reach end-users faster than the consolidated data feeds. The average latencies of the consolidation function at plan processors (from the time the processor receives information from the SROs to the time it distributes consolidated information to the public) are as follows: (1) Network A and Network B – less than 5 milliseconds for quotation data and less than 10 milliseconds for trade data; and (2) Network C – 5.892 milliseconds for quotation data and 6.680 milliseconds for trade data.⁴⁵ The individual trading center data feeds are discussed below in section IV.B.2.b.

2. Trade-Through Protection

Another important type of linkage in the current market structure is the protection against trade-throughs provided by Rule 611 of Regulation NMS. A trade-through is the execution of a trade at a price inferior to a protected quotation for an NMS stock. A protected quotation must be displayed by an automated trading center, must be disseminated in the consolidated quotation

⁴⁴ Regulation NMS Release, 70 FR at 37567 (“Adopted Rule 603(a) will not require a market center to synchronize the delivery of its data to end-users with delivery of data by a Network processor to end-users. Rather independently distributed data could not be made available on a more timely basis than core data is made available to a Network processor. Stated another way, adopted Rule 603(a) prohibits an SRO or broker-dealer from transmitting data to a vendor or user any sooner than it transmits the data to a Network processor.”). The plan processor for the CTA Plan and CQ Plan is the Securities Industry Automation Corporation (“SIAC”). The plan processor for the NASDAQ UTP Plan is NASDAQ.

⁴⁵ Sources: SIAC for Network A and Network B; NASDAQ for Network C.

data, and must be an automated quotation that is the best bid or best offer of an exchange or FINRA. Importantly, Rule 611 applies to all trading centers, not just those that display protected quotations. Trading center is defined broadly in Rule 600(b)(78) to include, among others, all exchanges, all ATs (including ECNs and dark pools), all OTC market makers, and any other broker-dealer that executes orders internally, whether as agent or principal.

Rule 611(a)(1) requires all trading centers to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs of protected quotations, subject to the exceptions set forth in Rule 611(b). Protection against trade-throughs is an important linkage among trading centers because it provides a baseline assurance that: (1) marketable orders will receive at least the best displayed price, regardless of the particular trading center that executes the order or where the best price is displayed in the national market system; and (2) quotations that are displayed at one trading center will not be bypassed by trades with inferior prices at any trading center in the national market system.

Rule 611 also helps promote linkages among trading centers by encouraging them, when they do not have available trading interest at the best price, to route marketable orders to a trading center that is displaying the best price. Although Rule 611 does not directly require such routing services (a trading center can, for example, cancel and return an order when it does not have the best price), competitive factors have led many trading centers to offer routing services to their customers. Prior to Rule 611, exchanges routed orders through an inflexible, partially manual system called the Intermarket Trading System ("ITS").⁴⁶ With Regulation NMS, however, the Commission adopted a "private linkages" approach that relies exclusively on

⁴⁶ See Regulation NMS Release, 70 FR at 37538-37539 ("Although ITS promotes access among participants that is uniform and free, it also is often slow and limited.").

brokers to provide routing services, both among exchanges and between customers and exchanges. These broker routing services are discussed next.

3. Broker Routing Services

In a dispersed and complex market structure with many different trading centers offering a wide spectrum of services, brokers play a significant role in linking trading centers together into a unified national market system. Brokers compete to offer the sophisticated technology tools that are needed to monitor liquidity at many different venues and to implement order routing strategies. To perform this function, brokers may monitor the execution of orders at both displayed and undisplayed trading centers to assess the availability of undisplayed trading interest. Brokers may, for example, construct real-time "heat maps" in an effort to discern and access both displayed and undisplayed liquidity at trading centers throughout the national market system.

Using their knowledge of available liquidity, many brokers offer smart order routing technology to access such liquidity. Many brokers also offer sophisticated algorithms that will take the large orders of institutional investors and others, divide a large "parent" order into many smaller "child" orders, and route the child orders over time to different trading centers in accordance with the particular trading strategy chosen by the customer. Such algorithms may be "aggressive," for example, and seek to take liquidity quickly at many different trading centers, or they may be "passive," and submit resting orders at one or more trading centers and await executions at favorable prices.

To the extent they help customers cope with the dispersal of liquidity among a large number of trading centers of different types and achieve the best execution of their customers'

orders, the routing services of brokers can contribute to the broader policy goal of promoting efficient markets.

Under the private linkages approach adopted by Regulation NMS, market participants obtain access to the various trading centers through broker-dealers that are members or subscribers of the particular trading center.⁴⁷ Rule 610(a) of Regulation NMS, for example, prohibits an SRO trading facility from imposing unfairly discriminatory terms that would prevent or inhibit any person from obtaining efficient access through an SRO member to the displayed quotations of the SRO trading facility. Rule 610(c) limits the fees that a trading center can charge for access to its displayed quotations at the best prices. Rule 611(d) requires SROs to establish, maintain, and enforce rules that restrict their members from displaying quotations that lock or cross previously displayed quotations.

Section 6(a)(2) of the Exchange Act requires registered exchanges to allow any qualified and registered broker-dealer to become a member of the exchange – a key element in assuring fair access to exchange services. In contrast, the access requirements that apply to ATSs are much more limited. Regulation ATS includes two distinct types of access requirements: (1) order display and execution access in Rule 301(b)(3); and (2) fair access to ATS services in general in Rule 301(b)(5). An ATS must meet order display and execution access requirements if it displays orders to more than one person in the ATS and exceeds a 5% trading volume threshold.⁴⁸ An ATS must meet the general fair access requirement if it exceeds a 5% trading

⁴⁷ See Regulation NMS Release, 70 FR at 37540 (“[M]any different private firms have entered the business of linking with a wide range of trading centers and then offering their customers access to those trading centers through the private firms’ linkages. Competitive forces determine the types and costs of these private linkages.”).

⁴⁸ The Commission has proposed reducing the threshold for order display and execution access to 0.25%. Non-Public Trading Interest Release, 74 FR at 61213. It has not proposed to change the threshold for fair access in general.

volume threshold. If an ATS neither displays orders to more than one person in the ATS nor exceeds a 5% trading volume threshold, Regulation ATS does not impose access requirements on the ATS.

An essential type of access that should not be overlooked is the fair access to clearance and settlement systems required by Section 17A of the Exchange Act. If brokers cannot efficiently clear and settle transactions at the full range of trading centers, they will not be able to perform their linkage function properly.

The linkage function of brokers also is supported by a broker's legal duty of best execution. This duty requires a broker to obtain the most favorable terms reasonably available when executing a customer order.⁴⁹ Of course, this legal duty is not the only pressure on brokers to obtain best execution. The existence of strong competitive pressure to attract and retain customers encourages brokers to provide high quality routing services to their customers. In this regard, Rules 605 and 606 of Regulation NMS are designed to support competition by enhancing the transparency of order execution and routing practices. Rule 605 requires market centers to publish monthly reports of statistics on their order execution quality. Rule 606 requires brokers to publish quarterly reports on their routing practices, including the venues to which they route orders for execution. As the Commission emphasized when it adopted the rules in 2000, "[b]y increasing the visibility of order execution and routing practices, the rules adopted today are intended to empower market forces with the means to achieve a more competitive and efficient

⁴⁹ See, e.g., Regulation NMS Release, 70 FR at 37537-37538 (discussion of duty of best execution).

national market system for public investors.”⁵⁰ In section IV.A.1.b. below, comment is requested on whether Rules 605 and 606 should be updated for the current market structure.

IV. Request for Comments

This section will focus on three categories of issues that the Commission particularly wishes to present for comment – the performance of the current market structure, high frequency trading, and undisplayed liquidity. The Commission emphasizes, however, that it is interested in receiving comments on all aspects of the equity market structure that the public believes are important. The discussion in this release should not be construed as in any way limiting the scope of comments that will be considered.

This concept release focuses on the structure of the equity markets and does not discuss the markets for other types of instruments that are related to equities, such as options and OTC derivatives. The limited scope of this release is designed to focus on a discrete set of issues that have gained increased prominence in the equity markets. Comment is requested, however, on the extent to which the issues identified in this release are intertwined with other markets. For example, market participants may look to alternative instruments if they believe the equity markets are not optimal for their trading objectives. Should the Commission consider the extent to which instruments substitute for one another in evaluating equity market structure?

In addition, comment is requested on the impact of globalization on market structure. How does global competition for trading activity impact the U.S. market structure? Should global competition affect the approach to regulation in the U.S.? Will trading activity and capital tend to move either to the U.S. or overseas in response to different regulation in the U.S.? How should the Commission consider these globalization issues in its review of market structure?

⁵⁰ Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75415 (December 1, 2000) (Disclosure of Order Execution and Routing Practices).

A. Market Structure Performance

The secondary markets for NMS stocks are essential to the economic success of the country and to the financial well-being of individual Americans. High quality trading markets promote capital raising and capital allocation by establishing prices for securities and by enabling investors to enter and exit their positions in securities when they wish to do so.⁵¹ The Commission wishes to request comment broadly on how well or poorly the current market structure is performing its vital economic functions.

In recent months, the Commission has heard a variety of concerns about particular aspects of the current market structure, as well as the view that recent improvements to the equity markets have benefitted both individual and institutional investors. The concerns about market structure often have related to high frequency trading and various types of undisplayed liquidity. Prior to discussing these particular areas of concern in this release, the Commission believes it is important to assess more broadly the performance of the market structure, particularly for long-term investors and for businesses seeking to raise capital. Assessing overall market structure performance should help provide context for particular concerns, as well as the nature of any regulatory response that may be appropriate to address concerns.

1. Long-Term Investors

⁵¹ See, e.g., S. Report 94-75 at 3 (“The rapid attainment of a national market system as envisaged by this bill is important, therefore, not simply to provide greater investor protection and bolster sagging investor confidence but also to assure that the country maintains a strong, effective and efficient capital raising and capital allocating system in the years ahead. The basic goals of the Exchange Act remain salutary and unchallenged: to provide fair and honest mechanisms for the pricing of securities, to assure that dealing in securities is fair and without undue preferences or advantages among investors, to ensure that securities can be purchased and sold at economically efficient transaction costs, and to provide, to the maximum degree practicable, markets that are open and orderly.”).

In assessing the performance of the current equity market structure and whether it is meeting the relevant Exchange Act objectives, the Commission is particularly focused on the interests of long-term investors. These are the market participants who provide capital investment and are willing to accept the risk of ownership in listed companies for an extended period of time. Unlike long-term investors, professional traders generally seek to establish and liquidate positions in a shorter time frame. Professional traders with these short time frames often have different interests than investors concerned about the long-term prospects of a company.⁵² For example, short-term professional traders may like short-term volatility to the extent it offers more trading opportunities, while long-term investors do not. The net effect of trading strategies pursued by various short-term professional traders, however, may not increase volatility and may work to dampen volatility.

Nevertheless, the interests of investors and professional traders may at times be aligned. Indeed, the collective effect of professional traders competing to profit from short-term trading strategies can work to the advantage of long-term investors. For example, as just noted, short-term trading strategies may work to dampen short-term volatility. Professional traders with an informed view of prices can promote efficient pricing. Professional traders competing to provide liquidity may narrow spreads and give investors the benefit of better prices when they simply want to trade immediately at the best available price.

Given the difference in time horizons, however, the trading needs of long-term investors and short-term professional traders often may diverge. Professional trading is a highly

⁵² See Regulation NMS Release, 70 FR at 37500 (“The Commission recognizes that it is important to avoid false dichotomies between the interests of short-term traders and long-term investors, and that many difficult line-drawing exercises can arise in precisely defining the difference between the two terms. For present purposes, however, these issues can be handled by simply noting that it makes little sense to refer to someone as ‘investing’ in a company for a few seconds, minutes, or hours.”) (citation omitted).

competitive endeavor in which success or failure may depend on employing the fastest systems and the most sophisticated trading strategies that require major expenditures to develop and operate. Such systems and strategies may not be particularly useful, in contrast, for investors seeking to establish a long-term position rather than profit from fleeting price movements. Where the interests of long-term investors and short-term professional traders diverge, the Commission repeatedly has emphasized that its duty is to uphold the interests of long-term investors.⁵³

Comment is requested on the practicality of distinguishing the interests of long-term investors from those of short-term professional traders when assessing market structure issues. In what circumstances should an investor be considered a "long-term investor"? If a time component is needed to define this class of investor, how should the Commission determine the length of expected ownership that renders an investor "long-term"? Under what circumstances would a distinction between a long-term investor and a short-term professional trader become unclear, and how prevalent are these circumstances? To the extent that improved market liquidity and depth promote the interests of long-term investors by leading to reduced transaction costs, what steps should the Commission consider taking to promote market liquidity and depth?

Long-term investors include individuals that invest directly in equities and institutions that invest on behalf of many individuals. The Commission is interested in hearing how all types

⁵³ See, e.g., Flash Order Release, 74 FR at 48635-48636; Regulation NMS Release, 70 FR at 37499-37501; Fragmentation Concept Release, 65 FR at 10581 n. 26; see also S. Rep. No. 73-1455, 73rd Cong., 2d Sess. 5 (1934) ("Transactions in securities on organized exchanges and over-the-counter are affected with the national public interest. . . . In former years transactions in securities were carried on by a relatively small portion of the American people. During the last decade, however, due largely to the development of means of communication . . . the entire Nation has become acutely sensitive to the activities on the securities exchanges. While only a fraction of the multitude who now own securities can be regarded as actively trading on the exchanges, the operations of these few profoundly affect the holdings of all.").

of individual investors and all sizes of institutional investors— small, medium, and large — are faring in the current market structure. For example, has the current market structure become so dispersed and complex that only the largest institutions can afford to deploy their own highly sophisticated trading tools? If so, are smaller institutions able to trade effectively? Some broker-dealers offer sophisticated trading tools, such as smart routing and algorithmic trading. How accessible are these trading tools to smaller institutions? Are the costs of paying for these tools so high that they are effectively inaccessible? Moreover, to the extent that a competitive advantage flows from these trading tools, does that competitive advantage help to promote and enable competition, beneficial innovation, and, ultimately, enhanced market quality? Is there a risk that certain competitive advantages may reduce competition or lead to detrimental innovations? To what extent is it important for market participants to be allowed to gain competitive advantages, such as by using more sophisticated trading tools?

In addition, the Commission recognizes that there is wide variation in types of equity securities and that there may be important differences in market performance among the different types. With respect to corporate equities, for example, the Commission is interested in how market structure impacts stocks of varying levels of market capitalization (for example, top tier, large, middle, and small). A vital function of the equity markets is to support the capital raising function, including capital raising by small companies. The Commission recognizes that small company stocks may trade differently than large company stocks and requests comment specifically on how the market structure performs for smaller companies and whether it supports the capital raising function for them.

a. Market Quality Metrics

Given these broad concerns for all types of long-term investors and the full range of equities, what are useful metrics for assessing the performance of the current market structure? In the past, the Commission and its staff have considered a wide variety of metrics, most of which have applied to smaller orders (such as 10,000 shares or less).⁵⁴ These metrics have included measures of spreads – the difference between the prices that buyers pay and sellers receive when they are seeking to trade immediately at the best prices. Spread measures include quoted spreads, effective spreads (which reflects whether investors receive prices that are better than, equal to, or worse than quoted spreads), and realized spreads (which reflects how investors are affected by subsequent price movements in a stock). Another often used metric has been speed of execution.⁵⁵

Short-Term Volatility. Spreads and speed of execution may not, however, give a full picture of execution quality, even for the small orders of individual investors that generally will be fully executed in one transaction (unlike the large orders of institutional investors that may require many smaller executions). For example, short-term price volatility may harm individual

⁵⁴ See, e.g., Memorandum to File from Office of Economic Analysis dated December 15, 2004 regarding comparative analysis of execution quality on NYSE and NASDAQ based on a matched sample of stocks (“Comparative Analysis of Execution Quality”) (available at <http://www.sec.gov/spotlight/regnms.htm>); Memorandum to File from Office of Economic Analysis dated December 15, 2004 regarding Analysis of Volatility for Stocks Switching from Nasdaq to NYSE (available at <http://www.sec.gov/spotlight/regnms.htm>); Office of Economic Analysis, Report on Comparison of Order Executions Across Equity Market Structures (January 8, 2001) (“Report on Comparison of Order Executions”) (available at <http://www.sec.gov/news/studies/ordrxmkt.htm>); Commission, Report on the Practice of Preferencing (April 15, 1997) (available at <http://www.sec.gov/news/studies/studiesarchive/1997archive.shtml>).

⁵⁵ When assessing market structure during the development of Regulation NMS, for example, Commission staff used Rule 605 data to measure quoted spreads, effective spreads, realized spreads, price impact, net price improvement, execution speed, and fill rates. All of the cost values were calculated both in terms of absolute value (cents) and in terms of proportional costs as a percentage of stock prices. Comparative Analysis of Execution Quality at 8-9.

investors if they are persistently unable to react to changing prices as fast as high frequency traders. As the Commission previously has noted, long-term investors may not be in a position to assess and take advantage of short-term price movements.⁵⁶ Excessive short-term volatility may indicate that long-term investors, even when they initially pay a narrow spread, are being harmed by short-term price movements that could be many times the amount of the spread.

The Commission has used a variety of measures of short-term volatility, including variance ratios (for example, 5 minute return variance to 60 minute return variance, 1 day return variance to 1 week return variance, and 1 day return variance to 4 week return variance).⁵⁷ Variance ratios are useful because they focus on short-term volatility that may be directly related to market structure quality, as opposed to long-term volatility that may be much more affected by fundamental economic forces that are independent of market structure quality. Another possible metric for assessing whether investors are harmed by short-term volatility is realized spread, which indicates whether prices moved for or against the submitter of the order after the order was executed. Rule 605, for example, measures realized spreads based on quotations 5 minutes after the time of order execution.

⁵⁶ Fragmentation Concept Release, 65 FR at 10581 n. 26 (“In theory, short-term price swings that hurt investors on one side of the market can benefit investors on the other side of the market. In practice, professional traders, who have the time and resources to monitor market dynamics closely, are far more likely than investors to be on the profitable side of short-term price swings (for example, by buying early in a short-term price rise and selling early before the price decline).”).

⁵⁷ Variance ratios are calculated by comparing return variances for a short time period with return variances for a longer time period. One of the advantages of this measure of volatility is that “there is a built-in control for the underlying uncertainty as to the ‘true’ value of the stock. For example, the high variance of returns on technology stocks is to be expected given the high uncertainty as to their future cash flows. The point is that this uncertainty will manifest itself in both the daily and weekly return variances. When [Commission staff] divide the weekly return by the daily return, the natural uncertainty associated with the stock ‘washes out’ and [Commission staff] are left with a measure associated with transaction costs or some other form of inefficiency.” Report on Comparison of Order Executions, supra note 54, at 18.

Finally, the Commission has evaluated various measures of the depth that is immediately available to fill orders. These metrics include fill rates for limit orders, quoted size at the inside prices, the effect of reserve size and undisplayed size at the inside prices or better, and quoted depth at prices away from the inside.

Metrics for Smaller Orders. Comment is requested on whether these metrics that focus on the execution of smaller orders continue to be useful. Which metrics are most useful in today's market structure? Are there other useful metrics not listed above? Are there other relevant metrics that reflect how individual investors are likely to trade? For example, a significant number of individual investor orders are submitted after regular trading hours when such investors have an opportunity to evaluate their portfolios. These orders typically are executed at opening prices. What are the best metrics for assessing whether individual investor orders are executed fairly and efficiently at the opening? Are there other particular times or contexts in which retail investors often trade and, if so, what are the best metrics for determining whether they are treated fairly and efficiently in those contexts as well?

Measuring Institutional Investor Transaction Costs. Most of the Commission's past analyses of market performance have focused on the execution of smaller orders (for example, less than 10,000 shares), rather than attempting to measure the overall transaction costs of institutional investors to execute large orders (for example, greater than 100,000 shares). Measuring the transaction costs of institutional investors that need to trade in large size can be extremely complex.⁵⁸ These large orders often are broken up into smaller child orders and

⁵⁸ See generally Investment Company Act Release No. 26313 (December 18, 2003), 68 FR 74820, 74821 (December 24, 2003) (Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs) ("The Commission is aware of the need for transparency of mutual fund fees and expenses and committed to improving disclosure of the costs that are borne by mutual fund investors; but it is mindful of the

executed in a series of transactions. Metrics that apply to small order executions may miss how well or poorly the large order traded overall. Direct measures of large order transaction costs typically require access to institutional order data that is not publicly available. In this regard, a few trading analytics firms with access to institutional order data publish periodic analyses of institutional investor transaction costs.⁵⁹ These analyses allow such costs to be tracked over time to determine whether they are improving or worsening. Comment is requested on these published analyses generally and whether they accurately reflect the transaction costs experienced by institutional investors. Are there other studies or analyses of institutional trading costs that the Commission should consider? Comment is requested in general on other means for assessing the transaction costs of institutional investors in the current market structure. For example, are any of the measures of short-term volatility discussed above useful for assessing the transactions costs of larger orders and, if so, how?

complexities associated with identifying, measuring, and accounting for transaction costs.”).

⁵⁹ See, e.g., U.S. Government Accountability Office, “Securities Markets: Decimal Pricing Has Contributed to Lower Trading Costs and a More Challenging Trading Environment,” at 96 (May 2005) (“We obtained data from three leading firms that collect and analyze information about institutional investors’ trading costs. These trade analytics firms . . . obtain trade data directly from institutional investors and brokerage firms and calculate trading costs, including market impact costs (the extent to which the security changes in price after the investor begins trading), typically for the purpose of helping investors and traders limit costs of trading. These firms also aggregate client data so as to approximate total average trading costs for all institutional investors. Generally, the client base represented in aggregate cost data can be used to make generalizations about the institutional investor industry.”); see also Pam Abramowitz, Technology Drives Trading Costs, Institutional Investor (November 4, 2009) (13th annual survey of transaction costs conducted for Institutional Investor Magazine by Elkins/McSherry); Elkins McSherry LLC, “Trading Cost Averages and Volatility Continued to Decline in 3Q09” (November 2009) (available at https://www.elkinsmcsberry.com/em/pdfs/Newsletters/Nov_2009_newsletter.pdf); Investment Technology Group, Inc., “ITG Global Trading Cost Review: 2009 Q2” (September 15, 2009) (available at http://www.itg.com/news_events/papers/ITGGlobalTradingCostReview_2009Q2.pdf).

Trend of Market Quality Metrics. With respect to all of the metrics that are useful for assessing market structure performance for long-term investors, the Commission is interested in whether commenters believe they show improvement or worsening in recent years. For example, do the relevant metrics indicate that market quality has improved or worsened over the last ten years and the last five years? Have markets improved or worsened more recently, since January 2009? Which of the recent developments in market structure do you consider to have the greatest effect on market quality? The Commission wishes to hear about any current regulations that may be harming, rather than improving, market quality. Specifically, how could any current regulations be modified to fit more properly with the current market?

Recognizing that there is no such thing as a perfect market structure that entirely eliminates transaction costs, the Commission believes that an understanding of trends is important because they provide a useful, pragmatic touchstone for assessing the goals with respect to market structure performance.⁶⁰

Effect of Broad Economic Forces. The Commission notes that many metrics of market performance may be affected by broad economic forces, such as the global financial crisis during the Autumn of 2008, that operate independently of market structure. Periods of high volatility may be associated with high intermediation costs. This may reflect both compensation for risk assumed by liquidity providers and the higher demand for immediacy by long-term investors. How should the effect of these economic forces be adjusted for in assessing the performance of

⁶⁰ A very recent study, for example, examined trading activity trends through the end of 2008. Chordia, Tarun, Richard Roll, & Avanidar Subrahmanyam, Why Has Trading Volume Increased? (January 6, 2010). It focused on comparisons of pre- and post-decimal trading in NYSE-listed stocks (subperiods from 1993-2000 and 2001-2008). Among the study's findings are that average effective spreads decreased significantly (from 10.2 cents to 2.2 cents for small trades (<\$10,000) and from 10.7 cents to 2.7 cents for large trades (>\$10,000)), while average depth available at the inside bid and offer declined significantly (from 11,130 shares to 2797 shares).

market structure over the last ten years, five years, and the last year? For example, the CBOE Volatility Index (“VIX”) reached record levels during 2008.⁶¹ The VIX is sometimes referred to as the “fear index” because it measures expected volatility of the S&P 500 Index over the next 30 calendar days.⁶² To what extent are metrics of market structure performance correlated with the VIX or other analogous measures of volatility? Is the level of the VIX largely independent of market structure quality or are the level of the VIX and market structure quality interdependent? Given that the VIX measures expected volatility over the next 30 days, how important is the VIX to long-term investors?

b. Fairness of Market Structure

The Commission requests comment on whether the current market structure is fair for long-term investors. For example, the speed of trading has increased to the point that the fastest traders now measure their latencies in microseconds. Is it necessary or economically feasible for long-term investors to expend resources on the very fastest and most highly sophisticated systems or otherwise obtain access to these systems? If not, does the fact that professional traders likely always will be able to trade faster than long-term investors render the equity markets unfair for these investors? Or do the different trading needs and objectives of long-term investors mean that the disparities in speed in today’s market structure are not significant to the interests of such investors? In addition, what standards should the Commission apply in assessing the fairness of the equity markets? For example, is it unfair for market participants to

⁶¹ See infra note 81 and accompanying text.

⁶² See Chicago Board Options Exchange, “The CBOE Volatility Index – VIX,” at 1, 4 (“VIX measures 30-day expected volatility of the S&P 500 Index. The components of VIX are near- and next-term put and call options, usually in the first and second SPX contract months.”) (available at <http://www.cboe.com/micro/vix/vixwhite.pdf>).

obtain a competitive advantage by investing in technology and human resources that enable them to trade more effectively and profitably than others?

Rules 605 and 606 and Other Tools to Protect Investor Interests. In assessing the fairness of the current market structure, the Commission is interested in whether long-term investors and their brokers have the tools they need to protect their own interests in a dispersed and complex market structure. Do, for example, broker-dealers provide routing tools to their agency customers that are as powerful and effective as the routing tools they may use for their proprietary trading? If not, is this difference in access to technology unfair to long-term investors? Or is a broker-dealer's ability to develop and use more powerful and effective trading tools a competitive advantage that spurs competition and beneficial innovation?

In addition, comment is requested on Rules 605 and 606, which were adopted in 2000. Do these rules need to be updated and, if so, in what respects? Do Rule 605 and Rule 606 reports continue to provide useful information for investors and their brokers in assessing the quality of order execution and routing practices? The Commission notes that Rule 606 statistics reveal that brokers with significant retail customer accounts send the great majority of non-directed marketable orders to OTC market makers that internalize executions, often pursuant to payment for order flow arrangements.⁶³ Do individual investors understand and pay attention to Rule 605 and 606 statistics? If not, what market participants, if any, make decisions based on this data? Are those decisions beneficial to individual investors?

Rule 605 currently requires that the speed of execution for immediately executable orders (market orders and marketable limit orders) be disclosed to the tenth of a second. Do investors and brokers need more finely tuned statistics, such as hundredths or thousandths of a second?

⁶³ See supra note 34 and accompanying text.

For non-marketable limit orders with prices that render them not immediately executable at the

best displayed prices, the shortest time category is 0-9 seconds. Would a shorter time period be useful for investors that use non-marketable limit orders? In addition, Rule 605 does not include any statistics measuring the execution quality of orders submitted for execution at opening or closing prices. Would such statistics be helpful to investors? Rule 605 also does not include any statistics measuring commission costs of orders, access fees, or liquidity rebates. Would such statistics be helpful to investors?

Rule 605 does not require disclosure of the amount of time that canceled non-marketable orders are displayed in the order book of trading center before cancellation. Considering the high cancellation percentage of non-marketable orders, should Rule 605 require the disclosure of the average time that canceled orders were displayed in the order book? Conversely, should Rule 605 exclude or otherwise distinguish canceled orders with a very limited duration (such as less than one second)?

Moreover, Rules 605 and 606 were drafted primarily with the interests of individual investors in mind and are focused on the execution of smaller orders. Orders with large sizes, for example, are excluded from both rules.⁶⁴ Should the rules be updated to address the interests of

⁶⁴ Orders with a size of 10,000 shares or greater are exempt from Rule 605 reporting. See generally Staff Legal Bulletin 12R: Frequently Asked Questions About Rule 11Ac1-5 (Revised), now Regulation NMS Rule 605, Question 26: Exemption of Block Orders (available at <http://www.sec.gov/divisions/marketreg/disclosure.htm>). Rule 606 requires broker-dealers to report on their routing of "non-directed orders," which is defined in Rule 600(b)(48) as limited to customer orders. "Customer order" is defined in Rule 600(b)(18) of Regulation NMS to exclude an order in NMS stocks with a market value of at least \$200,000. See generally Staff Legal Bulletin 13A: Frequently Asked Questions About Rule 11Ac1-6, now Regulation NMS Rule 606, Question 6: Definition of Customer Orders – Large Order Exclusion (available at <http://www.sec.gov/divisions/marketreg/disclosure.htm>).

institutional investors in efficiently executing large orders (whether in one large trade or many smaller trades)? If so, what metrics would be useful for institutional investors?

Intermarket sweep orders (“ISOs”) are mostly used by institutional traders.⁶⁵ Rule 605 disclosures do not report regular orders and ISOs separately.⁶⁶ Would a distinction between ISO and non-ISO marketable orders benefit individual and/or institutional investors? Should any other order types be treated differently in Rule 605 reports?

More broadly, are there any approaches to improving the transparency of the order routing and order execution practices for institutional investors that the Commission should consider? For example, do institutional investors currently have sufficient information about the smart order routing services and order algorithms offered by their brokers? Would a regulatory initiative to improve disclosure of these broker services be useful and, if so, what type of initiative should the Commission pursue?

2. Other Measures

The Commission requests comment on any other measures of market structure performance that the public believes the Commission should consider. For example, are there useful metrics for assessing the quality of price discovery in equity markets, such as how

⁶⁵ Intermarket sweep orders are exceptions provided in Rule 611(b)(5) and (6) that enable an order router to sweep one or more price levels simultaneously at multiple trading centers without violating trade-through restrictions. As defined in Rule 600(b)(30) of Regulation NMS, intermarket sweep orders must be routed to execute against the full displayed size of any protected quotation that otherwise would be traded through by the orders. In addition, a single ISO can be routed to the best displayed price at the time of routing to help assure an execution even if quotations change after the order is routed. See Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, Question 4.04 (April 4, 2008 Update) (available at <http://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm>)

⁶⁶ An ISO is excluded from a Rule 605 report as requiring special handling if it has a limit price that is inferior to the NBBO at the time of order receipt. All other ISOs should be included in a Rule 605 report, absent another applicable exclusion. *Id.* at Question 7.06.

efficiently prices respond to new information? -In addition, what is the best approach for assessing whether the secondary markets are appropriately supporting the capital-raising function for companies of all sizes?

B. High Frequency Trading

One of the most significant market structure developments in recent years is high frequency trading (“HFT”). The term is relatively new and is not yet clearly defined. It typically is used to refer to professional traders acting in a proprietary capacity that engage in strategies that generate a large number of trades on a daily basis. These traders could be organized in a variety of ways, including as a proprietary trading firm (which may or may not be a registered broker-dealer and member of FINRA), as the proprietary trading desk of a multi-service broker-dealer, or as a hedge fund (all of which are referred to hereinafter collectively as a “proprietary firm”). Other characteristics often attributed to proprietary firms engaged in HFT are: (1) the use of extraordinarily high-speed and sophisticated computer programs for generating, routing, and executing orders; (2) use of co-location services and individual data feeds offered by exchanges and others to minimize network and other types of latencies; (3) very short time-frames for establishing and liquidating positions; (4) the submission of numerous orders that are cancelled shortly after submission; and (5) ending the trading day in as close to a flat position as possible (that is, not carrying significant, unhedged positions over-night). Estimates of HFT volume in the equity markets vary widely, though they typically are 50% of total volume or higher.⁶⁷ By any measure, HFT is a dominant component of the current market structure and is likely to affect nearly all aspects of its performance.

⁶⁷ See, e.g., Jonathan Spicer and Herbert Lash, Who’s Afraid of High-Frequency Trading?, Reuters.com, December 2, 2009 (available at <http://www.reuters.com/article/idUSN173583920091202>) (“High-frequency trading now

The Commission today is proposing an initiative to address a discrete-HFT concern that the Commission already has identified. It would address the use of various types of arrangements to obtain the fastest possible market access.⁶⁸ This concept release is intended to request comment on the full range of concerns with respect to HFT, in contrast to the discrete concerns the Commission already has identified.

The lack of a clear definition of HFT, however, complicates the Commission's broader review of market structure issues. The lack of clarity may, for example, contribute to the widely varying estimates of HFT volume in today's equity markets. Although the term itself clearly implies a large volume of trades, some concerns that have been raised about particular strategies used by proprietary firms may not necessarily involve a large number of trades. Indeed, any particular proprietary firm may simultaneously be employing many different strategies, some of which generate a large number of trades and some that do not. Conceivably, some of these strategies may benefit market quality and long-term investors and others could be harmful.

In sum, the types of firms engaged in professional trading and the types of strategies they employ can vary considerably. Rather than attempt any single, precise definition of HFT, this release will focus on particular strategies and tools that may be used by proprietary firms and inquire whether these strategies and tools raise concerns that the Commission should address.

1. Strategies

Comment generally is requested on the strategies employed by proprietary firms in the current market structure. What are the most frequently used strategies? What are the key

accounts for 60 percent of total U.S. equity volume, and is spreading overseas and into other markets."); Scott Patterson and Goeffrey Rogow, What's Behind High-Frequency Trading, Wall Street Journal, August 1, 2009 ("High frequency trading now accounts for more than half of all stock-trading volume in the U.S.");

⁶⁸ Market Access Release, supra note 15.

features of each strategy? What technology tools and other market structure components (such as exchange fee structures) are necessary to implement each strategy? Have any of these strategies been a competitive response to particular market structure components or to particular problems or challenges in the current market structure? Does implementation of a specific strategy benefit or harm market structure performance and the interests of long-term investors? Is it possible to reliably identify harmful strategies through, for example, such metrics as adding or taking liquidity, or trading with (momentum) or against (contrarian) prevailing price movements? Are there regulatory tools that would address harmful strategies while at the same time have a minimal impact on beneficial strategies?

Do commenters believe that the overall use of harmful strategies by proprietary firms is sufficiently widespread that the Commission should consider a regulatory initiative to address the problem? What type of regulatory initiative would be most effective? For example, should there be a minimum requirement on the duration of orders (such as one second) before they can be cancelled, whether across the board, in particular contexts, or when used by particular types of traders? If so, what would be an appropriate time period? Should the use of "pinging" orders by all or some traders to assess undisplayed liquidity be prohibited or restricted in all or some contexts?⁶⁹

⁶⁹ A "pinging" order is an immediate-or-cancel order that can be used to search for and access all types of undisplayed liquidity, including dark pools and undisplayed order types at exchanges and ECNs. The trading center that receives an immediate-or-cancel order will execute the order immediately if it has available liquidity at or better than the limit price of the order and otherwise will immediately respond to the order with a cancellation. As noted in section IV.B.1.d. below, there is an important distinction between using tools such as pinging orders as part of a normal search for liquidity with which to trade and using such tools to detect and trade in front of large trading interest as part of an "order anticipation" trading strategy.

The use of certain strategies by some proprietary firms has, in many trading centers, largely replaced the role of specialists and market makers with affirmative and negative obligations.⁷⁰ Has market quality improved or suffered from this development? How important are affirmative and negative obligations to market quality in today's market structure? Are they more important for any particular equity type or during certain periods, such as times of stress? Should some or all proprietary firms be subject to affirmative or negative trading obligations that are designed to promote market quality and prevent harmful conduct? Is there any evidence that proprietary firms increase or reduce the amount of liquidity they provide to the market during times of stress?

As noted above, the Commission wishes to request comment broadly on all strategies used by proprietary firms. To help present issues for comment, but without limiting the broad request, this release next will briefly discuss four broad types of trading strategies that often are associated with proprietary firms – passive market making, arbitrage, structural, and directional. The discussion of directional strategies will focus on two directional strategies that may pose particular problems for long-term investors – order anticipation and momentum ignition. The Commission notes that many of the trading strategies discussed below are not new. What is new is the technology that allows proprietary firms to better identify and execute trading strategies.

a. Passive Market Making

Passive market making primarily involves the submission of non-marketable resting orders (bids and offers) that provide liquidity to the marketplace at specified prices. While the

⁷⁰ Affirmative and negative obligations generally are intended to promote market quality. Affirmative obligations might include a requirement to consistently display high quality, two-sided quotations that help dampen price moves, while negative obligations might include a restriction on “reaching across the market” to execute against displayed quotations and thereby cause price moves.

proprietary firm engaging in passive market making may sometimes take liquidity if necessary to liquidate a position rapidly, the primary sources of profits are from earning the spread by buying at the bid and selling at the offer and capturing any liquidity rebates offered by trading centers to liquidity-supplying orders. If the proprietary firm is layering the book with multiple bids and offers at different prices and sizes, this strategy can generate an enormous volume of orders and high cancellation rates of 90% or more. The orders also may have an extremely short duration before they are cancelled if not executed, often of a second or less.

Although proprietary firms that employ passive market making strategies are a new type of market participant, the liquidity providing function they perform is not new. Professional traders with a permanent presence in the marketplace, standing ready to buy and sell on an ongoing basis, are a perennial type of participant in financial markets. Proprietary firms largely have replaced more traditional types of liquidity providers in the equity markets, such as exchange specialists on manual trading floors and OTC market makers that trade directly with customers. In contrast, proprietary firms generally are not given special time and place privileges in exchange trading (nor are they subject to the affirmative and negative trading obligations that have accompanied such privileges). In addition, proprietary firms typically do not trade directly with customer order flow, but rather trade by submitting orders to external trading venues such as exchanges and ATSS.⁷¹

Proprietary firms participate in the marketplace in some ways that are similar to both exchange specialists and OTC market makers. Indeed, a single firm or its affiliates may operate simultaneously in all three capacities. For example, proprietary traders are like exchange

⁷¹ It is possible for a single firm to provide liquidity in a variety of different forms. Some firms, for example, may blur the distinction between proprietary firms and OTC market makers by both trading actively in external trading centers and operating trading centers themselves that offer customers direct electronic access to their liquidity.

specialists in the sense that they transact most of their volume in public markets where their orders will trade with all comers. Unlike the traditional floor specialists, however, they do not have time and place advantages, except insofar as their sophistication and size enables them to employ the fastest, most powerful systems for generating, routing, and cancelling orders and thereby most take advantage of the current highly automated market structure (including such tools as individual trading center data feeds and co-location discussed below in section IV.B.2.). Proprietary traders are analogous to OTC market makers in that they have considerable flexibility in trading without significant negative or affirmative obligations for overall market quality. But unlike an OTC market maker, a proprietary firm typically does not trade directly with customers. The proprietary firm therefore may not have ongoing relationships with customers that can pressure the proprietary trader to provide liquidity in tough trading conditions or less actively traded stocks.

Quality of Liquidity. The Commission requests comment on the passive market making strategies of proprietary firms. To what extent do proprietary firms engage in the types of strategies described above? Do they provide valuable liquidity to the market for top-tier, large, medium, and small capitalization stocks? Has market quality improved or worsened as traditional types of liquidity providers have been replaced by proprietary firms? Does the very brief duration of many of their orders significantly detract from the quality of liquidity in the current market structure? For example, are their orders accurately characterized as phantom liquidity that disappears when most needed by long-term investors and other market participants? Or, is the collective result of many different proprietary firms engaging in passive market making a relatively stable quoted market in which there are many quotation updates (primarily

updates to size of the NBBO), but relatively few changes in the price of the NBBO? What types of data are most useful in assessing the quality of liquidity provided by proprietary firms?

Liquidity Rebates. One important aspect of passive market making is the liquidity rebates offered by many exchanges and ECNs when resting orders that add liquidity are accessed by those seeking to trade immediately by taking liquidity. The Commission requests comment on the volume of high frequency trading geared toward earning liquidity rebates and on the benefits or drawbacks of such trading. Are liquidity rebates unfair to long-term investors because they necessarily will be paid primarily to proprietary firms engaging in passive market making strategies? Or do they generally benefit long-term investors by promoting narrower spreads and more immediately accessible liquidity? Do liquidity rebates reward proprietary firms for any particular types of trading that do not benefit long-term investors or market quality? For example, are there risk-free trading strategies driven solely by the ability to recoup a rebate that offer little or no utility to the marketplace? Are these strategies most likely when a trading center offers inverted pricing and pays a liquidity rebate that is higher than its access fee for taking liquidity? Does the distribution of consolidated market data revenues pursuant to the Plans lead to the current trading center pricing schedules? If so, would there be any benefits to restructuring the Plans and, if so, how?

b. Arbitrage

An arbitrage strategy seeks to capture pricing inefficiencies between related products or markets. For example, the strategy may seek to identify discrepancies between the price of an ETF and the underlying basket of stocks and buy (sell) the ETF and simultaneously sell (buy) the underlying basket to capture the price difference. Many of the trades necessary to execute an arbitrage strategy are likely to involve taking liquidity, in contrast to the passive market making

strategy that primarily involves providing liquidity. In this respect, it is quite possible for a proprietary firm using an arbitrage strategy to trade with a proprietary firm using a passive market making strategy, and for both firms to end up profiting from the trade. Arbitrage strategies also generally will involve positions that are substantially hedged across different products or markets, though the hedged positions may last for several days or more.

The Commission requests comment on arbitrage strategies and whether they benefit or harm the interests of long-term investors and market quality in general. To what extent do proprietary firms engage in the types of strategies described above? For example, what is the volume of trading attributable to arbitrage involving ETFs (both in the ETF itself and in any underlying securities) and has the increasing popularity of ETFs in recent years significantly affected volume and trading patterns in the equity markets? If so, has the impact of ETF trading been positive or negative for long-term investors and overall market quality?

In addition, to what extent are arbitrage strategies focused on capturing pricing differences among the many different trading centers in NMS stocks? For example, do these arbitrage strategies significantly depend on latencies among trading center data feeds and the consolidated market data feeds? Are these strategies beneficial for long-term investors and market structure quality? If not, how should such strategies be addressed?

c. Structural

Some proprietary firm strategies may exploit structural vulnerabilities in the market or in certain market participants. For example, by obtaining the fastest delivery of market data through co-location arrangements and individual trading center data feeds (discussed below in section IV.B.2.), proprietary firms theoretically could profit by identifying market participants who are offering executions at stale prices. In addition, some market participants offer guarantee

match features to guarantee the NBBO up to a certain limit. A proprietary firm could enter a small limit order in one part of the market to set up a new NBBO, after which the same proprietary firm triggers guaranteed match trades in the opposite direction.⁷² Are proprietary firms able to profitably exploit these structural vulnerabilities? To what extent do proprietary firms engage in the types of strategies described above? What is the effect of this trading on market quality?

d. Directional

Neither passive market making nor arbitrage strategies generally involve a proprietary firm taking a significant, unhedged position based on an anticipation of an intra-day price movement of a particular direction. There may, however, be a wide variety of short-term strategies that anticipate such a movement in prices. Some “directional” strategies may be as straightforward as concluding that a stock price temporarily has moved away from its “fundamental value” and establishing a position in anticipation that the price will return to such value. These speculative strategies often may contribute to the quality of price discovery in a stock.⁷³

⁷² The Commission has found that similar conduct is manipulative, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. See Terrance Yoshikawa, Securities Exchange Act Release No. 53731 (April 26, 2006) (Commission opinion affirming NASD disciplinary action).

⁷³ See, e.g., Sanford Grossman & Joseph Stiglitz, On the Impossibility of Informationally Efficient Markets, American Economic Review (June 1980) (“We propose here a model in which there is an equilibrium degree of disequilibrium: prices reflect the information of informed individuals (arbitrageurs) but only partially, so that those who expend resources do receive compensation. How informed the price system is depends on the number of individuals who are informed, but the number of individuals who are informed is itself an endogenous variable in the model.”).

The Commission requests comment on two types of directional strategies that may present serious problems in today's market structure – order anticipation and momentum ignition.

Order Anticipation Strategies. One example of an order anticipation strategy is when a proprietary firm seeks to ascertain the existence of one or more large buyers (sellers) in the market and to buy (sell) ahead of the large orders with the goal of capturing a price movement in the direction of the large trading interest (a price rise for buyers and a price decline for sellers).⁷⁴ After a profitable price movement, the proprietary firm then may attempt to sell to (buy from) the large buyer (seller) or be the counterparty to the large buyer's (seller's) trading. In addition, the proprietary firm may view the trading interest of the large buyer (seller) as a free option to trade against if the price moves contrary to the proprietary firm's position.

Of course, any proprietary firm or other person that violates a duty to a large buyer or seller or misappropriates their order information and then uses the information for its own trading to the detriment of the large buyer and seller has engaged in misconduct that already is prohibited, such as forms of front running. Regulatory authorities currently examine for, investigate, and prosecute this type of misconduct and will continue to do so. The Commission requests comment on any regulatory change that would limit the potential for proprietary firms to profit from misconduct with respect to the trading activities of large buyers and sellers.

The type of order anticipation strategy referred to in this release involves any means to ascertain the existence of a large buyer (seller) that does not involve violation of a duty,

⁷⁴ See Larry Harris, Trading and Exchanges: Market Microstructure for Practitioners (2003) at 222, 245 (“Harris Treatise”) (“Order anticipators are speculators who try to profit by trading before others trade. They make money when they correctly anticipate how other traders will affect prices or when they can extract option values from the orders that other traders offer to the market.”) (emphasis in original).

misappropriation of information, or other misconduct. Examples include the employment of sophisticated pattern recognition software to ascertain from publicly available information the existence of a large buyer (seller), or the sophisticated use of orders to “ping” different market centers in an attempt to locate and trade in front of large buyers and sellers.

It is important to recognize the distinction between order anticipation and a normal search for liquidity to implement a trading strategy. When a proprietary firm employs an order anticipation strategy and detects a large buyer (seller), it will first attempt to buy (sell), and the proprietary firm largely will be indifferent to whether the party is a buyer or a seller. In contrast, long-term investors searching for liquidity to trade against will be seeking specifically either to establish a position or to liquidate a position. If buying, the long-term investor will attempt to find large selling interest and buy from it or, if selling, will attempt to find large buying interest and sell to it. Both the long-term investor and the large buyer (seller) benefit from the liquidity seeking strategy, in contrast to the order anticipation strategy where the large buyer (seller) is harmed when the proprietary firm initially trades in front of the large buyer (seller).

Order anticipation is a not a new strategy. Indeed, a 2003 treatise on market structure described order anticipation as follows: “Order anticipators are parasitic traders. They profit only when they can prey on other traders. They do not make prices more informative, and they do not make markets more liquid. . . . Large traders are especially vulnerable to order anticipators.”⁷⁵ An important issue for purposes of this release is whether the current market structure and the availability of sophisticated, high-speed trading tools enable proprietary firms to engage in order anticipation strategies on a greater scale than in the past. Alternatively, is it possible that the widespread use of high-speed trading tools by a variety of proprietary firms and

⁷⁵ Harris Treatise at 251 (emphasis in original).

institutions limits the ability of market participants to engage in profitable order anticipation strategies? Does your answer depend on whether top tier, large, medium, or small market capitalization stocks are considered?

The Commission requests comment on all aspects of order anticipation strategies. Do commenters believe that order anticipation significantly detracts from market quality and harms institutional investors (for example, does it represent a substantial transfer of wealth from the individuals represented by institutional investors to proprietary firms)? Do commenters believe that order anticipation has become more or less prevalent in recent years? If more prevalent, is the use of proprietary firm strategies an important factor in this development? If commenters believe order anticipation has become more prevalent, are there ways to distinguish order anticipation from other beneficial trading strategies? Are there regulatory tools that would effectively address concerns about order anticipation, without unintentionally interfering with other strategies that may be beneficial for long-term investors and market quality?

Momentum Ignition Strategies. Another type of directional strategy that may raise concerns in the current market structure is momentum ignition. With this strategy, the proprietary firm may initiate a series of orders and trades (along with perhaps spreading false rumors in the marketplace) in an attempt to ignite a rapid price move either up or down. For example, the trader may intend that the rapid submission and cancellation of many orders, along with the execution of some trades, will “spoo” the algorithms of other traders into action and cause them to buy (sell) more aggressively. Or the trader may intend to trigger standing stop loss orders that would help cause a price decline. By establishing a position early, the proprietary firm will attempt to profit by subsequently liquidating the position if successful in igniting a price movement. This type of strategy may be most harmful in less actively traded stocks, which

may receive little analyst or other public attention and be vulnerable to price movements sparked by a relatively small amount of volume.

Of course, any market participant that manipulates the market has engaged in misconduct that already is prohibited. The Commission and other regulatory authorities already employ their examination and enforcement resources to detect violations and bring appropriate proceedings against the perpetrators. This concept release is focused on the issue of whether additional regulatory tools are needed to address illegal practices, as well as any other practices associated with momentum ignition strategies. For example, while spreading false rumors to cause price moves is illegal, such rumors can be hard to find (if not spread in writing), and it can be difficult to ascertain the identity of those who spread rumors to cause price moves.

The Commission requests comment on whether momentum ignition strategies are a significant problem in the current market structure. To what extent do proprietary firms engage in the types of strategies described above? Does, for example, the speed of trading and ability to generate a large amount of orders across multiple trading centers render this type of strategy more of a problem today? If momentum ignition strategies have caused harm, are there objective indicia that would reliably identify problematic strategies? Are there regulatory tools (beyond the currently applicable anti-fraud and anti-manipulation provisions) that would effectively reduce or eliminate the use of momentum ignition strategies while at the same time have a minimal impact on other strategies that are beneficial to long-term investors and market quality?

2. Tools

This section will focus on two important tools that often are used by proprietary firms to implement their short-term trading strategies – co-location and trading center data feeds.

a. Co-Location

Many proprietary firm strategies are highly dependent upon speed – speed of market data delivery from trading center servers to servers of the proprietary firm; speed of decision processing of trading engines of the proprietary firm; speed of access to trading center servers by servers of the proprietary firm; and speed of order execution and response by trading centers. Speed matters both in the absolute sense of achieving very small latencies and in the relative sense of being faster than competitors, even if only by a microsecond. Co-location is one means to save micro-seconds of latency.

Co-location is a service offered by trading centers that operate their own data centers and by third parties that host the matching engines of trading centers. The trading center or third party rents rack space to market participants that enables them to place their servers in close physical proximity to a trading center's matching engine. Co-location helps minimize network and other types of latencies between the matching engine of trading centers and the servers of market participants.

The Commission believes that the co-location services offered by registered exchanges are subject to the Exchange Act. Exchanges that intend to offer co-location services must file proposed rule changes and receive approval of such rule changes in advance of offering the services to customers.⁷⁶ The terms of co-location services must not be unfairly discriminatory, and the fees must be equitably allocated and reasonable.⁷⁷

⁷⁶ Section 3(a)(27) of the Exchange Act defines “rules of an exchange” as, among other things, a stated policy, practice, or interpretation of the exchange that the Commission has by rule determined to be rules of the exchange. Rule 19b-4(b) under the Exchange Act defines “stated policy, practice, or interpretation” to mean, in part, [a]ny material aspect of the operation of the facilities of the self-regulatory organization.” The Commission views co-location services as being a material aspect of the operation of the facilities of an exchange.

⁷⁷ Section 6(b)(4) and (5) of the Exchange Act.

Fairness of Co-Location Services. Beyond these basic statutory requirements, the

Commission broadly requests comment on co-location and whether it benefits or harms long-term investors and market quality. For example, does co-location provide proprietary firms an unfair advantage because they generally will have greater resources and sophistication to take advantage of co-location services than other market participants, including long-term investors? If so, specify how this disparity harms long-term investors. Conversely, does co-location offer benefits to long-term investors? For example, do co-location services enable liquidity providers to operate more efficiently and thereby increase the quality of liquidity they provide to the markets? Please quantify any harm or benefits, if possible. Is it fair for some market participants to pay to obtain better access to the markets than is available to those not in a position to pay for or otherwise obtain co-location services? Aside from physical proximity, are there other aspects of services offered by exchanges to co-location participants that may lead to unfair access concerns?

In addition, are brokers generally able to obtain and use co-location services on behalf of their customers? If so, are long-term investors harmed by not being able to use co-location directly? Are co-location fees so high that they effectively create a barrier for smaller firms? Do commenters believe that co-location services fundamentally differ from other respects in which market participants can obtain latency advantages, particularly if co-location services are not in short supply and are available to anyone on terms that are fair and reasonable and not unreasonably discriminatory?

If commenters believe that co-location services create unfair access to trading, should the Commission prohibit or restrict exchanges, and other trading centers, such as ATSS, from offering co-location services? If exchanges and other trading centers were no longer permitted to

provide the services, would third parties, who may be outside the Commission's regulatory authority, be encouraged to obtain space close to an exchange's data center and rent such space to market participants? Alternatively, could exchanges and other trading centers batch process all orders each second and, if so, what would be the effect of such a policy on market quality?

The Commission also requests comment on exchanges and other trading centers that place their trading engines in data facilities operated by third parties. Such parties are not regulated entities subject to the access and other requirements of the Exchange Act and Commission rules. Could this disparity create competitive disadvantages among trading centers? Should the third party data centers be considered facilities of the exchange or trading center? Alternatively, should the Commission require trading centers to obtain contractual commitments from third parties to provide any co-location services on terms consistent with the Exchange Act and Commission rules?

With respect to those market participants that purchase co-location services, should exchanges and other trading centers be subject to specific requirements to help assure that all participants are treated in a manner that is not unfairly discriminatory? Latency can arise from a variety of sources, such as cable length and capacity, processing capabilities, and queuing. Is it possible for trading centers to guarantee equal latency across all market participants that use comparable co-location services? Should the Commission require latency transparency – the disclosure of information that would enable market participants to make informed decisions about their speed of access to an exchange or other trading center? Such disclosures could include, for example, periodic public reports on the latencies of the fastest market participants (on an anonymous basis), as well as private reports directly to individual market participants of

their specific latencies. If latency disclosure should be required, what information should be disclosed and in what manner?

Affirmative or Negative Trading Obligations. Finally, the Commission requests comment on whether all or some market participants (such as proprietary firms) that obtain co-location services should be subject to any affirmative or negative obligations with respect to their trading behavior. Such obligations historically were applied to exchange specialists that enjoyed a unique time and place advantage on the floor of an exchange. Are co-location services analogous to the specialist advantages? Or does the wider availability of co-location services to many market participants distinguish co-located market participants from exchange specialists? If all or some co-location participants should be subject to trading obligations, what should be the nature of such obligations? For example, should some or all co-location participants be prohibited from aggressively taking liquidity and moving prices always or only under specified circumstances? If only under specified circumstances, what should those include or exclude? Should some or all co-location participants ever be required to provide liquidity on an ongoing basis or in certain contexts?

b. Trading Center Data Feeds

Another important tool widely used by proprietary firms is the individual data feeds offered by many exchanges and ECNs. As discussed in section III.B.1. above, the consolidated data feeds include the best-priced quotations of all exchanges and certain ATs and all reported trades. The individual data feeds of exchanges and ECNs generally will include their own best-priced quotations and trades, as well as other information, such as inferior-priced orders included in their depth-of-book. When it adopted Regulation NMS in 2005, the Commission did not require exchanges, ATs, and other broker-dealers to delay their individual data feeds to

synchronize with the distribution of consolidated data, but prohibited them from independently transmitting their own data any sooner than they transmitted the data to the plan processors.⁷⁸

Given the extra step required for SROs to transmit market data to plan processors, and for plan processors to consolidate the information and distribute it the public, the information in the individual data feeds of exchanges and ECNs generally reaches market participants faster than the same information in the consolidated data feeds. The extent of the latency depends, among other things, on the speed of the systems used by the plan processors to transmit and process consolidated data and on the distances between the trading centers, the plan processors, and the recipients. As noted above,⁷⁹ the Commission understands that the average latency of plan processors for the consolidated data feeds generally is less than 10 milliseconds. This latency captures the difference in time between receipt of data by the plan processors from the SROs and distribution of the data by the plan processors to the public.

Latency of Consolidated Data. The Commission requests comment on all aspects of the latency between consolidated data feeds and individual trading center data feeds. What have market participants experienced in terms of the degree of latency between trading center and consolidated data? Is the latency as small as possible given the necessity of the consolidation function, or could plan processor systems be improved to significantly reduce the latency from current levels, while still retaining the high level of reliability required of plan processors?

More broadly, is the existence of any latency, or the disparity in information transmitted, fair to investors or other market participants that rely on the consolidated market data feeds and do not use individual trading center data feeds? If so, should the unfairness be addressed by a requirement that trading center data be delayed for a sufficient period of time to assure that

⁷⁸ Regulation NMS Release, 70 FR at 37567.

⁷⁹ See supra note 45 and accompanying text.

consolidated data reaches users first? Would such a mandated delay adequately address unfairness? Would a mandatory delay seriously detract from the efficiency of trading and harm long-term investors and market quality? Should the Commission require that additional information be included in the consolidated market data feeds?

Odd-Lot Transactions. Finally, the consolidated trade data currently does not include reports of odd lot orders or odd lot transactions (transactions with sizes of less than 1 round lot, which generally is 100 shares). It appears that a substantial volume of trading (approximately 4%) may be attributable to odd lot transactions. Why is the volume of odd lots so high? Should the Commission be concerned about this level of activity not appearing in the consolidated trade data? Has there been an increase in the volume of odd lots recently? If so, why? Do market participants have incentives to strategically trade in odd lots to circumvent the trade disclosure or other regulatory requirements? Would these trades be important for price discovery if they were included in the consolidated trade data? Should these transactions be required to be reported in the consolidated trade data? Why?

3. Systemic Risks

Stepping back from the particular strategies and tools used by proprietary traders, comment is requested more broadly on whether HFT poses significant risks to the integrity of the current equity market structure. For example, do the high speed and enormous message traffic of automated trading systems threaten the integrity of trading center operations? Also, many proprietary firms potentially could engage in similar or connected trading strategies that, if such strategies generated significant losses at the same time, could cause many proprietary firms to become financially distressed and lead to large fluctuations in market prices. To the extent that proprietary firms obtain financing for their trading activity from broker-dealers or other types of

financial institutions, the significant losses of many proprietary firms at the same time also could lead to more widespread financial distress.⁸⁰

Comment also is requested on whether proprietary traders help promote market integrity by providing an important source of liquidity in difficult trading conditions. The Commission notes that, from an operational standpoint, the equity markets performed well during the world-wide financial crisis in the Autumn of 2008 when volume and volatility spiked to record highs.⁸¹ Unlike some financial crises in the past, the equity markets continued to operate smoothly and participants generally were able to trade at currently displayed prices (though most investors likely suffered significant losses from the general decline of market prices). Does the 2008

⁸⁰ A broker-dealer conducting a general securities business that is required to register with the Commission under Section 15(b) of the Exchange Act must comply with the Commission's net capital rule, Exchange Act Rule 15c3-1. Under Rule 15c3-1, broker-dealers are required to maintain, at all times, a minimum amount of net capital. This means that firms must be able to demonstrate that they have sufficient net capital for intra-day positions. In addition, if a broker-dealer is engaged in proprietary trading on margin, it may be subject to certain provisions of Regulation T, 12 CFR 220.1, *et. seq.*, as well as SRO margin rules applicable to broker-dealers. See, e.g., NYSE Rule 431(e)(5) (specialists' and market makers' accounts), (e)(6)(A) (broker/dealer accounts), (e)(6)(B) (Joint Back Office Arrangements) and NASD Rule 2520(e)(5), (e)(6)(A) and (e)(6)(B). Moreover, high frequency traders who are not broker-dealers must comply with the SRO day trading rules if they meet the definition of "pattern day trader." NYSE Rule 431(f)(8)(B) and NASD Rule 2520(f)(8)(B).

⁸¹ See, e.g., NYSE Euronext, Consolidated Volume in NYSE Listed Issues 2000-2009 (available at <http://www.nyxdata.com/nyxdata/NYSE/FactsFigures/tabid/115/Default.aspx>) (consolidated average daily volume in NYSE-listed stocks reached a then record high of 7.1 billion shares in October 2008, compared to an average of 3.4 billion shares for the year 2007); Pam Abramowitz, *Technology Drives Trading Costs*, Institutional Investor (November 4, 2009) ("[V]olatility has fallen substantially over the past six to nine months as equity markets have rallied. . . . [The] VIX, which hit an all-time high of 89.53 in October 2008, averaged 25.49 in the third quarter of 2009, close to its precrisis historical average of 20.3"); Tom Lauricella, *Volatility Requires New Strategies*, Wall Street Journal (October 20, 2008) ("The stock market's collapse and unprecedented daily price swings are forcing investors of all stripes to rethink their strategies, all the while looking for any hints that the financial markets will stabilize. . . . So far this month, there have been 10 days where the Dow Jones Industrial Average ricocheted in a range of more than 5% . . .").

experience indicate that systemic risk is appropriately minimized in the current market structure? If not, what further steps should the Commission take to address systemic risk? Should, for example, all proprietary firms be required to register as broker-dealers and become members of FINRA to help assure that their operations are subject to full regulatory oversight? Moreover, does the current regulatory regime adequately address the particular concerns raised by proprietary firms and their trading strategies and tools?

C. Undisplayed Liquidity

As noted in section III.A. above, undisplayed liquidity is trading interest that is available for execution at a trading center, but is not included in the consolidated quotation data that is widely disseminated to the public. Undisplayed liquidity also is commonly known as “dark” liquidity. The Commission recently published proposals to address certain practices with respect to undisplayed liquidity. These include the use of actionable indications of interest, or “IOIs,” to attract order flow, the lowering of the trading volume threshold that would trigger ATS order display obligations, and the real-time disclosure of the identity of ATSS on the public reports of their executed trades.⁸² This release is intended to request comment on a wide range of issues with respect to undisplayed liquidity in all of its forms.

Undisplayed liquidity in general is not a new phenomenon. Market participants that need to trade in large size, such as institutional investors, always have faced a difficult trading dilemma. On the one hand, if they prematurely reveal the full extent of their large trading interest to the market, then market prices are likely to run away from them (a price rise for those seeking to buy and a price decline for those seeking to sell), which would greatly increase their transaction costs and reduce their overall investment returns. On the other hand, if an

⁸² See Non-Public Trading Interest Release, 74 FR at 61209-61210.

institutional investor that wants to trade in large size does nothing, then it will not trade at all.

Finding effective and innovative ways to trade in large size with minimized transaction costs is a perennial challenge for institutional investors, the brokers that represent their orders in the marketplace, and the trading centers that seek to execute their orders.

A primary source of dark liquidity for many years was found on the manual trading floors of exchanges. The floor brokers “worked” the large orders of their customers by executing such orders in a number of smaller transactions without revealing to potential counterparties the total size of the order. One consequence of the decline in market share of the NYSE floor in recent years is that this historically large undisplayed liquidity pool in NYSE-listed stocks appears to have largely migrated to other types of venues. As discussed in section III.A.3. above, a recent form of undisplayed liquidity is the dark pool – an ATS that does not display quotations in the consolidated quotation data. Other sources of undisplayed liquidity are broker-dealers that internalize orders⁸³ and undisplayed order types of exchanges and ECNs.

Although they offer liquidity that is not included in the consolidated quotation data, dark pools and OTC market makers generally trade with reference to the best displayed quotations and execute orders at prices that are equal to or better than the NBBO. Indeed, all dark pools and OTC market makers are covered by the trade-through restrictions of Rule 611 and, subject to limited exceptions, cannot execute transactions at prices that are inferior to the best displayed prices.

The Commission requests comment on all forms of undisplayed liquidity in the current market structure. It particularly wants to present three issues for comment – the effect of

⁸³ As noted in section III.A.2. above, many broker-dealers may submit orders to exchanges or ECNs, which then are included in the consolidated quotation data. The internalized executions of broker-dealers, however, primarily reflect liquidity that is not included in the consolidated quotation data and are appropriately classified as undisplayed liquidity.

undisplayed liquidity on order execution quality, the effect of undisplayed liquidity on public price discovery, and fair access to sources of undisplayed liquidity.

1. Order Execution Quality

It appears that a significant percentage of the orders of individual investors are executed at OTC market makers, and that a significant percentage of the orders of institutional investors are executed in dark pools. Comment is requested on the order execution quality provided to these long-term investors. Given the strong Exchange Act policy preference in favor of price transparency and displayed markets, do dark pools and OTC market makers offer substantial advantages in order execution quality to long-term investors? If so, do these advantages justify the diversion of a large percentage of investor order flow away from the displayed markets that play a more prominent role in providing public price discovery? If investors were limited in their ability to use undisplayed liquidity, how would trading behavior change, if at all? What types of activity might evolve to replace undisplayed liquidity if its use were constrained?

Individual Investors. Liquidity providers generally consider the orders of individual investors very attractive to trade with because such investors are presumed on average to not be as informed about short-term price movements as are professional traders. Do individual investor orders receive high quality executions when routed to OTC market makers? For example, does competition among OTC market makers to attract order flow lead to significantly better prices for individual investor orders than they could obtain in the public markets? Do OTC market makers charge access fees comparable to those charged by public markets? Does the existence of payment for order flow arrangements between routing brokers and OTC market makers (and internalization arrangements when the routing broker and OTC market maker are affiliated) detract from the quality of executions for investor orders? If more individual investor

orders were routed to public markets, would it promote quote competition in the public markets, lead to narrower spreads, and ultimately improve order execution quality for individual investors beyond current levels? Finally, are a significant number of individual investor orders executed in dark pools and, if so, what is the execution quality for these orders?

Institutional Investors. An important objective of many dark pools is to offer institutional investors an efficient venue in which to trade in large size (often by splitting a large parent order into many child orders) with minimized market impact. To what extent do dark pools meet this objective of improving execution quality for the large orders of institutional investors? Does execution quality vary across different types of dark pools and, if so, which types? If so, does this difference depend on the characteristics of particular securities (such as market capitalization and security price)?

As noted above in section IV.C., many dark pools execute orders with reference to the displayed prices in public markets. Does this reference pricing create opportunities for institutional investors to be treated unfairly by improper behavior (such as placing a small order to change the NBBO for a very short period and quickly submitting orders to dark pools for execution at prices affected by the new NBBO)?⁸⁴ If so, to what extent does gaming occur? Do all types of dark pools employ anti-gaming tools? How effective are such tools?

Finally, are institutional investors able to trade more efficiently using undisplayed liquidity at dark pools and broker-dealers than they are using the undisplayed liquidity at exchanges and ECNs? What are the advantages and disadvantages of each form of undisplayed liquidity? If the use of undisplayed liquidity at dark pools and broker-dealers were curtailed in

⁸⁴ The Commission has found that similar conduct is manipulative. See supra note 72.

any way, could institutional investors adjust by using undisplayed liquidity on exchanges and ECNs without incurring higher transaction costs?

2. Public Price Discovery

Comment is requested on whether the trading volume of undisplayed liquidity has reached a sufficiently significant level that it has detracted from the quality of public price discovery and execution quality. For example, has the level of undisplayed liquidity led to increased spreads, reduced depth, or increased short-term volatility in the displayed trading centers? If so, has such harm to public price discovery led to a general worsening of execution quality for investors in undisplayed markets that execute trades with reference to prices in the displayed markets?

It appears that a significant percentage of the orders of long-term investors are executed either in dark pools or at OTC market makers, while a large percentage of the trading volume in displayed trading centers is attributable to proprietary firms executing short-term trading strategies. Has there in fact been an increase in the proportion of long-term investor orders executed in undisplayed trading centers? If so, what is the reason for this tendency and is the practice beneficial or harmful to long-term investors and to market quality? With respect to undisplayed order types on exchanges and ECNs, do commenters believe that these order types raise similar concerns about public price discovery as undisplayed liquidity at dark pools and broker-dealers?

If commenters do not believe the current level of undisplayed liquidity has detracted from the quality of public price discovery, is there any level at which they believe the Commission should be concerned? In this regard, it appears that the overall percentage of trading volume between undisplayed trading centers and displayed trading centers has remained fairly steady for

many years between 70% and 80%.⁸⁵ Does this overall percentage accurately reflect the effect of undisplayed liquidity on public price discovery or does it mask potentially important changes in the routing of underlying types of order flow? For example, the NYSE captures a smaller percentage of trading in NYSE-listed stocks, while the overall volume in NYSE stocks has increased dramatically.⁸⁶ Should this change in market share be interpreted to mean that a greater percentage of long-term individual investor and long-term institutional investor order flow in NYSE-listed stocks has shifted to dark pools and OTC market makers, while the public markets are executing an expanding volume of trading that is primarily attributable to HFT strategies? If so, does this underlying shift in order flow affect the quality of public price discovery in NYSE-listed stocks and what are the reasons for this development? Do similar order flow patterns affect the quality of public price discovery in stocks listed on other exchanges as well?

Trade-At Rule. If commenters believe that the quality of public price discovery has been harmed by undisplayed liquidity, are there regulatory tools that the Commission should consider to address the problem? Should the Commission consider a “trade-at” rule that would prohibit any trading center from executing a trade at the price of the NBBO unless the trading center was displaying that price at the time it received the incoming contra-side order? Under this type of rule, for example, a trading center that was not displaying the NBBO at the time it received an incoming marketable order could either: (1) execute the order with significant price improvement (such as the minimum allowable quoting increment (generally one cent)); or (2)

⁸⁵ See supra note 21 and accompanying text (estimated 25.4% of share volume in NMS stocks executed in undisplayed trading centers in September 2009).

⁸⁶ See supra notes 8 and 10 and accompanying text.

route ISOs to full displayed size of NBBO quotations and then execute the balance of the order at the NBBO price.

The Commission requests comment on all aspects of a trade-at rule. Would it help promote pre-trade public price discovery by preventing the diversion of a significant volume of highly valuable marketable order flow away from the displayed trading centers and to undisplayed trading centers? If so, to what extent would the increased routing of this marketable order flow to displayed trading centers create significantly greater incentives for market participants to display quotations in greater size or with more aggressive prices?

Given the order-routing and trading system technologies currently in place to prevent trade-throughs, would it be feasible for market participants to comply with a trade-at rule at reasonable cost? Should a trade-at rule apply to all types of trading centers (e.g., exchanges, ECNs, OTC market makers, and dark pools) or only to some of them? If so, which ones and why? In addition, if the Commission were to consider such a rule, how should it treat the issue of displayed markets that charge access fees? Should it, for example, condition the "trade-at" protection of a displayed quotation on there being no access fee or an access fee that is much smaller than the current 0.3 cent per share cap in Rule 610(c) of Regulation NMS?

Depth-of-Book Protection. Rule 611 currently provides trade-through protection only to quotations that reflect the best, "top-of-book," prices of a trading center.⁸⁷ Should Rule 611 be expanded to provide trade-through protection to the displayed "depth-of-book" quotations of a trading center? Would depth-of-book protection significantly promote the greater display of

⁸⁷ See Regulation NMS Release, 70 FR at 37529-37530 (discussion of decision not to adopt a "Voluntary Depth Alternative" that would have provided trade-through protection to depth-of-book quotations that a market voluntarily included in the consolidated quotation data).

trading interest? Is depth-of-book protection feasible under current trading conditions and could the securities industry implement depth-of-book protection at reasonable cost?

Low-Priced Stocks. There may be greater incentives for broker-dealer internalization in low-priced stocks than in higher priced stocks. In low-priced stocks, the minimum one cent per share pricing increment of Rule 612 of Regulation NMS is much larger on a percentage basis than it is in higher-priced stocks. For example, a one cent spread in a \$20 stock is 5 basis points, while a one cent spread in a \$2 stock is 50 basis points – 10 times as wide on a percentage basis. Does the larger percentage spread in low-price stocks lead to greater internalization by OTC market makers or more trading volume in dark pools? If so, why? Should the Commission consider reducing the minimum pricing increment in Rule 612 for lower priced stocks?

3. Fair Access and Regulation of ATSS

A significant difference between the undisplayed liquidity offered by exchanges and the undisplayed liquidity offered by dark pools and broker-dealers is the extent of access they allow to such liquidity. As noted in section III.B.3. above, registered exchanges are required to offer broad access to broker-dealers. As ATSS that are exempt from exchange registration, dark pools are not required to provide fair access unless they reach a 5% trading volume threshold in a stock, which none currently do.⁸⁸ Broker-dealers that internalize also are not subject to fair access requirements. As a result, access to the undisplayed liquidity of dark pools and broker-dealers is determined primarily by private negotiation.

The Commission requests comment on whether trading centers offering undisplayed liquidity are subject to appropriate regulatory requirements for the type of business they conduct.

⁸⁸ The Commission understands that ECNs, unlike most dark pools, generally offer wide access to their services, including undisplayed liquidity, even if not subject to the fair access requirement of Rule 301(b)(5) of Regulation ATS.

For example, should the trading volume threshold in Regulation ATS that triggers the fair access requirement be lowered from its current 5%? If so, what is the appropriate threshold?

If an ATS exceeds the trading volume threshold, Regulation ATS requires that the ATS have access standards that do not unreasonably prohibit or limit any person in respect to access services, and prohibits the ATS from applying such standards in an unfair or discriminatory manner. Do commenters believe that all types of dark pools can comply with this fair access requirement, yet still achieve the objective of enabling institutional investors to trade in large size with minimized price impact? Can dark pool restrictions designed to prevent predatory trading behavior⁸⁹ be drafted in an objective fashion that would comply with the Regulation ATS fair access requirement?

The majority of dark pool volume is executed in ATSs that are sponsored by multi-service broker-dealers.⁹⁰ Can a broker-dealer sponsored dark pool apply objective fair access standards reasonably to prevent predatory trading, but without using such standards as a pretext to discriminate based on the competitive self interest of the sponsoring broker?

Finally, do investors have sufficient information about dark pools to make informed decisions about whether in fact they should seek access to dark pools? Should dark pools be required to provide improved transparency on their trading services and the nature of their participants? If so, what disclosure should be required and in what manner should ATSs provide such disclosures?

More broadly, are there any other aspects of ATS regulation that should be enhanced for dark pools or for all ATSs, including ECNs? For example, do ATSs contribute appropriately to

⁸⁹ See, e.g., section IV.B.1.d. supra (discussion of order anticipation strategies that seek to ascertain the existence of large buyers and sellers).

⁹⁰ Data compiled from Forms ATS submitted to Commission for 3d quarter 2009.

the costs of consolidated market surveillance? Currently, FINRA is the SRO for ATSS, and ATSS must pay the applicable FINRA regulatory fees. Do these FINRA fees adequately reflect the significant volume currently executed by ATSS? Should ATSS be required to contribute more directly to the cost of market surveillance? Finally, are there any ways in which Regulation ATS should be modified or supplemented to appropriately reflect the significant role of ATSS in the current market structure?

D. General Request for Comments

The Commission requests and encourages all interested persons to submit their views on any aspect of the current equity market structure. While this release was intended to present particular issues for comment, it was not intended in any way to limit the scope of comments or issues to be considered. In addition, the views of commenters are of greater assistance when they are accompanied by supporting data and analysis.

By the Commission.


Elizabeth M. Murphy
Secretary

Dated: January 14, 2010

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61363; File No. PCAOB-2009-02)

January 15, 2010

Public Company Accounting Oversight Board; Order Approving Proposed Rules on Auditing Standard No. 7, Engagement Quality Review, and Conforming Amendment

I. Introduction

On August 4, 2009, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") a notice (the "Notice") of proposed rules (File No. PCAOB-2009-02) on Auditing Standard No. 7, Engagement Quality Review, and Conforming Amendment to the Board's Interim Quality Control Standards, pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"). Notice of the proposed rules was published in the Federal Register on November 5, 2009.¹ The Commission received nine comment letters relating to the proposed rules. For the reasons discussed below, the Commission is granting approval of the proposed rules. As specified by the Board, the rules are effective for the engagement quality review ("EQR") of audits and interim reviews for fiscal years beginning on or after December 15, 2009.

II. Description

Section 103 of the Act directs the Board, among other things, to set standards for public company audits, including a requirement for each registered public accounting firm to "provide a concurring or second partner review and approval of [each] audit report (and other related information), and concurring approval in its issuance" According to the Board, the

¹ See SEC Release No. 34-60903 (October 29, 2009); 74 FR 57357 (November 5, 2009).

proposed rules would strengthen and expand the Board's existing requirements for concurring reviews.

According to the Board, a well-performed EQR can serve as an important safeguard against erroneous or insufficiently supported audit opinions and, accordingly, can contribute to audit quality. As described in the Notice, the engagement quality review will serve as a meaningful check on the work performed by the engagement team, and the Board believes this should increase the likelihood that a registered public accounting firm will identify any significant engagement deficiencies before it issues its audit report.

Auditing Standard No. 7 requires the engagement quality reviewer (or the "reviewer") to evaluate the significant judgments made and related conclusions reached by the engagement team in forming the overall conclusion on the engagement and in preparing the engagement report. Auditing Standard No. 7 also requires the engagement quality reviewer to perform certain procedures designed to focus the reviewer on those judgments and conclusions. As discussed in the Notice, the procedures required of an engagement quality reviewer are different in nature from the procedures required of the engagement team. Unlike the engagement team, a reviewer does not perform substantive procedures or obtain sufficient evidence to support an opinion on the financial statements or internal control over financial reporting. If more audit work is necessary before the reviewer may provide concurring approval of issuance, the engagement team – not the reviewer – is responsible under PCAOB standards for performing the work. In contrast, the reviewer fulfills the obligation to perform an EQR by holding discussions with the engagement team, reviewing documentation, and determining whether to provide concurring approval of issuance.

The proposed rules also amend the Board's interim quality control standards by replacing the third sentence of paragraph 18 of QC section 20, "System of Quality Control for a CPA

Firm's Accounting and Auditing Practice" with a statement that a firm's quality control policies and procedures also should address engagement quality reviews pursuant to PCAOB Auditing Standard No. 7.

III. Discussion

The Commission received nine comment letters on the proposed rules. Seven letters were received from registered public accounting firms, and two letters were received from professional organizations.² The commenters generally agreed with the requirements of Auditing Standard No. 7 and also expressed agreement with the changes made by the PCAOB in response to its comment process.³

PCAOB Use and Purpose of Release Text

Many of the comments indicated that there is a lack of clarity resulting from perceived inconsistencies between Auditing Standard No. 7 and text in the Board's adopting release.⁴ One commenter expressed a concern whether the release text has the "same weight" as the standard itself.⁵ One commenter expressed a concern that the release text issued with an adopted standard is not subject to the PCAOB's comment process.⁶

² See comments of Deloitte & Touche LLP ("Deloitte"), Ernst & Young LLP ("EY"), Grant Thornton LLP ("Grant"), KPMG LLP ("KPMG"), McGladrey & Pullen LLP ("McGladrey"), Piercy Bowler Taylor & Kern ("PBTK"), PricewaterhouseCoopers LLP ("PWC"), Center for Audit Quality ("CAQ"), and Center for Capital Markets Competitiveness of the US Chamber of Commerce ("CCMC").

³ One commenter (CCMC) provided comments related to the PCAOB's standard-setting process in general, including due process and convergence with international auditing standards. These comments were similar to comments received by the PCAOB during its standard-setting process for Auditing Standard No. 7. In response, the PCAOB stated in its adopting release for Auditing Standard No. 7 that it continuously endeavors to improve its processes, including the standard-setting process, and is considering comments it receives. The Commission encourages the Board to continue to consider comments to improve the Board's standard-setting process. The Commission will continue to provide oversight as the Board endeavors to improve all of its processes.

⁴ See comments of CAQ, CCMC, Deloitte, EY, Grant, KPMG, McGladrey, and PWC.

⁵ See comments of PBTK.

⁶ See comments of CCMC.

The release text summarizes issues that the Board considered significant in reaching the conclusions set forth in the standard, including responses to comments and the rationale for accepting certain approaches and rejecting others. The Commission publishes notice of and approves the “Rules of the Board” as defined in Section 2(a)(13) of the Act, including the auditing standards adopted by the Board. The release text accompanying the Board’s issuance of an auditing standard is not part of the “Rules of the Board” that are approved by the Commission; rather, it is a statement made by the PCAOB to provide insight into the Board’s decision-making process.

Documentation of the EQR

Commenters generally expressed agreement with the documentation requirement as set forth in Auditing Standard No. 7.⁷ Many of the same commenters, however, expressed concerns regarding an example in the PCAOB’s adopting release that describes the documentation requirement for significant engagement deficiencies identified by the engagement quality reviewer. The release states that “the EQR documentation should contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand, e.g., the significant deficiency identified, how the reviewer communicated the deficiency to the engagement team, why such matter was important, and how the reviewer evaluated the engagement team’s response.”

Commenters were concerned that the example in the release could be read to be inconsistent with the requirement in the standard and could result in unintended consequences in terms of performance. The primary concern was that the engagement quality reviewer may be compelled to document every interaction with the engagement team, not knowing whether a

⁷ See comments of CAQ, Deloitte, EY, Grant, KPMG, McGladrey, and PWC.

matter will ultimately be identified as a significant engagement deficiency. Commenters viewed this as a documentation requirement for an EQR that is incremental to the requirements of PCAOB Auditing Standard No. 3, Audit Documentation. Auditing Standard No. 3 does not require the auditor to document each discussion and preliminary conclusion.

In addition, one commenter was concerned that the example provided in the PCAOB's adopting release may disrupt the communication between the engagement team and the engagement quality reviewer.⁸ The commenter expressed a view that, if unable to determine which matters may be significant, the engagement quality reviewer would need to document every issue and therefore would not perform any review procedures until the engagement team completed all audit work and finalized all of its conclusions.

The Commission does not believe that there is any inconsistency between the example in the adopting release and the requirements of Auditing Standard No. 7. The PCAOB specified in its adopting release that the example applies "if a reviewer identified a significant engagement deficiency to be addressed by the engagement team." We believe that documentation suggested in the example from the adopting release is appropriate after the engagement quality reviewer has concluded that he or she has identified a significant engagement deficiency. However, since several comments were related to this point, we encourage the PCAOB to provide further implementation guidance on the documentation requirement.⁹

Standard of Care

Commenters generally expressed agreement with the revisions that the PCAOB made to the description of due professional care in the standard in response to comments, including

⁸ See comments of KPMG.

⁹ We note clarifications have been provided in other contexts. For example, see PCAOB Staff Q&A at http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2009/09-02_FASB_Codification.pdf

establishing the expected standard of performance by referring to AU Section 230, Due Professional Care in the Performance of Work (“AU 230”).¹⁰ However, many of the same commenters expressed concern with language in the adopting release about the concept of due professional care. Particularly, many commenters pointed to language in the adopting release that a qualified reviewer who has performed the required review with due professional care “will, necessarily, have discovered any significant engagement deficiencies that could reasonably have been discovered under the circumstances.” Certain commenters expressed a view that the language in the release could be read as requiring absolute assurance or a “flawless” review.¹¹

The Commission believes that the PCAOB adequately responded to comments in this area during its reproposal process. We do not find any inconsistency between the PCAOB’s adopting release and the requirement to conduct the EQR with due professional care as described in paragraphs 12 and 17 of Auditing Standard No. 7. Paragraph 12 of Auditing Standard No. 7 references AU 230, which is the source of guidance regarding due professional care in the PCAOB’s interim auditing standards. Moreover, the PCAOB specified in its adopting release that “the Board is not redefining due professional care in the context of the EQR standard.”

Definition of Partner

One commenter suggested that the PCAOB revise the description of the qualifications of the engagement quality reviewer in Auditing Standard No. 7 to specify that equity ownership in the firm is not a requirement for a reviewer.¹² The commenter believed Board language in its adopting release on the distinction between “partner” and “non-partner” could be considered “muddying and potentially biasing (and perhaps unintended) restrictive language.”

¹⁰ See comments of CAQ, Deloitte, EY, Grant, KPMG, and PWC.

¹¹ See comments of Deloitte, Grant, and KPMG.

¹² See comments of PBTK.

The discussion of requiring a partner or an individual in an equivalent position to perform the EQR is consistent with the Commission's independence rules.¹³ We do not believe that equity ownership is necessarily inherent in the analysis; rather the analysis of whether an individual is a partner or in an equivalent position is based on the organization of the individual firm and other related facts and circumstances.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed PCAOB Rules on Auditing Standard No. 7, Engagement Quality Review, and Conforming Amendment (File No. PCAOB-2009-02) are consistent with the requirements of the Act and the securities laws and are necessary or appropriate in the public interest or for the protection of investors.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that the proposed PCAOB Rules on Auditing Standard No. 7, Engagement Quality Review, and Conforming Amendment (File No. PCAOB-2009-02) be and hereby are approved.

By the Commission.



Elizabeth M. Murphy
Secretary

¹³ 17 CFR 210.2-01(f)(7)(ii).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61366 / January 15, 2010

In the Matter of
Full Value Advisors, LLC

STAY ORDER

On January 11, 2010, the Commission issued an order denying an application filed by Full Value Advisors, LLC ("Full Value"), a Delaware limited liability company and an investment adviser to certain private investment companies.¹ Full Value's application, which it filed on October 24, 2006 pursuant to Section 13(f)(2) of the Securities Exchange Act of 1934 ("Exchange Act"), sought an exemption from Rule 13f-1 under the Exchange Act ("Exemptive Application"). On January 11, 2010, the Commission also issued a separate order denying two written requests made by Full Value pursuant to Section 13(f)(3) of the Exchange Act and Rule 24b-2 thereunder seeking confidential treatment of information that Full Value otherwise was required to disclose on Forms 13F for the quarters ended December 31, 2006 and March 31, 2007, respectively (collectively, "CT Requests").²

We understand Full Value may file a petition for review. Therefore, it appears appropriate under the circumstances to grant a stay of the Commission's orders that deny Full Value's Exemptive Application and CT Requests for sixty days or, should Full Value file a timely appeal in a Court of Appeals specified in Section 25 of the Exchange Act, pending determination of that appeal.

Accordingly, it is ORDERED that the Commission's January 11, 2010 order denying Full Value's Exemptive Application be, and it hereby is, stayed for sixty (60) days from January 11, 2010; and it is further

¹ *Full Value Advisors, LLC*, Securities Exchange Act Rel. No. 61327 (Jan. 11, 2010), ___ SEC Docket ___.

² *Full Value Advisors, LLC*, Exchange Act Rel. No. 61328 (Jan. 11, 2010), ___ SEC Docket ___. Under Form 13F Confidential Treatment Instruction 4, Full Value must disclose the holdings information required on Form 13F within six business days of notification of the Commission's denial of the CT Requests.

ORDERED that if Full Value files a timely appeal with a Court of Appeals, the stay of the denial of Full Value's Exemptive Application and CT Requests shall continue pending the determination of that appeal by the Court of Appeals.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

*Commissioner Casey and
Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61377 / January 19, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13752

In the Matter of

MORTGAGES LTD.
SECURITIES, LLC

Respondent.

ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS PURSUANT TO SECTION
15(b) OF THE SECURITIES EXCHANGE
ACT OF 1934, MAKING FINDINGS, AND
REVOKING BROKER-DEALER
REGISTRATION

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Mortgages Ltd. Securities, LLC ("MLS" 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,¹ except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Revoking Broker-Dealer Registration, as set forth below.

¹ The findings herein are not binding on any other person or entity in this or any other proceeding.

III.

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

Summary

These proceedings arise out of the conduct of MLS, a registered broker-dealer and affiliate of Mortgages Ltd. ("MLtd."), an Arizona-based private lender that, through MLS, raised more than \$741 million from about 2,700 investors nationwide from February 2004 to June 2008. MLS made oral and written misrepresentations to investors concerning the safety and liquidity of the investment and risks associated with the investment. MLS led investors to believe that the loans MLtd. had underwritten were safer than they actually were, and investors were unaware that MLtd. was taking on larger and riskier loans. MLS misrepresented how the declining market conditions that worsened throughout 2007 impacted the safety of the investment, and how MLtd. and its principal had increasingly resorted to selling their personal assets to prop up MLtd.

Respondent

1. Respondent MLS is an Arizona limited liability company with its principal place of business in Phoenix, Arizona. MLS has been registered with the Commission since 2004 as a broker-dealer. MLS is solely owned by SMC Revocable Trust, a family trust established by MLS's deceased president and CEO, Scott M. Coles, who was also the sole trustee.

Other Relevant Persons and Entities

2. Mortgages Ltd. is an Arizona-based private lender which, from 2004 to June 2, 2008, raised more than \$741 million from about 2,700 investors nationwide through MLS. MLtd. also received more than \$197 million in the form of promissory notes from its largest investor, Radical Bunny, LLC.

3. Scott M. Coles ("Coles") owned, operated and managed MLtd. until his death on June 2, 2008.

4. Radical Bunny, LLC ("Radical Bunny") is an Arizona limited liability company co-managed by four individuals. Between 1996 and 2008, Radical Bunny raised funds from investors in a series of unregistered securities offerings and either invested or loaned the offerings proceeds to MLtd.

Background

5. From its inception in 2004 through June 2008, MLS raised \$741 million from approximately 2,700 investors nationwide through the offer and sale of securities issued by MLtd. MLtd. maintained an inventory of high interest, short-term loans it made to real estate developers, which MLtd. then securitized and sold through eleven private placement offerings made through MLS. Investors had the option to invest either in specific loans (the "pass-through

investors”) or in one of several funds (the “pooled fund investors”) that purchased various loans or portions of loans originated by MLtd. MLtd. typically created an “impound account” that would take a portion of the loan amount, set it aside, and use those funds to make the periodic interest payments to the investors for the term of the investment.

6. In lieu of commissions, MLtd. paid MLS a monthly placement fee. From January 2007 to June 2008 (the “relevant period”), MLS’s monthly placement fees totaled \$6,973,785. During the relevant period, MLS employed eight to ten registered representatives at a time. MLS did not advertise. New investors came to MLS through word-of-mouth referrals from existing investors.

7. Before investing, investors received a private offering memorandum (“POM”), subscription agreement, the most recent quarterly report for the funds, and current newsletter. Pass-through investors also received a loan summary sheet that detailed the specific loan. MLtd. also sent newsletters to existing investors. The POMs contained broad, general statements regarding MLtd.’s loan origination business and general risk factors. The POMs did not address the specific practices employed by MLtd. and related risks, and were never amended or updated to reflect these facts. Moreover, while investors received the audited financial statements for MLtd. for the years ended December 31, 2005 and 2006, there was very little discussion about its liquidity position, market risk and loan funding practices and investors received no information about Coles’s financial condition. Such information became increasingly important as Coles and MLtd. resorted to purchasing the non-performing loans to maintain the illusion that its loans were all “performing.”

8. In addition to the written materials, MLS registered representatives made a number of oral statements to investors. Those statements covered four common themes: MLtd. had never failed to pay back principal in its 40+ year history; the risk was low, minimal, or of “some” degree typically described as other than “high”; the rate of return was consistently above average or “higher than normal”; and a first deed of trust provided investors with security. Continuing to June 2008, MLS persisted in highlighting these themes.

9. From 2001 through 2006, Coles and MLtd. increasingly originated significantly larger, but fewer, loans. Many of these loans contained “delayed funding” terms which obligated MLtd. to fund substantial portions of the loan in stages rather than the entire amount upfront. The concentration of MLtd.’s loan portfolio in fewer, larger loans and the delayed funding commitments magnified the effects of deteriorating market conditions that began to impact MLtd. in late 2006 and continued throughout 2007. Coles and MLtd. pursued various strategies to stave off a liquidity crisis but these strategies only increased the risks to the investors.

10. Beginning around December 2006, Coles and MLtd. received indications that some of its borrowers were at risk of becoming delinquent. Such information was known to MLS because Coles was both the manager of MLtd. and the president of MLS. He also made available such information to MLS personnel. At the beginning of 2007, MLS management recognized, and warned Coles of, the potential threats to MLtd. posed by the concentration of few, big loans. Specifically, MLtd.’s vice-president of operations discussed with Coles MLtd.’s

liquidity issues, which were attributed to conditions in the real estate market and the fact that some of MLtd.'s borrowers were not paying off loans as they matured. Another officer alerted Coles that while MLtd.'s fundraising from investors was sufficient to meet its existing loan funding obligations, the amount of incoming investor funds was insufficient to originate new loans. He told Coles, as did MLS's president, that MLtd.'s individual loan commitments were too large and that it wasn't prudent to create this concentration of risk. Coles continually brushed these warnings aside, and marginalized those who disagreed with his management decisions. In addition, MLS's management was concerned about the risks that its largest investor, Radical Bunny, posed to MLtd. Radical Bunny was conducting its own unregistered securities offering to invest in MLtd. and already had become a significant source of capital for MLtd.

11. By summer 2007, MLtd. stopped writing new loans with one or two exceptions later in the fall. In October 2007, MLtd. faced increased loan workouts. In most instances, Coles and MLtd. negotiated an extension of time to repay principal, with interest payments due in the interim. As a result, Coles and MLtd. maintained the illusion that the loans were current. Further, the impound accounts masked nonperforming loans because interest payments continued to be made to investors from these prefunded accounts.

12. Conditions worsened in 2008. By February 2008, Coles and MLtd. expected \$70 million in loan payoffs but only \$1 – 2 million in payoffs occurred. From January through May 2008, MLtd.'s chief financial officer, at Coles' direction, called Radical Bunny daily to seek funding from it and used these funds to meet MLtd.'s delayed funding obligations (a portion of which went to the impound account to pay investors). Still, MLtd. continued to solicit and accept new investment capital until Coles's death in June 2008.

13. MLS registered representatives downplayed the true nature of the safety and risks associated with the investment. In fact, Coles routinely instructed MLS's registered representatives to go beyond the statements made in the POM by promising key aspects of the investment – such as promises of a guaranteed redemption – in order to induce individuals to invest. In early 2008, as MLtd.'s loan portfolio unraveled and its cash flow situation continued to deteriorate, Coles sent investor newsletters containing misrepresentations concerning the safety of investment, the performance of the loan portfolio, and strength of MLtd.

14. The POMs contained over twelve pages of disclosures relating to the investment risk, but these statements were broad and general and none of the disclosures discussed the risks, known to Coles and MLS by 2007, of MLtd.'s increasingly concentrated loan portfolio and the demands it placed on MLtd.'s liquidity. Similarly, rather than provide meaningful disclosure about these known risks, MLS registered representatives highlighted general information about MLtd., such as its consistent track record of performing as advertised.

15. MLS further misrepresented the level of risk to its pooled fund investors because Coles knew that MLtd.'s borrowers were experiencing difficulties in obtaining the takeout financing that would be used to repay MLtd. and, consequently, the risk of loss this presented to the investors' principal.

16. MLS misrepresented the strength of MLtd.'s business because Coles, and MLS registered representatives, knew that by the summer 2007, MLtd. stopped originating loans. This was a significant fact as it went directly to the financial health of MLtd., a loan originator that was no longer originating loans.

17. MLS misrepresented the performance of MLtd.'s loans. As the number of nonperforming loans grew significantly, which put the pooled fund investors' principal at risk of repayment, Coles simply bought up these loans to remove them from the portfolio.

18. When soliciting investors, MLS and its registered representatives emphasized the fact that during its long existence, no investor in MLtd. had ever lost any of his or her principal. This statement was misleading. In fact, contrary to what MLS's registered representatives told investors, by late 2007 MLtd. failed to honor its commitments to redeem investor requests for principal.

19. In addition, MLS made misleading statements regarding loan performance. In January 2008, MLS issued a newsletter that described MLtd.'s securities as "predictable investments." The newsletter states: "A predictable investment, by our definition, is an investment that is short-term, liquid and measurable – receiving monthly payments." This was misleading because MLS's definition of "predictable" focused only on one aspect – the issuance of monthly interest payments, which continued while MLtd. extended the payoff dates for its borrowers rather than exercise its option to foreclose – while ignoring the fact that investors who expected the return of their principal at the conclusion of their loan term would learn that those expectations were misplaced. According to MLS's chief compliance officer, Coles opted to use the word "predictable" in the newsletter over her objections against doing so.

20. Similarly, in an investor letter dated February 21, 2008, MLS stated that "[a]t the present time, all of our loans are current." In another investor letter dated March 26, 2008, MLS stated that "there are no current delinquencies to investors." Both of these letters misled investors into thinking that their investment was safe because MLtd.'s borrowers were impliedly making interest payments and satisfying payoffs at maturity. In actuality, MLtd. routinely plucked troubled loans from its investor pools, repackaged and sold them at a higher note rate to others, or Coles purchased them himself. Such practices cosmetically enhanced the appearance of the pools' performance.

21. Although MLtd.'s increased concentration in a few large loans was well known throughout MLS, and Coles was alerted to risks of making such loans, investors were not told of the risks that such concentration posed to them.

22. Coles and MLS registered representatives made oral misrepresentations, at times later confirmed in writing, regarding MLtd.'s obligation to repurchase the investment made by pass-through investors. MLS registered representatives commonly represented to pass-through investors that investors would receive back their principal upon notice (or an agreed upon term set at the outset of the investment). While the POMs state that MLtd. merely had to use its "best

efforts" to cause the repurchase, Coles authorized the registered representatives to make specific contrary representations.

23. In late 2007 through April 2008, however, when investors requested repayment of principal, citing representations that had been made about MLtd.'s repurchase obligation, Coles refused these requests, specifically citing the "best efforts" language in the POM as justification.

24. From September 2005 to June 2008, MLtd. borrowed \$197 million from Radical Bunny. Radical Bunny raised the money that it loaned to MLtd. from hundreds of investors to whom it issued promissory notes. By early 2007, notes held by Radical Bunny were maturing and MLtd. was obligated to pay them a much higher rate of return in exchange for Radical Bunny's continued capital infusions. As MLtd. faced decreased payoffs of loans, Radical Bunny became increasingly important as a source of capital to MLtd.

25. Investors had no way of knowing of Radical Bunny's critical role in providing capital to MLtd. These funds enabled MLtd. to continue its lending operations, which ultimately impacted MLtd.'s ability to pay investors' principal.

26. In January 2007, MLtd. and Radical Bunny met and discussed a number of issues concerning their relationship. Among the concerns raised at that meeting, which Coles attended, were the following: (1) whether MLtd. had accepted money that Radical Bunny had raised pursuant to an unregistered offering of securities; (2) whether some of the monies that MLtd. accepted from Radical Bunny came from unaccredited investors; and (3) whether Radical Bunny had failed to provide its investors with offering documents making the appropriate disclosures and audited financial statements.

27. Radical Bunny's offering was never registered; and MLtd. never ceased accepting the monies that Radical Bunny continued to raise through its unregistered offering. Neither MLtd. nor MLS ever disclosed to investors that Radical Bunny had failed and continued to fail to comply with the securities registration provisions, or that MLtd. had relied and continued to rely on Radical Bunny's unregistered offering proceeds to fund virtually all of its business activity. Indeed, MLtd. accepted about \$120 million from Radical Bunny after the compliance issues first surfaced.

28. As a result of the conduct described above, MLS willfully violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

29. As a result of the conduct described above, MLS willfully violated Section 15(c) of the Exchange Act, which prohibits a broker or dealer from making use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of any security (other than commercial paper, bankers' acceptances, or commercial bills), otherwise than on a national securities exchange of which it is

a member, or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), by means of any manipulative, deceptive, or other fraudulent device or contrivance.

Disgorgement and Civil Penalties

30. Respondent has submitted a sworn Statement of Financial Condition dated February 28, 2009, a sworn affidavit providing updated financial information through July 31, 2009, and other evidence, and has asserted its inability to pay disgorgement plus prejudgment interest and has further asserted its inability to pay a civil penalty.

MLS'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 and in the public interest to impose the sanctions agreed to in Respondent MLS's Offer.

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

A. The registration of Respondent MLS as a broker or dealer with the Commission be, and hereby is, revoked pursuant to Section 15(b)(4) of the Exchange Act;

B. Respondent shall pay disgorgement of \$6,973,785 and prejudgment interest of \$331,048, but that payment of such amount is waived and the Commission is not imposing a penalty against Respondent based upon Respondent's sworn representations in its Statement of Financial Condition dated February 28, 2009, a sworn affidavit providing updated financial information through July 31, 2009, and other documents submitted to the Commission.

C. 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 civil penalty. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement and interest and civil penalty should not be ordered; (3) contest the amount of disgorgement and interest and civil penalty to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[Release No. 34-61379; File No. S7-03-10]

RIN 3235-AK53

Risk Management Controls for Brokers or Dealers with Market Access

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is proposing for comment new Rule 15c3-5 under the Securities Exchange Act of 1934 ("Exchange Act") that would require brokers or dealers with access to trading directly on an exchange or alternative trading system ("ATS"), including those providing sponsored or direct market access to customers or other persons, to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. Given the increased speed and automation of trading on securities exchanges and ATSS today, and the growing popularity of sponsored or direct market access arrangements where broker-dealers allow customers to trade in those markets electronically using the broker-dealers' market participant identifiers, the Commission is concerned that the various financial and regulatory risks that arise in connection with such access may not be appropriately and effectively controlled by all broker-dealers. The Commission believes it is critical that broker-dealers, which under the current regulatory structure are the only entities that may be members of exchanges and, as a practical matter, constitute the majority of subscribers to ATSS, appropriately control the risks associated with market access, so as not to jeopardize their own

financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system.

Specifically, the proposed rulemaking would require that brokers or dealers with access to trading securities directly on an exchange or ATS, as a result of being a member or subscriber thereof, establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, are reasonably designed to systematically limit the financial exposure of the broker or dealer that could arise as a result of market access, and ensure compliance with all regulatory requirements that are applicable in connection with market access. The proposed rule encompasses trading in all securities on an exchange or ATS, including equities, options, exchange-traded funds, and debt securities. The required financial risk management controls and supervisory procedures must include those reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous. The required regulatory risk management controls and supervisory procedures must also include those reasonably designed to prevent the entry of orders without compliance with all regulatory requirements that must be satisfied on a pre-order entry basis, prevent the entry of orders that the broker-dealer or customer is restricted from trading, restrict market access technology and systems to authorized persons, and assure appropriate surveillance personnel receive immediate post-trade execution reports. The requirement that a broker-dealer's financial and regulatory risk management controls and procedures be reasonably designed to prevent the entry of orders that fail to comply with the specified conditions would necessarily require the controls be applied on an automated, pre-trade basis before orders route to an exchange or ATS, thereby effectively prohibiting the practice of "unfiltered" or "naked" access to an exchange or ATS.

The financial and regulatory risk management controls and supervisory procedures required by Proposed Rule 15c3-5 must be under the direct and exclusive control of the broker or dealer with market access. In addition, a broker or dealer with market access would be required to establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required by Proposed Rule 15c3-5 and for promptly addressing any issues. Among other things, the broker or dealer would be required to review, no less frequently than annually and in accordance with written procedures, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures, and document that review. In addition, the Chief Executive Officer (or equivalent officer) of the broker or dealer would be required, on an annual basis, to certify that such risk management controls and supervisory procedures comply with Proposed Rule 15c3-5, and that the regular review described above has been conducted.

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

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. S7-03-10 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

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

All submissions should refer to File No. S7-03-10. 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: Marc F. McKayle, Special Counsel, at (202) 551-5633; Theodore S. Venuti, Special Counsel, at (202) 551-5658; and Daniel Gien, Attorney, at (202) 551-5747, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

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Appendix

I. Introduction

The Commission has long recognized that beneficial innovations in trading and technology can significantly improve the efficiency and quality of our nation's securities markets. At the same time, the Commission must ensure that the regulatory framework keeps pace with market developments and effectively addresses any emerging risks. In recent years, the development and growth of automated electronic trading has allowed ever increasing volumes of securities transactions across the multitude of trading systems that constitute the U.S. national market system. In fact, much of the order flow in today's marketplace is typified by high-speed, high-volume, automated algorithmic trading, and orders are routed for execution in milliseconds or even microseconds.

Over the past decade, the proliferation of sophisticated, high-speed trading technology has changed the way broker-dealers trade for their own accounts and as agent for their customers.¹ In addition, customers – particularly sophisticated institutions – have themselves begun using technological tools to place orders and trade on markets with little or no substantive intermediation by their broker-dealers. This, in turn, has given rise to the increased use and reliance on “direct market access” or “sponsored access” arrangements.² Under these

¹ The Commission notes that high frequency trading has been estimated to account for more than 60 percent of the U.S. equities market volume. See, e.g., Nina Mehta, Naked Access Bashed at Roundtable, *Trader's Magazine*, August 6, 2009 (citing a report by Aite Group).

² It has been reported that sponsored access trading volume accounts for 50 percent of overall average daily trading volume in the U.S. equities market. See, e.g., Carol E. Curtis, Aite: More Oversight Inevitable for Sponsored Access, *Securities Industry News*, December 14, 2009 (citing a report by Aite Group). In addition, sponsored access has been reported to account for 15 percent of Nasdaq volume. See, e.g., Nina Mehta,

arrangements, the broker-dealer allows its customer – whether an institution such as a hedge fund, mutual fund, bank or insurance company, an individual, or another broker-dealer – to use the broker-dealer’s market participant identifier (“MPID”) or other mechanism for the purposes of electronically accessing the exchange or ATS. With “direct market access,”³ as commonly understood, the customer’s orders flow through the broker-dealer’s systems before passing into the markets, while with “sponsored access”⁴ the customer’s orders flow directly into the markets without first passing through the broker-dealer’s systems. In all cases, however, whether the broker-dealer is trading for its own account, is trading for customers through more traditionally intermediated brokerage arrangements, or is allowing customers direct market access or sponsored access, the broker-dealer with market access⁵ is legally responsible for all trading activity that occurs under its MPID.⁶

Sponsored Access Comes of Age, Traders Magazine, February 11, 2009 (quoting Brian Hyndman, Senior Vice President for Transaction Services, Nasdaq OMX Group, Inc. “[direct sponsored access to customers is] a small percentage of our overall customer base, but it could be in excess of 15 percent of our overall volume.”).

³ Generally, direct market access refers to an arrangement whereby a broker-dealer permits customers to enter orders into a trading center but such orders are filtered through the broker-dealer’s trading systems prior to reaching the trading center. See, e.g., Nasdaq Rule 4611(d)(1)(B).

⁴ Generally, sponsored access refers to an arrangement whereby a broker-dealer permits its customers to enter orders into a trading center that bypass the broker-dealer’s trading system and are routed directly to a trading market via a dedicated port, in some cases supported by a service bureau or other third party technology provider. See, e.g., Nasdaq Rule 4611(d)(1)(A). “Unfiltered” or “naked” access is generally understood to be a subset of sponsored access where pre-trade filters or controls are not applied to orders before such orders are submitted to an exchange or ATS. The Commission notes that the proposed rule would effectively prohibit any access to trading on an exchange or ATS, whether sponsored or otherwise, where pre-trade controls are not applied.

⁵ Under Proposed Rule 15c3-5(a)(1), the term “market access” is defined as access to trading in securities on an exchange or ATS as a result of being a member or subscriber of the exchange or ATS, respectively. See infra Section III.C.

⁶ See, e.g., NYSE IM-89-6 (January 25, 1989); and Securities Exchange Act Release No. 40354 (August 24, 1998), 63 FR 46264 (August 31, 1998) (NASD NTM- 98-66).

Certain market participants may find the wide range of access arrangements beneficial. For instance, facilitating electronic access to markets can provide broker-dealers, as well as exchanges and ATSS, opportunities to compete for greater volumes and a wider variety of order flow. For a broker-dealer's customers, which could include hedge funds, institutional investors, individual investors, and other broker-dealers, such arrangements may reduce latencies and facilitate more rapid trading, help preserve the confidentiality of sophisticated, proprietary trading strategies, and reduce trading costs by lowering operational costs,⁷ commissions, and exchange fees.⁸

Current self-regulatory organization ("SRO") rules and interpretations governing electronic access to markets have sought to address the risks of this activity, as discussed below. However, the Commission preliminarily believes that more comprehensive and effective standards that apply consistently across the markets are needed to effectively manage the financial, regulatory, and other risks, such as legal and operational risks, associated with market access. These risks – whether they involve the potential breach of a credit or capital limit, the submission of erroneous orders as a result of computer malfunction or human error, the failure to comply with SEC or exchange trading rules, the failure to detect illegal conduct, or otherwise – are present whenever a broker-dealer trades as a member of an exchange or subscriber to an ATS, whether for its own proprietary account or as agent for its customers, including traditional agency brokerage and through direct market access or sponsored access arrangements.

⁷ For example, broker-dealers may receive market access from other broker-dealers to an exchange where they do not have a membership.

⁸ The Commission notes that exchanges offer various discounts on transaction fees that are based on the volume of transactions by a member firm. See, e.g., Nasdaq Rule 7018 and NYSE Arca, Inc. ("NYSE Arca") Fee Schedule. Exchange members may use access arrangements as a means to aggregate order flow from multiple market participants under one MPID to achieve higher transaction volume and thereby qualify for more favorable pricing tiers.

Accordingly, to effectively address these risks and the vulnerability they present to the U.S. national market system, the Commission has designed the proposed rule to apply broadly to all access to trading on an exchange or ATS provided directly by a broker-dealer.⁹

The Commission, however, is particularly concerned about the quality of broker-dealer risk controls in sponsored access arrangements, where the customer order flow does not pass through the broker-dealer's systems prior to entry on an exchange or ATS. The Commission understands that, in some cases, the broker-dealer providing sponsored access may not utilize any pre-trade risk management controls (i.e. "unfiltered" or "naked" access),¹⁰ and thus could be unaware of the trading activity occurring under its market identifier and have no mechanism to control it. The Commission also understands that some broker-dealers providing sponsored access may simply rely on assurances from their customers that appropriate risk controls are in place.

Appropriate controls to manage financial and regulatory risk for all forms of market access are essential to assure the integrity of the broker-dealer, the markets, and the financial system. The Commission preliminarily believes that risk management controls and supervisory procedures that are not applied on a pre-trade basis or that are not under the exclusive control of the broker-dealer are inadequate to effectively address the risks of market access arrangements, and pose a particularly significant vulnerability in the U.S. national market system.

The securities industry itself has begun to recognize the risks associated with sponsored access, and to call for guidelines on appropriate credit and risk controls in order to avert a

⁹ Proposed Rule 15c3-5 would not apply to non-broker-dealers, including non-broker-dealers that are subscribers of an ATS.

¹⁰ It has been reported that "unfiltered" access accounts for an estimated 38 percent of the average daily volume of the U.S. stock market. See, e.g., Scott Patterson, Big Slice of Market Is Going 'Naked', Wall Street Journal, December 14, 2009 (citing a report by Aite Group).

potential “disaster scenario.”¹¹ Today, order placement rates can exceed 1,000 orders per second with the use of high-speed, automated algorithms.¹² If, for example, an algorithm such as this malfunctioned and placed repetitive orders with an average size of 300 shares and an average price of \$20, a two-minute delay in the detection of the problem could result in the entry of, for example, 120,000 orders valued at \$720 million. In sponsored access arrangements, as well as other access arrangements, appropriate pre-trade credit and risk controls could prevent this outcome from occurring by blocking unintended orders from being routed to an exchange or ATS.

Incidents involving algorithmic or other trading errors in connection with market access occur with some regularity.¹³ For example, it was reported that, on September 30, 2008, trading in Google became extremely volatile toward the end of the day, dropping 93% in value at one point, due to an influx of erroneous orders onto an exchange from a single market participant. As a result, Nasdaq had to cancel numerous trades, and adjust the closing price for Google and

¹¹ See letter to Elizabeth M. Murphy, Secretary, Commission, from Ann Vlcek, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), February 26, 2009. In commenting on a NASDAQ Stock Exchange LLC (“Nasdaq”) proposed rule change to establish a new Nasdaq market access rule, SIFMA urged that “without clear guidelines for the establishment and maintenance of both counterparty-specific and enterprise-wide credit and risk controls ... some [broker-dealers] may allow ... trad[ing] well in excess of [a] client’s traditional risk limits as well as the [broker-dealer’s] own capital maintenance requirements;” and concluded that such unencumbered trading activity and market access could lead to a potential “disaster scenario.”

¹² See letter to Elizabeth M. Murphy, Secretary, Commission, from John Jacobs, Director of Operations, Lime Brokerage LLC, February 17, 2009.

¹³ For example, information from Nasdaq indicates that in 2008 and 2009 Nasdaq granted approximately 4,000 requests and approximately 1,600 requests to break trades as erroneous trades, respectively.

the closing value for the Nasdaq 100 Index.¹⁴ In addition, it was reported that, in September 2009, Southwest Securities announced a \$6.3 million quarterly loss resulting from deficient market access controls with respect to one of its correspondent brokers that vastly exceeded its credit limits. Despite receiving intra-day alerts from the exchange, Southwest Securities' controls proved insufficient to allow it to respond in a timely manner, and trading by the correspondent continued for the rest of the day, resulting in a significant loss.¹⁵ Another example, although not in the U.S., which highlights the need for appropriate controls in connection with market access occurred in December 2005, when Mizuho Securities, one of Japan's largest brokerage firms, sustained a significant loss due to a manual order entry error that resulted in a trade that, under the applicable exchange rules, could not be canceled. Specifically, it was reported that a trader at Mizuho Securities intended to enter a customer sell order for one share of a security at price of 610,000 Yen, but the numbers were mistakenly transposed and an order to sell 610,000 shares of the security at price of one Yen was entered instead.¹⁶ A system-driven, pre-trade control reasonably designed to reject orders that are not reasonably related to the quoted price of the security, would have prevented this order from reaching the market. Most recently, on January 4, 2010, it was reported that shares of Rambus, Inc. suffered an intra-day

¹⁴ Ben Rooney, Google Price Corrected After Trading Snafu, CNNMoney.com, September 30, 2008, http://money.cnn.com/2008/09/30/news/companies/google_nasdaq/?postversion=2008093019 ("Google Trading Incident").

¹⁵ John Hintze, Risk Revealed in Post-Trade Monitoring, Securities Industry News, September 8, 2009 ("SWS Trading Incident").

¹⁶ Erroneous Trade to Cost Japan's Mizuho Securities at Least \$225 Million, Associated Press, December 8, 2005 ("Mizuho Trading Incident").

price drop of approximately thirty-five percent due to erroneous trades causing stock and options exchanges to break trades.¹⁷

While incidents such as these involving trading errors in connection with market access occur with some regularity, the Commission also is concerned about preventing any potentially more severe, widespread incidents that could arise as a result of inadequate risk controls on market access. As trading in the U.S. securities markets has become more automated and high-speed trading more prevalent, the potential impact of a trading error or a rapid series of errors, caused by a computer or human error, or a malicious act, has become more severe. The Commission believes it must be proactive in addressing these concerns, by proposing requirements designed to help assure that broker-dealers that provide access to markets implement effective controls to minimize the likelihood of severe events that could have systemic implications.

As discussed in Section II below, the SROs have, over time, issued a variety of guidance and rules that, among other things, address proper risk controls by broker-dealers providing electronic access to the securities markets. In addition, the Commission has just approved via delegated authority a new Nasdaq rule that requires broker-dealers offering direct market access or sponsored access to Nasdaq to establish controls regarding the associated financial and regulatory risks, and to obtain a variety of contractual commitments from sponsored access

¹⁷ See Whitney Kisling and Ian King, Rambus Trades Cancelled by Exchanges on Error Rule, BusinessWeek, January 4, 2010, <http://www.businessweek.com/news/2010-01-04/rambus-trading-under-investigation-as-potential-error-update1-.html> (stating “[a] series of Rambus Inc. trades that were executed about \$5 below today’s average price were canceled under rules that govern stock transactions that are determined to be ‘clearly erroneous.’” (“Rambus Trading Incident”).

customers.¹⁸ Although these rules and guidance, and particularly Nasdaq's new rule, have been a step in the right direction, as discussed throughout this release, the Commission preliminarily believes that more should be done to assure that comprehensive and effective risk management controls on market access are imposed by broker-dealers whether they are trading on Nasdaq or another exchange or ATS.

Proposed Rule 15c3-5 would require a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its MPID or otherwise,¹⁹ to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks, such as legal and operational risks, related to market access. The proposed rule would apply to trading in all securities on an exchange or ATS, including equities, options, exchange-traded funds, and debt securities. Specifically, the proposed rule would require that brokers or dealers with access to trading securities on an exchange or ATS, as a result of being a member or subscriber thereof, establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, are reasonably designed to (1) systematically limit the financial exposure of the broker or dealer that could arise as a result of market access, and (2) ensure compliance with all regulatory requirements that are applicable in connection with market access. The required financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous. The required regulatory risk management

¹⁸ See Securities Exchange Act Release No. 61345 (January 13, 2010) (SR-NASDAQ-2008-104) ("Nasdaq Market Access Approval Order"), discussed in greater detail in the Appendix.

¹⁹ The Commission notes that brokers-dealers typically access exchanges and ATSs through the use of unique MPIDs or other identifiers, which are assigned by the market.

controls and supervisory procedures must be reasonably designed to prevent the entry of orders that fail to comply with any regulatory requirements that must be satisfied on a pre-order entry basis, prevent the entry of orders that the broker-dealer or customer is restricted from trading, restrict market access technology and systems to authorized persons, and assure appropriate surveillance personnel receive immediate post-trade execution reports. For instance, such systems would block orders that do not comply with exchange trading rules relating to special order types and odd-lot orders, among others.²⁰ The requirement that a broker-dealer's financial and regulatory risk management controls and procedures be reasonably designed to prevent the entry of orders that fail to comply with the specified conditions would necessarily require the controls be applied on an automated, pre-trade basis before orders route to an exchange or ATS. This requirement would effectively prohibit the practice of "unfiltered" or "naked" access to an exchange or ATS.

The risk management controls and supervisory procedures required by Proposed Rule 15c3-5 must be under the direct and exclusive control of the broker or dealer with market access. In addition, a broker or dealer with market access would be required to establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required by Proposed Rule 15c3-5 and for promptly addressing any issues. Among other things, the broker or dealer would be required to review, no less frequently than annually and in accordance with written procedures, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures. The broker-dealer also would be required to document that review. When establishing the specifics of this regular review, the Commission

²⁰ See infra Section III.F.

expects that each broker or dealer with market access would establish written procedures that are effective to provide that the broker-dealer's controls and procedures are adjusted, as necessary, to assure their continued effectiveness in light of any changes in the broker-dealer's business or weaknesses that have been revealed. Finally, the Chief Executive Officer (or equivalent officer) of the broker or dealer would be required, on an annual basis, to certify that such risk management controls and supervisory procedures comply with Proposed Rule 15c3-5, and that the regular review described above has been conducted.

The Commission believes that Proposed Rule 15c3-5 would reduce the risks faced by broker-dealers, as well as the markets and the financial system as a whole, as a result of various market access arrangements, by requiring effective financial and regulatory risk management controls to be implemented on a market-wide basis. These financial and regulatory risk management controls should reduce risks associated with market access and thereby enhance market integrity and investor protection in the securities markets.²¹ Proposed Rule 15c3-5 is intended to complement and bolster existing rules and guidance issued by the exchanges and the Financial Industry Regulatory Authority ("FINRA") with respect to market access. Moreover, by establishing a single set of broker-dealer obligations with respect to market access risk management controls across markets, the proposed rule would provide uniform standards that would be interpreted and enforced in a consistent manner and, as a result, reduce the potential for regulatory arbitrage.²²

²¹ For example, a system-driven, pre-trade control designed to reject orders that are not reasonably related to the quoted price of the security would prevent erroneously entered orders from reaching the securities markets, which should lead to fewer broken trades and thereby enhance the integrity of trading on the securities markets.

²² See, e.g., letters to Elizabeth M. Murphy, Secretary, Commission, from Manisha Kimmel, Executive Director, Financial Information Forum, February 19, 2009 ("The [Nasdaq] proposal to establish a well-defined set of rules governing sponsored access is a positive

II. SRO Rules and Guidance

Over time, the SROs have issued a variety of guidance and rules designed to address the risks associated with broker-dealers providing electronic access to the securities markets to other persons.²³ The Commission believes that the SRO efforts have been productive steps in the right direction. As noted above, however, the Commission preliminarily believes that a more comprehensive and effective set of rules is needed to more effectively manage the financial, regulatory, and other risks, such as legal and operational risks, associated with market access. To provide context for the Commission's proposed rulemaking, the SRO efforts to address electronic access to markets are briefly summarized below. A more detailed discussion is in the Appendix.

The NYSE and FINRA (formerly known as the National Association of Securities Dealers, Inc. ("NASD"))²⁴ have each issued several Information Memoranda ("IM") and Notices to Members ("NTM"), respectively, that are designed to provide guidance to their members that provide market access to customers. The guidance provided by the NYSE and the NASD is primarily advisory, as opposed to compulsory, and is similar in many respects. As discussed in more detail in the Appendix, both SROs emphasize that members are required to implement and

step towards addressing consistency in sponsored access requirements."); and Ted Myerson, President, FTEN, Inc., February 19, 2009 ("[I]t is imperative that Congress and regulators, together with the private sector, work together to encourage effective real-time, pre-trade, market-wide systemic risk solutions that help prevent [sponsored access] errors from occurring in the first place.").

²³ See, e.g., FINRA Rules 3010, 3012, and 3130.

²⁴ In 2007, the NASD and the member-related functions of New York Stock Exchange Regulation, Inc., the NYSE's regulatory subsidiary, were consolidated. As part of this regulatory consolidation, the NASD changed its name to FINRA.

maintain internal procedures and controls to manage the financial and regulatory risks associated with market access, and recommend certain best practices be followed.²⁵

In addition, the exchanges each have adopted rules that, in general, permit non-member “sponsored participants” to obtain direct access to the exchange’s trading facilities, so long as a sponsoring broker-dealer that is a member of the exchange takes responsibility for the sponsored participant’s trading, and certain contractual commitments are made.²⁶ In addition, the Commission has just approved by delegated authority a new Nasdaq rule that requires broker-dealers offering direct market access or sponsored access to Nasdaq to establish controls regarding the associated financial and regulatory risks, and to obtain a variety of contractual commitments from sponsored access customers.²⁷ The key elements of that rule are described in the Appendix. The Commission preliminarily believes, however, that a more comprehensive and effective set of rules is needed to help assure that effective risk controls on market access are established and implemented by broker-dealers whether trading occurs on Nasdaq or another exchange or ATS. Specifically, the Commission preliminarily believes significant strengthening of the requirements beyond the Nasdaq rule is warranted, in particular to assure that rules are applied on a market-wide basis to effectively prohibit “naked” access.

III. Proposed Rule 15c3-5

A. Introduction

²⁵ The Commission notes that the collective NASD and NYSE guidance now constitutes FINRA’s current guidance on market access.

²⁶ See, e.g., NYSE Rule 123B.30, NYSE Alternext Equities Rule 123B.30, NYSE Amex Rule 86, NYSE Arca Rules 7.29 and 7.30, NYSE Rule 86, CBOE Rule 6.20A, CHX Article 5, Rule 3, NSX Rule 11.9, BATS Rule 11.3(b), ISE Rule 706, NASDAQ Rule 4611(d), NASDAQ OMX BX Rule 4611(d), NASDAQ OMX PHLX Rule 1094(b)(ii).

²⁷ See Nasdaq Market Access Approval Order, supra note 18.

As discussed above, SRO rules and interpretations governing market access have, over the years, sought to address the risks associated with broker-dealers providing electronic access to the securities markets. However, the Commission preliminarily believes that more comprehensive and effective standards, applied uniformly at the Commission level, are needed to appropriately manage the financial, regulatory, and other risks, such as legal and operational risks, associated with this activity. These risks – whether they involve the potential breach of a credit or capital limit, the submission of erroneous orders as a result of computer malfunction or human error, the failure to comply with SEC or exchange trading rules, the failure to detect illegal conduct, or otherwise – are present whenever a broker-dealer trades as a member of an exchange or subscriber to an ATS, whether for its own proprietary account or as agent for its customers.

The Commission, however, is particularly concerned about the quality of broker-dealer risk controls in sponsored access arrangements, where the customer order flow does not pass through the broker-dealer's systems prior to entry on an exchange or ATS. The Commission understands that, in some cases, the broker-dealer providing sponsored access may not utilize any pre-trade risk management controls (i.e., “unfiltered” or “naked” access), and thus could be unaware of the trading activity occurring under its market identifier and have no mechanism to control it. The Commission also understands that some broker-dealers providing sponsored access may simply rely on assurances from their customers that appropriate risk controls are in place.

Appropriate controls to manage financial and regulatory risk for all forms of market access are essential to assure the integrity of the broker-dealer, the markets, and the financial system. The Commission preliminarily believes that risk management controls and supervisory

procedures that are not applied on a pre-trade basis or that are not under the exclusive control of the broker-dealer are inadequate to effectively address the risks of market access arrangements, and pose a particularly significant vulnerability in the U.S. national market system.

Section 15(c)(3) of the Exchange Act²⁸ enables the Commission to adopt rules and regulations regarding the financial responsibility and related practices of broker-dealers that the Commission shall prescribe as necessary or appropriate in the public interest or for the protection of investors. Pursuant to this authority, the Commission is proposing Rule 15c3-5 – Risk Management Controls for Brokers or Dealers with Market Access – to reduce the risks faced by broker-dealers, as well as the markets and the financial system as a whole, as a result of various market access arrangements, by requiring effective financial and regulatory risk management controls to be implemented on a market-wide basis. These financial and regulatory risk management controls should reduce risks associated with market access and thereby enhance market integrity and investor protection in the securities markets. Proposed Rule 15c3-5 is intended to strengthen the controls with respect to market access and, because it will apply to trading on all exchanges and ATSS, reduce regulatory inconsistency and the potential for regulatory arbitrage. Finally – and importantly – because it would require direct and exclusive control by the broker or dealer of the risk management controls and supervisory procedures, and further require those controls to be implemented on a pre-trade basis, Proposed Rule 15c3-5 would have the effect of eliminating the practice of broker-dealers providing “unfiltered” or “naked” access to any exchange or ATS. As a result, the Commission preliminarily believes the proposed rule should substantially mitigate a particularly serious vulnerability of the U.S. securities markets.

²⁸ 15 U.S.C. 78o(c)(3).

B. General Description of Proposed Rule

Proposed Rule 15c3-5 would require a broker or dealer that has market access, or that provides a customer or any other person with access to an exchange or ATS through use of its MPID or otherwise, to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks, such as legal and operational risks, related to such market access. Specifically, the proposed rule would require that brokers or dealers with access to trading securities on an exchange or ATS, as a result of being a member or subscriber thereof, establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, are reasonably designed to (1) systematically limit the financial exposure of the broker or dealer that could arise as a result of market access, and (2) ensure compliance with all regulatory requirements that are applicable in connection with market access. The required financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous. The proposed regulatory risk management controls and supervisory procedures must also be reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis, prevent the entry of orders that the broker-dealer or customer is restricted from trading, restrict market access technology and systems to authorized persons, and assure appropriate surveillance personnel receive immediate post-trade execution reports. Each such broker or dealer would be required to preserve a copy of its supervisory procedures and a written description of its risk management

controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act.²⁹

The financial and regulatory risk management controls and supervisory procedures required by Proposed Rule 15c3-5 must be under the direct and exclusive control of the broker or dealer with market access. In addition, a broker or dealer with market access would be required to establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures and for promptly addressing any issues. Among other things, the broker or dealer would be required to review, no less frequently than annually, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures and document that review. Such review would be required to be conducted in accordance with written procedures and would be required to be documented. The broker or dealer would be required to preserve a copy of such written procedures, and documentation of each such review, as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act,³⁰ and Rule 17a-4(b) under the Exchange Act, respectively.³¹

In addition, the Chief Executive Officer (or equivalent officer) of the broker or dealer would be required, on an annual basis, to certify that the risk management controls and

²⁹ See 17 CFR 240.17a-4(e)(7). Pursuant to Rule 17a-4(e)(7), every broker or dealer subject to Rule 17a-3 is required to maintain and preserve in an easily accessible place each compliance, supervisory, and procedures manual, including any updates, modifications, and revisions to the manual, describing the policies and practices of the broker or dealer with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the broker or dealer until three years after the termination of the use of the manual.

³⁰ Id.

³¹ See 17 CFR 240.17a-4(b). Pursuant to Rule 17a-4(b), every broker or dealer subject to Rule 17a-3 is required to preserve for a period of not less than three years, the first two years in an easily accessible place, certain records of the broker or dealer.

supervisory procedures comply with Proposed Rule 15c3-5, and that the regular review described above has been conducted. Such certifications would be required to be preserved by the broker or dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act.³²

Proposed Rule 15c3-5 is divided into the following provisions: (1) relevant definitions, as set forth in Proposed Rule 15c3-5(a); (2) the general requirement to maintain risk management controls and supervisory procedures in connection with market access, as set forth in Proposed Rule 15c3-5(b); (3) the more specific requirements to maintain certain financial risk management controls and supervisory procedures and regulatory risk management controls and supervisory procedures, as set forth in Proposed Rule 15c3-5(c); (4) the mandate that those controls and supervisory procedures be under the direct and exclusive control of the broker-dealer with market access, as set forth in Proposed Rule 15c3-5(d); and (5) the requirement that the broker-dealer regularly review the effectiveness of the risk management controls and supervisory procedures, as set forth in Proposed Rule 15c3-5(e).

C. Definitions

For the purpose of Proposed Rule 15c3-5, there are two defined terms: “market access” and “regulatory requirements.” Under Proposed Rule 15c3-5(a)(1), the term “market access” is defined as access to trading in securities on an exchange or ATS as a result of being a member or subscriber of the exchange or ATS, respectively. The proposed definition is intentionally broad, so as to include not only direct market access or sponsored access services offered to customers of broker-dealers, but also access to trading for the proprietary account of the broker-dealer and

³²

Id.

for more traditional agency activities.³³ The Commission believes any broker-dealer with such direct access to trading on an exchange or ATS should establish effective risk management controls to protect against breaches of credit or capital limits, erroneous trades, violations of SEC or exchange trading rules, and the like. These risk management controls should reduce risks associated with market access and thereby enhance market integrity and investor protection in the securities markets. While today the more significant vulnerability in broker-dealer risk controls appears to be in the area of “unfiltered” or “naked” access, the Commission believes a broker-dealer with market access should assure the same basic types of controls are in place whenever it uses its special position as a member of an exchange, or subscriber to an ATS, to access those markets. The proposed definition encompasses trading in all securities on an exchange or ATS, including equities, options, exchange-traded funds, and debt securities.

Under Proposed Rule 15c3-5(a)(2), the term “regulatory requirements” is defined as all federal securities laws, rules and regulations, and rules of SROs, that are applicable in connection with market access. The Commission intends this definition to encompass all of a broker-dealer’s regulatory requirements that arise in connection with its access to trading on an exchange or ATS by virtue of its being a member or subscriber thereof. As discussed below in Section III.F, these regulatory requirements would include, for example, exchange trading rules relating to special order types, trading halts, odd-lot orders, SEC rules under Regulation SHO and Regulation NMS, as well as applicable margin requirements. The Commission emphasizes

³³ The Commission estimates that 1,295 brokers or dealers would have market access as defined under the proposed rule. Of these 1,295 brokers or dealers, the Commission estimates that at year-end 2008 there were 1,095 brokers-dealers that were members of an exchange. This estimate is based on broker-dealer responses to FOCUS report filings with the Commission. The Commission estimates that the remaining 200 broker-dealers were subscribers to an ATS but were not members of an exchange. This estimate is based on a sampling of subscriber information contained in Exhibit A to Form ATS-R filed with the Commission.

that the term “regulatory requirements” references existing regulatory requirements applicable to broker-dealers in connection with market access, and is not intended to substantively expand upon them.³⁴

D. General Requirement to Maintain Risk Controls

As noted above, the Commission believes the financial and regulatory risk management controls described in the proposed rule should apply broadly to all forms of market access by broker-dealers that are exchange members or ATS subscribers, including sponsored access, direct market access, and more traditional agency brokerage arrangements with customers, as well as proprietary trading.³⁵ Accordingly, the proposed term “market access” includes all such activities, and the proposed required risk management controls and supervisory procedures set forth in Proposed Rule 15c3-5 must encompass them. In many cases, particularly with respect to proprietary trading and more traditional agency brokerage activities, the proposed rule may be substantially satisfied by existing risk management controls and supervisory procedures already implemented by broker-dealers. In other cases, particularly with respect to sponsored access arrangements, the proposed rule is designed to assure that broker-dealer controls and procedures are appropriately strengthened on a market-wide basis to meet that standard. Among other things, Proposed Rule 15c3-5 would require that certain risk management controls be applied on an automated, pre-trade basis. Therefore, Proposed Rule 15c3-5 would effectively prohibit broker-dealers from providing “unfiltered” or “naked” access to any exchange or ATS. By requiring all forms of market access by broker-dealers that are exchange members or ATS

³⁴ The specific content of the “regulatory requirements” would, of course, adjust over time as laws, rules and regulations are modified.

³⁵ Proposed Rule 15c3-5 would not apply to non-broker-dealers, including non-broker-dealers that are subscribers of an ATS.

subscribers to meet standards for financial and regulatory risk management controls, Proposed Rule 15c3-5 should reduce risks and thereby enhance market integrity and investor protection.

Proposed Rule 15c3-5(b) provides that a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its MPID or otherwise, shall establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks, such as legal and operational risks, of this business activity. This provision sets forth the general requirement that any broker-dealer with access to trading on an exchange or ATS, by virtue of its special status as a member or subscriber thereof, must establish risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks, such as legal and operational risks, of this business activity. The proposed rule allows flexibility for the details of the controls and procedures to vary from broker-dealer to broker-dealer, depending on the nature of the business and customer base, so long as they are reasonably designed to achieve the goals articulated in the proposed rule. The controls and procedures would be required to be documented in writing, and the broker or dealer would be required to preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act.³⁶

E. Financial Risk Management Controls and Supervisory Procedures

Under Proposed Rule 15c3-5(c), a broker-dealer's risk management controls and supervisory procedures are required to include certain elements. Proposed Rule 15c3-5(c)(1) requires that the risk management controls and supervisory procedures be reasonably designed to

³⁶ See 17 CFR 240.17a-4(e)(7).

systematically limit the financial exposure of the broker-dealer that could arise as a result of market access. The Commission believes that, in today's fast electronic markets, effective controls against financial exposure should be required to be systematized and automated and should be required to be applied on a pre-trade basis. These pre-trade controls should protect investors by blocking orders that do not comply with such controls from being routed to a securities market. In addition, the risk management controls and supervisory procedures must be reasonably designed to limit the broker-dealer's financial exposure. As noted above, this standard allows flexibility for the details of the controls and procedures to vary from broker-dealer to broker-dealer, depending on the nature of the business and customer base, so long as they are reasonably designed to achieve the goals articulated in the proposed rule. In many cases, particularly with respect to proprietary trading and more traditional agency brokerage activities, the proposed rule may be substantially satisfied by existing financial risk management controls and supervisory procedures already implemented by broker-dealers. However, the Commission believes that the proposed rule would assure a consistent standard applies to all broker-dealers providing any type of market access and, importantly, will address the serious gap that exists with those broker-dealers that today offer "unfiltered" access.

Under Proposed Rule 15c3-5(c)(1)(i), the broker-dealer's controls and procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker or dealer, and where appropriate more finely-tuned by sector, security, or otherwise, by rejecting orders if such orders exceed the applicable credit or capital thresholds. Under this provision, a broker or dealer would be required to set appropriate credit thresholds for each customer for which it provides market access and appropriate capital thresholds for proprietary trading by the broker-dealer itself. Such

controls and procedures should help ensure that market participants do not exceed their allowable credit or capital thresholds. In designing its risk management controls and supervisory procedures, the broker-dealer would be required to set an aggregate exposure threshold for each account and, where appropriate, at more granular levels such as by sector or security. The broker-dealer must establish the credit threshold for each customer. The Commission expects broker-dealers would make such determinations based on appropriate due diligence as to the customer's business, financial condition, trading patterns, and other matters, and document that decision. In addition, the Commission expects the broker-dealer would monitor on an ongoing basis whether the credit thresholds remain appropriate, and promptly make adjustments to them, and its controls and procedures, as warranted.

In addition, because the proposed controls and procedures must prevent the entry of orders that exceed the applicable credit or capital thresholds by rejecting them, the broker-dealer's controls must be applied on an automated, pre-trade basis, before orders are routed to the exchange or ATS. Furthermore, because rejection must occur if such orders would exceed the applicable credit or capital thresholds, the broker-dealer must assess compliance with the applicable threshold on the basis of exposure from orders entered on an exchange or ATS, rather than waiting for executions to make that determination. The Commission believes that, because financial exposure through rapid order entry can be incurred very quickly in today's fast electronic markets, controls should measure compliance with appropriate credit or capital thresholds on the basis of orders entered rather than executions obtained. Broker-dealers also should consider establishing "early warning" credit or capital thresholds to alert them and their customers when the firm limits are being approached, so there is an opportunity to adjust trading behavior.

Under Proposed Rule 15c3-5(c)(1)(ii), the broker-dealer's controls and procedures must be reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders. Given the prevalence today of high-speed automated trading algorithms and other technology, and the fact that malfunctions periodically occur with those systems,³⁷ the Commission believes that broker-dealer risk management controls should be reasonably designed to detect malfunctions and prevent orders from erroneously being entered as a result, and that identifying and blocking erroneously entered orders on an order-by-order basis or over a short period of time would accomplish this. These controls also should be reasonably designed to prevent orders from being entered erroneously as a result of manual errors (e.g., erroneously entering a buy order of 2,000 shares at \$2.00 as a buy order of 2 shares at \$2,000.00). For example, a system-driven, pre-trade control reasonably designed to reject orders that are not reasonably related to the quoted price of the security would prevent erroneously-entered orders from reaching the market. As with the risk controls and procedures applying pre-set credit or capital thresholds, the broker-dealer also would be required to monitor on a regular basis whether its systematic controls and procedures are effective in preventing the entry of erroneous orders, and promptly make adjustments to them as warranted.

The Commission emphasizes that the financial risk management controls and supervisory procedures described above should not be viewed as a comprehensive list of the financial risk management controls and supervisory procedures that should be utilized by broker-dealers. Instead, the proposed rule simply is intended to set forth standards for the types of financial risk

³⁷ See, e.g., Google Trading Incident, *supra* note 14. See also SWS Trading Incident, *supra* note 15; Mizuho Trading Incident, *supra* note 16; and Rambus Trading Incident, *supra* note 17.

management controls and supervisory procedures that a broker-dealer with market access should implement. A broker-dealer may very well find it necessary to establish and implement financial risk management controls and supervisory procedures beyond those specifically described in the proposed rule based on its specific circumstances.

F. Regulatory Risk Management Controls and Supervisory Procedures

Under Proposed Rule 15c3-5(c)(2), a broker-dealer's risk management controls and supervisory procedures must be reasonably designed to ensure compliance with all regulatory requirements that are applicable in connection with market access. As noted above, the Commission intends these controls and procedures to encompass existing regulatory requirements applicable to broker-dealers in connection with market access, and not to substantively expand upon them.³⁸ As with the risk management controls and procedures for financial exposure, this provision would allow flexibility for the details of the regulatory risk management controls and procedures to vary from broker-dealer to broker-dealer, depending on the nature of the business and customer base, so long as they are reasonably designed to achieve the goals articulated in the proposed rule. In many cases, particularly with respect to proprietary trading and more traditional agency brokerage activities, the proposed rule should reinforce existing regulatory risk management controls already implemented by broker-dealers. However, the Commission believes that the proposed rule would assure a consistent standard applies to all broker-dealers providing any type of market access and, importantly, will address the serious gap that exists with those broker-dealers that today offer "unfiltered" access.

Under Proposed Rule 15c3-5(c)(2)(i), the broker-dealer's controls and procedures must be reasonably designed to prevent the entry of orders unless there has been compliance with all

³⁸ The specific content of the "regulatory requirements" will, of course, adjust over time as laws, rules and regulations are modified.

regulatory requirements that must be satisfied on a pre-order entry basis. Proposed Rule 15c3-5(c)(2)(ii) also would require the broker-dealer's controls and procedures to prevent the entry of orders for securities that the broker-dealer, customer, or other person, as applicable, is restricted from trading.

By requiring the regulatory risk management controls and procedures to be reasonably designed to prevent the entry of orders that fail to comply with regulatory requirements that apply on a pre-order entry basis, the proposed rule would have the effect of requiring the broker-dealer's controls be applied on an automated, pre-trade basis, before orders route to the exchange or ATS. These pre-trade, system-driven controls would therefore prevent orders from being sent to the securities markets, if such orders fail to meet certain conditions. The pre-trade controls must, for example, be reasonably designed to assure compliance with exchange trading rules relating to special order types, trading halts, odd-lot orders, SEC rules under Regulation SHO and Regulation NMS, as well as applicable margin requirements. They also must be reasonably designed to prevent the broker-dealer or customer or other person from entering orders for securities it is restricted from trading. For example, if the broker-dealer is restricted from trading options because it is not qualified to trade options, its regulatory risk management controls must automatically prevent it from entering orders in options, either for its own account or as agent for a customer. In addition, if a broker-dealer is obligated to restrict a customer from trading in a particular security, then the broker-dealer's controls must automatically prevent orders in such security from being submitted to an exchange or ATS for the account of that customer.

Under Proposed Rule 15c3-5(c)(2)(iii), the broker-dealer's controls and procedures also must be reasonably designed to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker-dealer. The

Commission believes that effective security procedures such as these are necessary for controlling the risks associated with market access. The Commission expects that elements of these controls and procedures would include: (1) an effective process for vetting and approving persons at the broker-dealer or customer, as applicable, who will be permitted to use the trading systems or other technology; (2) maintaining such trading systems or technology in a physically secure manner; and (3) restricting access to such trading systems or technology through effective passwords or other mechanisms that validate identity. Among other things, effective security procedures help assure that only authorized, appropriately-trained personnel have access to a broker-dealer's trading systems, thereby minimizing the risk that order entry errors or other inappropriate or malicious trading activity might occur.

Finally, Proposed Rule 15c3-5(c)(2)(iv) would require the broker-dealer's controls and procedures to assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access. Among other things, the Commission expects that broker-dealers would be able to identify the applicable customer associated with each such execution report. The Commission believes that immediate reports of executions would provide surveillance personnel with important information about potential regulatory violations, and better enable them to investigate, report, or halt suspicious or manipulative trading activity. In addition, these immediate execution reports should provide the broker-dealer with more definitive data regarding the financial exposure faced by it at a given point in time. This should provide a valuable supplement to the systematic pre-trade risk controls and other supervisory procedures required by the proposed rule.

G. Direct and Exclusive Broker-Dealer Control Over Financial and Regulatory Risk Management Controls and Supervisory Procedures

Proposed Rule 15c3-5(d) would require the financial and regulatory risk management controls and supervisory procedures described above to be under the direct and exclusive control of the broker-dealer that is subject to paragraph (b) of the proposed rule. This provision is designed to eliminate the practice, which the Commission understands exists today under current SRO rules, whereby the broker-dealer providing market access relies on its customer, a third party service provider, or others, to establish and maintain the applicable risk controls. The Commission believes the risks presented by market access – and in particular “naked” or “unfiltered” access – are too great to permit a broker-dealer to delegate the power to control those risks to the customer or to a third party, either of whom may be an unregulated entity. In addition, because the broker-dealer providing market access assumes the immediate financial risks of all orders, the Commission believes that such broker-dealer should have direct and exclusive control of the risk management controls and supervisory procedures even if the market access is provided to another broker-dealer.

Under the proposal, appropriate broker-dealer personnel should be able to directly monitor the operation of the financial and regulatory risk management controls in real-time.³⁹ Broker-dealers would have the flexibility to seek out risk management technology developed by third parties, but the Commission expects that the third parties would be independent of customers provided with market access. The broker-dealer would also be expected to perform appropriate due diligence to help assure controls are effective and otherwise consistent with the provisions of the proposed rule. The Commission understands that such technology allows the

³⁹ See, e.g., NASD NTM-05-48, Members’ Responsibilities When Outsourcing Activities to Third-Party Service Providers.

broker or dealer to exclusively manage such controls.⁴⁰ The broker-dealer also could allow a third party that is independent of customers to supplement its own monitoring of the operation of its controls. In addition, the broker-dealer could permit third parties to perform routine maintenance or implement technology upgrades on its risk management controls, so long as the broker-dealer conducts appropriate due diligence regarding any changes to such controls and their implementation. Of course, in all circumstances, the broker-dealer would remain fully responsible for the effectiveness of the risk management controls.

The Commission preliminarily believes it is important for appropriate broker-dealer personnel to have the direct and exclusive obligation to assure the effectiveness of, and the direct and exclusive ability to make appropriate adjustments to, the financial and regulatory risk management controls. This would allow the broker-dealer to more effectively make, for example, intra-day adjustments to risk management controls to appropriately manage a customer's credit limit. The Commission expects that, by requiring the financial and regulatory risk management controls and supervisory procedures be under the direct and exclusive control of the broker or dealer, any changes would be made only by appropriate broker-dealer personnel. Accordingly, the proposed rule should help assure the integrity of the controls and that the broker-dealer takes responsibility for them. Accordingly, the broker-dealer could not delegate the oversight of its controls to a third party, or allow any third party to adjust them. The broker-dealer, as the member of the exchange or subscriber of the ATS, is responsible for all trading that occurs under its MPID or other market identifier.⁴¹ If the broker-dealer does not effectively control the risks associated with that activity, it jeopardizes not only its own financial viability,

⁴⁰ The Commission's understanding is based on discussions with various industry participants.

⁴¹ See supra note 6.

but also the stability of the markets and, potentially, the financial system. The Commission believes this responsibility is too great to allow the requisite risk management controls to be controlled by a third party, and in particular the customer which, in effect, would be policing itself. The Commission notes that this risk exists even if the third party is another broker-dealer, as the broker-dealer providing the market access is liable intra-day, at a minimum, for the financial risks incurred as a result of trading under its MPID or other identifier and, in any event, is uniquely positioned to prevent erroneous trades and comply with exchange rules and other regulatory requirements.

H. Regular Review of Risk Management Controls and Supervisory Procedures

Under Proposed Rule 15c3-5(e), a broker-dealer that is subject to paragraph (b) of the proposed rule would be required to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures required by paragraphs (b) and (c) of the proposed rule and for promptly addressing any issues. Among other things, the broker or dealer would be required to review, no less frequently than annually, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures. The broker-dealer would be required to conduct the review in accordance with written procedures and document each such review. When establishing the specifics of this regular review, the Commission expects that each broker or dealer with market access would establish written procedures that are reasonably designed to assure that the broker-dealer's controls and procedures are adjusted, as necessary, to help assure their continued effectiveness in light of any changes in the broker-dealer's business or weaknesses that have been revealed. The broker or dealer would be required to preserve a copy of such written procedures, and documentation of

each such review, as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act, and Rule 17a-4(b) under the Exchange Act, respectively.

Finally, the Chief Executive Officer (or equivalent officer) of the broker or dealer would be required, on an annual basis, to certify that such risk management controls and supervisory procedures comply with Proposed Rule 15c3-5 and that the broker or dealer conducted the regular review. Such certifications would be required to be preserved by the broker or dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act.

Proposed Rule 15c3-5(e) is intended to assure that a broker-dealer that is subject to paragraph (b) of the proposed rule implements supervisory review mechanisms to support the effectiveness of its risk management controls and supervisory procedures on an ongoing basis. Because of the potential risks associated with market access, and the dynamic nature of both the securities markets and the businesses of individual broker-dealers, the Commission believes it is critical that broker-dealers with market access charge their most senior management with the responsibility to review and certify the efficacy of its controls and procedures at regular intervals. The Commission also believes that the requirements under Proposed Rule 15c3-5(e) should serve to bolster broker-dealer compliance programs, and promote meaningful and purposeful interaction between business and compliance personnel.

IV. Request for Comments

The Commission seeks comment on all aspects of the proposed rule. Does the proposed rule serve to appropriately and adequately mitigate the financial and regulatory risks associated with market access? If not, how should the Commission change the proposed rule to address these risks? Should the Commission address other risks in its proposed rule? Should these risks be addressed with additional specific controls in the rule text? Are there other feasible

alternatives that the Commission should consider in order to achieve the goals of the proposed rule? Would the proposed rule affect trading volume? If so, what impact would the proposed rule have on trading volume? Would the proposed rule affect market quality? If so, what impact would the proposed rule have on market quality? Would the proposed rule impact trading volume or market quality differently in equities, options, fixed-income or other securities? Please explain response and provide any appropriate data.

Under the proposed rule, market access means access to trading in securities on an exchange or ATS as a result of being a member or subscriber of the exchange or ATS, respectively. The proposed rule would apply equally to brokers or dealers with market access, whether they are proprietary traders, conduct traditional brokerage services, or provide direct market access or sponsored access. Should the proposed rule apply to all types of market access similarly? Should market access arrangements be treated differently under the proposed rule depending on the type of market participants that are party to the arrangement?

The proposed rule would require a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its market participant identifier or otherwise, to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks related to market access. Generally, are there access arrangements that warrant different requirements? If so, please state which ones and why. If a broker or dealer provides another broker or dealer with market access, should such an arrangement be treated differently under the proposed rule? In this situation, should the proposed rule permit an allocation of responsibilities for implementing the appropriate financial and regulatory risk management controls between those brokers or dealers? If so, to what extent, and on what basis?

Should the Commission require broker-dealers that provide other persons with sponsored access to an exchange or ATS to have separate identifiers for each such person? Are there any circumstances in which a broker-dealer ought not to be responsible for trading conducted by other persons under its MPID or otherwise? Should an ATS in its capacity as broker-dealer be required to implement appropriate risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks, such as legal and operational risks, associated with non-broker-dealer subscriber's access to its ATS?

The proposed rule encompasses trading in all securities on an exchange or ATS. Should the proposed rule apply equally to trading in all securities? For example, should the Commission consider alternatives to the proposed rule in which trading in debt securities, equities, and options are treated differently? If so, to what extent and on what basis?

Under the proposed rule, brokers or dealers would be required to implement controls that are reasonably designed to prevent the entry of orders that are not in compliance with financial controls and regulatory requirements and thereby effectively prohibit the practice of broker-dealers allowing for "unfiltered" or "naked" access to an exchange or ATS. What are the benefits and costs to the securities markets associated with "unfiltered" or "naked" access to an exchange or ATS? Specifically, what impact would effectively prohibiting "unfiltered" or "naked" access have on broker-dealers providing such access? What impact would it have on the markets? What impact would it have on customers that use such access? What percentage of volume is directed to the exchanges through "unfiltered" or "naked" access? Should the Commission consider alternatives to a prohibition on "naked" access? Would the proposed rule affect the way market participants use market access arrangements?

Are pre-trade controls the preferred method for adequately mitigating all the risks associated with market access? Should the method for managing risk be particular to the specific risk? Are there acceptable alternative modeling techniques that a broker-dealer may use to manage its financial and regulatory risks that would be functionally similar to the methods required by the rule? Please explain response and provide any appropriate data.

Would the proposed rule affect the speed or efficiency of trading? Would market participants be required to change their business models or practices in ways not contemplated by this release if the Commission were to adopt the proposed rule? Would the proposed rule potentially impact competition among, or innovation by, market participants? If so, in what way? Which market participants would be impacted? Would such changes be beneficial or detrimental? Are there other internal or external costs not identified by the Commission that could result from the proposed rule? Which market participants are the most common or active users of sponsored access, generally, and "unfiltered" access, in particular? How many small broker-dealers have or use sponsored access arrangements?

The proposed rule would require broker-dealers with market access to implement risk management controls and supervisory procedures that prevent the entry of orders that, among other things, exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker or dealer, exceed appropriate price or size parameters on an order-by-order basis or over a short period of time, are indicative of duplicative orders, are not in compliance with a regulatory requirement that must be satisfied on a pre-order entry basis, or that is for a security that a broker or dealer, customer, or other person is restricted from trading. Should the Commission include additional financial and regulatory risk management controls in the proposed rule? If so, what additional financial and regulatory risk management controls

should be included? Would the additional standards apply to all brokers or dealers, or to a subset? Conversely, if there are too many financial and regulatory standards, which ones are unnecessary? Would these standards be unnecessary for all parties, or should they still apply in certain specific cases? Should the Commission specify more precise details regarding the financial and regulatory risk management controls? Should the proposed rule specify financial and regulatory risk management controls that would apply after an order has been entered on exchange or ATS?

The proposed rule would require broker-dealers to establish an appropriate credit threshold for each customer. The Commission expects that broker-dealers would establish such threshold based on appropriate due diligence as to the customer's business, financial condition, trading patterns, and other matters, and document that decision. Should the criteria for determining the appropriate threshold be explicitly listed in the proposed rule? Are there specific factors broker-dealers should consider in conducting due diligence? Should the proposed rule require broker-dealers to establish "early warning" credit or capital thresholds to alert them and their customers when the firm limits are being approached, so there is an opportunity to adjust trading behavior? Should the proposed rule require a broker-dealer to establish an aggregate credit threshold for all of its customers?

Should the Commission provide additional guidance on the short period of time in the prevention of entering erroneous orders requirement? Is there a common understanding among market participants regarding the timeframe used to prevent the entry of erroneous orders?

The proposed rule would require broker-dealers with market access to implement risk management controls and supervisory procedures that are reasonably designed to restrict access to trading systems and technology that provide market access to permit access only to persons

and accounts pre-approved and authorized by the broker-dealer. Could the goal of this provision, the preservation of system and market integrity, be achieved in another way? If so, how?

The proposed rule would require broker-dealers with market access to implement risk management controls and supervisory procedures that are reasonably designed to assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access. Should the Commission expand on or clarify the requirement that risk management controls and supervisory procedures be reasonably designed to assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access? Is there a common understanding among market participants as to what constitutes immediate post-trade execution reports?

The Commission seeks comment on whether broker-dealers could effectively comply with the proposed rule – in particular, the requirement that the financial and regulatory risk management controls and supervisory procedures be under the direct and exclusive control of the broker-dealer with market access – by using risk management technology developed by third parties. Are there any circumstances where a broker or dealer would not be able to comply with the proposed rule using risk management technology developed by third parties? Are there additional considerations that the Commission should evaluate if a broker-dealer outsources the development of its risk management system and supervisory procedures?

The proposed rule would require the broker-dealer to periodically review its risk management controls and supervisory procedures. Among other things, the broker-dealer would be required to review in accordance with written procedures, and document that review, no less frequently than annually, its business activity in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures. Should this

review be conducted more or less frequently? In addition, the Chief Executive Officer (or equivalent officer) of the broker-dealer would be required, on an annual basis, to certify that such risk management controls and supervisory procedures comply with paragraphs (b) and (c) and that the regular review was conducted. Should the certification be conducted more or less frequently? The proposed rule would require a broker or dealer to preserve a copy of its supervisory procedures, a written description of its risk management controls, and written supervisory procedures for its regular review as part of its books and records in a manner consistent with Rule 17a-4(e)(7). Is this proposed record retention requirement clear? The proposed rule would require documentation of each regular review and Chief Executive Officer certifications be preserved by the broker or dealer as part of its books and records in a manner consistent with Rule 17a-4(b). Is this proposed record retention requirement clear?

The Commission strongly encourages commenters to respond within the designated comment period. It intends to act quickly in reviewing the comments and assessing further action.

V. Paperwork Reduction Act

Certain provisions of Proposed Rule 15c3-5 contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).⁴² In accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, the Commission has submitted the provisions to the Office of Management and Budget (“OMB”) for review. The title for the proposed new collection of information requirement is “Rule 15c3-5, Market Access.” 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.

⁴² 44 U.S.C. 3501 et seq.

A. Summary of Collection of Information

Proposed Rule 15c3-5 would require a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its MPID or otherwise, to establish, document, and maintain a system of risk management controls and supervisory procedures to assist it in managing the financial, regulatory, and other risks, such as legal and operational risks, of this business activity. The system of risk management controls and supervisory procedures, among other things, shall be reasonably designed to (1) systematically limit the financial exposure of the broker or dealer that could arise as a result of market access, and (2) ensure compliance with all regulatory requirements that are applicable in connection with market access. The financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous. As a practical matter, the proposed rule would require a respondent to set appropriate credit thresholds for each customer for which it provides market access and appropriate capital thresholds for proprietary trading by the broker-dealer itself. The regulatory risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that do not comply with regulatory requirements that must be satisfied on a pre-order entry basis, prevent the entry of orders that the broker-dealer or customer is restricted from trading, restrict market access technology and systems to authorized persons, and assure appropriate surveillance personnel receive immediate post-trade execution reports. Each such broker or dealer would be required to preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act.⁴³

⁴³ See supra note 29.

In addition, the proposed rule would require a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its MPID or otherwise, to establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required under the proposed rule and for promptly addressing any issues. Among other things, the broker or dealer would be required to review, no less frequently than annually, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures and document that review. Such review would be required to be conducted in accordance with written procedures and would be required to be documented. The broker or dealer would be required to preserve a copy of such written procedures, and documentation of each such review, as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act,⁴⁴ and Rule 17a-4(b) under the Exchange Act, respectively.⁴⁵

In addition, the Chief Executive Officer (or equivalent officer) of the broker or dealer, on an annual basis, would be required to certify that such risk management controls and supervisory procedures comply with the proposed rule, that the broker or dealer conducted such review, and such certifications shall be preserved by the broker or dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act.⁴⁶

B. Proposed Use of Information

The proposed requirement that a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its MPID or

⁴⁴ Id.

⁴⁵ See supra note 31.

⁴⁶ Id.

otherwise, establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, shall be reasonably designed to (1) systematically limit the financial exposure of the broker or dealer that could arise as a result of market access, and (2) ensure compliance with all regulatory requirements that are applicable in connection with market access, would serve to ensure that such brokers or dealers have sufficiently effective controls and procedures in place to appropriately manage the risks associated with market access. The proposed requirement to preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act would help assure that appropriate written records were made, and would be used by the Commission staff and SRO staff during an examination of the broker or dealer for compliance with the proposed rule.

The proposed requirement to maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required under the proposed rule would serve to ensure that the risk management controls and supervisory procedures remain effective. A broker-dealer would use these risk management controls and supervisory procedures to fulfill its obligations under the proposed rule, as well as to evaluate and ensure its financial integrity more generally. The Commission and SROs would use this information in their exams of the broker or dealer, as well as for regulatory purposes. The proposed requirement that a broker or dealer preserve a copy of written procedures, and documentation of each such regular review, as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act, and Rule 17a-4(b) under the Exchange Act, respectively, would help assure that the regular review was in fact completed, and would be used by the Commission staff and SRO staff during an examination of the broker or dealer for compliance with the

proposed rule. The proposed requirement that the Chief Executive Officer (or equivalent officer) of the broker or dealer, on an annual basis, certify that such risk management controls and supervisory procedures comply with proposed Rule 15c3-5, that the annual review was conducted, and that such certifications be preserved by the broker or dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act would help ensure that senior management review the efficacy of its controls and procedures at regular intervals and that such review is documented. This certification would be used internally by the broker or dealer as evidence that it complied with the proposed rule and possibly for internal compliance audit purposes. The certification also would be used by Commission staff and SRO staff during an examination of the broker or dealer for compliance with the proposed rule or more generally with regard to evaluation of a broker or dealer's risk management control procedures and controls.

The proposed rule would require a broker or dealer with market access to assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access. The broker or dealer would use these post-trade execution reports in reviewing for potential regulatory violations. In addition, these reports would better enable the broker or dealer to investigate, report, or halt suspicious or manipulative trading activity. In addition, the Commission and SROs may review these reports when examining the broker or dealer.

C. Respondents

The proposed "collection of information" contained in Proposed Rule 15c3-5 would apply to approximately 1,295 brokers and dealers that have market access or provide a customer or any other person with market access. Of these 1,295 brokers and dealers, the Commission

estimates that there are 1,095 brokers or dealers that are members of an exchange. This estimate is based on broker-dealer responses to FOCUS report filings with the Commission. The Commission estimates that the remaining 200 broker-dealers are subscribers to ATSs but are not exchange members. This estimate is based on a sampling of subscriber information contained in Exhibit A to Form ATS-R filed with the Commission. The Commission requests comment on the accuracy of these estimated figures.

D. Total Initial and Annual Reporting and Recordkeeping Burdens

As discussed above, brokers and dealers are currently subject to a variety of SRO guidance and rules related to market access. Currently, most brokers or dealers, when accessing an exchange or ATS in the ordinary course of their business, already have risk management controls and supervisory procedures in place, although these controls and procedures will differ based on each broker or dealer's unique business model.⁴⁷ For the purposes of the PRA, the Commission must consider the burden on respondents to bring their risk management controls and supervisory procedures into compliance with the proposed rule. The Commission notes that among brokers or dealers with market access, there is currently no uniform standard for risk management controls and supervisory procedures. The extent to which a respondent would be burdened by the proposed collection of information under the proposed rule would depend significantly on the financial and regulatory risk management controls that already exist in the respondent's system as well as the respondent's business model. In many cases, particularly with respect to proprietary trading, more traditional agency brokerage activities, and direct market access, the proposed rule may be substantially satisfied by a respondent's pre-existing financial and regulatory risk management controls and current supervisory procedures. These

⁴⁷ See supra note 23.

brokers or dealers likely would only require limited updates to their systems to meet the requisite risk management controls specified in the proposed rule.

The Commission believes that the majority of respondents has order management systems with pre-trade financial and regulatory controls, although the use and range of those controls may vary among firms. As noted above, certain pre-trade controls, such as pre-set trading limits or filters to prevent erroneous trades may already be in place within a respondent's risk management system. Similarly, the extent to which receipt of immediate post-trade execution reports creates a burden on respondents would depend on whether a respondent already receives such reports on an immediate, post-trade basis or on an end-of-day basis. For broker-dealers that rely largely on "unfiltered" or "naked" access, the proposed rule could require the development or significant upgrade of a new risk management system, which would be a significantly larger burden on a potential respondent. Therefore, the burden imposed by the proposed rule would differ vastly depending on a broker-dealer's current risk management system and business model.

Proposed Rule 15c3-5 would also require a respondent to update its review and compliance procedures to comply with the proposed rule's requirement to regularly review its risk management controls and supervisory procedures, including a certification annually by the Chief Executive Officer (or equivalent officer). The Commission notes that a respondent should currently have written compliance procedures reasonably designed to review its business activity.⁴⁸ Proposed Rule 15c3-5 would initially require a respondent to update its written compliance procedures to document the method in which the respondent plans to comply with the proposed rule.

⁴⁸

Id.

1. Technology Development and Maintenance

The Commission estimates that the initial burden for a potential respondent to comply with the proposed requirement to establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures, on average, would be 150 hours if performed in-house,⁴⁹ or approximately \$35,000 if outsourced.⁵⁰ This figure is based on the estimated number of hours for initial internal development and implementation by a respondent to program its system to add the controls needed to comply with the requirements of the proposed rule, expand system capacity, if necessary, and establish the ability to receive immediate post-trade execution reports. Based on discussion with various industry participants, the Commission expects that brokers or dealers with market access currently have the means to receive post-trade executions reports, at a minimum, on an end-of-day basis.

⁴⁹ This estimate is based on discussions with various industry participants. Specifically, the modification and upgrading of hardware and software for a pre-existing risk control management system, with few substantial changes required, would take approximately two weeks, while the development of a risk control management system from scratch would take approximately three months.

Based on discussions with industry participants, the Commission estimates that a dedicated team of 1.5 people would be required for the system development. The team may include one or more programmer analysts, senior programmers, or senior systems analysts. Each team member would work approximately 20 days per month, or 8 hours \times 20 days = 160 hours per month. Therefore, the total number of hours per month for one system development team would be 240 hours.

A two-week project to modify and upgrade a pre-existing risk control management system would require 240 hours/month \times 0.5 months = 120 hours, while a three-month project to develop a risk control management system from scratch would require 240 hours/month \times 3 months = 720 hours. Based on discussions with industry participants, the Commission estimates that 95% of all respondents would require modifications and upgrades only, and 5% would require development of a system from scratch. Therefore, the total average number of burden hours for an initial internal development project would be approximately $(0.95 \times 120 \text{ hours}) + (0.05 \times 720 \text{ hours}) = 150 \text{ hours}$.

⁵⁰ See *infra* note 61.

If the broker-dealer decides to forego internal technology development and instead opts to purchase technology from a third-party technology provider or service bureau, the technology costs would also depend on the risk management controls that are already in place, as well as the business model of the broker or dealer. Based on discussions with various industry participants, the Commission understands that technology for risk management controls is generally purchased on a monthly basis. Based on discussions with various industry participants, the Commission's staff estimates that the cost to purchase technology from a third-party technology provider or service bureau would be approximately \$3,000 per month for a single connection to a trading venue, plus an additional \$1,000 per month for each additional connection to that exchange. For a conservative estimate of the annual outsourcing cost, the Commission notes that for two connections to each of two different trading venues, the annual cost would be \$96,000.⁵¹ The potential range of costs would vary considerably, depending upon the business model of the broker-dealer.

On an ongoing basis, a respondent would have to maintain its risk management system by monitoring its effectiveness and updating its systems to address any issues detected. In addition, a respondent would be required to preserve a copy of its written description of its risk management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act. The Commission estimates that the ongoing annualized burden for a potential respondent to maintain its risk management system would be approximately 115

⁵¹ 12 months × \$4,000 (estimated monthly cost for two connections to a trading venue) × 2 trading venues = \$96,000. This estimate is based on discussions with various industry participants. For purposes of this estimate, "connection" is defined as up to 1000 messages per second inbound, regardless of the connection's actual capacity.

For the conservative estimate above, the Commission chose two connections to a trading venue, the number required to accommodate 1,500 to 2,000 messages per second. The estimated number of messages per second is based on discussions with various industry participants.

burden hours if performed in-house,⁵² or approximately \$26,800 if outsourced.⁵³ The Commission believes the ongoing burden of complying with the proposed rule's collection of information would include, among other things, updating systems to address any issues detected, updating risk management controls to reflect any change in its business model, and documenting and preserving its written description of its risk management controls.

For hardware and software expenses, the Commission estimates that the average initial cost would be approximately \$16,000 per broker-dealer,⁵⁴ while the average ongoing cost would be approximately \$20,500 per broker-dealer.⁵⁵

2. Legal and Compliance

The Commission provides a separate set of estimates for legal and compliance obligations. The Commission preliminarily believes that the majority of broker-dealers should

⁵² Based on discussions with industry participants, the Commission estimates that a dedicated team of 1.5 people would be used for the ongoing maintenance of all technology systems. The team may include one or more programmer analysts, senior programmers, or senior systems analysts. In-house system staff size varies depending on, among other things, the business model of the broker or dealer. Each staff member would work 160 hours per month, or $12 \text{ months} \times 160 \text{ hours} = 1,920 \text{ hours}$ per year. A team of 1.5 people therefore would work $1,920 \text{ hours} \times 1.5 \text{ people} = 2,880 \text{ hours}$ per year. Based on discussions with industry participants, the Commission estimates that 4% of the team's total work time would be used for ongoing risk management maintenance. Accordingly, the total number of burden hours for this task, per year, is $0.04 \times 2,880 \text{ hours} = 115.2 \text{ hours}$.

⁵³ See infra note 62.

⁵⁴ Industry sources estimate that to build a risk control management system from scratch, hardware would cost \$44,500 and software would cost \$58,000, while to upgrade a pre-existing risk control management system, hardware would cost \$5,000 and software would cost \$6,517. Based on discussions with industry participants, the Commission estimates that 95% of all respondents would require modifications and upgrades only, and 5% would require development of a system from scratch. Therefore, the total average hardware and software cost for an initial internal development project would be approximately $(0.95 \times \$11,517) + (0.05 \times \$102,500) = \$16,066$, or \$16,000.

⁵⁵ Industry sources estimate that for ongoing maintenance, hardware would cost \$8,900 on average and software would cost \$11,600 on average. The total average hardware and software cost for ongoing maintenance would be $\$8,900 + \$11,600 = \$20,500$.

already have compliance policies and supervisory procedures in place.⁵⁶ Accordingly, the Commission believes that the initial burden to comply with the proposed compliance requirements should not be substantial. Based on discussions with various industry participants and the Commission's prior experience with broker-dealers, the Commission estimates that the initial legal and compliance burden on average for a potential respondent to comply with the proposed requirement to establish, document, and maintain compliance policies and supervisory procedures would be approximately 35 hours. Specifically, the setting of credit and capital thresholds for each customer would require approximately 10 hours,⁵⁷ and the modification or establishment of applicable compliance policies and procedures would require approximately 25 hours,⁵⁸ which includes establishing written procedures for reviewing the overall effectiveness of the risk management controls and supervisory procedures.

On an ongoing basis, a respondent would have to maintain and review its risk management controls and supervisory procedures to assure their effectiveness as well as to address any deficiencies found. The broker or dealer would have to review, no less frequently than annually, its business activity in connection with market access to assure the overall effectiveness of the risk management controls and supervisory procedures and would be required to make changes to address any problems or deficiencies found through this review. Such review would be required to be conducted in accordance with written procedures and would be required to be documented. The broker or dealer would be required to preserve a copy of such

⁵⁶ See supra note 23.

⁵⁷ The Commission estimates that one compliance attorney and one compliance manager would each require 5 hours, for a total initial burden of 10 hours.

⁵⁸ The Commission estimates that one compliance attorney and one compliance manager would each require 10 hours, and one Chief Executive Officer would require 5 hours, for a total initial burden of 25 hours.

written procedures, and documentation of each such review, as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act, and Rule 17a-4(b) under the Exchange Act, respectively. On an annual basis, the Chief Executive Officer (or equivalent officer) of the broker or dealer would be required to certify that such risk management controls and supervisory procedures comply with the proposed rule, that the broker or dealer conducted such review, and that such certifications are preserved by the broker or dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act. The ongoing burden of complying with the proposed rule's collection of information would include documentation for compliance with its risk management controls and supervisory procedures, modification to procedures to address any deficiencies in such controls or procedures, and the required preservation of such records.

Based on discussions with industry participants and the Commission's prior experience with broker-dealers, the Commission estimates that a broker-dealer's implementation of an annual review, modification of its risk management controls and supervisory procedures to address any deficiencies, and preservation of such records would require 45 hours per year. Specifically, compliance attorneys who review, document, and update written compliance policies and procedures would require an estimated 20 hours per year; a compliance manager who reviews, documents, and updates written compliance policies and procedures is expected to require 20 hours per year; and the Chief Executive Officer, who certifies the policies and procedures, is expected to require another 5 hours per year.

Based on discussions with industry participants and the Commission's prior experience with broker-dealers, the Commission believes that the ongoing legal and compliance obligations under the proposed 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 does not believe that a broker-dealer would have any recurring external costs associated with legal and compliance obligations.

3. Total Burden

Under the proposed rule, the total initial burden for all respondents would be approximately 239,575 hours ($[(150 \text{ hours (for technology)} + 35 \text{ hours (for legal and compliance)}) \times 1,295 \text{ brokers and dealers} = 239,575 \text{ hours}]$) and the total ongoing annual burden would be approximately 207,200 hours ($[(115 \text{ hours (for technology)} + 45 \text{ hours (for legal and compliance)}) \times 1,295 \text{ brokers and dealers} = 207,200 \text{ hours}]$). For hardware and software expenses, the total initial cost for all respondents would be \$20,720,000 ($\$16,000 \text{ per broker-dealer} \times 1,295 \text{ brokers and dealers} = \$20,720,000$) and the total ongoing cost for all respondents would be \$26,547,500 ($\$20,500 \text{ per broker-dealer} \times 1,295 \text{ brokers and dealers} = \$26,547,500$). The estimates of the initial and annual burdens are based on discussions with potential respondents.

The Commission seeks comment on the reporting and recordkeeping collection of information burdens associated with the proposed rule. In particular:

1. How many broker-dealers would incur collection of information burdens if the proposed rule were adopted by the Commission?
2. What are the burdens, both initial and annual, that a broker-dealer would incur for programming, expanding systems capacity, establishing compliance programs, and maintaining post-trade reporting if the Commission were to adopt the proposed rule? Would there be additional burdens associated with the collection of information under this proposed rule?

3. How much work would it take for brokers or dealers with existing risk management control systems and supervisory procedures to comply with the proposed rule? Would brokers or dealers generally perform the work internally or outsource the work? What would be the hardware and software costs for brokers or dealers that complete the work internally? What about those that outsource the work?

E. General Information About Collection of Information

The collection of information would be mandatory. The collection of information would not be required to be made public but would not be confidential.

F. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;
2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
3. Enhance the quality, utility, and clarity of the information to be collected; and
4. Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit 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, Room 3208, New Executive Office Building, Washington, DC 20503; and should send a copy to

Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-03-10. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-03-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213.

VI. Consideration of Costs and Benefits

The Commission is sensitive to the costs and benefits of the proposed rule and requests comment on the costs and benefits of the proposed Rule 15c3-5 discussed above. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data regarding any such costs or benefits.

A. Benefits

Proposed Rule 15c3-5 should benefit investors, brokers-dealers, their counterparties, and the national market system as a whole by reducing the risks faced by broker-dealers and other market participants as a result of various market access arrangements by requiring financial and regulatory risk management controls to be implemented on a uniform, market-wide basis. The proposed financial and regulatory risk management controls should reduce risks to broker-dealers and markets, as well as systemic risk associated with market access and enhance market integrity and investor protection in the securities markets by effectively prohibiting the practice of "unfiltered" or "naked" access to an exchange or ATS. The proposed rule would establish a

uniform standard for a broker or dealer with market access with respect to risk management controls and procedures which should reduce the potential for regulatory arbitrage and lead to consistent interpretation and enforcement of applicable regulatory requirements across markets.

One of the benefits of the proposed rule should be the reduction of systemic risk associated with market access through the elimination of “unfiltered” or “naked” access. As discussed above, due in large part to technological advancements, the U.S. markets have experienced a rise in the use and reliance of “sponsored access” arrangements where customers place orders that are routed to markets with little or no substantive intermediation by a broker or dealer. The risk of unmonitored trading is heightened with the increased prominence of high-speed, high-volume, automated algorithmic trading, where orders can be routed for execution in milliseconds. If a broker-dealer does not implement strong systematic controls, the broker or dealer may be unaware of customer trading activity that is occurring under its MPID or otherwise. In the “unfiltered” or “naked” access context, as well as with all market access generally, the Commission is concerned that order entry errors could suddenly and significantly make a broker or dealer and other market participants financially vulnerable within mere minutes or seconds. Real examples of such potential catastrophic events have already occurred. For instance, as discussed earlier, on September 30, 2008, trading in Google became extremely volatile toward the end of the day trading, dropping 93% in value at one point, due to an influx of erroneous orders onto an exchange from a single market participant which resulted in the cancellation of numerous trades.⁵⁹

⁵⁹ See Google Trading Incident, supra note 14. See also SWS Trading Incident, supra note 15; Mizuho Trading Incident, supra note 16; and Rambus Trading Incident, supra note 17.

Without systematic risk protection, erroneous trades, whether resulting from manual errors or a faulty automated, high-speed algorithm, could potentially expose a broker or dealer to enormous financial burdens and disrupt the markets. Because the impact of such errors may be most profound in the “unfiltered” access context, but are not unique to it, it is clearly in a broker or dealer’s financial interest, and the interest of the U.S. markets as whole, to be shielded from such a scenario regardless of the form of market access. The mitigation of significant systemic risks should help ensure the integrity of the U.S. markets and provide the investing public with greater confidence that intentional, bona fide transactions are being executed across the national market system. Proposed Rule 15c3-5 should promote confidence as well as participation in the market by enhancing the fair and efficient operation of the U.S. securities markets.

The national market system is currently exposed to risk that can result from unmonitored order flow, as a recent report has estimated that “naked” access accounts for 38 percent of the daily volume for equities traded in the U.S. markets.⁶⁰ The Commission is aware that a certain segment of the broker-dealer community has declined to incorporate “naked” access arrangements into their business models because of the inherent risks of the practice. In the absence of a Commission rule that would prohibit such market access, these brokers or dealers could be compelled by competitive and economic pressures to offer “naked” access to their customers and thereby significantly increase a systemic vulnerability of the national market system.

Finally, the Commission believes that in many cases broker or dealers whose business activities include proprietary trading, traditional agency brokerage activities, and direct market access, would find that their current risk management controls and supervisory procedures may

⁶⁰ See supra note 10.

substantially satisfy the requirements of the proposed rule, and require minimal material modifications. Such broker or dealers would experience the market-wide benefits of the proposal with limited additional costs related to their own compliance.

The Commission seeks comment on the anticipated benefits of the proposed rule, including the following: Would the proposed rule provide market benefits that the Commission has not discussed? Would the proposed rule help level the playing field for broker-dealer competition? Would the proposed rule serve to reduce systemic risks to the US markets? Would the proposed rule serve to promote trading volumes? Would the proposed rule enhance market integrity, promote investor protection, and protect the public interest?

B. Costs

1. Technology Development and Maintenance

Broker-dealers with market access may comply with the proposed rule in several ways. Specifically, a broker-dealer may choose to internally develop risk management controls from scratch, or upgrade its existing systems; each of these approaches has potential costs that are divided into initial costs and annual ongoing costs. Alternatively, a broker-dealer may choose to purchase a risk management solution from an outside vendor. As stated above, it is likely many broker-dealers with market access would be able to substantially satisfy the proposed rule with their current risk management controls and supervisory procedures, requiring few material changes. However, for others, the costs of upgrading and introducing the required systems would vary considerably based on their current controls and procedures, as well as their particular business models. For instance, the needs of a broker-dealer would vary based on its current systems and controls in place, the comprehensiveness of its controls and procedures, the sophistication of its client base, the types of trading strategies that it utilizes, the number of

trading venues it connects to, the number of connections that it has to each trading market, and the volume and speed of its trading activity.

Commission staff's discussions with industry participants found that broker-dealers who must develop or substantially upgrade existing systems could face several months of work requiring considerable time and effort. For example, the Commission conservatively estimates that developing a system from scratch could take approximately three months, while upgrading a pre-existing risk control management system could take approximately two weeks. Overall, Commission staff estimates that the initial cost for an internal development team to develop or substantially upgrade an existing risk control system would be \$51,000 per broker-dealer,⁶¹ or

⁶¹ See *supra* note 49. The Commission estimates that the average initial cost of \$51,000 per broker-dealer consists of \$35,000 for technology personnel and \$16,000 for hardware and software. As stated in the PRA section, industry sources estimate that the average system development team consists of one or more programmer analysts, senior programmers, and senior systems analysts. The Commission estimates that the programmer analyst would work 40% of the total hours required for initial development, or $150 \text{ hours} \times 0.40 = 60 \text{ hours}$; the senior programmer would work 20% of the total hours, or $150 \text{ hours} \times 0.20 = 30 \text{ hours}$; and the senior systems analyst would work 40% of the total hours, or $150 \text{ hours} \times 0.40 = 60 \text{ hours}$. The total initial development cost for staff is estimated to be $60 \text{ hours} \times \193 (hourly wage for a programmer analyst) + $30 \text{ hours} \times \292 (hourly wage for a senior programmer) + $60 \text{ hours} \times \244 (hourly wage for a senior systems analyst) = \$34,980, or \$35,000.

The \$193, \$292, and \$244 per hour estimates for a programmer analyst, senior programmer, and senior systems analyst, respectively is from SIFMA's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

The Commission estimates that the average initial hardware and software cost is \$16,000 per broker-dealer. Industry sources estimate that to build a risk control management system from scratch, hardware would cost \$44,500 and software would cost \$58,000, while to upgrade a pre-existing risk control management system, hardware would cost \$5,000 and software would cost \$6,517. Based on discussions with industry participants, the Commission estimates that 95% of all respondents would require modifications and upgrades only, and 5% would require development of a system from scratch. Therefore, the total average hardware and software cost for an initial internal development project would be approximately $(0.95 \times \$11,517) + (0.05 \times \$102,500) = \$16,066$, or \$16,000.

\$66.0 million for 1,295 broker-dealers. The Commission further estimates that the total annual ongoing cost to maintain an in-house risk control management system is \$47,300 per broker-dealer, or \$61.3 million for 1,295 broker-dealers.⁶²

We note that the potential range of costs would vary considerably, depending upon the needs of the broker-dealer. For example, if 65 broker-dealers – *i.e.*, 5% of the 1,295 broker-dealers affected under the rule – were to build risk control management systems from scratch, the total initial technology cost would be approximately \$17.6 million. A team of 1.5 people, working full-time for 3 months, would work an estimated total of 720 burden hours on the project. The resulting personnel cost to build such a risk control management system would be approximately \$167,904 per broker-dealer, or \$10,913,760 for 65 broker-dealers. The hardware and software cost to build a risk control management system from scratch would be \$102,500 per

⁶² See *supra* note 52. The Commission estimates that the average annual ongoing cost of \$47,300 per broker-dealer consists of \$26,800 for technology personnel and \$20,500 for hardware and software. The Commission estimates that the programmer analyst would work 40% of the total hours required for ongoing maintenance, or $115 \text{ hours} \times 0.40 = 46$ hours; the senior programmer would work 20% of the total hours, or $115 \text{ hours} \times 0.20 = 23$ hours; and the senior systems analyst would work 40% of the total hours, or $115 \text{ hours} \times 0.40 = 46$ hours. The total ongoing maintenance cost for staff is estimated to be $46 \text{ hours} \times \193 (hourly wage for a programmer analyst) + $23 \text{ hours} \times \292 (hourly wage for a senior programmer) + $46 \text{ hours} \times \244 (hourly wage for a senior systems analyst) = \$26,818, or \$26,800.

The \$193, \$292, and \$244 per hour estimates for a programmer analyst, senior programmer, and senior systems analyst, respectively is from SIFMA's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

The Commission estimates that the average annual ongoing hardware and software cost is \$20,500 per broker-dealer. Industry sources estimate that for ongoing maintenance, hardware would cost \$8,900 on average and software would cost \$11,600 on average. The total average hardware and software cost for ongoing maintenance would be $\$8,900 + \$11,600 = \$20,500$.

broker-dealer, or \$6,662,500 for 65 broker-dealers. The combined personnel, hardware, and software cost would be \$17.6 million.

By contrast, if the remaining 1,230 broker-dealers were to upgrade and modify their pre-existing risk control management systems, the total initial technology cost for those 1,230 broker-dealers would be approximately \$48.6 million. A team of 1.5 people, working full-time for 2 weeks, would work an estimated total of 120 burden hours on the project. The resulting staff cost to upgrade and modify a pre-existing risk control management system would be approximately \$27,984 per broker-dealer, or \$34.4 million for 1,230 broker-dealers. The hardware and software cost to upgrade and modify a risk control management system would be \$11,517 per broker-dealer, or \$14.2 million for 1,230 broker-dealers. The combined personnel, hardware, and software cost would be \$48.6 million. The Commission welcomes comments on these estimates.

Rather than developing or upgrading systems, broker-dealers may choose to purchase a risk management solution from a third-party vendor. Potential costs of contracting with such a vendor were obtained from industry participants. Here again, the potential range of costs would vary considerably, depending upon the needs of the broker-dealer. For instance, the needs of a broker-dealer would vary based on its current systems and controls in place, the comprehensiveness of its controls and procedures, the sophistication of its client base, the types of trading strategies that it utilizes, the number of trading venues it connects to, the number of connections that it has to each trading market, and the volume and speed of its trading activity. As discussed previously, a broker-dealer is estimated to pay as much as approximately \$4,000 per month per trading venue for a startup contract depending on its particular needs. The Commission conservatively estimates \$8,000 per month (i.e., connection to two trading venues),

or \$96,000 annually, for a startup contract.⁶³ For instance, the Commission estimates that if 65 broker-dealers choose to purchase systems from a third-party vendor as an alternative to building a risk control management system from scratch,⁶⁴ the cost to the industry for initial startup contracts could be approximately \$6,240,000.⁶⁵ The Commission preliminarily believes that the annual ongoing cost would be significantly less than the initial startup cost; however, to be conservative, we estimate that the annual ongoing cost for 65 broker-dealers would be the same as the startup estimate of \$6,240,000 per year. The Commission welcomes comments on the reasonableness of these estimates.

2. Legal and Compliance

Like today, a broker or dealer would be obligated to comply with all applicable regulatory requirements such as exchange trading rules relating to special order types, trading halts, odd-lot orders, SEC rules under Regulation SHO and Regulation NMS, and applicable margin requirements. Accordingly, the Commission believes that the overall cost increase associated with developing and maintaining compliance policies and procedures is not expected to be significant because the proposed rule may be substantially satisfied by existing risk management controls and supervisory procedures already implemented by brokers-dealer that conduct proprietary trading, traditional brokerage activities, direct market access, and sponsored access. Therefore, many of the financial and regulatory risk management controls specified in

⁶³ See supra Section V.D.1.

⁶⁴ As stated previously, the Commission estimates that 5% of all broker-dealers will require development of a system from scratch. See supra note 49. The Commission believes that a total of 65 broker-dealers is a reasonable estimate here.

⁶⁵ 65 broker-dealers × \$96,000 (annual cost for a startup contract with a third-party technology provider or service bureau) = \$6,240,000.

the proposed rule – such as prevention of trading restricted products, or setting of trade limits – should already be in place and should not require significant additional expenditure of resources.

The Commission estimates that the initial cost for a broker or dealer to comply with the proposed requirement to establish, document, and maintain compliance policies and supervisory procedures would be approximately \$28,200 per broker-dealer, or \$36.5 million for 1,295 broker-dealers. Specifically, the costs for setting credit and capital thresholds would be approximately \$2,640;⁶⁶ and the modification or establishment of applicable compliance policies and procedures would be approximately \$25,555 per broker-dealer.⁶⁷

The Commission further estimates that the costs of the annual review, modification of applicable compliance policies and supervisory procedures, and preservation of such records

⁶⁶ The Commission estimates that one compliance attorney and one compliance manager would each require 5 hours, for a total initial burden of 10 hours. See supra Section V.B.2. The total initial cost for staff is estimated to be 5 hours × \$270 (hourly wage for a compliance attorney) + 5 hours × \$258 (hourly wage for a compliance manager) = \$2,640.

The \$270 and \$258 per hour estimates for a compliance attorney and compliance manager, respectively, is from SIFMA's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

⁶⁷ The Commission estimates that one compliance attorney and one compliance manager would each require 10 hours, while the Chief Executive Officer would require 5 hours, for a total initial burden of 25 hours. See supra Section V.B.2. The total initial cost for staff is estimated to be 10 hours × \$270 (hourly wage for a compliance attorney) + 10 hours × \$258 (hourly wage for a compliance manager) + 5 hours × \$4,055 (hourly wage for a Chief Executive Officer) = \$25,555.

The \$270 and \$258 per hour estimates for a compliance attorney and compliance manager, respectively, is from SIFMA's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. The \$4,055 per hour figure for a broker-dealer Chief Executive Officer comes from the median of June 2008 Large Bank Executive Compensation data from TheCorporateLibrary.com, divided by 1800 hours per work-year. We invite comments on whether large bank Chief Executive Officer total compensation is an appropriate proxy for broker-dealer Chief Executive Officer total compensation.

would be approximately \$30,800 per broker-dealer, or \$39.9 million for 1,295 broker-dealers. Specifically, compliance attorneys who review, document, and update written compliance policies and procedures would cost an estimated \$5,400 per year;⁶⁸ a compliance manager who reviews, documents, and updates written compliance policies and procedures is expected to cost \$5,160;⁶⁹ and the Chief Executive Officer, who certifies the policies and procedures, would cost \$20,275.⁷⁰

The Commission believes that the ongoing legal and compliance obligations under the proposed 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 does not believe that a broker-dealer would likely have any recurring external costs associated with legal and compliance obligations.

3. Total Cost

The Commission believes that this proposed rule would have its greatest impact on broker-dealers that provide “naked” access, and that the majority of broker-dealers with market

⁶⁸ 20 hours (total annual ongoing compliance hourly burden for a compliance attorney) × \$270 (hourly wage for a compliance attorney) = \$5,400. The \$270 per hour estimate for a compliance attorney is from SIFMA’s Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

⁶⁹ 20 hours (total annual ongoing compliance hourly burden for a compliance manager) × \$258 (hourly wage for a compliance manager) = \$5,160. The \$258 per hour estimate for a compliance manager is from SIFMA’s Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

⁷⁰ 5 hours (total annual ongoing compliance hourly burden for a Chief Executive Officer) × \$4,055 (hourly wage for a Chief Executive Officer) = \$20,275. The \$4,055 per hour figure for a broker-dealer Chief Executive Officer comes from the median of June 2008 Large Bank Executive Compensation data from TheCorporateLibrary.com, divided by 1800 hours per work-year. We invite comments on whether large bank Chief Executive Officer total compensation is an appropriate proxy for broker-dealer Chief Executive Officer total compensation.

access are likely to be able to substantially satisfy the requirements of the proposed rule change with much of their current existing risk management controls and supervisory procedures. However, for broker-dealers that would need to develop or substantially upgrade their systems the cost would vary considerably.

We note that the potential range of costs would vary considerably, depending upon the needs of the broker-dealer and its current risk management controls and supervisory procedures. For example, the Commission estimates that if 65 broker-dealers build risk management systems from scratch and modify their compliance procedures accordingly, the total initial cost could be approximately as much as \$19.4 million. The cost to build the risk control management systems would be \$17.6 million for 65 broker-dealers,⁷¹ while the cost to initially develop or modify compliance procedures for the same would be approximately \$28,200 per broker-dealer,⁷² or \$1,833,000 for 65 broker-dealers. The total initial cost to build systems from scratch is thus estimated to be approximately \$19.4 million.

By contrast, the Commission estimates that if the remaining 1,230 broker-dealers would upgrade their pre-existing risk control management systems and modify their compliance procedures accordingly, the total initial cost would be approximately as much as \$83.3 million. The cost to upgrade the risk control management systems would be \$48.6 million for 1,230 broker-dealers,⁷³ while the cost to initially develop or modify compliance procedures for the same would be approximately \$28,200 per broker-dealer,⁷⁴ or \$34.7 million for 1,230 broker-dealers. The total initial cost is thus estimated to be approximately \$83.3 million.

⁷¹ See supra Section VI.B.1.

⁷² See supra Section VI.B.2.

⁷³ See supra Section VI.B.1.

⁷⁴ See supra Section VI.B.2.

The total annual initial cost for 1,295 broker-dealers is estimated to be approximately \$102.6 million.⁷⁵

The total annual ongoing cost for 1,295 broker-dealers to maintain a risk management control system and annual review and modification of applicable compliance policies and procedures could be approximately as much as \$101.1 million. The annual technology cost to maintain a risk management control system would be approximately \$47,300 per broker-dealer,⁷⁶ or \$61.3 million for 1,295 broker-dealers, while the cost for annual review and modification of applicable compliance policies and procedures would be approximately \$30,800 per broker-dealer,⁷⁷ or \$39.9 million for 1,295 broker-dealers. The total annual ongoing cost is estimated to be approximately \$101.1 million.

The estimates of the initial and annual burdens are based on discussions with industry participants. The Commission welcomes comments on these estimates.

Based on discussions with industry participants, the Commission is aware that, if the Commission were to adopt the proposed rule, there is a potential for latency, ranging approximately from 200 to 500 microseconds, for orders that currently route to exchanges or ATs via “naked” access arrangements. The Commission however preliminarily believes that the potential costs associated with the elimination of “unfiltered” access, including the potential for latency, are justified by the overall benefit to the U.S. markets. We solicit comment on the Commission’s view. Would the controls imposed by the rule substantially increase latency? To what extent would broker-dealers have greater incentives to reduce any such latency? Would

⁷⁵ \$19.4 million (initial cost for 65 broker-dealers building a system from scratch) + \$83.3 million (initial cost for 1,230 broker-dealers upgrading pre-existing systems) = approximately \$102.6 million.

⁷⁶ See supra note 62.

⁷⁷ See supra notes 68, 69, and 70.

broker-dealers incur additional costs in reducing any such latency? What would be the costs to market participants of any additional latency? Can these costs be quantified?

The Commission is also aware that some broker-dealers may benefit from offering sponsored access because they receive volume discounts offered by exchanges and other market centers due to the trades entered under the broker-dealer's MPID or otherwise. How much would the proposed rules affect the volume discounts enjoyed by broker-dealers? Would this effect differ across broker-dealers? What characteristics impact a broker-dealer's reliance on sponsored access for these volume discounts? How would any effect alter a broker-dealer's business? Can any such costs be quantified?

The Commission seeks comment on any other potential costs to brokers or dealers that may result from the proposed rule. While the Commission does not anticipate that there would be significant adverse consequences to a broker or dealer's business, activities, or financial condition as a result of the proposed rule, it seeks commenters' views regarding the possibility of any such impact. For instance, would the proposed rule impact a broker or dealer's ability to attract or retain its market access customers? Could a broker or dealer lose order flow, because its customer might seek other arrangements in order to access the securities markets, such as becoming a member of a particular exchange or becoming a broker or dealer? The Commission requests for commenters to quantify those costs, where possible.

The Commission preliminarily believes that any additional burden or costs on brokers and dealers who provide market access as a result of the proposed amendments would be justified by the improved market security to brokers, dealers, market participants, the self-regulatory organizations, and the public generally, all of which contribute to investor protection and market integrity. To assist the Commission in evaluating the costs that could result from the

proposed rule, the Commission requests comments on the potential costs identified in this proposal, as well as any other costs that could result from the proposed rule. In particular, comments are requested on whether there are costs to any entity not identified above.

Commenters should provide analysis and data to support their views on the costs. In particular, the Commission requests comment on the costs of the proposed rule on brokers, dealers, market participants, self-regulatory organizations, as well as any costs on others, including the investor public.

The Commission also requests comment on the following: Would the proposed rule impair the ability of market participants that currently rely on “unfiltered” access to compete? Would the proposed rule have any unintended, negative consequences for the U.S. markets? Would the proposed rule decrease the propensity of market participants that currently rely on “unfiltered” access to provide liquidity to the U.S. markets? Would the proposed rule stifle or impact certain trading strategies that may add value to the market? Would the proposed rule limit price discovery mechanisms?

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

Section 3(f) of the Exchange Act⁷⁸ 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, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act⁷⁹ requires the Commission, when making rules under the Exchange Act, to consider the impact of such rules on competition. Section 23(a)(2) also prohibits the

⁷⁸ 15 U.S.C. 78c(f).

⁷⁹ 15 U.S.C. 78w(a)(2).

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.

A. Competition

We consider in turn the impacts of Proposed Rule 15c3-5 on the market center and broker-dealer industries. Information provided by market centers and broker-dealers in their registrations and filings with us and with FINRA informs our views on the structure of the markets in these industries. We begin our consideration of potential competitive impacts with observations of the current structure of these markets.

The broker-dealer industry, including market makers, is a highly competitive industry, with most trading activity concentrated among several dozen large participants and with thousands of small participants competing for niche or regional segments of the market.

There are approximately 5,178 registered broker-dealers, of which 890 are small broker-dealers.⁸⁰ The Commission estimates that 1,295 brokers or dealers would have market access as defined under the proposed rule.⁸¹ Of these 1,295 brokers or dealers, the Commission estimates that approximately 21 of those were small broker-dealers. To limit costs and make business more viable, small broker-dealers often contract with larger broker-dealers to handle certain functions, such as clearing and execution, or to update their technology. Larger broker-dealers typically enjoy economies of scale over small broker-dealers and compete with each other to service the small broker-dealers, who are both their competitors and their customers.

Proposed Rule 15c3-5 is intended to address a broker-dealer's obligations generally with respect to market access risk management controls across markets, to prohibit the practice of

⁸⁰ These numbers are based on the Commission's staff review of 2007 and 2008 FOCUS Report filings reflecting registered broker-dealers, and discussions with SRO staff. The number does not include broker-dealers that are delinquent on FOCUS Report filings.

⁸¹ See supra note 33.

“unfiltered” or “naked” access to an exchange or an ATS where customer order flow does not pass through the broker-dealer’s systems or filters prior or to entry on an exchange or ATS, and to provide uniform standards that would be interpreted and enforced in a consistent manner. Such proposed requirements may promote competition by establishing a level playing field for broker-dealers in market access, in that each broker or dealer would be subject to the same requirements in providing access.

The proposed rule would require brokers or dealers that offer market access, including those providing sponsored or direct market access to customers, to implement appropriate risk management controls and supervisory procedures to manage the financial and regulatory risks of this business activity. As noted above, we expect there to be costs of implementing and monitoring these systems. However, we do not believe that these costs will create or increase any burdens of entry into the broker-dealer industry.

The Commission seeks comment on whether or how the proposed rule would affect the competitive landscape in the broker-dealer industry and on whether or how the proposed rule might create new barriers to entry or increase existing barriers to entry in the broker-dealer industry.

The costs to implement appropriate risk management controls and supervisory procedures to manage the financial and regulatory risks may disproportionately impact small- or medium-sized broker-dealers. In particular, the costs of instituting such controls and procedures could be a larger portion of revenues for small- and medium-sized broker-dealers than for larger broker dealers. In addition, to the extent that the cost of obtaining sponsored access increases, the increases could be a larger portion of the revenues of small and medium-sized broker-dealers. This could impair the ability of small- and medium-sized broker-dealers to compete for order

routing business with larger firms, limiting choice and incentives for innovation in the broker dealers industry. However, the effect on smaller broker-dealers could be mitigated, to some extent, by purchasing a risk management solution from a third-party vendor.

We do not believe that the proposed rule will alter the competitive landscape in the competition between large broker-dealers and small and medium broker-dealers. However, we request comment on the following questions:

How common is it for smaller broker-dealers to offer sponsored access or direct market access? If smaller broker-dealers provide this service, would costs of implementing and complying with the proposed rule be particularly burdensome for them? Could the proposed rule impair the ability of small- and medium-sized broker-dealers to compete for order routing business with larger firms, limiting choice and incentives for innovation in the broker-dealer industry, because it would not be cost effective for them to implement the required risk management controls and supervisory procedures?

How common is it for smaller broker-dealers to be the sponsored participants for larger broker-dealers? If this is common, would the rule affect the ability of these smaller broker-dealers to access markets? If so, in what ways and to what extent? How would any such effects impact the securities markets more generally? If it is common for smaller broker-dealers to offer or purchase market access, would the rule adversely affect the ability of smaller broker-dealers to compete or the level of service that they can provide to their customers?

Would the Proposed Rule 15c3-5 create vertical integration in the industry, by inducing large customers (non-members) to acquire and integrate with broker-dealers? Would this potential outcome have an impact on competition in the industry?

What are the types of customers who use sponsored access or direct market access?

Would this rule affect the competitive landscape for any of these customer types? Would the rule affect the competitive landscape for any other market participants, including market makers?

In addition, the Commission is mindful of a potential race-to-the-bottom issue in which broker-dealers competing for sponsored access or direct market access clients with low prices will skimp on spending for risk controls. Will the proposed rule help to halt or encourage such a “race to the bottom”?

The trading industry is a highly competitive one, characterized by ease of entry. In fact, the intensity of competition across trading platforms in this industry has increased dramatically in the past decade as a result of market reforms and technological advances. This increase in competition has resulted in substantial decreases in market concentration, effective competition for the securities exchanges, a proliferation of trading platforms competing for order flow, and significant decreases in trading fees. The low barriers to entry for equity trading venues are shown by new entities, primarily ATSS, continuing to enter the market. Currently, there are approximately 50 registered ATSS that trade equity securities. In addition, the Commission within the past few years has approved applications by two entities – BATS and Nasdaq – to become registered as national securities exchanges for trading equities, and approved proposed rule changes by two existing exchanges – ISE and CBOE – to add equity trading facilities to their existing options business. We believe that competition among trading centers has been facilitated by Rule 611 of Regulation NMS,⁸² which encourages quote-based competition between trading centers; Rule 605 of Regulation NMS,⁸³ which empowers investors and broker-

⁸² 17 CFR 242.611.

⁸³ 17 CFR 242.605.

dealers to compare execution quality statistics across trading centers; and Rule 606 of Regulation NMS,⁸⁴ which enables customers to monitor order routing practices.

Market centers compete with each other in several ways. National exchanges compete to list securities; market centers compete to attract order flow to facilitate executions; and market centers compete to offer access to their markets to members or subscribers. In this last area of competition, one could argue that the ability to access a market through sponsored access or direct market access could substitute for becoming a member or subscriber. Of course, there are both benefits and responsibilities in being a member or subscriber that do not accrue directly to someone using sponsored access or direct market access. Nonetheless, to the extent that these forms of market access are substitutes for membership, an increase in the costs of sponsored access or direct market access may make a potential member more likely to decide to become a member or subscriber. At the same time, market centers may reduce the cost of access to members or subscribers in order to attract trading flow to their venue.

We request comment on the following questions: Would the Proposed Rule 15c3-5 modify the competition among market centers and broker-dealers to obtain members or offer sponsored access? What are the benefits of being a member or subscriber to a market center that would not be available to someone with sponsored access or direct market access? Would the proposed rule increase or decrease the propensity of broker-dealers and others to become members or subscribers? Would the proposed rule increase or decrease the propensity of non-broker-dealer market participants to register to become broker-dealers? How would the proposed rule affect overall access to markets? Would the proposed rule affect any other type of competition between market centers?

⁸⁴

17 CFR 242.606.

B. Capital Formation

The Commission believes that the proposed rule would have a minimal impact on the promotion of capital formation. We request comment on the following questions:

By requiring financial and regulatory controls to be implemented on a market-wide basis to reduce the risks faced by broker-dealers, and by prohibiting "unfiltered" or "naked" access, would Proposed Rule 15c3-5 promote capital formation? If so, to what extent? Would the proposed rule promote investor protection, which could, in turn, make investors more willing to invest and promote capital formation? Are there any other impacts of the proposed rule on capital formation? To the extent that the proposed requirements impact trading strategies or other behavior, how might that impact capital formation?

C. Efficiency

By proposing to address broker-dealer obligations with respect to market access risk controls across markets, and by having the effect of prohibiting "unfiltered" or "naked" access, the proposed rule would provide uniform standards that would be interpreted and enforced in a consistent manner. Proposed Rule 15c3-5 would help to facilitate and maintain stability in the markets and help ensure that they function efficiently.

In recent years, the development and growth of automated electronic trading has allowed ever increasing volumes of securities transactions across the multitude of trading centers that constitute the U.S. national market system. The Commission believes that the risk management controls and procedures that brokers and dealers would be required to include as part of their compliance systems should prevent erroneous and unintended trades from occurring and thereby contribute to overall market efficiency.

While the Commission has consistently sought to encourage innovations that enhance the efficiency and quality of the markets, it also must assure that the regulatory framework keeps pace with market developments so that emerging risks are effectively addressed. The Commission believes that safer transactions – and the anticipated increased confidence in the markets – should promote greater efficiency in the long run. The Commission is aware of concerns that pre-trade controls potentially could slow down the speed of order routing and the incorporation of information into prices, but the Commission notes that such concerns should be balanced against the Commission’s goals, as mandated by the Exchange Act, including to promote the integrity of the markets and investor protection. We request comment on the following questions:

How would Proposed Rule 15c3-5 affect price efficiency? Would pre-trade reviews limit unlawful or erroneous trading? To what extent would limits on erroneous trading improve price efficiency? To what extent would the pre-trade reviews reveal other trading that could affect price efficiency? To what extent would the controls imposed by the rule create latency that can slow the incorporation of information into prices? To what extent would broker-dealers have greater incentives to reduce any such latency?

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or “SBREFA,”⁸⁵ the Commission must advise 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 (either in the form of an increase or a decrease); (2) a major increase in costs or prices for

⁸⁵ 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).

consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of the proposed rule on the economy on an annual basis, on the costs or prices for consumers or individual industries, and on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. Initial Regulatory Flexibility Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA"), in accordance with the provisions of the Regulatory Flexibility Act ("RFA"),⁸⁶ regarding proposed new Rule 15c3-5 under the Securities Exchange Act of 1934:

A. Reasons for the Proposed Action

Over the past decade, the proliferation of sophisticated, high-speed trading technology has changed the way broker-dealers trade for their accounts and as an agent for their customers. Current SRO rules and interpretations governing electronic access to markets have sought to address the risks of this activity. However, the Commission preliminarily believes that more comprehensive standards that apply consistently across the markets are needed to effectively manage the financial, regulatory, and other risks, such as legal and operational risks, associated with market access.

The Commission notes that these risks are present whenever a broker-dealer trades as a member of an exchange or subscriber to an ATS, whether for its own proprietary account or as agent for its customers, including traditional agency brokerage and through direct market access

⁸⁶ 5 U.S.C. 603(a).

or sponsored access arrangements. For this reason, proposed new Rule 15c3-5 is drafted broadly to cover all forms of access to trading on an exchange or ATS provided directly by a broker-dealer. The Commission believes a broker-dealer with market access should assure the same basic types of controls are in place whenever it uses its special position as a member of an exchange, or subscriber to an ATS, to access those markets. The Commission, however, is particularly concerned about the quality of broker-dealer risk controls in sponsored access arrangements, where the customer order flow does not pass through the broker-dealer's systems prior to entry on an exchange or ATS.

B. Objectives

Proposed Rule 15c3-5 would apply to any broker or dealer that has access to trading in securities on an exchange or ATS as a result of being a member or subscriber of the exchange or ATS, respectively. As noted above, the proposed rule would include not only direct market access or sponsored access services offered to customers of broker-dealers, but also access to trading for the proprietary account of the broker-dealer and for more traditional agency activities. The Commission believes that any broker-dealer with market access should establish effective risk management controls to protect against breaches of credit or capital limits, erroneous trades, violations of SEC or exchange trading rules, and the like.

Proposed Rule 15c3-5 would require a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its MPID or otherwise, to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks related to market access. The proposed rule would apply to trading in all securities on an exchange or ATS, including equities, options, exchange-traded funds, and debt securities.

Specifically, the proposed rule would require that brokers or dealers with access to trading securities on an exchange or ATS, as a result of being a member or subscriber thereof, establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, are reasonably designed to (1) systematically limit the financial exposure of the broker or dealer that could arise as a result of market access, and (2) ensure compliance with all regulatory requirements that are applicable in connection with market access.

The required financial risk management controls would be required to be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous. The required regulatory risk management controls and supervisory procedures would also be required to be reasonably designed to prevent the entry of orders that fail to comply with any regulatory requirements that must be satisfied on a pre-order entry basis, prevent the entry of orders that the broker-dealer or customer is restricted from trading, restrict market access technology and systems to authorized persons, and assure appropriate surveillance personnel receive immediate post-trade execution reports. For example, such systems would block orders that do not comply with exchange trading rules relating to special order types and odd-lot orders, among others.

The proposed requirement that a broker-dealer's financial and regulatory risk management controls and procedures be reasonably designed to prevent the entry of orders that fail to comply with the specified conditions would necessarily require the controls be applied on an automated, pre-trade basis before orders route to an exchange or ATS, thereby effectively prohibiting the practice of "unfiltered" or "naked" access to an exchange or ATS.

The risk management controls and supervisory procedures required by proposed Rule 15c3-5 must be under the direct and exclusive control of the broker or dealer with market access.

This provision is designed to eliminate the practice, which the Commission understands exists today under current SRO rules, whereby the broker-dealer providing market access relies on its customer, a third party service provider, or others, to establish and maintain the applicable risk controls. The Commission believes the risks presented by market access – and in particular “naked” access – are too great to permit a broker-dealer to delegate the power to control those risks to the customer or to a third party, either of whom may be an unregulated entity.

C. Legal Basis

Pursuant to the Exchange Act and particularly, Sections 2, 3(b), 11A, 15, 17(a) and (b), and 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78k-1, 78o, 78q(a) and (b), and 78w(a), the Commission is proposing new Rule 15c3-5.

D. Small Entities Subject to the Rule

For purposes of Commission rulemaking in connection with the RFA, 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.”⁸⁷ The Commission staff estimates that at year-end 2008 there were 1,095 broker or dealers which were members of an exchange, and 21 of those were classified as “small businesses.”⁸⁸ In addition, the Commission estimates that there were 200 brokers or dealers that were subscribers to ATSS but not members of an exchange.⁸⁹ The Commission estimates that, of those 200 brokers or dealers, only a small number would be classified as “small businesses.”

Currently, most small brokers or dealers, when accessing an exchange or ATS in the ordinary course of their business, should already have risk management controls and supervisory

⁸⁷ 17 CFR 240.0-10(c).

⁸⁸ See supra note 33.

⁸⁹ Id.

procedures in place. The extent to which such small brokers or dealers would be affected economically under the proposed rule would depend significantly on the financial and regulatory risk management controls that already exist in the broker or dealer's system, as well as the nature of the broker or dealer's business. In many cases, the proposed rule may be substantially satisfied by a small broker-dealer's pre-existing financial and regulatory risk management controls and current supervisory procedures. Further, staff discussions with various industry participants indicated that very few, if any, small broker-dealers with market access provide other persons with "unfiltered" access, which may require more significant systems upgrades to comply with the proposed rule. Therefore, these brokers or dealers should only require limited updates to their systems to meet the requisite risk management controls and other requirements in the proposed rule. The proposed rule also would impact small brokers or dealers that utilize risk management technology provided by a vendor or some other third party; however, the proposed requirement to directly monitor the operation of the financial and regulatory risk management controls should not impose a significant cost or burden because the Commission understands that such technology allows the broker or dealer to exclusively manage such controls.⁹⁰

E. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed rule would require brokers or dealers to establish, document, and maintain certain risk management controls and supervisory procedures as well as regularly review such controls and procedures, and document the review, and remediate issues discovered to assure overall effectiveness of such controls and procedures. Each such broker or dealer would be required to preserve a copy of its supervisory procedures and a written description of its risk

⁹⁰ The Commission's understanding is based on discussions with various industry participants.

management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act. Such regular review would be required to be conducted in accordance with written procedures and would be required to be documented. The broker or dealer would be required to preserve a copy of such written procedures, and documentation of each such review, as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act, and Rule 17a-4(b) under the Exchange Act, respectively.

In addition, the Chief Executive Officer (or equivalent officer) would be required to certify annually that the broker or dealer's risk management controls and supervisory procedures comply with the proposed rule, and that the broker-dealer conducted such review. Such certifications would be required to be preserved by the broker or dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act. Most small brokers or dealers currently should already have supervisory procedures and record retention systems in place. The proposed rule would require small brokers or dealers to update their procedures and perform additional internal compliance functions. Based on discussions with industry participants and the Commission's prior experience with broker-dealers, the Commission estimates that implementation of a regular review, modification of applicable compliance policies and procedures, and preservation of such records would require, on average, 45 hours of compliance staff time for brokers or dealers depending on their business model.⁹¹ The Commission believes that the business models of small brokers or dealers would necessitate less than the average of 45 hours. We request comments on these estimates.

F. Duplicative, Overlapping, or Conflicting Federal Rules

⁹¹ See supra Section V.D.2.

The Commission believes that there are no Federal rules that duplicate, overlap, or conflict with the proposed rule amendments and the proposed new rule.

G. Significant Alternatives

Pursuant to Section 3(a) of the Regulatory Flexibility Act,⁹² the Commission must consider certain types of alternatives, including: (1) the establishment of differing compliance or recording requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

The Commission considered whether it would be necessary or appropriate to establish different compliance or reporting requirements or timetables; or to clarify, consolidate, or simplify compliance and reporting requirements under the rule for small entities. Because the proposed rule is designed to mitigate, as discussed in detail throughout this release, significant financial and regulatory risks, the Commission preliminarily believes that small entities should be covered by the rule. The proposed rule includes performance standards. The Commission also preliminarily believes that the proposed rule is flexible enough for small brokers and dealers to comply with the proposed rule without the need for the establishment of differing compliance or reporting requirements for small entities, or exempting them from the proposed rule's requirements.

H. Request for Comments

⁹² 5 U.S.C. 603(c).

The Commission encourages written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on the number of small entities that would be affected by the proposed new rule, and whether the effect on small entities would be economically significant. Commenters are asked to describe the nature of any impact on small entities, including broker-dealers or other small businesses or small organizations, and provide empirical data to support their views.

X. Statutory Authority

Pursuant to the Exchange Act and particularly, Sections 2, 3(b), 11A, 15, 17(a) and (b), and 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78k-1, 78o, 78q(a) and (b), and 78w(a), the Commission proposes a new Rule 15c3-5 under the Exchange Act that would require broker-dealers with market access, or that provide a customer or any other person with market access through use of its market participant identifier or otherwise, to establish appropriate risk management controls and supervisory systems.

XI. Text of Proposed Rule

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, 17 CFR Part 240 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 240.15c3-5 is added to read as follows:

§240.15c3-5 Risk management controls for brokers or dealers with market access.

(a) For the purpose of this section:

(1) The term market access shall mean access to trading in securities on an exchange or alternative trading system as a result of being a member or subscriber of the exchange or alternative trading system, respectively.

(2) The term regulatory requirements shall mean all federal securities laws, rules and regulations, and rules of self-regulatory organizations, that are applicable in connection with market access.

(b) A broker or dealer with market access, or that provides a customer or any other person with access to an exchange or alternative trading system through use of its market participant identifier or otherwise, shall establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. Such broker or dealer shall preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with §240.17a-4(e)(7).

(c) The risk management controls and supervisory procedures required by paragraph (b) of this section shall include the following elements:

(1) Financial risk management controls and supervisory procedures. The risk management controls and supervisory procedures shall be reasonably designed to systematically

limit the financial exposure of the broker or dealer that could arise as a result of market access, including being reasonably designed to:

(i) Prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker or dealer and, where appropriate, more finely-tuned by sector, security, or otherwise by rejecting orders if such orders would exceed the applicable credit or capital thresholds; and

(ii) Prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.

(2) Regulatory risk management controls and supervisory procedures. The risk management controls and supervisory procedures shall be reasonably designed to ensure compliance with all regulatory requirements, including being reasonably designed to:

(i) Prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis;

(ii) Prevent the entry of orders for securities for a broker or dealer, customer, or other person if such person is restricted from trading those securities;

(iii) Restrict access to trading systems and technology that provide market access to permit access only to persons and accounts pre-approved and authorized by the broker or dealer; and

(iv) Assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access.

(d) The financial and regulatory risk management controls and supervisory procedures described in paragraph (c) of this section shall be under the direct and exclusive control of the broker or dealer that is subject to paragraph (b) of this section.

(e) A broker or dealer that is subject to paragraph (b) of this section shall establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required by paragraphs (b) and (c) of this section and for promptly addressing any issues.

(1) Among other things, the broker or dealer shall review, no less frequently than annually, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures. Such review shall be conducted in accordance with written procedures and shall be documented. The broker or dealer shall preserve a copy of such written procedures, and documentation of each such review, as part of its books and records in a manner consistent with §240.17a-4(e)(7) and §240.17a-4(b), respectively.

(2) The Chief Executive Officer (or equivalent officer) of the broker or dealer shall, on an annual basis, certify that such risk management controls and supervisory procedures comply with paragraphs (b) and (c) of this section, and that the broker or dealer conducted such review, and such certifications shall be preserved by the broker or dealer as part of its books and records in a manner consistent with §240.17a-4(b).

By the Commission.



Florence E. Harmon
Deputy Secretary

Date: January 19, 2010

Note: This Appendix to the Preamble will not appear in the Code of Federal Regulation.

Appendix

A. Current SRO Guidance

The New York Stock Exchange ("NYSE") and the Financial Industry Regulatory Authority ("FINRA") (formerly known as the National Association of Securities Dealers, Inc. ("NASD"))¹ have issued several Information Memoranda ("IM") and Notices to Members ("NTM"), respectively, that are designed to provide guidance to their members that provide market access to customers. The guidance provided by the NYSE and the NASD is primarily advisory, as opposed to compulsory, and is similar in many respects. As discussed in more detail below, both SROs emphasize the need for members to implement and maintain internal procedures and controls to manage the financial and regulatory risks associated with market access, and recommend certain best practices.²

1. NYSE Guidance

In 1989, the NYSE first issued an IM to provide guidance for its members that permitted customers to access the NYSE SuperDot System.³ NYSE IM-89-6 stated that it was permissible for members to receive electronic orders directly from their customers and re-transmit those

¹ In 2007, the NASD and the member-related functions of New York Stock Exchange Regulation, Inc., the NYSE's regulatory subsidiary, were consolidated. As part of this regulatory consolidation, the NASD changed its name to FINRA. For clarity, this release uses the term "NASD" to refer to matters that occurred prior to the consolidation and the term "FINRA" to refer to matters that occurred after the consolidation.

² The Commission notes that the collective NASD and NYSE guidance described below now constitutes FINRA's current guidance on market access.

³ See NYSE IM-89-6 (January 25, 1989).

orders to the NYSE's SuperDot system, but that members providing such access must satisfy all regulatory requirements relating to those orders.⁴

In 1992, the NYSE issued NYSE IM-92-15⁵ which stated that members should have written procedures and controls for the monitoring and supervision of electronic orders, including those that limit access to electronic order entry systems to authorized users, validate order accuracy, and check the order against established credit limits. The NYSE indicated that either the customer or the member could establish the necessary controls, but that the member would be ultimately responsible for maintaining and implementing them. Later that year, NYSE IM-92-43,⁶ was issued and stressed the importance of effective policies and procedures designed to minimize errors associated with electronic order entry.⁷

⁴ The NYSE specifically referenced NYSE Rule 405 pertaining to Diligence as to Accounts, and NYSE Rule 382, pertaining to Carrying Agreements. The NYSE also stated that a member's "know your customer" obligations had to be satisfied either through conventional methods or through automated system parameters. In NYSE IM-89-6, the NYSE required its members to provide a written statement acknowledging their responsibility for electronic customer orders retransmitted to the NYSE. *Id.*

⁵ NYSE IM-92-15 (May 28, 1992). In NYSE IM-92-15, the NYSE recognized that the "ongoing need to enhance efficiency and to facilitate the swift and orderly processing and execution of orders ... [had] led to the development and increased usage of electronic order routing systems by member organizations." However, the NYSE also warned that while technological developments facilitated the handling of a significantly higher order volume, it also increased the prospect of order errors and concerns regarding sufficient internal controls. Accordingly, the NYSE advised that internal control procedures were important elements of any electronic trading system and reaffirmed that members must adhere to certain regulatory requirements and business practices when permitting access to electronic order routing systems.

⁶ NYSE IM-92-43 (December 29, 1992).

⁷ NYSE IM-92-43 emphasized that the member was responsible for assuring that control procedures, whether established by the customer or the member, were reasonably expected to monitor and supervise the entry of orders and minimize the potential for errors. The NYSE also clarified that members should obtain and maintain, as part of their books and records, a copy of their customer's written control procedures pertaining to electronic order entry. If the control procedures were established by the member, the customer should sign an undertaking committing to adhere to them. The NYSE also

In 2002, NYSE IM-02-48 was issued to re-emphasize member obligations related to the submission of electronic orders.⁸ The NYSE noted that electronic order entry systems could lead to increased market volatility and significant exposure to financial risk for members, and thus members were required to have written internal control and supervisory procedures addressing those risks. The NYSE indicated that these should, at a minimum, incorporate controls to: (1) limit the use of the system to authorized persons; (2) validate order accuracy; (3) establish credit limits or systematically prevent the transmission of orders exceeding preset credit or order size parameters; and (4) monitor for duplicative orders. If a member used a vendor's order entry system, the NYSE stressed that it was the member's responsibility to ensure that the requisite controls were in place. If relying on the customer's controls, members were reminded that they had to obtain, for books and records purposes, the customer's written control procedures and a written undertaking to provide the member with written notification of any significant changes to such procedures.

2. NASD Guidance

The NASD offered its initial guidance on market access in 1998, when it issued NASD NTM-98-66⁹ to address a variety of issues for NASD members to consider if they chose to

noted that built-in system checks, such as pre-set size and dollar limits, were an alternative way to satisfy the control requirements. Id.

⁸ NYSE IM-02-48 (November 7, 2002). NYSE noted that there were a number of erroneous orders submitted via electronic order entry systems as a result of human error or defective commercial or proprietary software systems, and that the errors most commonly involved an incorrect quantity of shares being submitted, or the inadvertent release of files containing previously transmitted orders. Moreover, the NYSE emphasized the need for safeguards to prevent the disabling of the systemic controls or the system whether the system was provided by the member, a vendor, the customer or another third party. Id.

⁹ See Securities Exchange Act Release No. 40354 (August 24, 1998), 63 FR 46264 (August 31, 1998) (NASD NTM- 98-66).

allow customers to route orders to Nasdaq through member systems.¹⁰ Among other things, the NASD affirmed that members were responsible for honoring all executions that occurred as a result of market access,¹¹ and should perform appropriate due diligence of customers for which they offer this service.

The NASD also stated that members should have adequate written procedures and controls to effectively monitor and supervise order entry by customers. Specifically, the NASD indicated that members' controls should address: (1) the entry of unauthorized orders; (2) orders that exceed or attempt to exceed pre-set credit or other parameters, such as order size, established by the member; (3) potentially manipulative activity by electronic access customers; (4) potential violations of affirmative determination requirements¹² and short-sale rules. More generally, NASD stated that members should ensure compliance with SEC and NASD rules, and that "whenever possible ... controls should be automated and system driven."¹³ Finally, the NASD

¹⁰ NASD NTM-98-66 elaborated on the NASD's April 1998 Nasdaq interpretive letter regarding non-member access to SelectNet. In particular, NASD expanded the discussion to address non-member access to Nasdaq's Small Order Execution System ("SOES"). The systems were discussed separately because SOES was an automatic execution facility while SelectNet was an order-delivery facility. *Id.*

¹¹ The NASD required its members to provide a letter to Nasdaq acknowledging responsibility for non-member orders submitted through the member's system. *Id.*

¹² Formerly, NASD Rule 3370(b)(2)(A) stated, in part, that "[n]o member or person associated with a member shall accept a 'short' sale order for any customer ... in any security unless the member or person associated with a member makes an affirmative determination that the member will receive delivery of the security from the customer ... or that the member can borrow the security on behalf of the customer ... for delivery by settlement date." See former NASD Rule 3370(b)(2)(A). In 2004, NASD Rule 3370(b) was repealed because it was deemed to overlap with and be duplicative of Rule 203 of Regulation SHO. See Securities Exchange Act Release No. 50822 (December 8, 2004), 69 FR 74554 (December 14, 2004) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Repeal of Existing NASD Short Sale Rules in Light of SEC Regulation SHO).

¹³ The NASD also required that members provide a description of the system that permitted a non-member's access to Nasdaq execution facilities, including details on how orders

required a signed agreement setting forth the responsibilities of both the member and the non-member customer with respect to the access arrangement.¹⁴

In 2004, in response to an increase in order entry errors by non-member customers, NASD issued NTM-04-66¹⁵ to remind members of their responsibility for all orders entered under their MPID, and that reasonable steps should be taken to address order entry errors.¹⁶ The NASD advised that a member's supervisory system and written supervisory procedures should be consistent with the NASD's supervision rule, Rule 3010,¹⁷ and related guidance provided in a variety of NTMs.¹⁸ The NASD further noted that members should consider, when developing a supervisory system and written supervisory procedures, controls that: (1) limit the use of electronic order entry systems to authorized persons; (2) check for order accuracy; (3) prevent orders that exceed preset credit- and order-size parameters from being transmitted to a trading system; and (4) prevent the unwanted generation, cancellation, re-pricing, resizing, duplication,

were received and re-transmitted, the system's security and capacity, the manner that the system connected to Nasdaq, and any internal system protocols designed to fulfill the member's "know your customer" obligations and other regulatory obligations. See supra note 10.

¹⁴ Among other things, the agreement informed the customer of its potential liability under federal securities laws for any illegal trading activity, and of NASD surveillance to detect any illegal trading activity. Id.

¹⁵ NASD NTM-04-66 (September 2004).

¹⁶ The NASD noted that order entry errors typically resulted from mistakes in data entry or malfunctioning software. Id.

¹⁷ NASD Rule 3010 has not yet been consolidated as a FINRA rule; it is currently included in the FINRA Transitional Rulebook.

¹⁸ See NASD NTMs 88-84 (November 1988), 89-34 (April 1989), 98-96 (December 1998), and 99-45 (June 1999). A FINRA Information Notice, dated December 8, 2008, clarified that the NASD Rules generally apply to all FINRA member firms.

or re-transmission of orders.¹⁹ Finally, the NASD reminded members that it would closely examine the supervisory systems and written supervisory procedures of members with respect to the review and detection of potential order-entry errors and, where appropriate, initiate disciplinary action against firms and their supervisory personnel.

B. Exchange Rules

The exchanges each have adopted rules that, in general, permit non-member “sponsored participants” to obtain direct access to the exchange’s trading facilities, so long as a sponsoring broker-dealer that is a member of the exchange takes responsibility for the sponsored participant’s trading, and certain contractual commitments are made.²⁰ The required contractual commitments typically entail agreements by the sponsored participant to: (1) comply with exchange rules as if it were a member; (2) provide the sponsoring broker-dealer a current list of all “authorized traders” who may submit orders to the exchange, and restrict access to the order entry system to those persons; (3) take responsibility for all trading by its authorized traders (and anyone else using their passwords); (4) establish adequate procedures to effectively monitor and control its access to the exchange through its employees, agents, or customers; and (5) pay when due all amounts payable to the exchange, the sponsoring broker-dealer, or others that arise from its access to the exchange’s trading facilities.

C. New Nasdaq Rule

¹⁹ NASD further suggested members consider, among other things, safeguards that ensure that the testing or maintenance of a firm’s trading system does not result in inadvertent errors. See supra note 15.

²⁰ See, e.g., NYSE Rule 123B.30, NYSE Alternext Equities Rule 123B.30, NYSE Amex Rule 86, NYSE Arca Rules 7.29 and 7.30, NYSE Rule 86, CBOE Rule 6.20A, CHX Article 5, Rule 3, NSX Rule 11.9, BATS Rule 11.3(b), ISE Rule 706, NASDAQ Rule 4611(d), NASDAQ OMX BX Rule 4611(d), NASDAQ OMX PHLX Rule 1094(b)(ii).

As noted above, to address the increasing risks associated with market access, Commission staff has been urging the securities industry, the exchanges, FINRA and other market participants to enhance exchange and FINRA rules by requiring more robust broker-dealer financial and regulatory risk controls. In December 2008, Nasdaq filed a proposed rule change to require broker-dealers offering direct market access or sponsored access to Nasdaq to establish controls regarding the associated financial and regulatory risks, and to obtain a variety of contractual commitments from sponsored access customers.²¹ The Commission approved Nasdaq's improved market access rule on January 13, 2010.²²

²¹ See Securities Exchange Act Release No. 59275 (January 22, 2009), 74 FR 5193 (January 29, 2009) (File No. SR-NASDAQ-2008-104). After publication the Commission received thirteen comment letters on the proposal. The majority of commenters supported the proposal conceptually, but critiqued certain aspects of it. A few commenters wholly opposed Nasdaq's proposal because they believed Nasdaq's current rule was sufficient. One commenter opposed the current proposal because it lacked rigor. The various comments addressed: (1) the scope of the proposed Nasdaq rule and the definitions contained therein; (2) the required contracts; (3) compliance with financial and regulatory controls, and (4) confidentiality and regulatory propriety. Letters to Elizabeth M. Murphy, Secretary, Commission, from Harvey Cloyd, Chief Executive Officer, Electronic Transaction Clearing, Inc., dated February 5, 2009; John Jacobs, Director of Operations, Lime Brokerage LLC, dated February 17, 2009 ("Lime Letter"); Manisha Kimmel, Executive Director, Financial Information Forum, dated February 19, 2009 ("FIF Letter"); Ted Myerson, President, FTEN, Inc., dated February 19, 2009 ("FTEN Letter"); Michael A. Barth, Executive Vice President, OES Market Group, dated February 23, 2009; Jeff Bell, Executive Vice President, Clearing and Technology Group, Wedbush Morgan Securities, dated February 23, 2009; Stuart J. Kaswell, Executive Vice President & General Counsel, Managed Funds Association, dated February 24, 2009; Ann Vlcek, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA"), dated February 26, 2009 ("SIFMA Letter"), Nicole Harner Williams, Vice President, Associate General Counsel, Penson Financial Services, Inc., dated February 27, 2009; Samuel F. Lek, Chief Executive Officer, Lek Securities Corporation, dated June 15, 2009; letter to David S. Shillman, Associate Director, Division of Trading and Markets ("Division") Commission, from Gary LaFever, Chief Corporate Development Officer, FTEN, Inc., dated April 29, 2009; letter to James Brigagliano, Co-Acting Director, Division, Commission, from John Jacobs, Chief Operations Officer, Lime Brokerage LLC, dated June 30, 2009; and letter to David S. Shillman, Associate Director, Division, from Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, dated November 23, 2009. Nasdaq amended the

The Nasdaq rule requires a combination of contractual provisions, financial controls, and regulatory controls for Nasdaq members providing direct market access or sponsored access. Nasdaq's rule differs from its previous access rule, and other SRO access rules, by: (1) clearly defining "direct market access" and "sponsored access;" (2) requiring by rule that broker-dealers providing those services establish controls designed to address specified financial and regulatory risks; (3) requiring that appropriate supervisory personnel of the sponsoring member receive immediate post-trade execution reports for all direct market access and sponsored access customers.²³

With respect to controls for financial risk, Nasdaq's rule requires members offering direct market access or sponsored access to establish procedures and controls designed to systemically limit the sponsoring member's financial exposure.²⁴ At a minimum, these procedures and controls must be designed to prevent sponsored customers from: (1) entering orders that exceed appropriate preset credit thresholds; (2) trading products that the sponsored customer or

filing and responded to comments. See File No. SR-NASDAQ-2008-104, Amendments No. 2 and 3, received respectively on October 19 and 23, 2009. A more extensive summary of comments and NASDAQ's response to comments is contained in the Nasdaq Market Access Approval Order. See Securities Exchange Act Release No. 61345 (January 13, 2010) ("Nasdaq Market Access Approval Order").

²² See Nasdaq Market Access Approval Order, *supra* note 21.

²³ For sponsored access arrangements, the Nasdaq rule also requires sponsoring members to obtain certain contractual commitments from sponsored participants that echo those required by current exchange rules, and go further by requiring the sponsored participant (1) provide access to books and records, financial information and otherwise cooperate with the sponsoring member for regulatory purposes; (2) maintain its trading activity within the credit thresholds set by the sponsoring member; and (3) allow immediate termination of the access arrangement if it poses serious risk to the sponsoring member or the integrity of the market. See Nasdaq Rule 4611(d)(3)(A). In addition, if a service bureau or other third party provides the sponsored access system, the sponsoring member must obtain contractual commitments from the third party analogous to clauses (1) and (3) above, as well as to restrict access to authorized persons. See Nasdaq Rule 4611(d)(3)(B).

²⁴ See Nasdaq Rule 4611(d)(4).

sponsoring member is restricted from trading; and (3) submitting erroneous orders, by rejecting orders that exceed certain price or size parameters or that indicate duplicative orders.²⁵

With respect to controls for regulatory risk, Nasdaq's rule requires members offering direct market access or sponsored access to establish systemic controls designed to ensure compliance with applicable regulatory requirements.²⁶ In addition, Nasdaq's rule requires a sponsoring member to ensure that appropriate supervisory personnel receive and review timely reports of all trading activity by its sponsored customers, including immediate post-trade execution reports.²⁷

²⁵ See Nasdaq Rule 4611(d)(4)(A) – (C).

²⁶ The Nasdaq rule defines “regulatory requirements” to include all applicable federal securities laws and rules and Nasdaq rules, including but not limited to the Nasdaq Certificate of Incorporation, Bylaws, Rules and Nasdaq Market Center procedures. See Nasdaq Rule 4611(d)(3)(i).

²⁷ The immediate post-trade execution reports should include the identity of the applicable sponsored customer. In addition, appropriate supervisory personnel of the sponsoring member should receive all required audit trail information no later than the end of the trading day; and all information necessary to create and maintain the trading records required by regulatory requirements, no later than the end of the trading day. See Nasdaq Rule 4611(d)(5).

Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Bjorkstrom, age 53, is and has been a certified public accountant holding an inactive license to practice in the State of Pennsylvania. She served as Chief Financial Officer of Tvia, Inc. ("Tvia") from September 2004 through October 2006.

2. Tvia was, at all relevant times, a Delaware corporation with its principal place of business in Santa Clara, California. Tvia is a fabless semiconductor company which designs and develops digital display processors for use in LCD and other high-definition TVs. At all relevant times, Tvia'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 Global Market.

3. On November 17, 2009, the Commission filed a complaint against Bjorkstrom in SEC v. Diane Bjorkstrom (Civil Action No. CV-09-5394-JW). On January 6, 2010, the court entered an order permanently enjoining Bjorkstrom, by consent, from future violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 and Section 13(b)(5) of the Exchange Act and Rules 13a-14 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder. Bjorkstrom was also ordered to pay a \$20,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Bjorkstrom agreed to ship product and recognize revenue for a sale that she knew or should have known did not have the paperwork necessary to satisfy Tvia's revenue recognition policy, resulting in Tvia's filing of materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal year ended March 31, 2006.

IV.

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

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

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

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

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

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which she is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which she is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges her responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that her state CPA license is current and she has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The

Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61385 / January 20, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3107 / January 20, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13756

In the Matter of

DEANNA J. SERUGA, 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 Deanna J. Seruga ("Respondent" or "Seruga") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.¹

¹ Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, and the findings contained in Section III.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. Seruga, age 33, has been a certified public accountant licensed to practice in the Commonwealth of Pennsylvania. She served as Controller at World Health Alternatives, Inc. ("World Health") from 2003 until August 2005.

2. World Health was, at all relevant times, a Florida corporation with its principal place of business in Pittsburgh, Pennsylvania. World Health was engaged in the medical staffing business. At all relevant times, World Health 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 Over the Counter Bulletin Board.

3. On January 4, 2010, a final judgment was entered by consent against Seruga, permanently enjoining her from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2(b) thereunder, and aiding and abetting violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Richard E. McDonald, et al., Civil Action Number 09-CV-1685, in the United States District Court for the Western District of Pennsylvania.

4. The Commission's complaint alleged, among other things, that Seruga, at the direction of World Health's former President and Chief Executive Officer and on her own accord, engaged in a fraudulent scheme that resulted in World Health filing materially false and misleading financial statements in the company's annual and quarterly reports from the first quarter of 2003 through the first quarter of 2005. The complaint alleged that Seruga falsified World Health's books and records by, among other things, understating expenses and liabilities through numerous false and improper accounting entries. In addition, the complaint alleged that Seruga knowingly provided false information to World Health's auditors.

IV.

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

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.3. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Emas, age 54, is an attorney licensed to practice law in the States of Florida, New York, and New Jersey. In 1996, he earned an LL.M. in Securities Regulation. Emas represents numerous issuers who file periodic reports with the Commission. He is a resident of Florida.

2. World Health Alternatives, Inc. ("World Health") was, at all relevant times, a Florida corporation with its principal place of business in Pittsburgh, Pennsylvania. World Health was engaged in the medical staffing business. At all relevant times, World Health 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 Over the Counter Bulletin Board. From April 2004 to August 2005, Emas was World Health's outside securities counsel.

3. On January 4, 2010, a final judgment was entered by consent against Emas, permanently enjoining him from future violations of Sections 5(a), 5(c), 17(a)(2) and 17(a)(3) of the Securities Act of 1933 in the civil action entitled Securities and Exchange Commission v. Richard E. McDonald, et al., Civil Action No. 09-CV-1685, in the United States District Court for the Western District of Pennsylvania. Emas was also ordered to pay disgorgement of \$135,782, together with prejudgment interest of \$27,301, and a \$15,000 civil monetary penalty.

4. The Commission's complaint alleged that Emas (1) drafted and filed two post-effective amendments and a supporting legal opinion that he knew or should have known contained false statements concerning the registration of millions of shares of World Health stock; and (2) sold World Health securities when no registration statement was filed or in effect and no exemption from registration applied.

IV.

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

Accordingly, it is hereby **ORDERED**, effective immediately, that Emas is suspended from appearing or practicing before the Commission as an attorney. After two years from the date of this Order, Emas has the right to apply for reinstatement by submitting an affidavit to the Commission's Office of the General Counsel truthfully stating, under penalty of perjury, that he has complied with the Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, and that he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61384 / January 20, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3106 / January 20, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13755

In the Matter of

JOHN W. DWYER, CPA

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO RULE 102(e)
OF THE COMMISSION'S RULES
OF PRACTICE, MAKING FINDINGS,
AND IMPOSING REMEDIAL
SANCTIONS**

I.

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

¹ Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name:

(A) 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.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Dwyer, age 57, was Chief Financial Officer ("CFO") of Bally Total Fitness Holding Corporation ("Bally") from May 1994 to April 2004, when he was forced to resign. Prior to his employment at Bally, Dwyer was an audit partner in the Chicago office of Ernst & Young LLP. At all relevant times, Dwyer was a certified public accountant.
2. Bally purported to be the largest, and only nationwide, commercial operator of fitness centers. At all relevant times, Bally's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange ("NYSE"). The NYSE delisted Bally's common stock on June 8, 2007. After filing for reorganization under Chapter 11 of the Bankruptcy Code, on September 17, 2007, Bally emerged as a privately held reorganized entity.
3. On December 17, 2009, the Commission filed a complaint against Dwyer in SEC v. John W. Dwyer, 09-CV-2386 (CKK)(D.D.C.). On December 22, 2009, the court entered an order permanently enjoining Dwyer, by consent, from violating Section 17(a) of the Securities Act of 1933, and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.
4. The Commission's complaint alleges, among other things, that during the relevant time period, Dwyer violated the anti-fraud provisions, and aided and abetted Bally's violations of the reporting, record-keeping, and internal controls provisions, of the Federal securities laws. The complaint also alleges that Dwyer is responsible for Bally's materially false and misleading statements about its financial condition in filings with the Commission and in other public statements. These materially false and misleading statements portrayed Bally's financial condition (its net worth) and its performance (its income) as being materially better than they actually were during the relevant period.

IV.

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

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

Dwyer 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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Noncek, age 51, was Vice-President and Controller of Bally Total Fitness Holding Corporation ("Bally") from 2001 to February 2005, when he was terminated. Prior to his employment at Bally, Noncek was an auditor with Ernst & Young LLP. At all relevant times, Noncek was a certified public accountant.
2. Bally purported to be the largest, and only nationwide, commercial operator of fitness centers. At all relevant times, Bally's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange ("NYSE"). The NYSE delisted Bally's common stock on June 8, 2007. After filing for reorganization under Chapter 11 of the Bankruptcy Code, on September 17, 2007, Bally emerged as a privately held reorganized entity.
3. On December 17, 2009, the Commission filed a complaint against Noncek in SEC v. Theodore P. Noncek, 09-CV-2387 (CKK)(D.D.C.). On December 22, 2009, the court entered an order permanently enjoining Noncek, by consent, from violating Sections 17(a)(2) and (3) of the Securities Act of 1933, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.
4. The Commission's complaint alleges, among other things, that during the relevant time period, Noncek violated various provisions of the federal securities laws. The complaint also alleges that Noncek, with others, was responsible for Bally's materially false and misleading statements about its financial condition in filings with the Commission and in other public statements. These materially false and misleading statements portrayed Bally's financial condition (its net worth) and its performance (its income) as being materially better than they actually were during the relevant period.

IV.

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

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

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

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

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

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 61396 / January 21, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-13759

In the Matter of

**Macheezmo Mouse Restaurants, Inc.,
Mannix Resources, Inc. (f/k/a Ridel
Resources, Ltd.),
Mast/Keystone, Inc.,
Mego Financial Corp.,
Melloncamp, Inc.,
Metal Mines, Inc., and
Metawave Communications Corp.,**

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 Macheezmo Mouse Restaurants, Inc., Mannix Resources, Inc. (f/k/a Ridel Resources, Ltd.), Mast/Keystone, Inc., Mego Financial Corp., Melloncamp, Inc., Metal Mines, Inc., and Metawave Communications Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Macheezmo Mouse Restaurants, Inc. (CIK No. 928065) is an inactive Oregon corporation located in Portland, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Macheezmo Mouse Restaurants 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 April 6, 1999, which reported a

net loss of \$508,000 for the prior forty weeks. On May 20, 2003, the company filed a voluntary Chapter 7 petition in the U.S. Bankruptcy Court for the District of Oregon, and the case was terminated on February 4, 2005. As of January 19, 2010, the company's stock (symbol "MMRI") was traded on the over-the-counter markets.

2. Mannix Resources, Inc. (f/k/a Ridel Resources, Ltd.) (CIK No. 1052129) 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). Mannix Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F on August 18, 1998, which reported a loss of \$449,214 (Canadian) since the company's February 7, 1992 inception.

3. Mast/Keystone, Inc. (CIK No. 743250) is an Iowa corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mast/Keystone 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 September 30, 1993, which reported a net loss of \$307,000 for the year ended September 30, 1992.

4. Mego Financial Corp. (CIK No. 736035) is a New York corporation located in Henderson, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mego Financial 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 \$14 million for the prior nine months. On July 9, 2003, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Nevada, which was converted to Chapter 7, and the case was still pending as of January 19, 2010. As of January 19, 2010, the company's stock (symbol "LESR") was traded on the over-the-counter markets.

5. Melloncamp, Inc. (CIK No. 1107064) is a permanently revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Melloncamp 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 \$3,900 since the company's February 19, 1998 inception.

6. Metal Mines, Inc. (CIK No. 1261597) is a dissolved Nevada corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Metal Mines 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, which reported a net loss of \$10,356 for the prior nine months.

7. Metawave Communications Corp. (CIK No. 1028361) is a delinquent Delaware corporation located in Kirkland, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Metawave 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 \$47 million for the prior nine months. On January 31, 2003, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Washington, and the case was terminated on March 30, 2004. As of January 19, 2010, the company's stock (symbol "MTWVQ") was traded on the over-the-counter markets.

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 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.

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, 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

Appendix 1

**Chart of Delinquent Filings
Macheezmo Mouse Restaurants, Inc., et al.**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Macheezmo Mouse Restaurants, Inc.	<i>10-KSB</i>	06/29/99	09/27/99	Not filed	124
	<i>10-QSB</i>	09/28/99	11/12/99	Not filed	122
	<i>10-QSB</i>	12/28/99	02/11/00	Not filed	119
	<i>10-QSB</i>	03/28/00	05/12/00	Not filed	116
	<i>10-KSB</i>	06/27/00	09/25/00	Not filed	112
	<i>10-QSB</i>	09/26/00	11/13/00	Not filed	110
	<i>10-QSB</i>	12/26/00	02/09/01	Not filed	107
	<i>10-QSB</i>	03/27/01	05/11/01	Not filed	104
	<i>10-KSB</i>	07/03/01	10/01/01	Not filed	99
	<i>10-QSB</i>	10/02/01	11/16/01	Not filed	98
	<i>10-QSB</i>	01/01/02	02/15/02	Not filed	95
	<i>10-QSB</i>	04/02/02	05/17/02	Not filed	92
	<i>10-KSB</i>	07/02/02	09/30/02	Not filed	88
	<i>10-QSB</i>	10/01/02	11/15/02	Not filed	86
	<i>10-QSB</i>	12/31/02	02/14/03	Not filed	83
	<i>10-QSB</i>	04/01/03	05/16/03	Not filed	80
	<i>10-KSB</i>	07/01/03	09/29/03	Not filed	76
	<i>10-QSB</i>	09/30/03	11/14/03	Not filed	74
	<i>10-QSB</i>	12/30/03	02/13/04	Not filed	71
	<i>10-QSB</i>	03/30/04	05/14/04	Not filed	68
	<i>10-KSB</i>	06/29/04	09/27/04	Not filed	64
	<i>10-QSB</i>	09/28/04	11/12/04	Not filed	62
	<i>10-QSB</i>	12/28/04	02/11/05	Not filed	59
	<i>10-QSB</i>	03/29/05	05/13/05	Not filed	56
	<i>10-KSB</i>	06/28/05	09/26/05	Not filed	52
	<i>10-QSB</i>	09/27/05	11/14/05	Not filed	50
	<i>10-QSB</i>	12/27/05	02/10/06	Not filed	47
	<i>10-QSB</i>	03/28/06	05/12/06	Not filed	44
	<i>10-KSB</i>	06/27/06	09/25/06	Not filed	40
	<i>10-QSB</i>	09/26/06	11/13/06	Not filed	38
	<i>10-QSB</i>	12/26/06	02/09/07	Not filed	35
	<i>10-QSB</i>	03/27/07	05/11/07	Not filed	32

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-KSB	07/03/07	10/01/07	Not filed	27
	10-QSB	09/25/07	11/09/07	Not filed	26
	10-QSB	12/25/07	02/08/08	Not filed	23
	10-QSB	03/25/07	05/09/07	Not filed	32
	10-KSB	07/03/07	10/01/07	Not filed	27
	10-QSB	09/25/07	11/09/07	Not filed	26
	10-QSB	12/25/07	02/08/08	Not filed	23
	10-QSB	03/25/08	05/09/08	Not filed	20
	10-KSB	07/01/08	09/29/08	Not filed	16
	10-Q ¹	09/30/08	11/14/08	Not filed	14
	10-Q ¹	12/30/08	02/13/09	Not filed	11
	10-Q ¹	03/31/09	05/15/09	Not filed	8
	10-K ¹	06/30/09	09/28/09	Not filed	4
	10-Q ¹	09/29/09	11/13/09	Not filed	2

Total Filings Delinquent 46

**Mannix Resources, Inc. (f/k/a
Ridel Resources, Ltd.)**

20-F	09/30/98	03/31/99	Not filed	130
20-F	09/30/99	03/31/00	Not filed	118
20-F	09/30/00	04/02/01	Not filed	105
20-F	09/30/01	04/01/02	Not filed	93
20-F	09/30/02	03/31/03	Not filed	82
20-F	09/30/03	03/31/04	Not filed	70
20-F	09/30/04	03/31/05	Not filed	58
20-F	09/30/05	03/31/06	Not filed	46
20-F	09/30/06	04/02/07	Not filed	33
20-F	09/30/07	03/31/08	Not filed	22
20-F	09/30/08	03/31/09	Not filed	10

Total Filings Delinquent 11

Martech USA, Inc.

10-K	08/31/93	11/29/93	Not filed	194
10-Q	11/30/93	01/14/94	Not filed	192
10-Q	02/28/94	04/14/94	Not filed	189
10-Q	05/31/94	07/15/94	Not filed	186

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-K	08/31/94	11/29/94	Not filed	182
	10-Q	11/30/94	01/16/95	Not filed	180
	10-Q	02/28/95	04/14/95	Not filed	177
	10-Q	05/31/95	07/17/95	Not filed	174
	10-K	08/31/95	11/29/95	Not filed	170
	10-Q	11/30/95	01/16/96	Not filed	168
	10-Q	02/29/96	04/15/96	Not filed	165
	10-Q	05/31/96	07/15/96	Not filed	162
	10-K	08/31/96	11/29/96	Not filed	158
	10-Q	11/30/96	01/14/97	Not filed	156
	10-Q	02/28/97	04/14/97	Not filed	153
	10-Q	05/31/97	07/15/97	Not filed	150
	10-K	08/31/97	12/01/97	Not filed	145
	10-Q	11/30/97	01/14/98	Not filed	144
	10-Q	02/28/98	04/14/98	Not filed	141
	10-Q	05/31/98	07/15/98	Not filed	138
	10-K	08/31/98	11/30/98	Not filed	134
	10-Q	11/30/98	01/14/99	Not filed	132
	10-Q	02/28/99	04/14/99	Not filed	129
	10-Q	05/31/99	07/15/99	Not filed	126
	10-K	08/31/99	11/29/99	Not filed	122
	10-Q	11/30/99	01/14/00	Not filed	120
	10-Q	02/29/00	04/14/00	Not filed	117
	10-Q	05/31/00	07/17/00	Not filed	114
	10-K	08/31/00	11/29/00	Not filed	110
	10-Q	11/30/00	01/16/01	Not filed	108
	10-Q	02/28/01	04/16/01	Not filed	105
	10-Q	05/31/01	07/16/01	Not filed	102
	10-K	08/31/01	11/29/01	Not filed	98
	10-Q	11/30/01	01/14/02	Not filed	96
	10-Q	02/28/02	04/15/02	Not filed	93
	10-Q	05/31/02	07/15/02	Not filed	90
	10-K	08/31/02	11/29/02	Not filed	86
	10-Q	11/30/02	01/14/03	Not filed	84
	10-Q	02/28/03	04/14/03	Not filed	81
	10-Q	05/31/03	07/15/03	Not filed	78

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-K	08/31/03	12/01/03	Not filed	73
	10-Q	11/30/03	01/14/04	Not filed	72
	10-Q	02/29/04	04/14/04	Not filed	69
	10-Q	05/31/04	07/15/04	Not filed	66
	10-K	08/31/04	11/29/04	Not filed	62
	10-Q	11/30/04	01/14/05	Not filed	60
	10-Q	02/28/05	04/14/05	Not filed	57
	10-Q	05/31/05	07/15/05	Not filed	54
	10-K	08/31/05	11/29/05	Not filed	50
	10-Q	11/30/05	01/17/06	Not filed	48
	10-Q	02/28/06	04/14/06	Not filed	45
	10-Q	05/31/06	07/17/06	Not filed	42
	10-K	08/31/06	11/29/06	Not filed	38
	10-Q	11/30/06	01/16/07	Not filed	36
	10-Q	02/28/07	04/16/07	Not filed	33
	10-Q	05/31/07	07/16/07	Not filed	30
	10-K	08/31/07	11/29/07	Not filed	26
	10-Q	11/30/07	01/14/08	Not filed	24
	10-Q	02/29/08	04/14/08	Not filed	21
	10-Q	05/31/08	07/15/08	Not filed	18
	10-K	08/31/08	12/01/08	Not filed	13
	10-Q	11/30/08	01/14/09	Not filed	12
	10-Q	02/28/09	04/14/09	Not filed	9
	10-Q	05/31/09	07/15/09	Not filed	6
	10-K	08/31/09	11/30/09	Not filed	2
	10-Q	11/30/09	01/14/10	Not filed	0
Total Filings Delinquent		66			
Mast/Keystone, Inc.					
	10-Q	12/31/93	02/14/94	Not filed	191
	10-Q	03/31/94	05/16/94	Not filed	188
	10-Q	06/30/94	08/15/94	Not filed	185
	10-K	09/30/94	12/29/94	Not filed	181
	10-Q	12/31/94	02/14/95	Not filed	179
	10-Q	03/31/95	05/15/95	Not filed	176
	10-Q	06/30/95	08/14/95	Not filed	173
	10-K	09/30/95	12/29/95	Not filed	169

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	12/31/95	02/14/96	Not filed	167
	10-Q	03/31/96	05/15/96	Not filed	164
	10-Q	06/30/96	08/14/96	Not filed	161
	10-K	09/30/96	12/30/96	Not filed	157
	10-Q	12/31/96	02/14/97	Not filed	155
	10-Q	03/31/97	05/15/97	Not filed	152
	10-Q	06/30/97	08/14/97	Not filed	149
	10-K	09/30/97	12/29/97	Not filed	145
	10-Q	12/31/97	02/17/98	Not filed	143
	10-Q	03/31/98	05/15/98	Not filed	140
	10-Q	06/30/98	08/14/98	Not filed	137
	10-K	09/30/98	12/29/98	Not filed	133
	10-Q	12/31/98	02/16/99	Not filed	131
	10-Q	03/31/99	05/17/99	Not filed	128
	10-Q	06/30/99	08/16/99	Not filed	125
	10-K	09/30/99	12/29/99	Not filed	121
	10-Q	12/31/99	02/14/00	Not filed	119
	10-Q	03/31/00	05/15/00	Not filed	116
	10-Q	06/30/00	08/14/00	Not filed	113
	10-K	09/30/00	12/29/00	Not filed	109
	10-Q	12/31/00	02/14/01	Not filed	107
	10-Q	03/31/01	05/15/01	Not filed	104
	10-Q	06/30/01	08/14/01	Not filed	101
	10-K	09/30/01	12/31/01	Not filed	97
	10-Q	12/31/01	02/14/02	Not filed	95
	10-Q	03/31/02	05/15/02	Not filed	92
	10-Q	06/30/02	08/14/02	Not filed	89
	10-K	09/30/02	12/30/02	Not filed	85
	10-Q	12/31/02	02/14/03	Not filed	83
	10-Q	03/31/03	05/15/03	Not filed	80
	10-Q	06/30/03	08/14/03	Not filed	77
	10-K	09/30/03	12/29/03	Not filed	73
	10-Q	12/31/03	02/17/04	Not filed	71
	10-Q	03/31/04	05/17/04	Not filed	68
	10-Q	06/30/04	08/16/04	Not filed	65
	10-K	09/30/04	12/29/04	Not filed	61
	10-Q	12/31/04	02/14/05	Not filed	59
	10-Q	03/31/05	05/16/05	Not filed	56

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	06/30/05	08/15/05	Not filed	53
	10-K	09/30/05	12/29/05	Not filed	49
	10-Q	12/31/05	02/14/06	Not filed	47
	10-Q	03/31/06	05/15/06	Not filed	44
	10-Q	06/30/06	08/14/06	Not filed	41
	10-K	09/30/06	12/29/06	Not filed	37
	10-Q	12/31/06	02/14/07	Not filed	35
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-K	09/30/07	12/31/07	Not filed	25
	10-Q	12/31/07	02/14/08	Not filed	23
	10-Q	03/31/08	05/15/08	Not filed	20
	10-Q	06/30/08	08/14/08	Not filed	17
	10-K	09/30/08	12/29/08	Not filed	13
	10-Q	12/31/08	02/17/09	Not filed	11
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/16/09	Not filed	5
	10-K	09/30/09	12/29/09	Not filed	1

Total Filings Delinquent 64

Mego Financial Corp.

10-K	12/31/02	03/31/03	Not filed	82
10-Q	03/31/03	05/15/03	Not filed	80
10-Q	06/30/03	08/14/03	Not filed	77
10-Q	09/30/03	11/14/03	Not filed	74
10-K	12/31/03	03/30/04	Not filed	70
10-Q	03/31/04	05/17/04	Not filed	68
10-Q	06/30/04	08/16/04	Not filed	65
10-Q	09/30/04	11/15/04	Not filed	62
10-K	12/31/04	03/31/05	Not filed	58
10-Q	03/31/05	05/16/05	Not filed	56
10-Q	06/30/05	08/15/05	Not filed	53
10-Q	09/30/05	11/14/05	Not filed	50
10-K	12/31/05	03/31/06	Not filed	46
10-Q	03/31/06	05/15/06	Not filed	44
10-Q	06/30/06	08/14/06	Not filed	41

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	09/30/06	11/14/06	Not filed	38
	10-K	12/31/06	04/02/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-Q	09/30/07	11/14/07	Not filed	26
	10-K	12/31/07	03/31/08	Not filed	22
	10-Q ¹	03/31/08	05/15/08	Not filed	20
	10-Q ¹	06/30/08	08/14/08	Not filed	17
	10-Q ¹	09/30/08	11/14/08	Not filed	14
	10-K ¹	12/31/08	03/31/09	Not filed	10
	10-Q ¹	03/31/09	05/15/09	Not filed	8
	10-Q ¹	06/30/09	08/14/09	Not filed	5
	10-Q ¹	09/30/09	11/16/09	Not filed	2

Total Filings Delinquent 28

Melloncamp, Inc.

10-KSB	12/31/01	04/01/02	Not filed	93
10-QSB	03/31/02	05/15/02	Not filed	92
10-QSB	06/30/02	08/14/02	Not filed	89
10-QSB	09/30/02	11/14/02	Not filed	86
10-KSB	12/31/02	03/31/03	Not filed	82
10-QSB	03/31/03	05/15/03	Not filed	80
10-QSB	06/30/03	08/14/03	Not filed	77
10-QSB	09/30/03	11/14/03	Not filed	74
10-KSB	12/31/03	03/30/04	Not filed	70
10-QSB	03/31/04	05/17/04	Not filed	68
10-QSB	06/30/04	08/16/04	Not filed	65
10-QSB	09/30/04	11/15/04	Not filed	62
10-KSB	12/31/04	03/31/05	Not filed	58
10-QSB	03/31/05	05/16/05	Not filed	56
10-QSB	06/30/05	08/15/05	Not filed	53
10-QSB	09/30/05	11/14/05	Not filed	50
10-KSB	12/31/05	03/31/06	Not filed	46
10-QSB	03/31/06	05/15/06	Not filed	44
10-QSB	06/30/06	08/14/06	Not filed	41
10-QSB	09/30/06	11/14/06	Not filed	38
10-KSB	12/31/06	04/02/07	Not filed	33

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-QSB	03/31/07	05/15/07	Not filed	32
	10-QSB	06/30/07	08/14/07	Not filed	29
	10-QSB	09/30/07	11/14/07	Not filed	26
	10-KSB	12/31/07	03/31/08	Not filed	22
	10-Q ¹	03/31/08	05/15/08	Not filed	20
	10-Q ¹	06/30/08	08/14/08	Not filed	17
	10-Q ¹	09/30/08	11/14/08	Not filed	14
	10-K ¹	12/31/08	03/31/09	Not filed	10
	10-Q ¹	03/31/09	05/15/09	Not filed	8
	10-Q ¹	06/30/09	08/14/09	Not filed	5
	10-Q ¹	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent		32			

Metal Mines, Inc.

10-QSB	12/31/03	02/17/04	Not filed	71
10-QSB	03/31/04	05/17/04	Not filed	68
10-KSB	06/30/04	09/28/04	Not filed	64
10-QSB	09/30/04	11/15/04	Not filed	62
10-QSB	12/31/04	02/14/05	Not filed	59
10-QSB	03/31/05	05/16/05	Not filed	56
10-KSB	06/30/05	09/28/05	Not filed	52
10-QSB	09/30/05	11/14/05	Not filed	50
10-QSB	12/31/05	02/14/06	Not filed	47
10-QSB	03/31/06	05/15/06	Not filed	44
10-KSB	06/30/06	09/28/06	Not filed	40
10-QSB	09/30/06	11/14/06	Not filed	38
10-QSB	12/31/06	02/14/07	Not filed	35
10-QSB	03/31/07	05/15/07	Not filed	32
10-KSB	06/30/07	09/28/07	Not filed	28
10-QSB	09/30/07	11/14/07	Not filed	26
10-QSB	12/31/07	02/14/08	Not filed	23
10-QSB	03/31/08	05/15/08	Not filed	20
10-KSB	06/30/08	09/29/08	Not filed	16
10-Q ¹	09/30/08	11/14/08	Not filed	14
10-Q ¹	12/31/08	02/17/09	Not filed	11
10-Q ¹	03/31/09	05/15/09	Not filed	8
10-K ¹	06/30/09	09/28/09	Not filed	4

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q ¹	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent	24				
Metawave Communications Corp.					
	10-Q	09/30/02	11/14/02	Not filed	86
	10-K	12/31/02	03/31/03	Not filed	82
	10-Q	03/31/03	05/15/03	Not filed	80
	10-Q	06/30/03	08/14/03	Not filed	77
	10-Q	09/30/03	11/14/03	Not filed	74
	10-K	12/31/03	03/30/04	Not filed	70
	10-Q	03/31/04	05/17/04	Not filed	68
	10-Q	06/30/04	08/16/04	Not filed	65
	10-Q	09/30/04	11/15/04	Not filed	62
	10-K	12/31/04	03/31/05	Not filed	58
	10-Q	03/31/05	05/16/05	Not filed	56
	10-Q	06/30/05	08/15/05	Not filed	53
	10-Q	09/30/05	11/14/05	Not filed	50
	10-K	12/31/05	03/31/06	Not filed	46
	10-Q	03/31/06	05/15/06	Not filed	44
	10-Q	06/30/06	08/14/06	Not filed	41
	10-Q	09/30/06	11/14/06	Not filed	38
	10-K	12/31/06	04/02/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-Q	09/30/07	11/14/07	Not filed	26
	10-K	12/31/07	03/31/08	Not filed	22
	10-Q	03/31/08	05/15/08	Not filed	20
	10-Q	06/30/08	08/14/08	Not filed	17
	10-Q	09/30/08	11/14/08	Not filed	14
	10-K	12/31/08	03/31/09	Not filed	10
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent	29				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
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¹Regulation 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

January 21, 2010

IN THE MATTER OF

Big Sky Energy Corp.,
Biomedical Waste Systems, Inc.,
Biometrics Security Technology, Inc.,
Biosys, Inc.,
Bolder Technologies Corp.,
Boyd's Wheels, Inc.,
Breakaway Solutions, Inc., and
BRE-X Minerals, Ltd.,

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 Big Sky Energy Corp. because it has not filed any periodic reports since the period ended December 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Biomedical Waste Systems, Inc. because it has not filed any periodic reports since the period ended March 31, 1995.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Biometrics Security Technology, Inc. because it has not filed any periodic reports since December 31, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Biosys, Inc. because it has not filed any periodic reports since the period ended September 30, 1996.

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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 Bolder Technologies Corp. because it has not filed any periodic reports since the period ended September 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Boyds Wheels, Inc. because it has not filed any periodic reports since the period ended September 30, 1997.

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

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of BRE-X Minerals, Ltd. because it has not filed any periodic reports since the period ended August 19, 1996.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 21, 2010, through 11:59 p.m. EST on February 3, 2010.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 61391 / January 21, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-13758

In the Matter of

**Big Sky Energy Corp.,
Biomedical Waste Systems, Inc.,
Biometrics Security Technology, Inc.,
Biosys, Inc.,
Bolder Technologies Corp.,
Boyd's Wheels, Inc.,
Breakaway Solutions, Inc., and
BRE-X Minerals, Ltd.,**

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Big Sky Energy Corp., Biomedical Waste Systems, Inc., Biometrics Security Technology, Inc., Biosys, Inc., Bolder Technologies Corp., Boyd's Wheels, Inc., Breakaway Solutions, Inc., and BRE-X Minerals, Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Big Sky Energy Corp. (CIK No. 1075247) is a Nevada corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Energy is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2006, which reported a net loss of \$103,529,832 for the prior

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twelve months. As of January 15, 2010, the company's stock (symbol "BSKO") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had fourteen market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Biomedical Waste Systems, Inc. (CIK No. 865059) is a void Delaware corporation located in Boston, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Biomedical Waste Systems is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 1995, which reported a net loss of \$3,921,864 for the prior three months. As of January 15, 2010, the company's stock (symbol "BIOW") 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).

3. Biometrics Security Technology, Inc. (CIK No. 1004605) is a void Delaware corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Biometrics Security Technology is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2002, which reported a net loss of \$24,831,555. As of January 15, 2010, the company's stock (symbol "BSYT") 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).

4. Biosys, Inc. (CIK No. 883076) is a forfeited Delaware corporation located in Columbia, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Biosys 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, 1996, which reported a net loss of \$13,821,000 for the prior nine months. On September 30, 1996, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Maryland, and the case was terminated on December 15, 2003. As of January 15, 2010, the company's stock (symbol "BISYQ") was quoted on the Pink Sheets, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Bolder Technologies Corp. (CIK No. 1011108) is a delinquent Delaware corporation located in Golden, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bolder Technologies 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 \$15,545,174 for the prior nine months. On April 13, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was terminated on January 1, 2009. As of January 15, 2010, the company's stock (symbol "BOLDQ") 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).

6. Boyds Wheels, Inc. (CIK No. 913007) is a suspended California corporation located in Garden Grove, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Boyds Wheels 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 \$7,464,991 for the prior nine months. On January 30, 1998, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Central District of California, and the case was terminated on April 9, 2008. As of January 15, 2010, the company's stock (symbol "BYDSQ") was quoted on the Pink Sheets, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Breakaway Solutions, Inc. (CIK No. 1076643) is a forfeited Delaware corporation located in Conshohocken, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Breakaway 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, 2000, which reported a net loss of \$389,851,000 for the prior twelve months. On September 5, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was terminated on September 19, 2006. As of January 15, 2010, the company's stock (symbol "BWAY") 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).

8. BRE-X Minerals, Ltd. (CIK No. 1005640) is an Alberta, Canada corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BRE-X is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A on August 19, 1996, which reported a net loss of \$254,956 for the nine months ended September 31, 1995. As of January 15, 2010, the company's stock (symbol "BXMNF") 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).

B. DELINQUENT PERIODIC FILINGS

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

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

11. 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 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.

Elizabeth M. Murphy
Secretary


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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-61414; File No. S7-04-10]

RIN 3235-AH37

Purchases of Certain Equity Securities by the Issuer and Others

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (“Commission” or “SEC”) is proposing amendments to Rule 10b-18 under the Securities Exchange Act of 1934 (“Exchange Act”), which provides issuers with a “safe harbor” from liability for manipulation when they repurchase their common stock in the market in accordance with the Rule’s manner, timing, price, and volume conditions. The proposed amendments are intended to clarify and modernize the safe harbor provisions in light of market developments since Rule 10b-18’s adoption in 1982.

DATES: Comments should be received on or before [insert date 30 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. Please include File Number **S7-04-10** on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

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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 **S7-04-10**. 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: Josephine Tao, Assistant Director, Elizabeth Sandoe, Branch Chief, Joan Collopy, Special Counsel, Jeffrey Dinwoodie, Staff Attorney, Office of Trading Practices and Processing, Division of Trading and Markets, at (202) 551-5720, at the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on proposed amendments to Rule 10b-18 (the safe harbor rule for issuer repurchases) [17 CFR 240.10b-18] under the Exchange Act.

I. Introduction

Issuers repurchase their securities for many legitimate business reasons. For example, issuers may repurchase their stock in order to have shares available for dividend reinvestment, stock option and employee stock ownership plans, or to reduce the outstanding capital stock

following the cash sale of operating divisions or subsidiaries.¹ Issuers may believe that a repurchase program is preferable to paying dividends as a way of returning capital to shareholders.² Issuer repurchases also provide liquidity in the marketplace, which benefits shareholders.³

At the same time, an issuer has a strong interest in the market performance of its securities. Among other things, an issuer's securities may be the consideration in an acquisition, or serve as collateral for financing. Since the market price determines the price of offerings of additional securities, an issuer may have an incentive to manipulate the price of its securities.⁴ One way that an issuer can positively affect the price of its securities is to purchase the securities in the open market.⁵ Because issuer repurchases could affect the market price of an issuer's stock, an issuer may be exposed to claims that the repurchases were made in a manipulative manner even when the repurchases were not intended to move market prices.

Rule 10b-18 addresses this concern. In 1982, the Commission adopted Rule 10b-18,⁶

¹ Securities Exchange Act Release No. 19244 (Nov. 17, 1982), 47 FR 53333, 53334 (Nov. 26, 1982) ("1982 Adopting Release"). See also Gustavo Grullon and David L. Ikenberry, "What Do We Know About Stock Repurchases?," 13 *Journal of Applied Corporate Finance*, pp. 31-51 (2000) (noting issuers repurchase their stock for several reasons, including to convey management's expectation of future increases in earnings and cash flow).

² See Securities Exchange Act Release No. 46980 (Dec. 10, 2002), 67 FR 77594 (Dec. 18, 2002) ("2002 Proposing Release").

³ See *id.*

⁴ *Id.*

⁵ *Id.*

⁶ 1982 Adopting Release, 47 FR 53333. Since 1967, the Commission has considered on several occasions the issue of whether to regulate an issuer's market purchases of its own securities. The Commission first proposed Rule 10b-10 to govern issuer repurchases in connection with proposed legislation that became the Williams Act Amendments of 1968. Pub. L. No. 90-439, 82 Stat. 454 (July 29, 1968), reprinted in Hearings on S. 510 before Senate Committee on Banking and Currency, 90th Cong., 1st Sess. 214-216 (1967). The Commission then published for public comment proposed Rule 13e-2 in 1970, 1973, and 1980. Rule 13e-2, which was later withdrawn with the adoption of Rule 10b-18, would have been a prescriptive rule with mandatory disclosure

which provides issuers⁷ with a safe harbor from liability for manipulation under Sections 9(a)(2) and 10(b) of the Exchange Act, and Rule 10b-5 under the Exchange Act, when they repurchase their common stock in the market in accordance with the Rule's manner, timing, price, and volume conditions.⁸ Rule 10b-18's safe harbor conditions are designed to minimize the market impact of the issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer.⁹

The safe harbor conditions are intended to offer issuers guidance when repurchasing their common stock in the open market. Rule 10b-18, however, is not the exclusive means of making non-manipulative issuer repurchases.¹⁰ As the Rule states, there is no presumption that an issuer's bids or purchases outside of the safe harbor violate Sections 9(a)(2) or 10(b) of the Exchange Act, or Rule 10b-5 under the Exchange Act.¹¹ Given the widely varying market

requirements, substantive purchasing limitations, and general anti-fraud liability. Securities Exchange Act Release Nos. 8930 (July 13, 1970), 35 FR 11410 (July 16, 1970); 10539 (Dec. 6, 1973), 38 FR 34341 (Dec. 13, 1973); and 17222 (Oct. 17, 1980), 45 FR 70890 (Oct. 27, 1980) ("1980 Proposing Release").

⁷ The safe harbor is also available for "affiliated purchasers" of the issuer. In this Release, the term "issuer" includes affiliated purchasers. See 17 CFR 240.10b-18(a)(3), (a)(13) and (b).

⁸ In other words, an issuer will not be deemed to have violated Sections 9(a)(2) and 10(b) of the Exchange Act or Rule 10b-5 under the Exchange Act, solely by reason of the timing, price, volume, or manner of its repurchases, if the repurchases are made within the limitations of the rule. However, some repurchase activity that meets the safe harbor conditions may still violate the anti-fraud provisions of the Exchange Act. For example, as the Commission noted in 1982 when adopting Rule 10b-18, "Rule 10b-18 confers no immunity from possible Rule 10b-5 liability where the issuer engages in repurchases while in possession of favorable, material nonpublic information concerning its securities." 1982 Adopting Release, 47 FR at 53334. See also Securities Exchange Act Release No. 48766 (Nov. 10, 2003), 68 FR 64952 (Nov. 17, 2003) at n. 5 ("2003 Adopting Release").

⁹ See, e.g., 2003 Adopting Release, 68 FR at 64953.

¹⁰ See 1982 Adopting Release, 47 FR at 53334.

¹¹ See 17 CFR 240.10b-18(d). The safe harbor is available for repurchases of an issuer's common stock (or an equivalent interest including a unit of beneficial interest in a trust or a limited partnership or a depository share). See 17 CFR 240.10b-18(a)(13). See also 2003 Adopting Release, 68 FR at 64954. However, the safe harbor is not intended to define the appropriate limits to be observed by those persons not covered by the safe harbor nor the appropriate limits to be observed when repurchasing securities other than common stock.

characteristics for the stock of different issuers, it is possible for issuer repurchases to be made outside of the safe harbor conditions and not be manipulative.¹²

Since Rule 10b-18's adoption in 1982, there have been significant market changes with respect to trading strategies and developments in automated trading systems and technology that have increased the speed of trading and changed the profile of how issuer repurchases are effected. We understand that the increased speed of today's market activity, as evidenced by flickering quotes, has made it increasingly difficult for issuers to ensure that every purchase of its common stock during the day will meet the Rule's current price condition. As discussed below, currently, failure to meet any one of the four conditions under the Rule with respect to any of the issuer's repurchases during the day will disqualify all of the issuer's other Rule 10b-18 purchases from the safe harbor for that day. Moreover, the opportunity for issuers to effect repurchases using alternative trading strategies or pricing mechanisms, such as repurchases effected on a volume-weighted average price ("VWAP") basis (i.e., where a security's price is generally derived from adding up the dollar amounts traded for each transaction in the security (price multiplied by shares traded) and then dividing by the total number of shares traded for the day), has increased significantly. However, because such transactions may be priced without reference to the quoted price of the stock at the time of execution and, thus, possibly above Rule 10b-18's current price limitation, many issuers that repurchase their shares using such trading strategies must forego the protections of the safe harbor for such purchases.

In connection with the 2003 amendments to Rule 10b-18,¹³ the Commission sought comment as to whether Rule 10b-18's price condition should apply where the issuer has no control,

¹² See 1982 Adopting Release, 47 FR at 53334.

¹³ See 2003 Adopting Release, 68 FR 64952.

directly or indirectly, over the price at which a Rule 10b-18 purchase will be effected, for example, "passive" or independently-derived pricing, such as the VWAP.¹⁴ While the Commission did not adopt an exception for VWAP transactions at that time, it stated that it would take into account commenters' recommendations, as well as current market practices involving VWAP transactions, in considering whether any future changes to Rule 10b-18 were appropriate.¹⁵ Since that time, we understand from the industry that VWAP has become one of the most widely recognized and accepted pricing mechanisms and trading benchmarks.¹⁶

Based on our experience with the operation of Rule 10b-18 and to respond to these market developments, we propose to revise Rule 10b-18 as described below. The proposed amendments are intended to clarify and modernize the safe harbor provisions. In particular, our proposal to modify the price condition would provide issuers with greater flexibility to conduct their issuer repurchase programs within the safe harbor under conditions designed to reduce the potential for abuse. Our proposal to limit the general disqualification provision would also provide issuers with additional flexibility to conduct their share repurchase programs in fast moving markets. At the same time, our proposals to modify the timing condition and the "merger

¹⁴ See 2002 Proposing Release, 67 FR at 77594.

¹⁵ See id., 67 FR at 77599. See also Comment letters from William A. Lupien, Director, and William W. Uchimoto, Executive Vice President and General Counsel, Vie Financial Group, Inc., dated June 26, 2003, and William W. Uchimoto, Executive Vice President and General Counsel, Vie Financial Group, Inc., dated Mar. 3, 2003 (suggesting that the Commission provide an exception from the Rule's pricing condition for issuers' VWAP transactions that meet certain specific VWAP calculation standards) ("Uchimoto Letter").

¹⁶ See, e.g., Uchimoto Letter (noting that VWAP is the most widely recognized and accepted trading benchmark). See also Securities Exchange Act Release No. 54003 (June 16, 2006), 71 FR 36141, 36142 (SR-NASD-2006-056) (noting that VWAP is a benchmark often used by institutional investors to determine whether they received a good price for a large trade).

exclusion” provision¹⁷ under the Rule are intended to maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer, and to promote safe harbor availability only during normal market conditions for an issuer.¹⁸

II. Overview of Current Rule 10b-18 Conditions

Rule 10b-18 provides a safe harbor for an issuer’s purchases of shares of its common stock on a given day. To come within the safe harbor for that day, an issuer must satisfy the Rule’s manner, timing, price, and volume conditions when purchasing its own common stock in the market.¹⁹ The current Rule provides that failure to meet any one of the four conditions removes (or disqualifies) all of an issuer’s purchases from the safe harbor for that day.²⁰

A. Manner of Purchase Condition

The manner of purchase condition requires an issuer to use a single broker or dealer per day to bid for or purchase its common stock.²¹ This requirement is intended to avoid the appearance of widespread trading in a security that could result if an issuer used many brokers or dealers to

¹⁷ See 17 CFR 240.10b-18(a)(13)(iv). As discussed below, the “merger exclusion” precludes issuer repurchases effected during the period from the time of public announcement of a merger, acquisition, or similar transaction involving a recapitalization, until the earlier of the completion of such transaction or the completion of the vote by the target shareholders, including any period where the market price of a security will be a factor in determining the consideration to be paid pursuant to a merger, acquisition, or similar transaction. See also 2003 Adopting Release, 68 FR at 64955.

¹⁸ See 2003 Adopting Release, 68 FR at 64953.

¹⁹ 17 CFR 240.10b-18(b)(1) - (4).

²⁰ See Preliminary Note 1 to 17 CFR 240.10b-18.

²¹ 17 CFR 240.10b-18(b)(1).

repurchase its stock.²² The “single broker or dealer” condition, however, applies only to Rule 10b-18 purchases that are “solicited” by or on behalf of an issuer.²³ Accordingly, an issuer may purchase shares from more than one broker-dealer if the issuer does not solicit the transactions. An issuer must evaluate whether a transaction is “solicited” based on the facts and circumstances of each case.²⁴

B. Timing Condition

The timing condition restricts the periods during which an issuer may bid for or purchase its common stock.²⁵ Market activity at the open and close of trading is considered to be a significant indicator of the direction of trading, the strength of demand, and the current market value of the security.²⁶ Accordingly, the timing condition precludes an issuer from being the opening (regular way) purchase reported in the consolidated system.²⁷ The timing condition also excludes from the safe harbor purchases effected during the last half hour (or during the last ten minutes for actively-traded securities) before the scheduled close of the primary trading session in the principal market for the security and in the market where the purchase is effected.²⁸ Rule 10b-18’s limitation on

²² See 1980 Proposing Release, 45 FR at 70891.

²³ 17 CFR 240.10b-18(b)(1)(i).

²⁴ Although Rule 10b-18 does not define “solicitation,” the issuer’s disclosure and announcement of a repurchase program would not necessarily cause a subsequent purchase to be deemed “solicited” by or on behalf of an issuer. See 1982 Adopting Release, 47 FR at 53337.

²⁵ 17 CFR 240.10b-18(b)(2).

²⁶ 2003 Adopting Release, 68 FR 64953.

²⁷ 17 CFR 240.10b-18(b)(2)(i). For purposes of Rule 10b-18’s timing and price conditions, Rule 10b-18(a)(6) defines “consolidated system” to mean “a consolidated transaction or quotation reporting system that collects and publicly disseminates on a current and continuous basis transaction or quotation information in common equity securities pursuant to an effective transaction reporting plan or an effective national market system plan (as those terms are defined in § 242.600).”

²⁸ 17 CFR 240.10b-18(b)(2). Reliance on the safe harbor under Rule 10b-18 is precluded if a purchase is effected during the 10 minutes before the scheduled close of the primary trading session in the principal market for the

bids and purchases near the close of trading for purposes of qualifying for the safe harbor is to prevent the issuer from creating or sustaining a high bid or transaction price at or near the close of trading. Where there is no independent opening transaction on a given day, an issuer is precluded from making purchases under the safe harbor for that day.²⁹

C. Price Condition

The Rule's price condition specifies the highest price an issuer may bid or pay for its common stock.³⁰ The price condition is intended to prevent an issuer from leading the market for the security through its repurchases by limiting the issuer to bidding for or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, quoted or reported in the consolidated system.³¹ As such, the price condition uses an independent reference price that has not been set by an issuer.³²

For those securities that are not quoted or reported in the consolidated system, the issuer must look to the highest independent bid or the last independent transaction price, whichever is higher, that is displayed and disseminated on any national securities exchange or on any inter-dealer quotation system, as defined in Exchange Act Rule 15c2-11(e)(2), that displays at least

security, and the 10 minutes before the scheduled close of the primary trading session in the market where the purchase is effected, for a security that has an average daily trading volume ("ADTV") value of \$1 million or more and a public float value of \$150 million or more; and purchases during the 30 minutes before the scheduled close of the primary trading session in the principal market for the security, and the 30 minutes before the scheduled close of the primary trading session in the market where the purchase is effected, for all other securities. 17 CFR 240.10b-18(b)(2)(ii) and (b)(2)(iii).

²⁹ See 2003 Adopting Release, 68 FR at 64954.

³⁰ 17 CFR 240.10b-18(b)(3).

³¹ See 2003 Adopting Release, 68 FR at 64954.

³² 17 CFR 240.10b-18(b)(3).

two independent priced quotations for the security.³³ For all other securities, the issuer must look to the highest independent bid obtained from three independent dealers.³⁴

D. Volume Condition

The volume condition limits the amount of securities an issuer may repurchase in the market in a single day.³⁵ The volume condition is designed to prevent an issuer from dominating the market for its securities through substantial purchasing activity.³⁶ An issuer dominating the market for its securities in this way can mislead investors about the integrity of the securities market as an independent pricing mechanism. Under the current volume condition, an issuer may effect daily purchases in an amount up to 25 percent of the ADTV in its shares, as calculated under the Rule (the “25% volume limitation”).³⁷ Alternatively, once each week an issuer may purchase one block of its common stock in lieu of purchasing under the 25% volume limitation for that day.³⁸ The “one block per week” exception to the volume condition is intended to provide issuers with moderate or low ADTV greater flexibility in carrying out their repurchase programs.³⁹

III. Proposed Amendments to Rule 10b-18

³³ 17 CFR 10b-18(b)(3)(ii).

³⁴ 17 CFR 240.10b-18(b)(3)(iii).

³⁵ 17 CFR 240.10b-18(b)(4).

³⁶ See 2003 Adopting Release, 68 FR at 64954.

³⁷ 17 CFR 240.10b-18(a)(1) (defining ADTV for purposes of the safe harbor). See also *supra* note 28 (noting that “ADTV” means a security’s average daily trading volume).

³⁸ See 17 CFR 240.10b-18(a)(5) (defining “block”). However, shares purchased by the issuer relying on the “one block per week” exception may not be included when calculating a security’s four-week ADTV under the Rule. See 2003 Adopting Release, 68 FR at 64960; 17 CFR 240.10b-18(b)(4)(ii).

³⁹ See 2003 Adopting Release, 68 FR at 64960.

In this release, we are proposing revisions to the safe harbor rule. In particular, we propose to:

- modify the timing condition to preclude Rule 10b-18 purchases as the opening purchase in the principal market for the security and in the market where the purchase is effected (in addition to the current prohibition against effecting Rule 10b-18 purchases as the opening purchase reported in the consolidated system);
- relax the price condition for certain VWAP transactions;
- limit the disqualification provision in fast moving markets under certain specific conditions;
- modify the “merger exclusion” provision to extend the time in which the safe harbor is unavailable in connection with an acquisition by a special purpose acquisition company (“SPAC”); and
- update certain definitional provisions consistent with the current Rule.

We solicit any comment on our approach and the specific proposals. We also encourage commenters to present data in support of their positions.

A. Discussion of Amendments to the Purchasing Conditions

1. Time of Purchases

We propose to modify Rule 10b-18’s timing condition to preclude Rule 10b-18 purchases as the opening purchase in the principal market for the security and in the market where the purchase is effected.⁴⁰ Currently, to qualify for the safe harbor, an issuer’s purchase may not be

⁴⁰ The proposed amendment would continue to limit an issuer from effecting a Rule 10b-18 purchase as the opening purchase reported in the consolidated system.

the opening regular way purchase reported in the consolidated system.⁴¹ Under the current rule, an issuer's purchase, however, may be the opening purchase in the principal market for its security and the opening purchase in the market where the purchase is effected, provided there is already an opening purchase reported in the consolidated system that day.⁴²

However, similar to transactions in the principal market for a security at the end of a trading day,⁴³ the opening transaction in the principal market for a security and in the market where the repurchase is effected, can be a significant indicator of the direction of trading, the strength of demand, and the current market value of a security.⁴⁴ This is particularly true considering the large trading volume that can occur at the principal market's open as the result of the increased use of electronic opening crosses and opening auctions to establish a security's official opening price for the day. However, we understand from industry sources that the dissemination of market data from these larger opening crosses has led to some confusion as to which opening transaction Rule 10b-18's opening purchase limitation applies when there is a delayed opening in the principal market for a stock.⁴⁵ For example, when a small number of an issuer's shares prints as a regional exchange's opening transaction in the consolidated system

⁴¹ See 17 CFR 240.10b-18(b)(2)(i).

⁴² For example, if the principal market has a delayed opening in the issuer's stock and, therefore, is not the opening purchase reported in the consolidated system that day, the issuer would be able to effect a Rule 10b-18 purchase as the opening purchase in the principal market for its security that day.

⁴³ See *supra* note 28.

⁴⁴ See, e.g., James Ramage, "Primary Market Still Guides Open," *Traders Magazine* (June 2008) ("Primary Market"); Raymond M. Brooks and Jonathan Moulton, "The Interaction between Opening Call Auctions and Ongoing Trade: Evidence from the NYSE," 13 *Review of Financial Economics*, pp. 341-356 (2004); Michael J. Barclay and Terrence Henderschott, "A Comparison of Trading and Non-trading Mechanisms for Price Discovery," *Journal of Empirical Finance* 15, 839-849 (2008).

⁴⁵ See, e.g., Security Traders Association, "Special Report: STA's Perspective on U.S. Market Structure," at p. 10 (May 2008) (noting that competing venues can open the same stock using different processes and different

and then immediately thereafter, a substantially larger number of the issuer's shares prints in the consolidated system as the official opening transaction in the principal market for the issuer's securities, we understand that some issuers are unsure as to which transaction is the relevant opening transaction for purposes of Rule 10b-18's opening purchase limitation.⁴⁶ Moreover, because the principal market's official opening price has become a widely-recognized benchmark within the industry, we are concerned that this much larger official opening transaction in the principal market may be a more significant indicator of the direction of trading, the strength of demand, and the current market value of a security than the smaller regional exchange's opening purchase reported in the consolidated system that day.⁴⁷

To address these developments, we propose to amend the Rule's opening purchase limitation. Specifically, the proposed amendment would continue to limit an issuer from effecting a Rule 10b-18 purchase as the opening purchase reported in the consolidated system. However, consistent with the limitations placed on purchases at the end of the trading day,⁴⁸ the proposal would amend paragraph (b)(2)(i) of the Rule to also preclude the issuer from being the opening purchase in both the principal market for the security and in the market where the purchase is effected.

As discussed above, similar to transactions at the end of a trading day, the opening transaction in the principal market for the security and in the market where the repurchase is

order flows, which can create confusion for investors if the first reported price is different from the primary market's opening price) ("STA Special Report").

⁴⁶ See, e.g., *id.* See also NYSE Trader "Opening Trades Update -15 Sept. 2008" (noting that different vendors will process trades marked with "OPD" (indicating an out-of-sequence, opening trade) differently for purposes of their VWAP calculations) at http://traderupdates.nyse.com/2008/09/as_previously_reported_the_con.html.

⁴⁷ See, e.g., STA Special Report, *supra* note 45 at pp. 10-11. See also Primary Market, *supra* note 44.

⁴⁸ See 17 CFR 240.10b-18(b)(2)(ii) and (b)(2)(iii).

effected can be a significant indicator of the direction of trading, the strength of demand, and the current market value of a security. Thus, the proposed modification to the timing condition is designed to maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer. The amendment also would allow issuers to carry out their repurchase programs more effectively by providing issuers with guidance in complying with Rule 10b-18 in the situation described above where the principal market has a delayed opening in a stock and another exchange's smaller opening transaction is reported in the consolidated system first. In such situation, the proposed amendments would require the issuer to wait until both of these opening transactions were reported in the consolidated system (rather than just the first transaction) before it could effect a Rule 10b-18 purchase within the safe harbor that day.

Q. Is the proposed opening purchase limitation appropriate? If not, why not? Are there other aspects of the limitation that the Commission should consider revising? If so, please explain in what way.

Q. Are there aspects of the Rule's end of the day timing limitation that the Commission should consider revising? If so, please explain in what way. For example, for securities that have an ADTV value of \$1 million or more and a public float value of \$150 million or more, Rule 10b-18 currently excludes from the safe harbor purchases of such securities effected during the 10 minutes (rather than 30 minutes) before the scheduled close of the primary trading session in the principal market for the security, and the 10 minutes before the scheduled close of the

primary trading session in the market where the purchase is effected.⁴⁹ Should eligibility for the current end of the day timing limitation, i.e., 10 minutes before the scheduled close of trading, continue to be based on a security's ADTV and an issuer's public float? Should the current ADTV and public float value qualifying thresholds be raised to adjust for inflation? Are there alternative tests we should consider? For example, should the 10 minutes before the scheduled close of trading limitation be based on the securities offering reform standard?⁵⁰ Further, does the 10 minute limitation adequately protect against an issuer affecting the closing price of its security? Please explain. Is a shorter or longer period warranted for an issuer whose security meets the applicable ADTV and public float thresholds? If so, please identify what time limitation would be appropriate and provide data and a detailed rationale supporting the suggested alternative, including how it will promote securities prices based on independent market forces without undue issuer influence.

Q. Currently, repurchases of OTC Bulletin Board ("OTCBB") and Pink Sheet securities do not have an opening purchase timing restriction under the safe harbor. Should Rule 10b-18's timing condition be amended to apply to repurchases effected in markets where there is no official opening of trading, such as on the OTCBB and Pink Sheets? If so, what opening timing limitation should be applied to such securities? Should such a limitation be based on normal market hours or such market's regular hours of operation rather than the opening of trading? Should the current end of the day timing limitation be modified in any way with respect to OTCBB and Pink Sheets securities? If so, how? If not, why not? Please explain. In what way

⁴⁹ 17 CFR 240.10b-18(b)(2)(ii).

⁵⁰ See Securities Offering Reform, Securities Exchange Act Release No. 52056 (July 19, 2005), 70 FR 44722, 44731 at n. 88 (Aug. 3, 2005) (setting a public float threshold of \$700 million and noting that those issuers had \$52 million ADTV).

could market activity at the end of the trading day be considered a significant indicator of the direction of trading, the strength of demand, and the current market value of an OTCBB or a Pink Sheets security?

2. Price of Purchases

a. VWAP Transactions

Rule 10b-18 limits an issuer to bidding for or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, quoted or reported in the consolidated system at the time the purchase is effected.⁵¹ We understand that issuers would like to be able to repurchase their securities on a VWAP basis knowing that such purchases are within the safe harbor. However, because VWAP transactions are priced on the basis of individual trades that are executed and reported throughout the trading day, there may be instances where the execution price of an issuer's VWAP purchase effected at the end of that trading day (after the security's VWAP has been calculated and assigned to the transaction) exceeds the highest independent bid or last independent transaction price quoted or reported in the consolidated system for that security and, therefore, will be outside of the safe harbor's current price condition.

In order to provide issuers with additional flexibility to conduct repurchase programs using VWAP within the safe harbor, we propose to except from the Rule 10b-18's price condition Rule 10b-18 purchases effected on a VWAP basis, provided certain criteria are met. Specifically,

⁵¹ 17 CFR 240.10b-18(b)(3).

the proposal would amend paragraph (b)(3) of the Rule to except those Rule 10b-18 VWAP purchases that satisfy the criteria set forth in proposed paragraph (a)(14) of the Rule.⁵²

To qualify for the proposed exception, the VWAP purchase must be for a security that qualifies as an actively-traded security (as defined under Rule 101(c)(1) of Regulation M).⁵³ Similar to the Rule 10b-18's timing condition, the proposed exception would incorporate Regulation M's standards and methods of calculating ADTV and public float value. Under Regulation M, issuers with a security that has an ADTV value of \$1 million or more and a public float value of \$150 million or more are excluded from Rule 101 of Regulation M under its "actively-traded securities" exception.⁵⁴ The securities of issuers that have an ADTV value of at least \$1 million and a public float value at or above \$150 million are considered to have a sufficient market presence to make them less likely to be manipulated.⁵⁵ Moreover, the public float value test is intended in part to exclude issuers from the "actively-traded securities" category where a high trading volume level is an aberration.⁵⁶

Additionally, the VWAP purchase must be entered into or matched before the regular trading session opens, and the execution price of the VWAP matched trade must be determined based on a full trading day's volume.⁵⁷ We believe that requiring the VWAP calculation to be

⁵² Proposed Rule 10b-18(b)(3)(i)(a). The proposed amendment would except issuers' VWAP Rule 10b-18 purchases from only the pricing condition of the safe harbor. Issuers would remain responsible for compliance with all other conditions of Rule 10b-18 to secure the protections of the safe harbor.

⁵³ Proposed Rule 10b-18(a)(14)(i). See also 17 CFR 242.101(c)(1).

⁵⁴ See 17 CFR 242.101(c)(1).

⁵⁵ See Securities Exchange Act Release No. 38067 (Dec. 20, 1996), 62 FR 520 (Jan. 3, 1997).

⁵⁶ Id.

⁵⁷ Proposed Rules 10b-18(a)(14)(ii) and (iii). Specifically, under proposed paragraph (a)(14)(iii) of Rule 10b-18 would require the execution price of the VWAP matched trade must be determined based on all regular way

based on a full day of trading would be the method of calculation that is the least susceptible to manipulation, because it would take into account the greatest volume of transactions occurring during regular trading hours.

To qualify for the exception, the issuer's VWAP purchase also must not exceed 10% of the ADTV in the security⁵⁸ and must not be effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.⁵⁹ These conditions are similar to the conditions contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions.⁶⁰ We believe that such conditions would similarly work well

trades effected in accordance with the Rule's timing and price conditions that are reported in the consolidated system during the primary trading session for the security. See Proposed Rule 10b-18(a)(14)(iii).

The proposed criteria are similar to the criteria contained in VWAP exemptive relief from former Rule 10a-1 under the Exchange Act. See, e.g., Letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Edith Hallahan, Counsel, Phlx, dated Mar. 24, 1999; letter Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Soo J. Yim, Wilmer, Cutler & Pickering, dated Dec. 7, 2000 ("Wilmer, Cutler & Pickering"); letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to William W. Uchimoto, Esq., Vie Institutional Services, dated Feb. 12, 2003.

⁵⁸ The VWAP exemptive relief from former Rule 10a-1 VWAP included the condition that a broker or dealer will act as principal on the contra-side to fill customer short sale orders only if the broker-dealer's position in the subject security, as committed by the broker-dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume, as defined in Regulation M. See, e.g., Wilmer, Cutler & Pickering, id.

⁵⁹ Proposed Rule 10b-18(a)(14)(iv) and (v).

⁶⁰ See text accompanying supra note 57.

in restricting the exemptive relief to situations that generally would not raise the harms that Rule 10b-18 is designed to prevent. Additionally, the VWAP must be calculated by first calculating the values for every regular way trade reported in the consolidated system (except those trades that are expressly excluded under proposed paragraph (a)(14)(iii) of the Rule, as described below), by multiplying each such price by the total number of shares traded at that price; then compiling an aggregate sum of all values; and then dividing this aggregate sum by the total number of trade reported shares for that day in the security that represent regular way trades effected in accordance with the conditions of paragraphs (b)(2) and (b)(3) of Rule 10b-18 that are reported in the consolidated system during the primary trading session for the security.⁶¹

This method of calculating VWAP is consistent with the method of calculation contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions, and it is consistent with industry practices for calculating VWAP for purposes of the Rule 10b-18 safe harbor. In addition, the VWAP assigned to the purchase must be based on trades effected in accordance with the Rule's timing and price conditions and, therefore, must not include trades effected as the opening purchase reported in the consolidated system (including the opening purchase in the principal market for the security and in the market where the purchase is effected) or during the last 10 minutes before the scheduled close of the primary trading session in the principal market for the security, and in the market where the purchase is effected. Moreover, the VWAP assigned to the purchase must not include trades effected at a price that exceeds the highest independent bid or the last independent transaction price, whichever is higher, quoted or

⁶¹ Proposed Rule 10b-18(a)(14)(vi).

reported in the consolidated system at the time such trade is effected.⁶²

In addition, the VWAP purchase also must be reported using a special VWAP (e.g., a “.W”) trade modifier⁶³ in order to indicate to the market that such purchases are unrelated to the current or closing price of the security. The special trade modifier requirement is intended to prevent the issuer’s Rule 10b-18 VWAP purchase from providing any price discovery information or influencing the pricing direction of the security.

The proposed VWAP exception from the Rule’s price condition is intended to provide issuers and their brokers with greater certainty and flexibility in effecting qualifying VWAP transactions within the safe harbor. We believe that VWAP transactions meeting the above criteria would present little potential for manipulative abuse and, therefore, should be exempt from the Rule’s price condition.⁶⁴ In using VWAP as a pricing mechanism to effect repurchases, issuers relinquish control over the pricing of their executions, thereby reducing the risk of potential manipulation. In addition, the nature of the pricing is objective since VWAP is a commonly used benchmark that is based on independent market forces and is identifiable to all market participants.

⁶² Proposed Rule 10b-18(a)(14)(iii).

⁶³ Proposed Rule 10b-18(a)(14)(vii). For example, FINRA rules require VWAP transaction reports to be identified with a special modifier to indicate to the market that such transaction reports are unrelated to the current or closing price of the security. See FINRA Rule 6380A(a)(5)(E).

⁶⁴ The staff has previously recognized the limited potential to influence the price of transactions effected pursuant to passive pricing mechanisms, such as the VWAP, by exempting such transactions from the former Rule 10a-1 under the Exchange Act. See, e.g., supra note 57.

Q. Should the proposed VWAP exception be modified in any way? If so, please explain. Are all of the proposed criteria for the VWAP exception appropriate, or should any be eliminated or modified? What, if any, additional or alternative criteria should the Commission consider including in the proposed definition of a VWAP Rule 10b-18 purchases in order to prevent any potential manipulative abuse?

Q. Should a “full day” of trading be defined to permit VWAP purchases to be entered into or matched between 9:30 a.m. EST and 10:00 a.m. EST (rather than requiring the VWAP purchase to be entered into or matched before the regular trading session opens)? Please explain.

Q. Should we consider excepting VWAP purchases that are based on an intra-day VWAP (or a time-weighted average price, or “TWAP”), such as a particular time interval from 9:30 a.m. EST through 1:00 p.m. EST, rather than on a full-day’s trading volume? If so, please describe, in light of the objectives of the safe harbor, which time intervals would be appropriate.

Q. Similar to the conditions contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions, the proposed definition of a VWAP Rule 10b-18 purchase uses an “actively-traded” standard. Should the proposed definition also include securities that also comprise the S&P Index, similar to the conditions contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions? Should we consider requiring the securities offering reform thresholds,⁶⁵ instead of the proposed “actively traded” standard? Should a different standard be used?

Q. The proposed definition of a VWAP Rule 10b-18 purchase is based on all regular way trades reported in the consolidated system. Should the proposed definition also permit an issuer in listed securities to calculate the VWAP based only on trades occurring in the principal

⁶⁵ See *supra* note 50.

market for the security? Please explain. Would permitting issuers to use either a consolidated or a principal market calculation for their VWAP purchases be consistent with securities information vendor standards used in the dissemination of VWAP calculations to market participants?

Q. Should the proposed exception distinguish between manually executed VWAP purchases and VWAP purchases executed through automated trading systems? If so, how?

Q. Should we require an issuer to establish and maintain written policies and procedures reasonably designed to assure that the issuer's VWAP purchase was effected in accordance with the proposed criteria and that it has supervisory systems in place to produce records that enable the issuer to accurately and readily reconstruct, in a time-sequenced manner, all orders effected in reliance on the exception? If no, why not? Please explain. How long would it take to update systems and procedures in a manner that ensured compliance with the proposed exception? Please explain. What technological challenges, if any, would be encountered?

Q. What types of costs, if any, would be associated with implementing the proposed exception? We seek specific comment as to what length of implementation period, if any, would be necessary and appropriate and, why, such that issuers would be able to meet the conditions of the proposed exception.

Q. Do VWAP transactions create improper incentives for broker-dealers, such that an exception should not be granted? If the proposed exception is adopted, are there ways to detect and limit the effects of such incentives?

Q. How would trading systems and strategies used in today's marketplace be impacted by the proposed exception? How might market participants alter their trading systems and

strategies in response to the proposed amendments? Please provide an estimate of costs if possible.

b. Other Alternative Passive Pricing Systems

We are considering whether to except other passive pricing mechanisms from the Rule's price condition. We understand that some issuers may effect repurchases through electronic trading systems that use passive or independently-derived pricing mechanisms, such as the mid-point of the national best bid and offer ("NBBO") or "mid-peg" orders. Under Rule 10b-18, matches to a mid-peg order involving an issuer repurchase will necessarily be above the highest bid and may also occur at a price above the last sale price and, therefore, would fall outside of the Rule's price condition, absent an exception. Thus, we seek comment regarding the appropriateness of expanding the proposed exception to include issuer repurchases effected through certain electronic trading systems that match and execute trades at various times and at independently-derived prices, such as at the mid-point of the NBBO. We believe it may be appropriate to expand the safe harbor to permit an issuer to submit a buy order that is "pegged" to the mid-point of the NBBO at the time of execution (a "mid-peg" order) where the issuer's mid-peg order is matched and executed against a sell order that also is pegged to the mid-point of the NBBO at the time of execution, provided certain criteria are met, as discussed below. In the past, the Commission has granted limited exemptive relief in connection with these systems under former Rule 10a-1 under the Exchange Act because matches could potentially occur at a price below the last sale price.⁶⁶

⁶⁶ See, e.g., Letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Andre E. Owens, Schiff Hardin & Waite, dated Apr. 23, 2003 (granting exemptive relief from former Rule 10a-1 for trades executed through an alternative trading system that matches buying and selling interest among institutional investors and broker-dealers at various set times during the day).

Thus we are considering whether to except from Rule 10b-18's price condition purchases that are effected in an electronic trading system that matches buying and selling interest at various times throughout the day if, for example: (i) matches occur at an externally derived price within the existing market and above the current national best bid; (ii) sellers and purchasers are not assured of receiving a matching order; (iii) sellers and purchasers do not know when a match will occur; (iv) persons relying on the exception are not represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction; (v) transactions in the electronic trading system are not made for the purpose of creating actual, or apparent, active trading in, or depressing or otherwise manipulating the price of, any security; (vi) the covered security qualifies as an "actively-traded security" (as defined in Rule 101(c)(1) of Regulation M); and (vii) during the period of time in which the electronic trading system may match buying and selling interest, there is no solicitation of customer orders, or any communication with customers that the match has not yet occurred.

These conditions parallel the conditions provided in the exemptive relief granted under former Rule 10a-1.⁶⁷ Consistent with the relief granted under former Rule 10a-1 and the rationales provided in granting such relief, we believe it may be appropriate to expand the proposed VWAP exception to Rule 10b-18's price condition for purchases effected through these electronic trading systems due to the passive nature of pricing and the lack of price discovery. As such, we believe issuer repurchases effected through these passive pricing systems generally do not appear to involve the types of abuses that the Rule 10b-18 is designed to prevent.

Although purchases effected using mid-point NBBO pricing algorithms may be passively priced, such purchases are not reported using any special trade modifier to indicate to the market

⁶⁷ See, e.g., *id.*

that they are priced according to a special formula and, therefore, may be away from the quoted price of the stock at the time of execution. We, therefore, are concerned that a sizable purchase or series of purchases effected at the mid-point of the NBBO may result in the issuer leading the market for its security through its repurchases, which could undermine the purpose of the price condition. Thus, we seek comment below on what additional safeguards could be imposed to address the concern that such orders are not reported using any special trade modifier to indicate to the market that such transactions are priced at the mid-point of the NBBO.

Q. Should the safe harbor's price condition be modified to except electronic trading systems that effect issuer repurchases at the mid-point of the NBBO? For example, should the safe harbor permit an issuer to submit a buy mid-peg order that is "pegged" to the mid-point of the NBBO at the time of execution where the issuer's mid-peg order can only be matched and executed against a sell order that also is pegged to the mid-point of the NBBO at the time of execution? If so, should the exception be limited to repurchases of actively-traded securities effected through an electronic trading system that automatically matches and executes trades at random times, within specific time intervals, at an independently-derived mid-point of the NBBO price?

Q. If such an exception were adopted, what other conditions should apply? For instance, should we require that sellers and purchasers must not be assured of receiving a matching order or know when a match will occur? Should we require that persons relying on the exception not be represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction, and that during the period of time in which the electronic trading system may match buying and selling interest, there is no solicitation of customer orders, or any

communication with customers that the match has not yet occurred? What, if any, other criteria would be appropriate?

Q. What, if any, additional safeguards could be imposed to address the concern that such orders are not reported using any special trade modifier to indicate to the market that such transactions are priced at the mid-point of the NBBO? Should we require mid-point priced trades to be reported with a special trade modifier? What technological challenges would be encountered as a result? How long would it take to update systems and procedures in order to mark such trades with a special trade modifier? Please explain.

Q. What types of costs, if any, would be associated with requiring mid-point priced trades to be reported to the market with a special trade modifier? Please explain what length of implementation period, if any, would be necessary and appropriate to comply with such a requirement and why.

Q. Are there other benchmark/derivatively priced transactions that should be excepted from Rule 10b-18's price condition? For example, should we consider excepting benchmark/derivatively priced purchases that qualify for the trade through exception in Rule 611(b)(7) of Regulation NMS? If so, please provide specific examples of transactions (and specific supporting criteria) where modifying the Rule's price condition would be appropriate. We also seek comment concerning the potential for manipulative abuse that permitting such transactions may present.

3. Volume of Purchases

Under the current volume condition, an issuer may effect daily purchases in an amount up to 25 percent of the ADTV in its shares, as calculated under the Rule.⁶⁸ Alternatively, once each

⁶⁸ 17 CFR 240.10b-18(b)(4). See 17 CFR 240.10b-18(a)(1) (defining ADTV for purposes of the safe harbor).

week an issuer may purchase one block of its common stock in lieu of purchasing under the 25% volume limitation for that day (the “one block per week” exception).⁶⁹ Rule 10b-18(a)(5) currently defines a “block” as a quantity of stock that either: (i) has a purchase price of \$200,000 or more; or (ii) is at least 5,000 shares and has a purchase price of at least \$50,000; or (iii) is at least 20 round lots of the security and totals 150 percent or more of the trading volume for that security or, in the event that trading volume data are unavailable, is at least 20 round lots of the security and totals at least one-tenth of one percent (.001) of the outstanding shares of the security, exclusive of any shares owned by any affiliate.⁷⁰ When we adopted the “one block per week” exception in connection with the 2003 amendments to Rule 10b-18, we had retained the former Rule’s “block” definition, including paragraph (iii) which references “trading volume” rather than “ADTV.” However, Rule 10b-18, as amended in 2003, uses the term “ADTV” instead of the former term “trading volume.” We therefore propose a non-substantive conforming change to Rule 10b-18 that would amend paragraph (a)(5)(iii) of the “block” definition to reference “ADTV” instead of “trading volume” in order to make the definition consistent with the current Rule. We also request and encourage comment on the following:

Q. We seek specific comment concerning the proposal to amend the definition of a “block” to reference “ADTV” instead of “trading volume” in paragraph (a)(5)(iii) of Rule 10b-18.

⁶⁹ 17 CFR 240.10b-18(b)(4). See text accompanying supra note 38 (regarding “block” purchases under Rule 10b-18).

⁷⁰ See 17 CFR 240.10b-18(a)(5).

Q. Is a volume limitation based on an ADTV calculation feasible with respect to Rule 10b-18 purchases of thinly traded securities? Should we raise (or lower) the volume limit for these securities? Would this increase the potential for manipulative activity in such securities?

Q. Should we retain the current 25% volume limitation? Is the 25% a reasonable limitation that furthers the objectives of the Rule or should the volume limitation be reduced?

Q. Should we retain the current "one block per week" exception? What, if any, modifications should be made to the definition of a "block" purchase for purposes of this exception? For example, should we retain the current "one block per week exception" but increase the amount of shares constituting a block (for instance, should the amount of shares constituting a block conform to the markets' definition of a block trade,⁷¹ that is, typically at least 10,000 shares)?

Q. Does the current "one block per week" exception enable issuers of thinly or moderately traded securities to avail themselves of the Rule 10b-18 safe harbor? If not, why not?

Q. Should we modify the volume condition to allow issuers, for example, once a week to purchase up to a daily aggregate amount of 500 shares, as an alternative to the 25% volume limitation? Would this allow issuers of thinly traded securities to carry out their repurchase programs more effectively? Please provide specific examples of where modifying the Rule's current volume condition with respect to thinly traded securities would be appropriate. We also seek comment concerning the potential for manipulative abuse that such transactions may present.

⁷¹ See, e.g., NYSE Rule 97.10 (defining a "block" as consisting of at least 10,000 shares, or a quantity of securities that has a current market value of at least \$200,000).

Q. We encourage commenters to submit data regarding what percentage of individual issuer repurchase trading volume over the past three years has been effected in reliance on the current “one block per week” exception. The Commission requests data and analysis on what effect limiting the former block exception has had on such issuer’s repurchasing activity.

B. Amendments Concerning Scope of the Safe Harbor

1. “Flickering Quotes”

Rule 10b-18 provides a safe harbor for purchases on a given day. To come within the safe harbor on a particular day, an issuer must satisfy the Rule’s manner, timing, price, and volume conditions when purchasing its own common stock in the market.⁷² Moreover, the Rule provides that failure to meet any one of the four conditions with respect to any of the issuer’s repurchases during the day will disqualify all of the issuer’s Rule 10b-18 purchases from the safe harbor for that day (the “disqualification provision”).⁷³ However, as noted above, we understand that the increased speed of today’s markets, as evidenced by flickering quotes,⁷⁴ has made it increasingly difficult for an issuer to ensure that every purchase of its common stock during the day will meet the Rule’s current price condition. Accordingly, even if an issuer inadvertently effects a Rule 10b-18 purchase outside of the Rule’s price condition⁷⁵ due to flickering bid quotes in a market, the

⁷² 17 CFR 240.10b-18(b)(1) - (4).

⁷³ See Preliminary Note 1 to 17 CFR 240.10b-18.

⁷⁴ “Flickering quotes” occur when there are rapid and repeated changes in the current national best bid during the period between identification of the current national best bid and the execution or display of the Rule 10b-18 bid or purchase. In many active NMS stocks, the price of a trading center’s best displayed quotations can change multiple times in a single second. See, e.g., Securities Exchange Act Release No. 51808 (June 9, 2005), 71 FR 37496, 37522-23 (June 29, 2005) (providing an exception in Rule 611 of Regulation NMS for flickering quotations).

⁷⁵ As discussed above, Rule 10b-18(b)(3) limits an issuer to bidding for or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, quoted or reported in the consolidated system at the time the purchase is effected. 17 CFR 240.10b-18(b)(3).

Rule's general disqualification provision would cause the issuer to forfeit the safe harbor for all of its Rule 10b-18 compliant purchases that day.

In order to accommodate the increasing occurrence of flickering price quotations in today's markets, we propose to limit the general disqualification provision in Rule 10b-18. Specifically, we propose to amend Preliminary Note 1 to Rule 10b-18 and paragraph (d) of the Rule to limit the Rule's disqualification provision in instances where an issuer's repurchase order is entered in accordance with the Rule's four conditions but is, immediately thereafter, executed outside of the price condition solely due to flickering quotes.⁷⁶ In these instances, only the non-compliant purchase, rather than all of the issuer's other Rule 10b-18 purchases for that day, would be disqualified from the safe harbor.⁷⁷ In this way, if an issuer's repurchase fails to meet the price condition due to flickering quotes, the issuer would not forfeit the safe harbor for all of its compliant purchases that day. This proposed limitation to the general disqualification provision would allow an issuer in fast moving markets to effect one otherwise compliant Rule 10b-18 purchase that was inadvertently purchased outside of the safe harbor, due to flickering quotes, without disqualifying all of the issuer's other purchases from the safe harbor for that day.

While we recognize that today's fast moving markets may still present challenges to issuers attempting to repurchase their securities within the safe harbor, Rule 10b-18(b)(3) would also continue to retain the "last independent transaction price" alternative (in addition to the highest

See also 17 CFR 240.10b-18(b)(3)(iii) (price limits for securities for which bids and transaction prices not reported in the consolidated system).

⁷⁶ See Proposed Preliminary Note No. 1 to Rule 10b-18.

⁷⁷ The disqualified non-compliant purchase would still count toward an issuer's daily volume limitation and would still have to satisfy the Rule's "single broker or dealer" and timing conditions, in order for the issuer's remaining purchases during that day to still qualify for the safe harbor.

independent bid), which should provide issuers with additional flexibility and a reliable mechanism in which to comply with the safe harbor's price condition in the event of flickering bid quotes.⁷⁸

Q. Do flickering bid quotes make the Rule's "highest independent bid" alternative difficult to satisfy? Does the "last independent transaction price" alternative help issuers comply with Rule's price condition when there are flickering bid quotes? If not, why not? Please provide specific examples concerning the impact of quote flickering with respect to the Rule's price condition, including specific alternatives to address these concerns.

Q. Should we condition reliance on the disqualification limitation on issuers executing their otherwise compliant purchase within a certain period of time (i.e., a second) after being entered? If so, how much time would be appropriate? Please explain.

Q. Should we require issuers wishing to rely on the disqualification limitation to have specific data management strategies to retain and recall order and trade history to demonstrate compliance with the safe harbor's price condition at the time of order entry? We understand that most broker-dealers already retain the appropriate market data, order status, and execution report elements to provide a "snap shot" of the market conditions at time of order entry versus execution. In order to rely on the safe harbor, what, if any, specific procedures should be established and enforced that would help issuers develop the necessary protocols to deal with the various market centers when flickering quotes appear or fast-moving markets occur in order to help reduce any unnecessary or undue reliance on the proposed limitation? How long would it take to develop these protocols, including updating systems and procedures in a manner that would help reduce any unnecessary or undue reliance on the proposed limitation? Please explain. What

⁷⁸ We note, however, that trade prices also may flicker quickly, which can complicate compliance with Rule 10b-18's price condition because the last trade price printed to the Tape may not necessarily be the last trade price in terms of the actual order of trades.

technological challenges, if any, would be encountered? What types of costs, if any, would be associated with implementing the necessary protocols?

Q. We seek specific comment as to what length of implementation period, if any, would be necessary and appropriate and, why, such that issuers would be able to reduce any unnecessary or undue reliance on the proposed limitation.

Q. Should we limit the number of times that an issuer may rely on the disqualification limitation, for example, once per day?

Q. Should we specify the volume of purchases that are eligible to rely on the disqualification limitation to, for example, 1%, 2%, or 5% of ADTV?

Q. Should we restrict use of the disqualification limitation during certain times of the day in order to maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer? For example, should the limitation not be available for purchases effected immediately after the opening or just before the last half hour of trading?

Q. What effect, if any, would the proposed disqualification limitation have on Rule 10b-18 purchases effected in reliance on the proposed VWAP exception? Similarly, what effect, if any, would the proposed VWAP exception have on issuers' ability to effect Rule 10b-18 purchases in instances where there may be flickering quotes? Please explain.

2. "Merger Exclusion" Provision

The proposed amendments also would add a provision that extends the time in which the safe harbor is unavailable in connection with a SPAC⁷⁹ acquisition until the completion of the vote by the SPAC shareholders. Rule 10b-18 assumes normal market conditions.⁸⁰ Accordingly, the definition of a “Rule 10b-18 purchase” excludes issuer bids and purchases made during certain corporate events because of the heightened incentive of an issuer to facilitate a corporate action, such as a merger. We do not believe that it is appropriate to make the safe harbor available when an issuer is under pressure to complete a merger or similar corporate action and may attempt to bring about a successful conclusion to the corporate action with issuer repurchases. Currently, paragraph (a)(13)(iv) of Rule 10b-18, which defines a Rule 10b-18 purchase, precludes purchases effected during the period from the time of public announcement of a merger, acquisition, or similar transaction involving a recapitalization, until the earlier of the completion of such transaction or the completion of the vote by the target shareholders (the “merger exclusion”).⁸¹ Thus, ordinarily, it is the target shareholder vote that determines the completion of the merger exclusion period for purposes of Rule 10b-18.

Paragraph (a)(13)(iv) illustrates the modernization of the safe harbor in 2003. The Commission adopted the amended merger exclusion in recognition of issuers’ incentives to facilitate corporate actions with issuer purchases. The Commission adopted this modified provision of Rule 10b-18 out of concern for issuer activity designed to facilitate a merger, which

⁷⁹ SPACs are shell, developmental stage, or blank-check companies that raise capital in initial public offerings (“IPOs”) generally for the purpose of acquiring or merging with an unidentified company or companies, or other entity, that will be identified at a future date (a “target”). See generally 17 CFR 230.419 (defining blank-check companies).

⁸⁰ 2002 Proposing Release, 67 FR at 77595.

⁸¹ 17 CFR 240.10b-18(a)(13)(iv). This would include any period where the market price of a security will be a factor in determining the consideration to be paid pursuant to a merger, acquisition, or similar transaction. See 2008 Adopting Release, 68 FR at 64955.

had been highlighted by news articles suggesting that banks repurchased their respective securities in order to boost their stock price to enhance the value of their competing merger proposals.⁸² At that time, the concern about issuers facilitating corporate actions was on raising the market price of an issuer's stock in order to facilitate the merger or acquisition in a contested takeover. The exclusion advanced the goal of making the safe harbor available to an issuer only during those times when there is no special event that may impact an issuer's purchasing activity. Since 2003, securities markets and capital raising have evolved significantly, and we once again believe it is appropriate to modify the merger exclusion with respect to issuer purchases aimed at facilitating corporate actions. This proposal is triggered by the rapid growth of SPAC capital raising, and its objective is to maintain the integrity of the safe harbor by narrowing its use during corporate actions that can impact an issuer's purchasing activity.⁸³

SPAC acquisitions can present unique conflicts of interest and significant financial incentives for SPAC management. For instance, a SPAC generally must complete its acquisition within 18 to 24 months,⁸⁴ which can put SPAC management under severe time pressure to identify an appropriate target and complete the acquisition. Typically, if an acquisition target is identified during this timeframe, both the SPAC shareholders and target shareholders are given the opportunity to vote on whether or not to approve the proposed acquisition. However,

⁸² See 2003 Adopting Release, 68 FR at 64955 n. 29.

⁸³ See FINRA Regulatory Notice 08-54: Guidance on Special Purpose Acquisition Companies. (stating that 22% of all IPOs in 2007 were SPAC IPOs totaling \$12 billion in raised capital).

⁸⁴ This 18- to 24-month deadline is designed to help investors by forcing a timely return of most of their capital (previously held in an escrow or trust account) if an acquisition is not completed within this timeframe and the SPAC must liquidate. See id.

because of the special incentives and deferred compensation involved with a SPAC,⁸⁵ if SPAC management believes that SPAC holders will vote against an acquisition, or to otherwise ensure that the acquisition will be approved, they may attempt to rely on Rule 10b-18 to repurchase a substantial percentage of shares of the SPAC's common stock in the open market,⁸⁶ thereby reducing the possibility that the acquisition will be disapproved.⁸⁷ These open market repurchases can also have the effect of supporting and/or raising the market price of the SPAC shares, and cause other investors to buy up shares in the SPAC in the open market when they might not otherwise have done so.⁸⁸ Moreover, because the SPAC shareholder vote typically occurs much later than the vote by the target shareholders, this allows the SPAC management an

⁸⁵ SPAC managers, as well as underwriters, often have significant financial incentives that may conflict with their investors' interests and may cause them to effect an acquisition regardless of the merit of the target or the potential for future success of the entity as a public company. For instances, the SPAC underwriters may be paid a portion of their fee, usually half, following the IPO, but the remainder is only paid upon the closing of an acquisition. In addition, SPAC managers may not be paid a salary but will receive an equity stake, roughly 20%, in the company post-acquisition.

⁸⁶ See, e.g., Douglas S. Ellenoff, "Facilitating a Business Combination: The Valuation and Economics of a Proposed SPAC Don't Determine a Successful Outcome," *Equities Magazine* (Sept. 2009) (stating that SPAC sponsors and affiliates consider additional purchases of open market shares in order to implement a favorable approval process); Frederick D. Lipman, "International and US IPO Planning: A Business Strategy Guide," at p. 218 and 223 (2008) ("Lipman") (stating that business combinations that trade below the Trust's per share amount after announcement require the SPAC's sponsors or the target's owners to enter into agreements to incentivize the SPAC's public stockholders or potential investors to support the transaction" and that "SPAC sponsors may commit to spend funds to buy stock in the open market that can be targeted during the proxy process").

⁸⁷ See, e.g., Lipman, *id.* at p. 217 (noting that getting the SPAC's stockholder vote and limiting exercises of conversions is by far the most difficult and uncertain part of the process and that this uncertainty affects the extent to which concessions will be made by the SPAC sponsors to complete the transaction – the greater the percentage of arbitrageurs holding the SPAC's stock and the less favorable the transaction is perceived, the greater the concessions that will have to be made). "In most [SPAC] transactions, negotiations and deals need to occur during the proxy process because at the time of the IPO, it is not possible to foresee all the variables involved in the business combination that will affect how much stock will need to be turned over from no votes to yes votes." *Id.* at p. 218 (emphasis added)

⁸⁸ See, e.g., *id.* (stating that SPAC sponsors may enter into Rule 10b5-1 trading plans which require them to purchase up to a specified number of shares or dollar amount of shares at the prevailing market prices, and that these purchases are intended to support the market price of the stock during the proxy process and provide potential sellers the ability to dispose of their shares and achieve the same or greater return than if they were to vote against the transaction and exercise their conversion rights).

even longer period of time in which to engage in substantial open market repurchases of the SPAC's stock in order to secure "yes" votes in favor of the proposed merger or acquisition. In view of this heightened incentive, we do not believe it is appropriate to provide a safe harbor for purchases made in connection with an acquisition by a SPAC during this period and, therefore, believe a longer exclusionary period is warranted.

Thus, we propose to add a provision that would increase the time in which the safe harbor is unavailable in connection with an acquisition by a SPAC until the completion of the vote by the SPAC's shareholders. Specifically, the proposal would amend the language of paragraph (a)(13)(iv) to provide that, in connection with a SPAC, Rule 10b-18's "merger exclusion" would apply to purchases that are effected during the period from the time of public announcement of a merger, acquisition, or similar transaction until the earlier of such transaction or the completion of the vote by both the target shareholders and the SPAC shareholders.⁸⁹ By extending the "merger exclusion" to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders), the proposal would maintain reasonable limits on the safe harbor and prevent it from being used in contexts where there is a heightened incentive to engage in substantial repurchase activity solely in order to facilitate a corporate action. The benefit of a safe harbor is only appropriate during "normal" market conditions.⁹⁰

We note, however, that SPACs would still have the ability to make safe harbor repurchases following an announcement of a merger or covered transaction (subject to Regulation M's restricted period and any other applicable restriction) so long as the total amount of the issuer's Rule 10b-18 purchases effected on any single day does not exceed the lesser of

⁸⁹ Proposed Rule 10b-18(a)(13)(iv).

⁹⁰ See supra note 80. See infra note 106.

25% of the security's four-week ADTV or the issuer's average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction.⁹¹ Moreover, the issuer may effect block purchases pursuant to paragraph (b)(4) of the Rule (subject to Regulation M's restricted period and any other applicable restrictions) provided that the issuer does not exceed the average size and frequency of block purchases effected pursuant to paragraph (b)(4) of the Rule during the three full calendar months preceding the date of the announcement of such transaction.⁹²

Q. Given the significant financial incentives on the part of SPAC managers and underwriters to engage in repurchase activity solely to facilitate an acquisition, should the safe harbor in general continue to apply to issuer repurchases of SPAC securities? If so, should the Commission consider other modifications, either in addition to or instead of, the safe harbor conditions proposed here in the case of issuer repurchases of SPAC securities? If not, what specific types of costs or burdens, if any, would be associated with making the safe harbor in general unavailable to issuer repurchases of SPAC securities? Please explain. Please provide detailed comment regarding excepting all issuer repurchases of SPAC securities from the definition of a Rule 10b-18 purchase. Are there other types of securities for which the safe harbor should not apply? We also seek specific comment concerning the potential for manipulative abuse that transactions in such securities may present.

3. Preliminary Note to Rule 10b-18

⁹¹ See 17 CFR 240.10b-18(a)(13)(iv)(B)(1).

⁹² See 17 CFR 240.10b-18(a)(13)(iv)(B)(2).

We also propose a non-substantive amendment that would update Preliminary Note No. 2 to Rule 10b-18 to reference “Item 16E” (instead of “Item 15(e)”) of Form 20-F. Preliminary Note No. 2 currently states, “[r]egardless of whether the repurchases are effected in accordance with § 240.10b-18, reporting issuers must report their repurchasing activity as required by Item 703 of Regulations S-K and S-B (17 CFR 229.703 and 228.703) and Item 15(e) of Form 20-F (17 CFR 249.220f) (regarding foreign private issuers), and closed-end management investment companies that are registered under the Investment Company Act of 1940 must report their repurchasing activity as required by Item 8 of Form N-CSR (17 CFR 249.331; 17 CFR 274.128).”⁹³ The proposed amendment would update this note by changing “Item 15(e)” to “Item 16E” consistent with the current Form 20-F.

4. Additional Request for Comments regarding Scope of Safe Harbor

Q. Should the safe harbor in general continue to apply to less liquid, less transparent securities, such as OTCBB and Pink Sheet securities? If so, should these securities be subject to more restrictive limitations in order to minimize the risk of manipulation by an issuer making market repurchases in these less liquid, less transparent securities?

Q. Should the Rule 10b-18 safe harbor be available for issuer repurchases during periods when an issuer’s insiders are selling their own shares of the issuer’s stock? If not, please provide specific suggestions regarding what, if any, limitations should be placed on the availability of the safe harbor during such periods.

Q. Should the Rule require that an issuer have current financial disclosures as a prerequisite to receiving the protection of the safe harbor? For example, should it be available to companies that do not make public filings of financial information, or are not current in required

⁹³ 17 CFR 240.10b-18.

filings? If so, how should we require the issuer to demonstrate such compliance? Should such information be required to be made available on the issuer's website for the investing public? What, if any, other requirements should be a prerequisite to receiving the protection of the safe harbor?

Q. Item 703 of Regulation S-K requires disclosure of repurchases of all shares of a company's equity securities of a class registered under Section 12 of the Exchange Act regardless of whether an issuer relies on the safe harbor. Should compliance with the disclosure requirements of Item 703 be made a condition of using the safe harbor? Should Rule 10b-18 contain a specific disclosure requirement as a condition of the safe harbor, similar to other Commission regulations that link a safe harbor with disclosure (e.g., Regulation D with Form D and Rule 144 with Form 144)? What specific types of information would be useful to investors regarding an issuer's repurchase activity?

Q. Would requiring specific disclosure as a condition of the safe harbor provide a useful way to monitor the operation of (or verify compliance with) the safe harbor? Would it provide useful information in assessing the level and market impact of issuer repurchases? If so, should the safe harbor require disclosure on a daily basis, or would more frequent disclosure (e.g., on a "real time" basis) be more meaningful to investors? If so, how should the disclosure be made (e.g., issuing daily press releases, posting daily notices on the issuer's website, or reporting such purchases to the tape using a special trade indicator)? Please provide specific suggestions.

Q. Should the safe harbor require issuers to maintain (and provide to the Commission, upon request) separately retrievable written records concerning the trade details (trade-by-trade information) about the manner, timing, price, and volume of their Rule 10b-18 repurchases?

Q. Should the safe harbor be made available to securities other than common equity, such as preferred stock, warrants, rights, convertible debt securities, or other products? If the safe harbor

were to include such securities, what price, volume, and time of purchase conditions should apply? We seek specific comment concerning the potential for manipulative abuse that transactions in such securities may present.

Q. Should the safe harbor be available for issuer repurchases involving security futures or option contracts (including the receipt or purchase for delivery of securities underlying such contracts)? Should the number of shares underlying an option or security futures contract (or other derivative security) entered into by an issuer count against an issuer's 25% daily volume limitation? What effect, if any, should taking delivery of common stock pursuant to a security futures contract or upon exercise of an option have regarding the Rule's other conditions (e.g., price, timing, and manner of purchase) with respect to the availability of the safe harbor for purchases effected in accordance with Rule 10b-18?

Q. Currently, the Rule 10b-18 safe harbor is not available for an issuer and the broker-dealer who engage in an accelerated share repurchase plan or use a forward contract to repurchase the issuer's stock, or for the broker's covering transactions. What, if any, manipulative concerns are raised by alternative or novel methods of repurchasing securities (e.g., use of derivatives or share accumulation programs)? Please provide specific comment as to what limitations should apply to such repurchases to address these concerns.

Q. Should the safe harbor apply to an issuer's repurchases of its common stock effected outside of the United States (e.g., on foreign exchanges)? If so, how should the safe harbor conditions apply to such purchases (e.g., should a security's ADTV include worldwide trading volume)?

Q. Should the safe harbor only be available outside of the United States to foreign private issuers, or to foreign companies whose principal market is outside the United States? If

so, are there certain conditions of Rule 10b-18 that should be modified or that should not apply at all with respect to purchases outside the United States and, if so, why?

Q. Are there different conditions under Rule 10b-18 that should apply with respect to purchases outside the United States and, if so, why are those conditions more appropriate than the conditions currently proposed for Rule 10b-18?

IV. General Request for Comment

We request and encourage any interested person to comment generally on these proposals. In addition to the specific requests for comment, the Commission invites interested persons to submit written comments on all aspects of the proposed amendments. The Commission also requests commenters to address whether the proposed Rule 10b-18 amendments provide appropriate safe harbor conditions in light of recent market developments. The Commission seeks comment on whether the safe harbor proposals raise any manipulation risks. Commenters may also discuss whether there are legal or policy reasons why the Commission should consider a different approach.

The Commission encourages commenters to provide information regarding the advantages and disadvantages of each proposed amendment. The Commission invites commenters to provide views and data as to the costs and benefits associated with the proposed amendments. We also seek comment regarding other matters that may have an effect on the proposed amendments.

V. Paperwork Reduction Act

A. Background

One provision of the proposed amendments to Rule 10b-18 would result in new “collection of information” requirements within the meaning of the Paperwork Reduction Act of

1995 (“PRA”).⁹⁴ The Commission is therefore submitting this proposal to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information requirements is “Purchases of Certain Equity Securities by the Issuer and Others.” If adopted, this collection would not be mandatory, but would be necessary for issuers that wish to avail themselves of the proposed VWAP exception to Rule 10b-18’s price condition. Responses to the collection of information requirements of the proposed VWAP exception to Rule 10b-18’s price condition would not be kept confidential. 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. OMB has not yet assigned a control number to the new collection for the proposed VWAP exception to the Rule’s price condition.

B. Summary

In order to provide issuers with additional flexibility to conduct repurchase programs using VWAP within the safe harbor, we are proposing to except from the Rule 10b-18’s price condition Rule 10b-18 purchases effected on a VWAP basis, provided certain criteria are met. Proposed Rule 10b-18(a)(14)’s definition of a “Rule 10b-18 VWAP Purchase” would require a new collection of information in that one of the requirements for qualifying for the exception is that the VWAP purchase must be reported using a special VWAP (e.g., a “.W”) trade modifier⁹⁵ in order to indicate to the market that such purchases are unrelated to the current or closing price of the security.

C. Proposed Use of Information

⁹⁴ 44 U.S.C. 3501 et seq.

⁹⁵ Proposed Rule 10b-18(a)(14)(vii).

The information that would be collected under the special trade modifier requirement would help prevent the issuer's Rule 10b-18 VWAP purchase from providing any price discovery information or influencing the pricing direction of the security. The information collected also would aid the Commission in monitoring compliance with the proposed VWAP exception.

D. Respondents

The collection of information that would be required by the proposed special trade modifier requirement of the proposed VWAP exception to Rule 10b-18 would apply to all 5,561 registered broker-dealers effecting Rule 10b-18 VWAP on behalf of issuers in reliance on the proposed VWAP exception to Rule 10b-18's price condition. As discussed below, the Commission has considered the above respondents for the purposes of calculating the reporting burdens under the proposed amendments to Rule 10b-18. The Commission requests comment on the accuracy of these figures.

E. Total Annual Reporting and Recordkeeping Burdens

Proposed Rule 10b-18(a)(14)'s definition of a "Rule 10b-18 VWAP Purchase" would require that the VWAP purchase must be reported using a special VWAP trade modifier.⁹⁶ VWAP trade reports are already required to be identified with a special trade indicator or modifier to indicate that such transaction reports are unrelated to the current or closing price of the security.⁹⁷ Thus, this identification is usual and customary in the conduct of this activity and

⁹⁶ Id.

⁹⁷ For example, FINRA rules require VWAP transaction reports to be identified with a special modifier to indicate to the market that such transaction reports are unrelated to the current or closing price of the security. See FINRA Rule 6380A(a)(5)(E) (requiring members to append the applicable trade report modifier, as specified by FINRA, to all last sale report that occur at a price based on an average weighting or another special pricing formula).

no new burden would be imposed.⁹⁸

F. Record Retention Period

The proposed VWAP exception's special modifier requirement does not contain any new record retention requirements. All registered broker-dealers that would be subject to the proposed special trade modifier requirement are currently required to retain records in accordance with Rule 17a-4(e)(7) under the Exchange Act.

G. Request for Comment

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

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. **S7-04-10**. Requests for materials submitted to OMB by the Commission with regard to

⁹⁸ 5 CFR 1320.3(b)(2).

this collection of information should be in writing, with reference to File No. **S7-04-10**, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Costs and Benefits of the Proposed Amendments

The Commission is considering the costs and the benefits of the proposed amendments. The Commission encourages commenters to discuss any additional costs or benefits. In particular, the Commission requests comment on the potential costs for any modifications to information gathering, management, and recordkeeping systems or procedures, as well as any potential benefits resulting from the proposals for issuers, investors, broker-dealers, other securities industry professionals, regulators, and others. Commenters should provide analysis and data to support their views on the costs and benefits associated with the proposed amendments.

A. Costs

As an aid in evaluating costs and reductions in costs associated with the proposed amendments, the Commission requests the public's views and any supporting information. The Commission believes that the proposed amendments would impose negligible costs, if any, on issuers and would not compromise investor protection. The Commission notes that any costs related to complying with the proposed amendments to Rule 10b-18 are assumed voluntarily because the Rule provides an optional safe harbor.⁹⁹ The Commission, however, notes that

⁹⁹ See discussion in Section VII, *infra*, noting that, even with the proposed modification to the "merger exclusion," all issuers, including SPACs, still have the ability to make safe harbor repurchase following an announcement of a merger or covered transaction (subject to Regulation M's restricted period and any other applicable

issuer repurchases effected under the proposed VWAP exception, or other passive pricing mechanisms, may create costs to both issuers and market participants to update systems and enhance recordkeeping in order to comply with the proposed exception. Also, to qualify as a “Rule 10b-18 VWAP Purchase” under the proposed Rule 10b-18(a)(14), the VWAP purchase be reported using a special VWAP trade modifier.¹⁰⁰ VWAP trade reports are already required to be identified with a special trade indicator or modifier to indicate that such transaction reports are unrelated to the current or closing price of the security.¹⁰¹ Thus, this identification is usual and customary and no new burden would be imposed. In addition, if adopted, an issuer may need to establish specific procedures that would help them develop the necessary protocols to deal with the various market centers when flickering quotes appear or fast-moving markets occur in order to help reduce any unnecessary or undue reliance on the proposed disqualification limitation. The Commission seeks estimates of such costs. The Commission also solicits comments as to whether the proposed amendments would impose greater costs on issuers than the current Rule.

The Commission also notes that the proposed modification to the “merger exclusion” in connection with SPAC acquisitions may create costs to issuers in terms of not being able to effect all of their issuer repurchases within the safe harbor. We understand that this, in turn, could affect some SPACs’ ability to complete an acquisition or other covered transaction.

restriction) so long as the total amount of the issuer’s Rule 10b-18 purchases effected on any single day does not exceed the lesser of 25% of the security’s four-week ADTV or the issuer’s average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction. See 17 CFR 240.10b-18(a)(13)(iv)(B)(1). See also 2003 Adopting Release, 68 FR at 64955.

¹⁰⁰ Id.

¹⁰¹ See, e.g., text accompanying supra note 97.

However, we preliminary do not believe that the proposed modification to the “merger exclusion” would significantly hinder a SPAC’s ability to complete an acquisition or other covered transaction. The proposed modification is designed to maintain reasonable limits on the availability of the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer. Moreover, even with the proposed modification to the “merger exclusion,” SPAC issuers, similar to other issuers, would still be able to effect other repurchases (i.e., privately negotiated repurchases) and certain ordinary course Rule 10b-18 purchases following the announcement of a merger or covered transaction (subject to Regulation M’s restricted period and any other applicable restriction) so long as the total amount of the issuer’s Rule 10b-18 purchases effected on any single day does not exceed the lesser of 25% of the security’s four-week ADTV or the issuer’s average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction.¹⁰² As such, we do not believe that the proposed modification to the “merger exclusion” would unfairly hinder a SPAC’s ability to complete an acquisition or other covered transaction. In fact, by extending the “merger exclusion” to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders), the proposal would simply make the safe harbor unavailable to SPAC issuers during the period when the incentive to engage in substantial repurchases to facilitate a corporate action is greatest.¹⁰³ We also note that some SPAC issuers may conduct privately

¹⁰² See 17 CFR 240.10b-18(a)(13)(iv)(B)(1). See also 2003 Adopting Release, 68 FR at 64955.

¹⁰³ Proposed Rule 10b-18(a)(13)(iv).

negotiated repurchases for which the safe harbor is already unavailable. As such, this proposal would not trigger new costs for that purchasing activity. Nevertheless, the Commission seeks estimates of any potential costs associated with the proposed modification to the “merger exclusion,” including the extent to which, if at all, the proposed modification would affect a SPAC’s ability to effect issuer repurchases within the safe harbor or otherwise complete an acquisition or other covered transaction.

B. Benefits

The proposed amendments would update the safe harbor in light of market developments since the 2003 Adopting Release, as well as provide issuers with greater flexibility to conduct their issuer repurchase programs within the safe harbor without sacrificing investor protection or market integrity. The proposed amendments would allow issuer repurchases under conditions designed to reduce the potential for manipulative abuse without either imposing undue restrictions on the operation of issuer repurchases or undermining the economic benefit such purchases provide investors, issuers, and the marketplace. In addition, the proposed amendments would provide clarity as to the scope of permissible market activity for issuers and the broker-dealers that assist them in their repurchasing. Many issuers may be reluctant to repurchase without the certainty that their activity comes within the safe harbor. If an issuer effects repurchases in compliance with Rule 10b-18, it may avoid what might otherwise be substantial and unpredictable risks of liability under the anti-manipulative provisions of the Exchange Act. Therefore, the safe harbor may provide increased liquidity to the marketplace from issuers that would not repurchase but for the safe harbor.

The proposed modification to the timing condition would maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the

issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer. As such, the proposed condition would establish additional reasonable limits on issuer activity that may influence market prices at or near the open. In addition, the amendment would allow issuers to carry out their repurchase programs more effectively by providing issuers with guidance in complying with Rule 10b-18's opening purchase limitation, particularly when, for example, the principal market has a delayed opening in a stock and another exchange's smaller opening transaction is reported in the consolidated system first.

The proposed VWAP exception from the Rule's price condition would provide issuers and their brokers with flexibility and greater certainty in effecting qualifying VWAP transactions within the safe harbor. The proposed VWAP exception to the Rule's price condition also may increase the likelihood that firms would engage in open market repurchases since the price condition would be less restrictive for such transactions. As such, the proposed VWAP exception may further provide increased liquidity to the marketplace.

In addition, if an issuer's repurchase meets all of the conditions under Rule 10b-18 but fails to meet the Rule's price condition due solely to flickering quotes, the proposed limitation to the general disqualification provision would disqualify only this otherwise compliant Rule 10b-18 purchase, rather than disqualifying all of the issuer's other purchases from the safe harbor for that day. The proposed amendments to the disqualification provision under the Rule also may increase the likelihood that firms would engage in open market repurchases since the execution of an otherwise compliant Rule 10b-18 purchase in a fast moving market would no longer jeopardize the availability of the safe harbor for all of an issuer's other Rule 10b-18 purchases

that day. As such, the proposed limitations to the general disqualification provision may further provide increased liquidity to the marketplace.

The proposal to modify the “merger exclusion” under the Rule in connection with a SPAC acquisition, merger, or similar transaction is designed to maintain the integrity of the safe harbor by narrowing its use where an issuer is under considerable pressure to complete an acquisition, merger, or similar transaction and effects a substantial amount of open market repurchases solely to facilitate the intended merger or other covered transaction. Additionally, as discussed above, these open market repurchases can have the effect of supporting and/or raising the market price of the SPAC shares, and cause other investors to buy up shares in the SPAC in the open market when they might not otherwise have done so. Thus, the proposed modification would maintain reasonable limits on the availability of the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer and, therefore, help to promote price efficiency in the marketplace.

The Commission encourages commenters to provide empirical data or other facts to support their views concerning these and any other benefits not mentioned here.

VII. 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 whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.¹⁰⁴ In addition, Section 23(a)(2) of the Exchange Act requires

¹⁰⁴ 15 U.S.C. 78c(f).

the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.¹⁰⁵ Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We believe the proposed amendments would have minimal impact on the promotion of price efficiency and capital formation and preliminarily believe that these proposals would promote efficiency, competition and capital formation by enhancing market transparency, promoting liquidity in issuer securities and providing clarity to market participants engaging in issuer repurchases.

First, the proposed modification to the timing condition would promote price transparency in issuer securities. The proposed modifications to Rule 10b-18's timing condition are designed to minimize the market impact of an issuer's repurchases during a period (the market open) where market activity is considered to be a significant indicator of the direction of trading, the strength of demand, and the current market value of the security. This additional, reasonable limit on issuer activity, consistent with the objectives of the Rule, would allow the market to establish a security's price based on independent market forces without undue influence by the issuer, thereby further promoting price transparency at the market open. Second, the proposed amendments to the Rule would promote increased liquidity in issuer securities, by providing issuers with additional flexibility to conduct their repurchase programs more effectively and within the safe harbor. For example, the proposed VWAP exception to the safe harbor's existing price condition may increase the likelihood that firms would engage in open market purchases, thereby potentially providing increased liquidity in issuers' securities.

¹⁰⁵ 15 U.S.C. 78c(f).

Finally, the commission preliminarily believes that the proposed amendments should improve market efficiency by providing greater clarity and uniformity of the safe harbor conditions. It is our understanding that significant market changes with respect to trading strategies and developments in automated trading systems that have increased the speed of trading (evidenced by flickering quotes) have made it increasingly difficult for issuer to operate within the Rule. As such, the proposed modifications to the Rule would clarify and modernize the Rule's provisions in light of market developments since the Rule's adoption, providing the market with additional comfort while engaging in issuer repurchases.

In addition, we believe that the proposed modification to the "merger exclusion" in connection with SPAC acquisitions would have minimal impact on the promotion of price efficiency and capital formation. While the proposed modification may impact an issuer's ability to effect all of their issuer repurchases within the safe harbor, the proposed modification is designed to maintain reasonable limits on the availability of the safe harbor¹⁰⁶ consistent with the objectives of the Rule to minimize the market impact of the issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer. An efficient market generally promotes capital formation. Moreover, even with the proposed modification to the "merger exclusion," SPAC issuers, similar to other issuers, would still be able to effect other repurchases (i.e., privately negotiated repurchases) and certain ordinary course Rule 10b-18 purchases following the announcement of a merger or covered transaction (subject to Regulation M's restricted period and any other

¹⁰⁶ As discussed above, because the benefit of a safe harbor is only appropriate during "normal" market conditions, and not where there is a heightened incentive to engage in substantial repurchase activity solely to facilitate a corporate action, we believe that extending the "merger exclusion" to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders) is warranted. See also supra note 80.

applicable restriction) so long as the total amount of the issuer's Rule 10b-18 purchases effected on any single day does not exceed the lesser of 25% of the security's four-week ADTV or the issuer's average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction.¹⁰⁷ As such, we do not believe that the proposed modification to the "merger exclusion" would unfairly hinder a SPAC's ability to complete an acquisition or other covered transaction. In fact, by extending the "merger exclusion" to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders), the proposal would simply make the safe harbor unavailable to SPAC issuers when the incentive to engage in substantial repurchases to facilitate a corporate action is greatest.¹⁰⁸

The Commission has considered the proposed amendments in light of the standards cited in Section 23(a)(2) and believes preliminarily that, if adopted, they would not likely impose any significant burden on competition not necessary or appropriate in furtherance of the Exchange Act. We believe the proposed VWAP exception to the Rule's price condition, the proposed amendments to the Rule's opening purchase condition, and the proposed limitation of the general disqualification provision under the Rule might help to avoid undermining competition by increasing the likelihood that more issuers will be able to effect qualifying Rule 10b-18 repurchases within the safe harbor. In addition, we believe that the proposed modification to the "merger exclusion" in connection with a SPAC acquisition would have a minimal impact on competition as SPAC issuers, similar to other issuers, would still be able to effect other

¹⁰⁷ See 17 CFR 240.10b-18(a)(13)(iv)(B)(1). See also 2003 Adopting Release, 68 FR at 64955.

¹⁰⁸ Proposed Rule 10b-18(a)(13)(iv).

repurchases (i.e., privately negotiated repurchases) and certain ordinary course Rule 10b-18 purchases following the announcement of a merger or other acquisition. Moreover, Rule 10b-18 is a safe harbor rather than a mandatory rule, and as such, issuers choose whether or not to use it. Many issuers might be reluctant to repurchase without the safe harbor. Therefore, the safe harbor may provide increased liquidity to the marketplace from issuers that would not repurchase but for the safe harbor. Issuers also have the option to repurchase securities outside the Rule 10b-18 safe harbor conditions without raising a presumption of manipulation. Moreover, the proposed version of the Rule 10b-18 safe harbor, like the current Rule, would apply to all issuers. Thus, we do not believe the proposed amendments would have a significant effect on competition because all issuers have the option of complying with the manner, volume, time and price conditions.

The Commission requests 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 views if possible.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"¹⁰⁹ we must advise the Office of Management and Budget 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:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);

¹⁰⁹ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. and as a note to 5 U.S.C. 601).

- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effect on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed 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 Act Certification

Section 3(a) of the Regulatory Flexibility Act ("RFA")¹¹⁰ requires the Commission to undertake an initial regulatory flexibility analysis of a proposed rule on small entities, unless the Commission certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.¹¹¹ Pursuant to Section 605(b) of the RFA, the Commission hereby certifies that the proposed amendments to Rule 10b-18, would not, if adopted, have a significant economic impact on a substantial number of small entities.

The proposed amendments are intended to clarify and modernize the safe harbor provisions. In particular, the proposal to modify the price condition is intended to provide issuers with greater flexibility to conduct their issuer repurchase programs within the safe harbor under conditions designed to reduce the potential for abuse. The proposal to limit the general disqualification provision is intended to provide issuers with additional flexibility to conduct their share repurchase programs in fast moving markets. At the same time, the proposals to modify the timing condition and the "merger exclusion" provision are intended to maintain

¹¹⁰ 5 U.S.C. 603(a).

¹¹¹ 5 U.S.C. 605(b).

reasonable limits on the safe harbor while furthering the objectives of Rule 10b-18. The Commission believes that the proposed amendments would impose negligible costs, if any, on issuers and would not, if adopted, have a significant impact on a substantial number of small entities. Based on Exchange Act Rule 0-10, a small issuer is one that on the last day of its most recent fiscal year had total assets of \$5,000,000 or less. The Commission believes that the majority of issuers effecting repurchase programs are not small entities.¹¹² Moreover, any costs related to complying with the proposed amendments to Rule 10b-18 would be assumed voluntarily because the Rule provides an optional safe harbor.

We encourage written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact. In particular, the Commission requests comment on: (i) the number of small entities that would be affected by the proposed amendments to the Rule, (ii) the nature of any impact the proposed amendments would have on small entities and empirical data supporting the extent of the impact, and (iii) how to quantify the number of small entities that would be affected by or how to quantify the impact of the proposed amendments.

X. Statutory Basis and Text of Proposed Amendment

The Rule amendments are being proposed pursuant to Sections 2, 3, 9(a)(6), 10(b), 12, 13(e), 15, 15(c), 23(a) of the Exchange Act, 15 U.S.C. 78b, 78c, 78i(a)(6), 78j(b), 78l, 78m(e), 78o, 78o(c), and 78w(a).

List of Subjects

17 CFR Part 240

¹¹² The Commission's OEA estimates that, of the 2,218 issuers that announced repurchases during the years 2005 through 2008 (and that had total asset figures available), only 25 had assets below \$5 million. Source: Securities Data Company "SDC" database.

Brokers, Dealers, Issuers, Securities.

For the reasons set forth 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 240.10b-18 is amended by:

- a. Revising the next to last sentence of the Preliminary Note 1;
- b. Revising the term "Item 15(e)" to read "Item 16E" in Preliminary Note 2;
- c. Revising paragraph (a)(5)(iii) and the introductory text of paragraph (a)(13)(iv);
- d. Adding paragraph (a)(14); and
- e. Revising paragraphs (b)(2)(i), (b)(3)(i) and (d).

The addition and revisions read as follows:

§ 240.10b-18 Purchases of certain equity securities by the issuer and others.

* * * * *

1. * * * Except as provided in paragraph (d)(2) of this section, failure to meet any one of the four conditions will remove all of the issuer's repurchases from the safe harbor for that day. * * *

* * * * *

(a) * * *

(5) * * *

(iii) Is at least 20 round lots of the security and totals 150 percent or more of the ADTV for that security or, in the event that ADTV data are unavailable, is at least 20 round lots of the security and totals at least one-tenth of one percent (.001) of the outstanding shares of the security, exclusive of any shares owned by any affiliate; Provided, however, That a block under paragraph (a)(5)(i), (ii), and (iii) of this section shall not include any amount a broker or dealer, acting as principal, has accumulated for the purpose of sale or resale to the issuer or to any affiliated purchaser of the issuer if the issuer or such affiliated purchaser knows or has reason to know that such amount was accumulated for such purpose, nor shall it include any amount that a broker or dealer has sold short to the issuer or to any affiliated purchaser of the issuer if the issuer or such affiliated purchaser knows or has reason to know that the sale was a short sale.

* * * * *

(13) * * *

(iv) Effected during the period from the time of public announcement (as defined in §230.165(f) of this chapter) of a merger, acquisition, or similar transaction involving a recapitalization, until either the earlier of the completion of such transaction or the completion of the vote by target shareholders or, in the case of an acquisition or other covered transaction by a special purpose acquisition company ("SPAC"), the earlier of the completion of such transaction or the completion of the votes by the target and SPAC shareholders. This exclusion does not apply to Rule 10b-18 purchases:

* * * * *

(14) Rule 10b-18 VWAP purchase means a purchase effected at the volume-weighted average price ("VWAP") by or on behalf of an issuer or an affiliated purchaser of the issuer that meets the conditions of paragraphs (b)(1), (b)(2), and (b)(4) of this section and the following criteria:

(i) The purchase is for a security that qualifies as an "actively-traded security" (as defined in §242.101(c)(1) of this chapter);

(ii) The purchase is entered into or matched before the opening of the regular trading session;

(iii) The execution price of the VWAP purchase is determined based on all regular way trades effected in accordance with the conditions of paragraphs (b)(2) and (b)(3) of this section that are reported in the consolidated system during the primary trading session for the security;

(iv) The purchase does not exceed 10% of the security's relevant average daily trading volume;

(v) The purchase is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security;

(vi) The VWAP assigned to the purchase is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system during the regular trading session, except as provided in paragraph (a)(14)(iii) of this section, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of trade reported shares for that day in the security that represent regular way trades effected in accordance with the conditions of

paragraphs (b)(2) and (b)(3) of this section that are reported in the consolidated system during the primary trading session for the security; and

(vii) The purchase is reported using a special VWAP trade modifier.

(b) * * *

(2) * * *

(i) The opening regular way purchase reported in the consolidated system, the opening regular way purchase in the principal market for the security, and the opening regular way purchase in the market where the purchase is effected;

* * * * *

(3) * * *

(i) Does not exceed the highest independent bid or the last independent transaction price, whichever is higher, quoted or reported in the consolidated system at the time the Rule 10b-18 purchase is effected; Provided, however, that Rule 10b-18 VWAP purchases, as defined in paragraph (a)(14) of this section, shall be deemed to satisfy paragraph (b)(3)(i) of this section;

* * * * *

(d) Other purchases. (1) No presumption shall arise that an issuer or an affiliated purchaser has violated the anti-manipulation provisions of section 9(a)(2) or 10(b) of the Act (15 U.S.C. 78i(a)(2) or 78j(b)), or §240.10b-5, if the Rule 10b-18 purchases of such issuer or affiliated purchaser do not meet the conditions specified in paragraph (b) or (c) of this section; and

(2) A Rule 10b-18 purchase of an issuer or affiliated purchaser that meets the conditions specified in paragraph (b) or (c) of this section at the time the purchase order is entered but does not meet the price condition specified in paragraph (b)(3)(i) of this section at the time the purchase is effected due to flickering quotes shall remove only such purchase, rather than all of the issuer's other Rule 10b-18 purchases, from the safe harbor for that day.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

Dated: January 25, 2010

III.

The Commission, having considered the aforesaid information, deems it appropriate and in the public interest that public proceedings pursuant to Section 8(d) of the Securities Act be, and they hereby are, instituted with respect to the registration statement to determine whether the allegations of the Division of Enforcement, as set forth in the Statement of Matters attached hereto and incorporated herein by reference, are true; to afford registrant with an opportunity to establish any defenses to these allegations; and to determine whether a stop order should issue suspending the effectiveness of the Tsukuda registration statement referred to herein. Accordingly,

IT IS ORDERED that public proceedings be and hereby are instituted under Securities Act Section 8(d), such hearing to be commenced at 10:00 a.m. on February 9, 2010, at the Commission's offices at 801 Brickell Ave., Suite 1800, Miami, FL 33131, and to continue thereafter at such time and place as the hearing officer may determine.

IT IS FURTHER ORDERED, in the interest of justice and without prejudice to any party, 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 and Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c).

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, in the interest of justice and without prejudice to any party, that the Administrative Law Judge shall issue an initial decision no later than 60 days from the date of service of this Order, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c).

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 and
Commissioner Aguilar
not participating*

**Administrative Proceeding
File No. 3-13761**

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

-----:
In the Matter of :
: **Statement Of Matters**
Registration Statement of : **Of The Division Of**
: **Enforcement To Be**
Tsukuda-America Inc. : **Considered At A Public**
519 East Interstate 30, Suite #248 : **Hearing Pursuant To**
Rockwall, Texas 75087 : **Section 8(d) Of The**
: **Securities Act Of 1933**
-----:

I

On or about March 27, 2009, Tsukuda-America Inc. ("Tsukuda") filed a registration statement on Form S-1 with the Commission, and on or about April 10, 2009, it filed an amended statement on Form S-1VA. The registration statement was declared effective on April 14, 2009. The registration statement included an audit report on the financial statements of Tsukuda purportedly made by Weinberg & Company, P.A. ("Weinberg"), an accounting firm in Boca Raton, Florida, and a consent to the inclusion of the audit report in the registration statement purportedly signed on behalf of Weinberg. The Division of Enforcement alleges that the registration statement included untrue statements of material fact and omitted material facts. The following are the matters to be considered at a hearing pursuant to Section 8(d) of the Securities Act of 1933 to determine whether a stop order should be issued with respect to the registration statement.

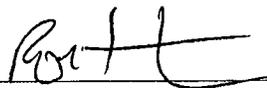
II

The registration statement, as originally filed and as amended, includes untrue statements of material fact and omits material facts, including but not limited to, the false representation that Weinberg audited, and prepared an audit report upon, the financial statements of Tsukuda, and that Weinberg consented to the inclusion of the audit report in Tsukuda's registration statement, and the omission to disclose that the audit report and consent were not legitimate, in violation of the requirements of the Securities Act and the Commission's forms and regulations governing the offer and sale of securities to the public.

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Accordingly, the Division of Enforcement believes that a stop order should be issued suspending the effectiveness of Tsukuda's registration statement, pending its correction of these deficiencies.

Date: 1/22/2010



Robert Long
Division of Enforcement
United States Securities and
Exchange Commission
801 Cherry Street, Suite 1800
Fort Worth, TX 76102
Tel: 817-978-6477
Fax: 817-978-4927
Email: LongR@sec.gov

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61420 / January 26, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13762

In the Matter of

**PCC Group, Inc.,
Play Co. Toys & Entertainment Corp.,
Point West Capital Corp.,
Power Spectra, Inc.,
Preference Technologies, Inc.,
Preferred Financial Resources, Inc.
(n/k/a Copper Financial Resources, Inc.),
Pro-Market Global plc,
Progenitor, Inc.,
PSA, Inc.
(n/k/a Shearson American REIT, Inc.), and
Purchasesoft, 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 PCC Group, Inc., Play Co. Toys & Entertainment Corp., Point West Capital Corp., Power Spectra, Inc., Preference Technologies, Inc., Preferred Financial Resources, Inc. (n/k/a Copper Financial Resources, Inc.), Pro-Market Global plc, Progenitor, Inc., PSA, Inc. (n/k/a Shearson American REIT, Inc.), and Purchasesoft, Inc.

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II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. PCC Group, Inc. (CIK No. 756972) is a suspended California corporation located in Pomona, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PCC Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2000, which reported a net loss of over \$1.13 million for the prior nine months.

2. Play Co. Toys & Entertainment Corp. (CIK No. 927643) is a void Delaware corporation located in San Marcos, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Play Co. Toys 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, 2000, which reported a net loss of over \$7.6 million for the prior nine months. As of January 21, 2010, the company's stock (symbol "PLCO") was traded on the over-the-counter markets.

3. Point West Capital Corp. (CIK No. 1002813) is a void Delaware corporation located in San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Point West 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. On September 24, 2004, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of California, which was still pending as of January 22, 2010. As of January 21, 2010, the company's stock (symbol "PWCCQ") was quoted on Pink Sheets operated by Pink OTC Markets, Inc. and had one market maker.

4. Power Spectra, Inc. (CIK No. 777527) is a suspended California corporation located in Sunnyvale, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Power Spectra 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 \$1.6 million for the prior nine months. As of January 21, 2010, the company's stock (symbol "PWSP") was traded on the over-the-counter markets.

5. Preference Technologies, Inc. (CIK No. 1083846) is a permanently revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Preference 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 \$22.8 million for the prior three months. As of January 21, 2010, the company's stock (symbol "PFER") was traded on the over-the-counter markets.

6. Preferred Financial Resources, Inc. (n/k/a Copper Financial Resources, Inc.) (CIK No. 24581) is a Colorado corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Preferred 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, 2004, which reported a net loss of \$3,533 for the prior three months.

7. Pro-Market Global plc (CIK No. 1133384) is a dissolved England and Wales corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pro-Market is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a net loss of \$5.3 million for the prior twelve months.

8. Progenitor, Inc. (CIK No. 936537) is a dissolved Delaware corporation located in Menlo Park, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Progenitor 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 \$10.5 million for the prior nine months.

9. PSA, Inc. (n/k/a Shearson American REIT, Inc.) (CIK No. 1065001) is a Nevada corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PSA 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. As of January 21, 2010, the company's stock (symbol "PSAZ") was traded on the over-the-counter markets.

10. PurchaseSoft, Inc. (CIK No. 727063) is a void Delaware corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PurchaseSoft 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 February 28, 2007, which reported a net loss of \$50,076 for the prior six months. The company also failed to make periodic filings between the periods ended February 28, 2005 and May 31, 2006. As of January 21, 2010, the company's stock (symbol "PSFX") 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 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.

Elizabeth M. Murphy
Secretary

Attachment

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

Appendix 1

**Chart of Delinquent Filings
In the Matter of PCC Group, Inc., et al.**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
PCC Group, Inc.	10-K	09/30/00	12/29/00	Not filed	109
	10-Q	12/31/00	02/14/01	Not filed	107
	10-Q	03/31/01	05/15/01	Not filed	104
	10-Q	06/30/01	08/14/01	Not filed	101
	10-K	09/30/01	12/31/01	Not filed	97
	10-Q	12/31/01	02/14/02	Not filed	95
	10-Q	03/31/02	05/15/02	Not filed	92
	10-Q	06/30/02	08/14/02	Not filed	89
	10-K	09/30/02	12/30/02	Not filed	85
	10-Q	12/31/02	02/14/03	Not filed	83
	10-Q	03/31/03	05/15/03	Not filed	80
	10-Q	06/30/03	08/14/03	Not filed	77
	10-K	09/30/03	12/29/03	Not filed	73
	10-Q	12/31/03	02/17/04	Not filed	71
	10-Q	03/31/04	05/17/04	Not filed	68
	10-Q	06/30/04	08/16/04	Not filed	65
	10-K	09/30/04	12/29/04	Not filed	61
	10-Q	12/31/04	02/14/05	Not filed	59
	10-Q	03/31/05	05/16/05	Not filed	56
	10-Q	06/30/05	08/15/05	Not filed	53
	10-K	09/30/05	12/29/05	Not filed	49
	10-Q	12/31/05	02/14/06	Not filed	47
	10-Q	03/31/06	05/15/06	Not filed	44
	10-Q	06/30/06	08/14/06	Not filed	41
	10-K	09/30/06	12/29/06	Not filed	37
	10-Q	12/31/06	02/14/07	Not filed	35
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-K	09/30/00	12/29/00	Not filed	109
	10-K	09/30/07	12/31/07	Not filed	25
	10-Q	12/31/07	02/14/08	Not filed	23
	10-Q	03/31/08	05/15/08	Not filed	20
10-Q	06/30/08	08/14/08	Not filed	17	
10-K	09/30/08	12/29/08	Not filed	13	
10-Q	12/31/08	02/17/09	Not filed	11	

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
PCC Group, Inc. (continued)	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-K	09/30/09	12/29/09	Not filed	1

Total Filings Delinquent **38**

Play Co. Toys & Entertainment Corp.

10-K	03/31/01	06/29/01	Not filed	103
10-Q	06/30/01	08/14/01	Not filed	101
10-Q	09/30/01	11/14/01	Not filed	98
10-Q	12/31/01	02/14/02	Not filed	95
10-K	03/31/02	07/01/02	Not filed	90
10-Q	06/30/02	08/14/02	Not filed	89
10-Q	09/30/02	11/14/02	Not filed	86
10-Q	12/31/02	02/14/03	Not filed	83
10-K	03/31/03	06/30/03	Not filed	79
10-Q	06/30/03	08/14/03	Not filed	77
10-Q	09/30/03	11/14/03	Not filed	74
10-Q	12/31/03	02/17/04	Not filed	71
10-K	03/31/04	06/29/04	Not filed	67
10-Q	06/30/04	08/16/04	Not filed	65
10-Q	09/30/04	11/15/04	Not filed	62
10-Q	12/31/04	02/14/05	Not filed	59
10-K	03/31/05	06/29/05	Not filed	55
10-Q	06/30/05	08/15/05	Not filed	53
10-Q	09/30/05	11/14/05	Not filed	50
10-Q	12/31/05	02/14/06	Not filed	47
10-K	03/31/06	06/29/06	Not filed	43
10-Q	06/30/06	08/14/06	Not filed	41
10-Q	09/30/06	11/14/06	Not filed	38
10-Q	12/31/06	02/14/07	Not filed	35
10-K	03/31/07	06/29/07	Not filed	31
10-Q	06/30/07	08/14/07	Not filed	29
10-Q	09/30/07	11/14/07	Not filed	26
10-Q	12/31/07	02/14/08	Not filed	23
10-K	03/31/08	06/30/08	Not filed	19
10-Q	06/30/08	08/14/08	Not filed	17
10-Q	09/30/08	11/14/08	Not filed	14

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Play Co. Toys & Entertainment Corp. (continued)	10-Q	12/31/08	02/17/09	Not filed	11
	10-K	03/31/09	06/30/09	Not filed	7
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2

Total Filings Delinquent **35**

Point West Capital Corp.

10-KSB	12/31/02	03/31/03	Not filed	82
10-QSB	03/31/03	05/15/03	Not filed	80
10-QSB	06/30/03	08/14/03	Not filed	77
10-QSB	09/30/03	11/14/03	Not filed	74
10-KSB	12/31/03	03/30/04	Not filed	70
10-QSB	03/31/04	05/17/04	Not filed	68
10-QSB	06/30/04	08/16/04	Not filed	65
10-QSB	09/30/04	11/15/04	Not filed	62
10-KSB	12/31/04	03/31/05	Not filed	58
10-QSB	03/31/05	05/16/05	Not filed	56
10-QSB	06/30/05	08/15/05	Not filed	53
10-QSB	09/30/05	11/14/05	Not filed	50
10-KSB	12/31/05	03/31/06	Not filed	46
10-QSB	03/31/06	05/15/06	Not filed	44
10-QSB	06/30/06	08/14/06	Not filed	41
10-QSB	09/30/06	11/14/06	Not filed	38
10-KSB	12/31/06	04/02/07	Not filed	33
10-QSB	03/31/07	05/15/07	Not filed	32
10-QSB	06/30/07	08/14/07	Not filed	29
10-QSB	09/30/07	11/14/07	Not filed	26
10-KSB	12/31/07	03/31/08	Not filed	22
10-Q*	03/31/08	05/15/08	Not filed	20
10-Q*	06/30/08	08/14/08	Not filed	17
10-Q*	09/30/08	11/14/08	Not filed	14
10-K*	12/31/08	04/01/09	Not filed	9
10-Q*	03/31/09	05/15/09	Not filed	8
10-Q*	06/30/09	08/14/09	Not filed	5
10-Q*	09/30/09	11/16/09	Not filed	2

Total Filings Delinquent **27**

Company Name
Power Spectra, Inc.

Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
10-K	12/31/98	03/31/99	Not filed	130
10-Q	03/31/99	05/17/99	Not filed	128
10-Q	06/30/99	08/16/99	Not filed	125
10-Q	09/30/99	11/15/99	Not filed	122
10-K	12/31/99	03/30/00	Not filed	118
10-Q	03/31/00	05/15/00	Not filed	116
10-Q	06/30/00	08/14/00	Not filed	113
10-Q	09/30/00	11/14/00	Not filed	110
10-K	12/31/00	04/02/01	Not filed	105
10-Q	03/31/01	05/15/01	Not filed	104
10-Q	06/30/01	08/14/01	Not filed	101
10-Q	09/30/01	11/14/01	Not filed	98
10-K	12/31/01	04/01/02	Not filed	93
10-Q	03/31/02	05/15/02	Not filed	92
10-Q	06/30/02	08/14/02	Not filed	89
10-Q	09/30/02	11/14/02	Not filed	86
10-K	12/31/02	03/31/03	Not filed	82
10-Q	03/31/03	05/15/03	Not filed	80
10-Q	06/30/03	08/14/03	Not filed	77
10-Q	09/30/03	11/14/03	Not filed	74
10-K	12/31/03	03/30/04	Not filed	70
10-Q	03/31/04	05/17/04	Not filed	68
10-Q	06/30/04	08/16/04	Not filed	65
10-Q	09/30/04	11/15/04	Not filed	62
10-K	12/31/04	03/31/05	Not filed	58
10-Q	03/31/05	05/16/05	Not filed	56
10-Q	06/30/05	08/15/05	Not filed	53
10-Q	09/30/05	11/14/05	Not filed	50
10-K	12/31/05	03/31/06	Not filed	46
10-Q	03/31/06	05/15/06	Not filed	44
10-Q	06/30/06	08/14/06	Not filed	41
10-Q	09/30/06	11/14/06	Not filed	38
10-K	12/31/06	04/02/07	Not filed	33
10-Q	03/31/07	05/15/07	Not filed	32
10-Q	06/30/07	08/14/07	Not filed	29
10-Q	09/30/07	11/14/07	Not filed	26
10-K	12/31/07	03/31/08	Not filed	22
10-Q	03/31/08	05/15/08	Not filed	20
10-Q	06/30/08	08/14/08	Not filed	17
10-Q	09/30/08	11/14/08	Not filed	14

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Power Spectra, Inc. (continued)	10-K	12/31/08	04/01/09	Not filed	9
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2
Total Filings Delinquent				44	

Preference Technologies, Inc.

10-K	12/31/00	04/02/01	Not filed	105
10-Q	03/31/01	05/15/01	Not filed	104
10-Q	06/30/01	08/14/01	Not filed	101
10-Q	09/30/01	11/14/01	Not filed	98
10-K	12/31/01	04/01/02	Not filed	93
10-Q	03/31/02	05/15/02	Not filed	92
10-Q	06/30/02	08/14/02	Not filed	89
10-Q	09/30/02	11/14/02	Not filed	86
10-K	12/31/02	03/31/03	Not filed	82
10-Q	03/31/03	05/15/03	Not filed	80
10-Q	06/30/03	08/14/03	Not filed	77
10-Q	09/30/03	11/14/03	Not filed	74
10-K	12/31/03	03/30/04	Not filed	70
10-Q	03/31/04	05/17/04	Not filed	68
10-Q	06/30/04	08/16/04	Not filed	65
10-Q	09/30/04	11/15/04	Not filed	62
10-K	12/31/04	03/31/05	Not filed	58
10-Q	03/31/05	05/16/05	Not filed	56
10-Q	06/30/05	08/15/05	Not filed	53
10-Q	09/30/05	11/14/05	Not filed	50
10-K	12/31/05	03/31/06	Not filed	46
10-Q	03/31/06	05/15/06	Not filed	44
10-Q	06/30/06	08/14/06	Not filed	41
10-Q	09/30/06	11/14/06	Not filed	38
10-K	12/31/06	04/02/07	Not filed	33
10-Q	03/31/07	05/15/07	Not filed	32
10-Q	06/30/07	08/14/07	Not filed	29
10-Q	09/30/07	11/14/07	Not filed	26
10-K	12/31/07	03/31/08	Not filed	22
10-Q	03/31/08	05/15/08	Not filed	20
10-Q	06/30/08	08/14/08	Not filed	17
10-Q	09/30/08	11/14/08	Not filed	14

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Preference Technologies, Inc. (continued)	10-K	12/31/08	04/01/09	Not filed	9
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2

Total Filings Delinquent **36**

Preferred Financial Resources, Inc.
(n/k/a Copper Financial Resources, Inc.)

10-KSB	04/30/04	07/29/04	Not filed	66
10-QSB	07/31/04	09/14/04	Not filed	64
10-QSB	10/31/04	12/15/04	Not filed	61
10-QSB	01/31/05	03/17/05	Not filed	58
10-KSB	04/30/05	07/29/05	Not filed	54
10-QSB	07/31/05	09/14/05	Not filed	52
10-QSB	10/31/05	12/15/05	Not filed	49
10-QSB	01/31/06	03/17/06	Not filed	46
10-KSB	04/30/06	07/31/06	Not filed	42
10-QSB	07/31/06	09/14/06	Not filed	40
10-QSB	10/31/06	12/15/06	Not filed	37
10-QSB	01/31/07	03/19/07	Not filed	34
10-KSB	04/30/07	07/30/07	Not filed	30
10-QSB	07/31/07	09/14/07	Not filed	28
10-QSB	10/31/07	12/17/07	Not filed	25
10-QSB	01/31/08	03/17/08	Not filed	22
10-KSB	04/30/08	07/29/08	Not filed	18
10-Q*	07/31/08	09/15/08	Not filed	16
10-Q*	10/31/08	12/15/08	Not filed	13
10-Q*	01/31/09	03/18/09	Not filed	10
10-K*	04/30/09	07/29/09	Not filed	6
10-Q*	07/31/09	09/15/09	Not filed	4
10-Q*	10/31/09	12/15/09	Not filed	1

Total Filings Delinquent **23**

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Pro-Market Global plc	20-F	12/31/02	06/30/03	Not filed	79
	20-F	12/31/03	06/30/04	Not filed	67
	20-F	12/31/04	06/30/05	Not filed	55
	20-F	12/31/05	06/30/06	Not filed	43
	20-F	12/31/06	07/02/07	Not filed	30
	20-F	12/31/07	06/30/08	Not filed	19
	20-F	12/31/08	06/30/09	Not filed	7
	Total Filings Delinquent				7

Progenitor, Inc.

10-K	09/30/98	12/29/98	Not filed	133
10-Q	12/31/98	02/16/99	Not filed	131
10-Q	03/31/99	05/17/99	Not filed	128
10-Q	06/30/99	08/16/99	Not filed	125
10-K	09/30/99	12/29/99	Not filed	121
10-Q	12/31/99	02/14/00	Not filed	119
10-Q	03/31/00	05/15/00	Not filed	116
10-Q	06/30/00	08/14/00	Not filed	113
10-K	09/30/00	12/29/00	Not filed	109
10-Q	12/31/00	02/14/01	Not filed	107
10-Q	03/31/01	05/15/01	Not filed	104
10-Q	06/30/01	08/14/01	Not filed	101
10-K	09/30/01	12/31/01	Not filed	97
10-Q	12/31/01	02/14/02	Not filed	95
10-Q	03/31/02	05/15/02	Not filed	92
10-Q	06/30/02	08/14/02	Not filed	89
10-K	09/30/02	12/30/02	Not filed	85
10-Q	12/31/02	02/14/03	Not filed	83
10-Q	03/31/03	05/15/03	Not filed	80
10-Q	06/30/03	08/14/03	Not filed	77
10-K	09/30/03	12/29/03	Not filed	73
10-Q	12/31/03	02/17/04	Not filed	71
10-Q	03/31/04	05/17/04	Not filed	68
10-Q	06/30/04	08/16/04	Not filed	65
10-K	09/30/04	12/29/04	Not filed	61
10-Q	12/31/04	02/14/05	Not filed	59
10-Q	03/31/05	05/16/05	Not filed	56
10-Q	06/30/05	08/15/05	Not filed	53

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Progenitor, Inc. (continued)	10-K	09/30/05	12/29/05	Not filed	49
	10-Q	12/31/05	02/14/06	Not filed	47
	10-Q	03/31/06	05/15/06	Not filed	44
	10-Q	06/30/06	08/14/06	Not filed	41
	10-K	09/30/06	12/29/06	Not filed	37
	10-Q	12/31/06	02/14/07	Not filed	35
	10-Q	03/31/07	05/15/07	Not filed	32
	10-Q	06/30/07	08/14/07	Not filed	29
	10-K	09/30/07	12/31/07	Not filed	25
	10-Q	12/31/07	02/14/08	Not filed	23
	10-Q	03/31/08	05/15/08	Not filed	20
	10-Q	06/30/08	08/14/08	Not filed	17
	10-K	09/30/08	12/29/08	Not filed	13
	10-Q	12/31/08	02/17/09	Not filed	11
	10-Q	03/31/09	05/15/09	Not filed	8
	10-Q	06/30/09	08/14/09	Not filed	5
	10-Q	09/30/09	11/16/09	Not filed	2

Total Filings Delinquent

44

PSA, Inc.
(n/k/a Shearson American REIT, Inc.)

10-KSB	12/31/01	04/01/02	Not filed	93
10-QSB	03/31/02	05/15/02	Not filed	92
10-QSB	06/30/02	08/14/02	Not filed	89
10-QSB	09/30/02	11/14/02	Not filed	86
10-KSB	12/31/02	03/31/03	Not filed	82
10-QSB	03/31/03	05/15/03	Not filed	80
10-QSB	06/30/03	08/14/03	Not filed	77
10-QSB	09/30/03	11/14/03	Not filed	74
10-KSB	12/31/03	03/30/04	Not filed	70
10-QSB	03/31/04	05/17/04	Not filed	68
10-QSB	06/30/04	08/16/04	Not filed	65
10-QSB	09/30/04	11/15/04	Not filed	62
10-KSB	12/31/04	03/31/05	Not filed	58
10-QSB	03/31/05	05/16/05	Not filed	56
10-QSB	06/30/05	08/15/05	Not filed	53
10-QSB	09/30/05	11/14/05	Not filed	50
10-KSB	12/31/05	03/31/06	Not filed	46
10-QSB	03/31/06	05/15/06	Not filed	44

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
PSA, Inc. (n/k/a Shearson American REIT, Inc.) (continued)	10-QSB	06/30/06	08/14/06	Not filed	41
	10-QSB	09/30/06	11/14/06	Not filed	38
	10-KSB	12/31/06	04/02/07	Not filed	33
	10-QSB	03/31/07	05/15/07	Not filed	32
	10-QSB	06/30/07	08/14/07	Not filed	29
	10-QSB	09/30/07	11/14/07	Not filed	26
	10-KSB	12/31/07	03/31/08	Not filed	22
	10-Q*	03/31/08	05/15/08	Not filed	20
	10-Q*	06/30/08	08/14/08	Not filed	17
	10-Q*	09/30/08	11/14/08	Not filed	14
	10-K*	12/31/08	04/01/09	Not filed	9
	10-Q*	03/31/09	05/15/09	Not filed	8
	10-Q*	06/30/09	08/14/09	Not filed	5
	10-Q*	09/30/09	11/16/09	Not filed	2

Total Filings Delinquent **31**

Purchasesoft, Inc.	10-QSB	02/28/05	04/14/05	Not filed	57
	10-KSB	05/31/05	08/29/05	Not filed	53
	10-QSB	08/31/05	10/17/05	Not filed	51
	10-QSB	11/30/05	01/17/06	Not filed	48
	10-QSB	02/28/06	04/14/06	Not filed	45
	10-KSB	05/31/06	08/29/06	Not filed	41
	10-KSB	05/31/07	08/29/07	Not filed	29
	10-QSB	08/31/07	10/15/07	Not filed	27
	10-QSB	11/30/07	01/14/08	Not filed	24
	10-QSB	02/29/08	04/14/08	Not filed	21
	10-KSB	05/31/08	08/29/08	Not filed	17
	10-Q*	08/31/08	10/15/08	Not filed	15
	10-Q*	11/30/08	01/14/09	Not filed	12

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Purchasesoft, Inc. (continued)	10-Q*	02/28/09	04/14/09	Not filed	9
	10-K*	05/31/09	08/31/09	Not filed	5
	10-Q*	08/31/09	10/15/09	Not filed	3
	10-Q*	11/30/09	01/14/10	Not filed	1
Total Filings Delinquent					17

* 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 and
Commissioner Ayala
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61423 / January 26, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13765

In the Matter of

East Delta Resources 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 pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against East Delta Resources Corp. ("East Delta" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. East Delta (CIK No. 0001093933) is a Delaware corporation located in Montreal, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). East Delta 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, 2008, which reported a cumulative deficit of \$30,064,306. The staff of the Division of Enforcement learned in August 2009 that East Delta was insolvent and could not meet its significant current obligations and that it was currently not conducting operations, had no revenues and had little or no likelihood of operating in the future. As of November 13, 2009, the company's stock (symbol "EDLT") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had eleven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

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B. DELINQUENT PERIODIC FILINGS

2. As noted above, East Delta is delinquent in its periodic filings with the Commission, having failed to meet its obligation to file an annual report for the year ended December 31, 2008, and having failed to file quarterly reports for the quarters ended March 31, 2009, June 30, 2009 and September 30, 2009. The staff of the Division of Enforcement reminded counsel for East Delta in August 2009 of the Company's continuing obligation to file annual and quarterly reports and the Division of Corporation Finance sent a delinquency notification to East Delta on November 17, 2009.

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

4. As a result of the foregoing, East Delta 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 Respondent an opportunity to establish any defenses to such allegations; and,

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

IV.

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

IT IS HEREBY FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within ten (10) days 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, the Respondent and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate name of 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 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: **Jill M. Peterson**
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 61422 / January 26, 2010

INVESTMENT ADVISERS ACT OF 1940

Release No. 2977 / January 26, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-13764

<p>In the Matter of</p> <p>AGB Partners LLC, Gregory A. Bied, and Andrew J. Goldberger,</p> <p>Respondents.</p>	<p>CORRECTED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e) AND 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER</p>
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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 Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), against AGB Partners LLC, Gregory A. Bied and Andrew J. Goldberger ("Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement of AGB Partners LLC, Gregory A. Bied and Andrew J. Goldberger (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the

Commission's jurisdiction over Respondents and the subject matter of these proceedings, which are admitted, Respondents consent 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 Sections 203(e) and 203(f) 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 Respondents' Offer, the Commission finds that:

Summary

These proceedings arise out of violations of Rule 105 of Regulation M, a rule designed to protect the independent pricing mechanism of the securities market shortly before follow-on and secondary offerings.¹ In connection with offerings in April 2007 and June 2008, Respondents violated Rule 105 through their improper short-selling practices.

Respondent AGB Partners LLC ("AGB Partners") managed two investment funds. One fund was AGB Partners' own account (the "AGB Partners Account"), which consisted solely of funds from its two principals, Respondents Gregory A. Bied ("Bied") and Andrew J. Goldberger ("Goldberger"). The other was Del Rey Management LLP ("Del Rey"), which raised and invested funds primarily from outside investors (the "Del Rey Account").

In April 2007, Respondents violated Rule 105 by covering short sales made during a specified time period (the "restricted period") of the stock of Boots and Coots International Well Control, Inc. in the AGB Partners Account, with shares of Boots and Coots obtained in a follow-on offering in the Del Rey Account. In June 2008, Respondents violated Rule 105 with respect to a follow-on offering by BGC Partners Inc. AGB Partners shorted shares in the AGB Partners Account during the restricted period while its other client, Del Rey, purchased follow-on offering shares of the same company in the Del Rey Account. Respondents' violative conduct with respect to the two offerings resulted in unlawful profits of \$23,740.

Respondents

1. AGB Partners LLC is a California limited liability corporation with its primary place of business in Boise, Idaho and an office in Santa Monica, California. The firm is an investment adviser that advises two private investment funds. AGB Partners is registered as an

¹ "The first time an issuer conducts a public offering of its securities, the offering is referred to as an initial public offering ("IPO"). Subsequent offerings by the issuer are referred to as follow-on offerings or repeat offerings. A secondary offering is an offering of securities held by security holders, for which there already exist trading markets for the same class of securities as those being offered." Short Selling in Connection With a Public Offering: Proposed Rule, 71 Fed. Reg. 75,002, 75,003 n.12 (Dec. 13, 2006) ("Proposing Release on Rule 105").

investment adviser with California and Idaho, but its assets under management are not sufficient to qualify it for investment adviser registration with the Commission under Section 203A of the Advisers Act.

2. Gregory A. Bied, during all relevant times through the present, owned 50 percent of AGB Partners and 50 percent of the general partner of Del Rey. The Del Rey Account is managed and traded almost exclusively by Bied, age 45, and a resident of Boise, Idaho. Bied is registered as an investment adviser representative with Idaho and California.

3. Andrew J. Goldberger, during all relevant times through the present, owned 50 percent of AGB Partners and 50 percent of the general partner of Del Rey. The AGB Partners Account is managed and traded primarily by Goldberger, age 44, and a resident of Pacific Palisades, California. Goldberger is registered as an investment adviser representative with Idaho and California.

Other Relevant Entities

4. Del Rey Management LP, a Delaware limited partnership with its principal place of business in Boise, Idaho, offered unregistered limited partnership interests to certain institutional and individual investors. Bied and Goldberger each own half of its general partner, GB Management. AGB Partners is the investment adviser to Del Rey. Del Rey's advisory agreement with AGB Partners provides for the payment of management fees based on a percentage of assets under management plus a percentage of profits.

Background

A. Background of Rule 105 of Regulation M

5. Prior to the Commission amending it in October 2007, Rule 105 of Regulation M, "Short Selling in Connection with a Public Offering," provided, in pertinent part:

In connection with an offering of securities for cash pursuant to a registration statement ... filed under the Securities Act, it shall be unlawful for any person to cover a short sale with offered securities purchased from an underwriter or broker or dealer participating in the offering, if such a short sale occurred during the ... period beginning five business days before the pricing of the offered securities and ending with such pricing ...

17 C.F.R. § 242.105(a)(1).

6. The Commission amended Rule 105 in October 2007, to provide, in pertinent part:

In connection with an offering of equity securities for cash pursuant to a registration statement ... filed under the Securities Act of 1933 (“offered securities”), it shall be unlawful for any person to sell short ... the security that is the subject of the offering and purchase the offered securities from an underwriter or broker or dealer participating in the offering if such short sale was effected during the period (“Rule 105 restricted period”) that is the shorter of the period: (1) Beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) Beginning with the initial filing of such registration statement ... and ending with the pricing. .

17 C.F.R. § 242.105(a)(1) (effective October 9, 2007).

7. Subsection (b)(2) of the amended Rule 105 provides that it does “not prohibit the purchase of the offered security in an account of a person where such person sold short during the Rule 105 restricted period in a separate account, if decisions regarding securities transactions for each account are made separately and without coordination of trading or cooperation among or between the accounts.” 17 C.F.R. § 242.105(b)(2).

8. The Commission’s adopting release on amended Rule 105 provides that “[g]enerally, the offering prices of follow-on and secondary offerings are priced at a discount to a stock’s closing price prior to pricing. This discount provides a motivation for a person who has a high expectation of receiving offering shares to capture this discount by aggressively short selling just prior to pricing and then covering the person’s short sales at the lower offering price with securities received through an allocation.” Short Selling in Connection With a Public Offering: Final Rule, 72 Fed. Reg. 45,094, 45,096 (Aug. 10, 2007) (the “Adopting Release on Rule 105”).

9. When persons are likely to be allocated offering shares, they have “an advantage over other persons, which they may exploit to the detriment of pricing efficiency. Not only is this conduct harmful to the market and current security holders, but it can reduce the proceeds the issuer or the selling security holder receives from the securities offering.” Proposing Release on Rule 105, 71 Fed. Reg. at 75,003.

10. The Commission further explained that “[c]overing the short sale with a specified amount of registered offering securities at a fixed price allows a short seller largely to avoid market risk and usually guarantee a profit.” Adopting Release on Rule 105, 72 Fed. Reg. at 45,096.

11. Effective October 9, 2007, the Commission amended Rule 105 to eliminate the covering component to “reduce[] a potential investor’s incentive to aggressively sell short prior

to pricing solely due to the anticipation of this discount.” *Id.* Both the pre- and post-amendment versions of Rule 105 are prophylactic and prohibit the conduct irrespective of the short seller’s intent in effecting the short sale. *See id.* at 45,094 (“Rule 105 is prophylactic. Thus, its provisions apply irrespective of a seller’s intent”); Proposing Release on Rule 105, 71 Fed. Reg. at 75,002 (“The proposal, like the current rule, provides a bright line test for Rule 105 compliance consistent with the prophylactic nature of Regulation M”).

B. Structure of AGB Partners and Del Rey

12. In addition to trading its own account, AGB Partners managed funds for an advisory client. The client, Del Rey, consists primarily of funds from about 15 investors along with a smaller proportion of Bied’s and Goldberger’s assets. With respect to the violations described below, the AGB Partners Account established a short position during the restricted period and the Del Rey Account purchased shares of the same issuer in the follow-on offering. Because the short positions were placed in the AGB Partners Account, owned equally by Bied and Goldberger and consisting of their personal funds, they alone received the economic benefit of the short positions.

13. The Del Rey Account and the AGB Partners Account were held at two different prime brokerages. Although Del Rey and AGB Partners had separate trading strategies and separate profit and loss statements, AGB Partners did not separately manage the AGB Partners and Del Rey Accounts. In one instance, Respondents allocated shares from the Del Rey Account to cover a short position in the AGB Partners Account. In addition, Bied and Goldberger each had authority to place trades in both the AGB Partners and Del Rey Accounts. With respect to their overall orders, Bied placed most of the trades for the Del Rey Account and approximately one-third of the trades for the AGB Partners Account, including certain of the short sales during the restricted period at issue here. Respondents lacked information barriers to separate the accounts or to prevent information sharing about securities positions and investment decisions. Instead, Bied and Goldberger often discussed and shared trading ideas.

C. Respondents’ Violations of Rule 105 of Regulation M

14. During the relevant period, Respondents violated Rule 105 with respect to two follow-on offerings resulting in unlawful profits of \$23,740.

15. Respondents violated the pre-amendment version of Rule 105 in connection with short sales made before a follow-on offering by Boots and Coots International Well Control, Inc. (“Boots and Coots” trading under AMEX ticker: WEL). On April 18, 2007, Boots and Coots priced a follow-on offering of 26 million shares of its common stock at \$2.10 per share. The registered shares were offered to the public through an underwriter on a firm commitment basis. Del Rey purchased 1,125,000 shares of the offering in the Del Rey Account.

16. During Rule 105's five-business day restricted period from April 12 to April 18, AGB Partners sold short 173,632 shares of Boots and Coots at an average price of \$2.57 per share in the AGB Partners Account. On April 19, 2007, AGB Partners covered 35,000 shares of its restricted period short position with shares that Del Rey had purchased in the secondary offering. AGB Partners' profit on these transactions was \$16,450.

17. Respondents also violated amended Rule 105. On June 5, 2008, BGC Partners Inc. ("BGCP" trading under NASDAQ ticker: BGCP) priced a secondary offering of 20 million shares of its common stock at \$8 per share and its shares closed at \$8.08 per share that day. The registered shares were offered to the public through an underwriter on a firm commitment basis. Del Rey purchased 200,000 shares of the offering in the Del Rey Account. During the May 30 to June 5 restricted period, AGB Partners had sold short 16,200 shares of BGCP at an average price of \$8.45 per share in the AGB Partners Account. The difference between AGB Partners' short sale proceeds and the price for the secondary offering on these transactions was \$7,290. AGB Partners also obtained a benefit of \$14,704 as of June 5 by participating in the secondary offering after selling short shares of BGCP during the restricted period.

18. As a result of the conduct described above with respect to trading in the shares of Boots and Coots, Respondents willfully violated Rule 105 of Regulation M then in effect, which made it "unlawful for any person to cover a short sale with offered securities purchased from an underwriter or broker or dealer participating in an offering, if such short sales occurred during the ... period beginning five business days before pricing of the offered securities and ending with such pricing."²

19. As a result of the conduct described above with respect to trading in the shares of BGCP, Respondents willfully violated Rule 105 of Regulation M of the Exchange Act, as amended effective October 9, 2007, which makes it "unlawful for any person to sell short ... the security that is the subject of the offering and purchase the offered securities from an underwriter, broker or dealer participating in the offering if such short sale was effected during the period: (1) Beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) Beginning with the initial filing of such registration statement ... and ending with such pricing."

20. AGB Partners, Bied and Goldberger violated Rule 105 by selling short securities during the restricted period and purchasing offered securities of the same issuer through two trading accounts that they failed to separately manage.

² A willful violation of the securities laws means "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)).

Respondents' Remedial Efforts

21. In determining to accept the Offer, the Commission considered Respondents' remedial efforts and cooperation afforded the Commission staff.

IV.

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

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

- A. Respondents shall cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act.
- B. Respondents are censured.
- C. Respondents shall, jointly and severally, within 30 days of the entry of this Order, pay disgorgement of \$38,444, prejudgment interest of \$2,921 and a civil penalty of \$20,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies AGB Partners, Bied and Goldberger as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Michael S. Dicke, Associate Director, Division of

Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600,
San Francisco, California 94104.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61421 / January 26, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 2976 / January 26, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13763

In the Matter of

**PALMYRA
CAPITAL ADVISORS LLC,**

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 Palmyra Capital Advisors LLC ("Palmyra" 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 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 ("Order"), as set forth below.

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III.

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

Summary

1. These proceedings arise out of a violation of Rule 105 of Regulation M of the Exchange Act by Palmyra, a registered investment adviser based in Los Angeles, California. Rule 105 prohibits short selling securities during a restricted period (generally defined as five business days before the pricing of a secondary offering) and then purchasing the same securities in a public secondary offering. Palmyra, through three of its managed funds, violated Rule 105 in connection with short sales made in advance of a public offering by Capital One Financial Corp. ("Capital One"), resulting in profits of \$225,500.

Respondent

2. Palmyra Capital Advisors LLC is a Los Angeles, California-based hedge fund manager that serves as an advisor to three limited partnerships, Palmyra Capital Fund, LP ("Palmyra Capital"), Palmyra Capital Offshore Funds, LP ("Palmyra Offshore"), and Palmyra Capital Institutional Fund, LP ("Palmyra Institutional") (collectively the "hedge Funds"). Palmyra was a registered investment adviser with the Commission during the time of the Rule 105 violations at issue.

Background

3. At all relevant times, pursuant to amendments effective as of October 9, 2007, Rule 105 prohibited short selling securities during a restricted period and then purchasing the same securities in a public offering. 17 C.F.R. § 242.105.; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on [Exchange Act] Form 1-A or Form 1-E and ending with pricing. "The goal of Rule 105 is to promote offering prices that are based upon open market prices determined by supply and demand rather than artificial forces." Final Rule: Short Sales, Exchange Act Release No. 50103, 2004 WL 1697019, at *19 (July 28, 2004). Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale.

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

4. On September, 18, 2008, three hedge Funds Palmyra advises sold short a total 50,000 shares of Capital One at \$53.51 per share.

5. On September 24, 2008, after the close of the market, Capital One announced the pricing of a secondary offering of 14 million shares of its common stock at \$49 per share. Palmyra received 50,000 shares of Capital One stock in the secondary offering at a price of \$49 per share, which were posted to the accounts of the three hedge Funds on September 24, 2008.

6. Palmyra made a profit of \$225,500 for its three hedge Funds from these trades.

7. As a result of the conduct described above, Palmyra willfully² violated Rule 105 of Regulation M, which makes it “unlawful for any person to sell short . . . [a] security that is the subject of . . . [an] offering and purchase the offered securities from an underwriter or broker or dealer participating in the offering if such short sale was effected during the . . . Rule 105 restricted period”

Palmyra's Remedial Efforts

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

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Palmyra'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 Palmyra cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act.

B. Respondent Palmyra is censured.

C. Respondent Palmyra shall, within 15 days of the entry of this Order, pay disgorgement of \$225,500, prejudgment interest in the amount of \$10,901.58, and a civil money penalty of \$105,000 to the United States Treasury. If timely payment is not made,

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

additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717.

D. Such payment by Respondent Palmyra shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) 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 (4) submitted under cover letter that identifies Palmyra 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 Gerald W. Hodgkins, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as Penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that it shall not, after offset or reduction in any Related Investor Action based upon 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 the 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

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-29125; File No. 812-13746]

Assurant, Inc., et al.; Notice of Application and Temporary Order

January 26, 2010

Agency: Securities and Exchange Commission (“Commission”).

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 (“Act”).

Summary of Application: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to an injunction entered against Assurant, Inc. (“Assurant”) on January 26, 2010 by the United States District Court for the Southern District of New York (“Injunction”), until the Commission takes final action on an application for a permanent order. Applicants also have applied for a permanent order.

Applicants: Assurant, Union Security Insurance Company (“USIC”) and Union Security Life Insurance Company of New York (“USLICNY,” and, together with USIC, the “Depositor Applicants”).¹

Filing Date: The application was filed on January 21, 2010, and amended on January 26, 2010.

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,

¹ Applicants request that any relief granted pursuant to the application also apply to any other company of which Assurant is or may become an affiliated person (together with the Applicants, the “Covered Persons”).

personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on February 22, 2010, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: Assurant, One Chase Manhattan Plaza, 41st Floor, New York, NY 10005; USIC, 2323 Grand Boulevard, Kansas City, MO 64108-2670; USLICNY, 212 Highbridge Street, Suite D, Fayetteville, NY 13066.

For Further Information Contact: John Yoder, at (202) 551-6878, or Michael W. Mundt, Assistant Director, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a temporary order and a summary of the application. The complete application may be obtained via the Commission's website 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. Assurant, through its subsidiaries and affiliates, is a provider of specialized insurance products and related services. The Depositor Applicants are indirect wholly-owned subsidiaries of Assurant and, before 2002, issued and sold variable life insurance and annuity contracts. In April 2001, Assurant's predecessor,

Fortis, Inc., sold its entire variable life insurance and annuity contract business to The Hartford Financial Services Group, Inc. ("Hartford") through modified coinsurance (the "Hartford Transaction"). As a result, the Depositor Applicants remained the issuers of the outstanding life insurance and annuity products, but Hartford has assumed all day-to-day responsibility for the administration of the policies. The Depositor Applicants currently serve as depositors for three separate accounts organized as unit investment trusts and registered under the Act ("Separate Accounts").

2. On January 26, 2010, the United States District Court for the Southern District of New York entered the Injunction against Assurant in a matter brought by the Commission.² The Commission alleged in the complaint ("Complaint") that Assurant violated 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 under the Exchange Act, in connection with Assurant's accounting and public reporting practices. The Complaint related to Assurant's inaccurate recording of income for third quarter of 2004 in the consolidated financial statements included in its periodic and other filings for 2004. The inaccuracies in the financial statements relate to recorded income from a purported reinsurance contract. The Complaint alleged that Assurant violated the corporate reporting, recordkeeping, and internal controls provisions of the Exchange Act. Without admitting or denying any of the allegations in the Complaint, except as to jurisdiction, Assurant consented to the entry of the Injunction.

Applicants' Legal Analysis:

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from engaging in or continuing any conduct or practice in connection with

² Securities and Exchange Commission v. Assurant, Inc., Final Judgment as to Defendant Assurant, Inc., 10-CV-0484 (S.D.N.Y, January 26, 2010).

the purchase or sale of a security from acting, among other things, as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end investment company, registered unit investment trust, or registered face-amount certificate company (the registered investment companies are collectively referred to as "Funds"). Section 9(a)(3) of the Act makes the prohibition in section 9(a)(2) applicable to a company, any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control, with the other person and any person directly or indirectly owning, controlling, or holding with the power to vote, 5 percent or more of the outstanding voting securities of such other person. Applicants state that Assurant is an affiliated person of each of the other Applicants within the meaning of section 2(a)(3). Applicants state that, as a result of the Injunction, they would be subject to the disqualification provisions of section 9(a).

2. Section 9(c) of the Act provides that the Commission shall grant an application for an exemption from the disqualification provisions of section 9(a) of the Act if it is established that these provisions, as applied to applicants, are unduly or disproportionately severe or that the conduct of the applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking temporary and permanent orders exempting them from the disqualification provisions of section 9(a).

3. Applicants believe that they meet the standards for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them

would be unduly and disproportionately severe and that it would not be against the public interest or the protection of investors to grant the requested exemption from section 9(a).

4. Applicants state that the alleged conduct giving rise to the Injunction did not involve any of the Applicants acting in the capacity of investment adviser, subadviser, depositor or principal underwriter for any Fund. Applicants state that the alleged conduct did not involve the assets of any of the Separate Accounts. Applicants state that, except as discussed below, since the closing of the Hartford Transaction in 2001, (i) none of the current or former directors, officers or employees of the Applicants (other than Assurant itself and its predecessor entities) had any knowledge of or had any involvement in, the conduct alleged in the Complaint and (ii) the personnel at Assurant who were involved in the violations alleged in the Complaint have had no, and will not have any future, involvement in the Covered Persons' serving as investment adviser, depositor, or principal underwriter for any Fund. In addition, Applicants represent that since the closing of the Hartford Transaction, Applicants have not been involved in any investment decisions with respect to the Separate Accounts.

5. Applicants state that three persons who are current or former officers of Assurant received Wells notices in connection with the Commission's investigation into the facts underlying the Complaint ("Wells Notice Recipients"). Applicants state that these persons have served as officers or directors of the Depositor Applicants. Applicants further state that one of the Wells Notice Recipients has overall responsibility for Assurant's health insurance business and therefore continues to serve as an officer of USIC to perform necessary services solely in connection with that business segment.

Applicants state that neither of the other Wells Notice Recipients is currently an officer, director or employee of either of the Depositor Applicants.

6. Applicants state that, other than signing certain public filings required under the federal securities laws containing representations with respect to the Separate Accounts and receiving communications that referenced the Separate Accounts, since the closing of the Hartford Transaction in 2001, the Wells Notice Recipients have not been involved in the Depositor Applicants' serving as a depositor for the Separate Accounts and will not be involved in that capacity in the future.³ Applicants further state that, to the extent other current or former officers, directors, or employees of the Depositor Applicants had any knowledge of, or any involvement in, the conduct alleged in the Complaint ("Certain Depositor Applicant Personnel"), since the closing of the Hartford Transaction in 2001, those individuals have not been involved in the Depositor Applicants' serving as a depositor for the Separate Accounts and will not be involved in that capacity in the future.

7. Applicants state that the inability of the Depositor Applicants to continue to serve as depositors to the Separate Accounts would result in potential hardships for the Depositor Applicants and the variable annuity contract holders and variable life insurance policyholders. If disqualified from serving as depositors for the Separate Accounts, the Depositor Applicants could no longer hold those assets and would be forced to cancel and unwind the variable annuity contracts and variable life insurance policies. Contract holders and policyholders, through no fault of their own, would incur the costs of seeking

³ Certain Wells Notice Recipients may, however, pursuant to their roles as officers of Assurant, sign, and receive information regarding the Separate Accounts from the Applicants in connection with the signing of, Assurant filings required under the applicable federal securities laws that make reference to Depositor Applicants.

and purchasing viable alternatives. Applicants also state that the Depositor Applicants have committed substantial resources to serve as depositors to the Separate Accounts and that prohibiting the Depositor Applicants from serving as depositors to the Separate Accounts would render critical terms of the Hartford Transaction void and would require significant and costly restructuring of the modified coinsurance transaction structure.

8. Applicants state that they have not previously applied for an exemptive order under section 9(c) of the Act.

Applicants' Conditions:

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

1. The Wells Notice Recipients and Certain Depositor Applicant Personnel will not be involved in the Covered Persons' serving as an investment adviser, depositor, or principal underwriter to any Fund. Applicants will develop and implement procedures designed reasonably to assure compliance with this condition.

2. Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

Temporary Order:

The Commission has considered the matter and finds that the Applicants have made the necessary showing to justify granting a temporary exemption. Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that Assurant, USIC, USLICNY, and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the Injunction, subject to the conditions in the application, from January 26, 2010, until the Commission takes final action on their application for a permanent order.

By the Commission.

Elizabeth M. Murphy
Secretary


By: Florence E. Harmon
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9103 / January 27, 2010

SECURITIES EXCHANGE ACT OF 1934
Release No. 61428 / January 27, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13557

In the Matter of

TD AMERITRADE, INC.,

Respondent.

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

TD Ameritrade, Inc. ("TDA") has submitted a letter, on behalf of itself and any of its current or future affiliates, dated October 5, 2009, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from TDA's settlement of administrative and cease-and-desist proceedings instituted by the Commission.

On July 20, 2009, the Commission instituted administrative and cease-and-desist proceedings against TDA, a registered broker-dealer.¹ In the order instituting proceedings, the Commission found, among other things, that TDA did not accurately characterize the investment nature of auction rate securities ("ARS") that TDA sold to its customers, and did not provide customers with adequate and complete disclosures regarding the complexity of the auction process and the risks associated with ARS. Based on these findings, the Commission found that TDA had violated Section 17(a)(2) of the Securities Act. Without admitting or denying the findings, TDA consented to a censure and an order to cease and desist from violations of Section 17(a)(2) of the Securities Act. TDA also voluntarily undertook to offer to buy back at par certain ARS from certain customers.

¹ In the Matter of TD Ameritrade, Inc., Sec. Act Rel. No. 9053, Exch. Act Rel. No. 60341 (July 20, 2009).

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

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

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that waivers from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to TDA and any current or future affiliates resulting from the entry of the Order are 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

SECURITIES EXCHANGE ACT OF 1934
Release No. 61432 / January 27, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3110 / January 27, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-11911

In the Matter of
Karen T. Baker, CPA

: ORDER GRANTING APPLICATION FOR
: REINSTATEMENT TO APPEAR AND PRACTICE
: BEFORE THE COMMISSION AS AN ACCOUNTANT
: RESPONSIBLE FOR THE PREPARATION OR
: REVIEW OF FINANCIAL STATEMENTS REQUIRED
: TO BE FILED WITH THE COMMISSION

On April 26, 2005, Karen T. Baker ("Baker") 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 Baker pursuant to Rule 102(e) of the Commission's Rules of Practice.¹ Baker consented to the entry of the April 26, 2005 order without admitting or denying the findings therein. This order is issued in response to Baker's application for reinstatement to practice before the Commission as an accountant.

Baker served as the audit manager for Deloitte & Touche LLP's audit of Just for Feet, Inc.'s financial statements for the fiscal year ended January 30, 1999. The Commission found that Baker reasonably should have known that the financial statements had not been prepared in accordance with GAAP, but nonetheless issued, with others, an unqualified audit report that represented that the financial statements were free from material misstatements and were fairly presented in conformity with GAAP and that the auditors had adhered to GAAS when the audit was performed. Baker did not comply with GAAS in the conduct of the audit and engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice through repeated instances of unreasonable conduct.

In her capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Baker attests that she will undertake to have her work reviewed by the independent audit committee of

¹ See Accounting and Auditing Enforcement Release No. 2238 dated April 26, 2005. Baker was permitted, pursuant to the order, to apply for reinstatement after one year upon making certain showings.

any company for which she works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Baker is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If she should wish to resume appearing and practicing before the Commission as an independent accountant, she will be required to submit an application to the Commission showing that she has complied and will comply with the terms of the original suspension order in this regard. Therefore, Baker's suspension from practice before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original suspension order

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."² This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Baker, it appears that she has complied with the terms of the April 26, 2005 order denying her the privilege of appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to her character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against her pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Baker, by undertaking to have her work reviewed by the independent audit committee of any company for which she works, or in some other manner acceptable to the Commission, in her practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Karen T. Baker, 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

² Rule 102(e)(5)(i) provides:

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61436 / January 28, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13767

In the Matter of

**Ariel Corp.,
Classica Group, Inc.,
Commodore Environmental Services, Inc.,
Dupont Direct Financial Holdings, Inc.,
Engage, Inc.,
New Paradigm Software Corp.
(n/k/a Brunton Vineyards Holdings, Inc.),
Polymer Research Corp. of America, and
Shopnet.Com, 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 Ariel Corp., Classica Group, Inc., Commodore Environmental Services, Inc., Dupont Direct Financial Holdings, Inc., Engage, Inc., New Paradigm Software Corp. (n/k/a Brunton Vineyards Holdings, Inc.), Polymer Research Corp. of America, and Shopnet.Com, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Ariel Corp. ("ADSPQ")¹ (CIK No. 911167) is a void Delaware corporation located in Cranbury, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ADSPQ is delinquent in its periodic filings with the

¹The short form of each issuer's name is also its stock symbol.

Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2001, which reported a net loss of \$6,820,981 for the prior six months. On June 26, 2003, ADSPQ filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of New Jersey which was still pending as of January 25, 2010. As of January 25, 2010, the common stock of ADSPQ was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had four market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

2. Classica Group, Inc. ("TCGI") (CIK No. 868075) is a dissolved New York corporation located in Sayreville, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TCGI 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, which reported a net loss of \$1,808,225 for the prior nine months. On March 23, 2004, TCGI filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of New Jersey which was terminated on June 23, 2009. As of January 25, 2010, the common stock of TCGI 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. Commodore Environmental Services, Inc. ("COES") (CIK No. 71528) is a Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). COES 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, 2004, which reported a net loss of \$540,000 for the prior six months. As of January 25, 2010, the common stock of COES was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

4. Dupont Direct Financial Holdings, Inc. ("DIRX") (CIK No. 807904) is a dissolved Georgia corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DIRX 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 March 31, 2004, which included no financial statements. On September 17, 2004, DIRX filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of New York which was dismissed on September 26, 2006. As of January 25, 2010, the common stock of DIRX was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

5. Engage, Inc. ("ENGA") (CIK No. 1084573) is a void Delaware corporation located in Andover, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ENGA is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 2003, which reported a net loss of \$28,111,000 for the prior six months. On June 19, 2003, ENGA filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Massachusetts which was still pending as of January 25, 2010. As of January 25, 2010, the common stock of ENGA was traded on the over-the-counter markets.

6. New Paradigm Software Corp. (n/k/a Brunton Vineyards Holdings, Inc.) ("BVYH") (CIK No. 933733) is a New York corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BVYH 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, 2001, which reported a net loss of \$74,690 for the prior three months. In 2007, the company changed its name in the Pink Sheets and in the records of the New York Secretary of State to Brunton Vineyards Holdings, Inc. but failed to report the change to the Commission on Form 8-K or record that change in the Commission's EDGAR database as required by Commission rules. As of January 25, 2010, the common stock of BVYH was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

7. Polymer Research Corp. of America ("PROAQ") (CIK No. 79424) is a New York corporation located in Brooklyn, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PROAQ 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, which reported a net loss of \$874,836 for the prior nine months. On October 1, 2004, PROAQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of New York, which was converted to a Chapter 7 petition on February 25, 2005, and was still pending as of January 25, 2010. As of January 25, 2010, the common stock of PROAQ 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).

8. Shopnet.Com, Inc. ("SPNT") (CIK No. 1017535) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SPNT 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 June 30, 2003, which reported a net loss of \$886,918 for the prior year. As of January 25, 2010, the common stock of SPNT 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

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

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

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

III.

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

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

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

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against 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 permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 28, 2010

In the Matter of

**Ariel Corp.,
Classica Group, Inc.,
Commodore Environmental Services, Inc.,
Dupont Direct Financial Holdings, Inc.,
New Paradigm Software Corp.
(n/k/a Brunton Vineyards Holdings, Inc.),
Polymer Research Corp. of America, and
Shopnet.Com, Inc.,**

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

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

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Classica Group, 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 Commodore Environmental Services, Inc. because it has not filed any periodic reports since the period ended June 30, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Dupont Direct Financial Holdings, Inc. because it has not filed any periodic reports since the period ended March 31, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of New Paradigm Software Corp. (n/k/a Brunton

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Vineyards Holdings, Inc.) because it has not filed any periodic reports since the period ended June 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Polymer Research Corp. of America 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 Shopnet.Com, Inc. because it has not filed any periodic reports since the period ended June 30, 2003.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 28, 2010, through 11:59 p.m. EST on February 10, 2010.

By the Commission.

Elizabeth M. Murphy
Secretary

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

The motion for reconsideration notes that the Order indicated that the Board had "not submitted a response to Applicants' motion" for a protective order, but that the Board had in fact filed an opposition to Applicants' motion on November 9, 2009 (the "November 9 Response"). Arguing that "the Commission made its decision without the benefit of the Board's arguments," the Board urges reconsideration in light of these arguments, specifically emphasizing that "granting Applicants' broad request to protect from disclosure all references to the Treatment Information would, in practical effect, make this proceeding non-public, a result the Commission already rejected when it denied Applicants' request for a non-public hearing."²

We review the Board's motion for reconsideration under Rule of Practice 470.³ Under Rule 470, the motion for reconsideration should address "the matters of record alleged to have been erroneously decided, the grounds relied upon, and the relief sought."⁴ Motions for reconsideration are granted in exceptional cases. Reconsideration is an extraordinary remedy "designed to correct manifest errors of law or fact, or to permit the presentation of newly discovered evidence."⁵

Neither the Board's present motion nor its original November 9 Response establish a basis for reconsideration. Both filings emphasize the need to preserve the public nature of the proceedings. The Order, by granting more limited confidentiality than was sought in Applicants' motion, accomplished this goal. The fact of the appeal and the progress of the proceedings remain public, and the record remains public except to the extent protected by the Order. Moreover, although the Order includes provisions protecting the Treatment Information from disclosure, the requirements of sealing and confidentiality in the Order do "not apply to any reference to the existence of the Treatment Information or to citation of particular information contained therein in testimony, oral arguments, briefs, opinions, or in any other similar use directly connected with this action or any appeal," and the Order preserves the Commission's "authority to reach a different conclusion regarding the protective status of any portion of the Treatment Information covered by [the] Order at any time before it determines the issues raised in the proceeding." Because the Order includes parameters balancing the policy concerns raised in the Board's November 9 Response against the sensitive nature of the Treatment Information, we do not find that reconsideration is merited in this case.

² See *supra* note 1.

³ 17 C.F.R. § 201.470.

⁴ *Id.*

⁵ *Perpetual Securities, Inc.*, Securities Exchange Act Rel. No. 56962 (Dec. 13, 2007), 92 SEC Docket 472, 473; see also *Laminaire Corp.*, Exchange Act Rel. No. 56789 (Nov. 15, 2007), 91 SEC Docket 3221, 3223; *Feeley & Willcox Asset Management Corp.*, 56 S.E.C. 1264, 1265 (2003).

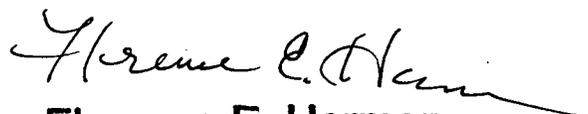
Accordingly, it is

ORDERED that the motion for reconsideration filed by the Board be, and it hereby is, denied; and it is further

ORDERED that a corrected version of the Order deleting the sentence "The PCAOB has not submitted a response to Applicants' motion." be, and it hereby is, issued.

By the Commission.

Elizabeth M. Murphy
Secretary


By: Florence E. Harmon
Deputy Secretary

CORRECTED

ADMINISTRATIVE PROCEEDINGS
FILE NO. 3-13535

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
January 28, 2010

In the Matter of the Application of

GATELY & ASSOCIATES, LLC

and

JAMES P. GATELY, CPA

For Review of Disciplinary Action Taken by

PCAOB

ORDER GRANTING
PARTIAL
PROTECTIVE ORDER

On November 2, 2009, Gately & Associates, LLC (the "Firm") and James P. Gately, CPA (together with the Firm, "Applicants"), filed a motion for a protective order in connection with an application for review of disciplinary action taken by the Public Company Accounting Oversight Board ("PCAOB").¹ Applicants argue that information regarding a condition for which Gately was receiving treatment (the "Treatment Information") is "necessary to provide a defense to the PCAOB allegations," but requests that such information be protected from public disclosure and that any reference to such information "be omitted from the record on appeal." Alternatively, Applicants request that Gately and the Firm be referred to by initials.

Under our Rule of Practice 322, any party "may file a motion requesting a protective order to limit from disclosure to other parties or to the public documents or testimony that

¹ Section 105(b)(5) of the Sarbanes-Oxley Act of 2002 generally provides for confidential and privileged treatment of documents and information in connection with a PCAOB inspection or investigation "unless and until" such documents and information are "presented in connection with a public proceeding." 15 U.S.C. § 7215(b)(5). On October 23, 2009, we ordered that these proceedings be public in accordance with our Rule of Practice 301, 17 C.F.R. § 201.301, and described the provisions for filing a motion for protective order under Rule of Practice 322, 17 C.F.R. § 201.322.

contain confidential information."² "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."³

The Commission recognizes that the Treatment Information could be sensitive. At this stage of 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 the record might be necessary to the resolution of the issues before us.

Accordingly, IT IS ORDERED that:

1. Except as otherwise provided in this Order, the Treatment Information 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 Treatment Information shall keep it confidential and, except as provided in this Order, shall not divulge the document or information to any person.

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

4. The Office of the Secretary shall place the Treatment Information in sealed envelopes or other sealed container 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 Treatment Information or to citation of particular information contained therein in testimony, oral arguments, briefs, opinions, or in any other similar use directly connected with this action or any appeal thereof.

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

By the Commission.


By: Florence E. Harmon
Deputy Secretary

Elizabeth M. Murphy
Secretary

² 17 C.F.R. § 201.322(a).

³ 17 C.F.R. § 201.322(b).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 29, 2010

In the Matter of

**L. Luria & Son, Inc.,
Lew Corp.
(n/k/a Questus Global Limited),
Library Bureau, Inc.,
Life Sciences, Inc.,
Lifesmart Nutrition Technologies, Inc.,
Lightning Rod Software, Inc.,
Lindatech, Inc.,
Littlefield, Adams & Company, and
Liuski International, Inc.**

File No. 500-1

**ORDER OF SUSPENSION OF
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of L. Luria & Son, Inc. because it has not filed any periodic reports since the period ended May 3, 1997.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Lew Corp. (n/k/a Questus Global Limited) because it has not filed any periodic reports since the period ended December 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Library Bureau, Inc. because it has not filed any periodic reports since July 2, 1994.

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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 Life Sciences, Inc. because it has not filed any periodic reports since the period ended May 31, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Lifesmart Nutrition Technologies, Inc. because it has not filed any periodic reports since the period ended February 28, 2003.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Lightning Rod Software, Inc. because it has not filed any periodic reports since the period ended December 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Lindatech, Inc. because it has not filed any periodic reports since the period ended March 31, 1999.

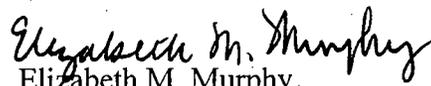
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Littlefield, Adams & Company because it has not filed any periodic reports since the period ended March 31, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Liuski International, Inc. because it has not filed any periodic reports since the period ended July 20, 1999.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 29, 2010, through 11:59 p.m. EST on February 11, 2010.

By the Commission.


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 61442 / January 29, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-13768

In the Matter of

**L. Luria & Son, Inc.,
Lew Corp.
(n/k/a Questus Global Limited),
Library Bureau, Inc.,
Life Sciences, Inc.,
Lifesmart Nutrition Technologies, Inc.,
Lightning Rod Software, Inc.,
Lindatech, Inc.,
Littlefield, Adams & Company, and
Liuski International, Inc.,**

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents L. Luria & Son, Inc., Lew Corp. (n/k/a Questus Global Limited), Library Bureau, Inc., Life Sciences, Inc., Lifesmart Nutrition Technologies, Inc., Lightning Rod Software, Inc., Lindatech, Inc., Littlefield, Adams & Company, and Liuski International, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. L. Luria & Son, Inc. (CIK No. 277057) is a dissolved Florida corporation located in Miami Lakes, Florida with a class of securities registered with the Commission

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pursuant to Exchange Act Section 12(g). Luria 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 May 3, 1997, which reported a net loss of \$1,553,000 for the prior thirteen weeks. On August 13, 1997, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Florida, and the case was terminated on December 6, 2007. As of January 25, 2010, the company's stock (symbol "LLUR") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Lew Corp. (n/k/a Questus Global Limited) (CIK No. 1138180) 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). Lew is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2001, which reported a net loss of \$3,147,936 for the prior twelve months. On April 28, 2003, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Nevada, and the case was terminated on February 26, 2004. As of January 25, 2010, the company's stock (symbol "VTGE") 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).

3. Library Bureau, Inc. (CIK No. 225662) is a void Delaware corporation located in Herkimer, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Library Bureau 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 July 2, 1994, which reported a net loss of \$2,248,026 for the prior nine months. On May 24, 1993 the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of New York, and the case was terminated on May 27, 1993. As of January 25, 2010, the company's stock (symbol "LBUR") 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).

4. Life Sciences, Inc. (CIK No. 59401) is a delinquent Delaware corporation located in St. Petersburg, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Life Sciences 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 May 31, 2000. On March 9, 2009, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Middle District of Florida, and the case was pending as of January 25, 2010. As of January 25, 2010, the company's stock (symbol "LFSCQ") 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).

5. Lifesmart Nutrition Technologies, Inc. (CIK No. 920273) is a Utah corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Lifesmart Nutrition Technologies 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 February 28, 2003, which reported a net loss of \$161,033 for the prior three months. As of January 25, 2010, the company's stock

(symbol "LSNU") 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).

6. Lightning Rod Software, Inc. (CIK No. 866283) is a Delaware corporation located in Minnetonka, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Lightning Rod is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2001, which reported a net loss of \$1,442,792 for the prior year. As of January 25, 2010, the company's stock (symbol "LROD") 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).

7. Lindatech, Inc. (CIK No. 1013277) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Lindatech 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, 1999, which reported a net loss of \$907,323 for the prior nine months. As of January 25, 2010, the company's stock (symbol "LNDA") 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).

8. Littlefield, Adams & Company (CIK No. 59870) is a New Jersey corporation located in Humber Heights, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Littlefield 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, 2000, which reported a net loss of \$497,000 for the prior three months. On November 15, 1994, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Texas, and the case was terminated on April 15, 1997. As of January 25, 2010, the company's stock (symbol "FUNW") was quoted on the Pink Sheets, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

9. Liuski International, Inc. (CIK No. 876429) is a void Delaware corporation located in Norcross, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Liuski 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, 1998, which reported a net loss of \$17,639,841 for the prior twelve months. On July 20, 1999, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of Georgia, and the case was terminated on April 18, 2003. As of January 25, 2010, the company's stock (symbol "LSKI") was quoted on the Pink Sheets, had one market maker, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

10. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to

them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

III.

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

A. Whether the allegations contained in Section II 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.


Elizabeth M. Murphy
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. 61444 / January 29, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 2979 / January 29, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13769

In the Matter of

ETHAN KASS,

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 15(b) OF THE
SECURITIES EXCHANGE ACT OF 1934
AND SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Ethan Kass ("Kass" 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 and III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61445 / January 29, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 2980 / January 29, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3112 / January 29, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13770

In the Matter of

MARK EVAN BLOOM (CPA),

Respondent.

ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 203(f) OF THE
INVESTMENT ADVISERS ACT OF 1940
AND 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 pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 102(e)(3)(i) of the Commission's Rules of Practice¹ against Mark Evan Bloom, CPA ("Respondent" or "Bloom").

¹ Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting

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 Sections III.2 and III.4 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 and 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. Bloom, 58 years old, is a resident of New York, New York. He was the principal and 100% owner of North Hills Management, LLC ("North Hills"), an unregistered investment adviser that served as Manager and General Partner of North Hills, L.P. (the "Fund"). Bloom is also a certified public accountant and was licensed to practice in the State of New York.

2. On February 25, 2009, the Commission filed a complaint against Bloom in SEC v. North Hills Management, LLC, et al., Civil Action No. 1:09-CV-1746 (JGK). On October 22, 2009, the Court entered an order permanently enjoining Bloom, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206-4(8) thereunder.

3. The Commission's complaint alleged that, from on or before July 2001 to February 2009, in connection with the offer, sale and purchase of limited partnership interests in the Fund, Bloom misused and misappropriated investor funds, falsely stated to investors that their funds were invested as represented in the offering materials, sent out false account statements indicating that investor funds were fully invested and earning returns, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors.

4. On July 30, 2009, Bloom pled guilty to one count of securities fraud in violation of Title 15, United States Code, Sections 78j(b) and 78ff, Title 17, Code of Federal Regulations, Section 240.10b5 and Title 18, United States Code, Section 2; one count of mail fraud in violation of Title 18, United States Code, Sections 1341 and 2; one count of wire fraud, Title 18, United States Code, Sections 1343 and 2; one count of money laundering, Title 18, United States Code,

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

Sections 1957 and 2; and one count of corruptly endeavoring to obstruct and impede the due administration of the internal revenue laws, Title 26, United States Code, Section 7212(a), before the United States District Court for the Southern District of New York, in United States v. Mark Evan Bloom (Criminal Information No. S1:09-CR-367).

5. The counts of the criminal information to which Bloom pled guilty alleged, inter alia, that Bloom defrauded investors and obtained money and property by means of materially false and misleading statements, that he used the United States mails to send false account statements, that he caused commercial interstate carriers to deliver investors' checks to him via wire, transferred investor funds to unlawfully renovate his home and purchase artwork and jewelry and obstructed the internal revenue laws by, among other things, promoting tax shelters.

IV.

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

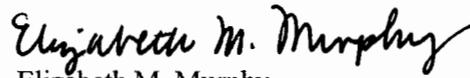
Accordingly, it is hereby ORDERED, effective immediately, that:

Pursuant to Section 203(f) of the Advisers Act, Respondent Bloom be, and hereby is barred from association with any investment adviser;

Pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, Respondent Bloom is suspended from appearing or practicing before the Commission as an accountant.

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61448 / January 29, 2010

Admin. Proc. File No. 3-13304

In the Matter of

OOO CENTREINVEST SECURITIES

ORDER DISMISSING PETITION FOR REVIEW AND NOTICE OF FINALITY

On August 31, 2009, an administrative law judge issued an initial decision, finding that OOO CentreInvest Securities ("OOO CentreInvest"), a broker-dealer based in the Russian Federation, violated Section 15(a) of the Securities Exchange Act of 1934¹ by soliciting institutional investors in the United States to purchase and sell stocks of Russian companies without registering with the Commission. The law judge barred OOO CentreInvest from associating with any broker or dealer, imposed a cease-and-desist order, required disgorgement of \$2,400,000 plus prejudgment interest, and assessed a \$1,275,000 civil money penalty.²

On September 24, 2009, in response to a petition for review of the initial decision filed by OOO CentreInvest on September 22, 2009, the Commission issued an order granting the petition and scheduling briefing ("Initial Order"). Pursuant to Rules of Practice 141(b) and 150(c)(2), the Commission attempted to serve the Initial Order by U.S. Postal Service to the Moscow address provided (in English) in the proceeding before the law judge, but the mailing was returned as undeliverable.³

¹ 15 U.S.C § 78o(a).

² *OOO CentreInvest Sec.*, Initial Decision Rel. No. 387 (Aug. 31, 2009), __ SEC Docket __ (granting Division of Enforcement's unopposed motion for summary disposition).

³ 17 C.F.R. §§ 201.141(b), 150(c)(2) (permitting service of orders other than orders instituting proceedings by "mailing the papers through the U.S. Postal Service by first class, certified, registered, or Express Mail").

On November 5, 2009, the Commission issued an amended order granting OOO CentreInvest's petition for review of the law judge's initial decision and setting a schedule requiring that a brief in support of the petition for review be filed by December 21, 2009 ("Amended Order"). The Amended Order further stated that, pursuant to Commission Rule of Practice 180(c),⁴ "failure to file a brief in support of the petition may result in dismissal of this review proceeding as to that petitioner." To ensure delivery of the Amended Order, the Commission sent it to the Moscow mailing address on the letterhead of the September 22, 2009 petition for review. The address label was written in Russian, using the Cyrillic alphabet and the correct format for addressing mail to Russia. On December 22, 2009, the Amended Order mailing was returned because, as reflected on the return receipt, the firm had "moved."

Pursuant to Commission Rule of Practice 150(d), service of the Amended Order was "complete upon mailing."⁵ Moreover, to the extent that OOO CentreInvest may have moved, Commission Rule of Practice 102(d) requires parties to "keep current . . . the business address" at which any notice or written communication may be sent.⁶ To date, OOO CentreInvest has failed to file a brief, extension request, or anything else with respect to its appeal subsequent to its petition for review. It thus appears that the OOO CentreInvest has abandoned its appeal. Under the circumstances, we find that dismissal is appropriate.⁷

Accordingly, it is ORDERED that the petition for review of OOO CentreInvest Securities be, and it hereby is, dismissed.

We also hereby give notice that the initial decision issued on August 31, 2009, by the administrative law judge has become the final decision of the Commission with respect to OOO CentreInvest Securities. The sanctions imposed in that decision are hereby declared effective.

By the Commission.


By: **Florence E Harmon**
Deputy Secretary

Elizabeth M. Murphy
Secretary

⁴ 17 C.F.R. § 201.180(c).

⁵ 17 C.F.R. § 201.150(d).

⁶ 17 C.F.R. § 201.102(d)(2).

⁷ See, e.g., *Markland Techs., Inc.*, Securities Exchange Act Rel. No. 59476 (Feb. 27, 2009), 95 SEC Docket 14599 (dismissing appeal for failure to file supporting brief).