SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **November 2010,** with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY L. SCHAPIRO, CHAIRMAN

KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(52 Documents)

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-62853; File No. 4-610]

State of the Municipal Securities Market Field Hearings

AGENCY: Securities and Exchange Commission.

ACTION: Notice of field hearings.

SUMMARY: On May 7, 2010, the Chairman of the Securities and Exchange Commission Mary L. Schapiro, announced that Commissioner Elisse B. Walter would lead an effort to gather facts, opinions and analyses about the municipal securities market by holding a series of field hearings across the country. A broad array of municipal market participants representing diverse viewpoints will be invited to participate in the field hearings by sharing their perspectives on important topics relating to the municipal securities market.

DATES: The initial field hearing will be held on September 21, 2010 in San Francisco, California and will be open to the public. The field hearing will begin at 9 a.m. Over the next several months, the Commission will hold four additional public field hearings in cities across the country. Information regarding the dates and times of future field hearings will be available on the Commission's website at http://www.sec.gov.

ADDRESSES: The September 21, 2010 field hearing will be held at the Port of San Francisco, Pier 1, The Embarcadero, San Francisco, CA 94111. Information regarding the locations of future field hearings will be available on the Commission's website at http://www.sec.gov. Comments relating to the state of the municipal securities market field hearings may be filed electronically by e-mail to munifieldhearings@sec.gov or through the comment form available at: http://www.sec.gov/rules/other.shtml. Transcripts of the field hearings and all submitted comments will also be available on the Commission's website at http://www.sec.gov. 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: Alicia F. Goldin, Office of Commissioner Elisse B. Walter, at (202)551-5618, Lesli Sheppard, Office of Commissioner Elisse B. Walter, at (202)551-2806 or Kayla Gillan, Office of the Chairman, at (202)551-2600.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: September 7, 2010

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9155 / November 1, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14103

In the Matter of MAZHAR UL HAQUE, Respondent.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Mazhar Ul Haque ("Respondent" or "Haque").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order (the "Order"), as set forth below.

III.

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

SUMMARY

1. These proceedings arise out of a scheme to pump and dump the stock of Veltex Corp. ("Veltex"), an apparel company with purported operations in the U.S., Canada, and Bangladesh. Beginning in at least 2006, Veltex's CEO, Javeed Azziz Matin ("Matin"), enlisted Mazhur Haque as a figurehead over a company Matin owned, Wilshire Equity, Inc. ("Wilshire Equity"), and then funneled millions of Veltex shares to Wilshire Equity in an unregistered offering. Wilshire Equity then immediately resold the stock to the public, thereby acting as underwriters. Haque signed subscription agreements and other documents to facilitate the distribution of Veltex shares.

RESPONDENT

2. Mazhar Ul Haque, age 61, resides in Mira Loma, California. He worked as an accountant at Veltex Corp. from 2004 through 2008, and as a director of Veltex from November 2007 through May 2008. He was also the officer and director of Wilshire Equity, Inc. He holds a bachelor's degree from Pakistan with emphasis in accounting and is not registered with the Commission in any capacity.

RELATED ENTITIES & PERSON

3. Veltex, previously called Coconino S.M.A., Inc., is a Utah corporation. Veltex shares are quoted on the Pink Sheets operated by Pink OTC Markets Inc. During the time of the relevant conduct, the company's principal place of business was in the City of Industry, California. Neither Veltex nor its securities are registered under the Securities Exchange Act of 1934 ("Exchange Act").

4. Matin, age 52, resides in Diamond Bar, California. Until August 2008, he was the CEO and a director of Veltex. Matin does not hold any securities licenses.

5. Wilshire Equity is a Colorado corporation with its principal place of business in Mira Loma, California. Wilshire Equity has been in delinquent corporate status since February 2008. Neither Wilshire Equity nor its securities are registered under the Exchange Act.

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

FACTS

6. In 2002, Matin formed Wilshire Equity to receive and sell Veltex shares. Although Matin owned 100% ownership interest in Wilshire Equity, he enlisted Haque as a figurehead to serve as Wilshire Equity's officer and director and the signatory on its bank and brokerage accounts.

7. From at least 2006 through mid-2008, Veltex issued approximately 8.5 million shares in separate and purportedly exempt transactions to Wilshire Equity. For each transaction, there was an authorizing Veltex board resolution and a subscription agreement, signed by Haque.

8. Haque followed Matin's directions in signing numerous subscription agreements on behalf of Wilshire Equity for the purchase of Veltex shares. The subscription agreements represented and warranted that (a) the stock transfer was pursuant to an exemption under Rule 504 of Regulation D of the Securities Act, which exempts from registration any offer or sale of securities that does not exceed $1 million for all securities sold within 12 months from the start of the offering; and (b) Wilshire Equity was not acquiring the shares with a view to distribution. Haque did not read the agreements and did not question Matin.

9. Based on the subscription agreements and other oral representations, Veltex's attorney issued opinion letters to Veltex's transfer agent stating that the stock sales to Wilshire Equity were exempt from registration based on Regulation D, Rule 504 of the Securities Act.

10. Contrary to his representations in the subscription agreements, Haque, at Matin's direction, caused Wilshire Equity to sell Veltex shares immediately upon receiving the same. During the relevant time period, Wilshire Equity sold about 8.5 million shares of Veltex, usually within days of receiving the shares, generating sales proceeds of approximately $6.5 million.

11. As a result of the conduct described above, Haque violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the direct or indirect sale or offer for sale of securities through the mail or interstate commerce unless a registration statement has been filed or is in effect.

IV.

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

Accordingly, it is hereby ORDERED that:

Pursuant to Section 8A of the Securities Act, Respondent Haque cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act.

By the Commission.

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63232 / November 2, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3101 / November 2, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14105

In the Matter of

Joseph D. Bonanno,

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 Joseph D. Bonanno ("Bonanno" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Bonanno, using the alias Timothy Hyde, was the president and owner of Hyde Financial Investments LLC, an investment adviser registered with the Commission. Bonanno was registered as an investment adviser representative from approximately February 9, 2009 through April 8, 2009. Bonanno was also a registered representative of at least two registered broker-dealers: Cadaret, Grant & Co. and AXA Advisors, LLC. Bonanno, 49 years old, currently resides in federal prison in Beaumont, Texas.

2. On August 6, 2009, in United States v. Joseph D. Bonanno, Case No. 5:09-CR-170 (N.D. Ohio), Bonanno pled guilty to wire fraud, aggravated identity theft, false statements, and false statements in application for a passport. On April 22, 2010, a judgment was entered against Bonanno, sentencing him to 3½ years in prison, 3 years of supervised release, and a $500 fine.

3. The criminal indictment to which Bonanno pled guilty alleged, inter alia, that in 1988, Bonanno fled to avoid felony larceny charges in Massachusetts and moved to Ohio where he assumed the identity of Timothy Hyde, a baby who died in 1976. The indictment further alleged that Bonanno obtained a copy of Hyde's birth certificate, requested a Social Security number for Hyde, and in 2001, using the Hyde alias, became a registered representative with a registered broker dealer. The indictment states that in doing so, Bonanno transmitted to the Financial Industry Regulatory Authority a Form U4 which represented that he was Timothy Hyde and further represented that he had never been charged with a felony.

IV.

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

Accordingly, it is hereby ORDERED:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro and Commissioner Casey not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9156 / November 2, 2010

SECURITIES EXCHANGE ACT OF 1934
Release No. 63231 / November 2, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3100 / November 2, 2010

INVESTMENT COMPANY ACT OF 1940
Release No. 29495 / November 2, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13675

In the Matter of **Value Line, Inc.,** **Value Line Securities, Inc.,** **Jean Bernhard Buttner, and** **David Henigson,** **Respondents.**	**ORDER MODIFYING ORDER INSTITUTING PROCEEDINGS EXTENDING PERIOD OF TIME FOR RESPONDENT JEAN BERNHARD BUTTNER TO COMPLY WITH ASSOCIATIONAL BARS**

I.

FACTS

1. On November 4, 2009, the Commission instituted and simultaneously settled public administrative and cease-and-desist proceedings against Value Line, Inc. ("VLI"), Value Line Securities, Inc., Jean Bernhard Buttner ("Buttner") (the former CEO, Chairman, and President of VLI), and David Henigson ("Henigson") (the former Chief Compliance Officer of VLI) for violations of Sections 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; Sections 206(1), 206(2), and 207 of the Investment Advisers Act of 1940, and Sections 34(b), 15(c), and 17(e)(1) of the Investment Company Act of 1940. See Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b)(4), 15(b)(6) and 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Admin. Proc. File No. 3-13675 (November 4, 2009) (the "Order").

2. In the Order, the Commission found that Respondents violated, or aided and abetted and caused violations of, the anti-fraud and other provisions of the federal securities laws in misappropriating assets from mutual funds that VLI managed by charging the funds over $24 million in phantom brokerage commissions, which VLI funneled to its affiliated broker-dealer. The Commission censured the Respondents and imposed cease-and-desist orders against them. The Commission also ordered VLI to pay a total of $43,705,765 in disgorgement, prejudgment interest and civil penalty, and ordered Buttner and Henigson to pay civil penalties of $1,000,000 and $250,000, respectively. The Commission further imposed officer and director bars and broker-dealer, investment adviser, and investment company associational bars ("Associational Bars") against Buttner and Henigson.

3. The Associational Bars against Buttner provide a one-year carve-out period, until November 4, 2010, that allowed Buttner to perform tasks related to VLI's regulated entities to the extent such tasks were related to, among other things, transactions that would result in Buttner's complete disassociation from the regulated entities.

4. VLI and Buttner have requested that the November 4, 2010 deadline to complete Buttner's full disassociation from the regulated entities be extended to December 24, 2010 in order to complete a proposed restructuring relating to VLI and the regulated entities.

5. The Commission deems it appropriate and in the public interest to grant the requested extension.

II.

In view of the foregoing, it is ORDERED that:

1. Section IV, Paragraph J of the November 4, 2009 Order be modified as follows:

> Buttner be, and hereby is, barred from association with any broker, dealer, or investment adviser, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter (collectively, "Associational Persons"), provided however, that Buttner may, for a period up to and including December 24, 2010, (i) serve as an officer or director and hold and exercise a controlling interest in any parent company of VLI that is not affiliated with any Associational Person other than through VLI and that does not have a class of securities registered pursuant to Section 12 of the Exchange Act and that is not required to file reports pursuant to Section 15(d) of the Exchange Act; (ii) continue to hold and exercise control over VLI through her beneficial ownership of VLI voting stock so long as she does not (A) attempt to influence or exercise voting control of her VLI shares concerning the operations of EULAV and EULAV Securities so long as EULAV is an investment adviser and so long as EULAV Securities is a broker or dealer; or (B) communicate directly or indirectly with any EULAV or EULAV Securities employee concerning the operations of EULAV and EULAV Securities so long as EULAV is an investment adviser and so long as EULAV Securities is a broker or dealer, in each

case except as necessary in connection with the activities contemplated by clause (iii) below; and (iii) perform tasks or functions relating to EULAV or EULAV Securities solely to the extent necessary to effectuate one or more transactions, the ultimate result of which is to terminate Buttner's affiliated person status with respect to EULAV and EULAV Securities and/or EULAV's status as an investment adviser and EULAV Securities' status as a broker or dealer and/or for VLI to cease to have a class of securities registered pursuant to Section 12 of the Exchange Act and not to be required to file reports pursuant to Section 15(d) of the Exchange Act. For the avoidance of doubt, at such time as Buttner terminates her affiliated person status with respect to EULAV and EULAV Securities, the proviso to the preceding sentence beginning with the words "provided however" shall cease to be operative. Buttner shall provide a copy of the Order to VLI's Board of Directors and notify them of the limitations placed on her participation in VLI's corporate functions.

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. 34-63241; File No. S7-03-10]

RIN 3235-AK53

Risk Management Controls for Brokers or Dealers with Market Access

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is adopting new Rule 15c3-5 under the Securities Exchange Act of 1934 ("Exchange Act"). Rule 15c3-5 will require brokers or dealers with access to trading securities directly on an exchange or alternative trading system ("ATS"), including those providing sponsored or direct market access to customers or other persons, and broker-dealer operators of an ATS that provide access to trading securities directly on their ATS to a person other than a broker or dealer, to 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 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 or dealer or customer is restricted from trading, restrict market

5 of 52

access technology and systems to authorized persons, and assure appropriate surveillance personnel receive immediate post-trade execution reports.

The financial and regulatory risk management controls and supervisory procedures required by Rule 15c3-5 must be under the direct and exclusive control of the broker or dealer with market access, with limited exceptions specified in the Rule that permit reasonable allocation of certain controls and procedures to another registered broker or dealer that, based on its position in the transaction and relationship with the ultimate customer, can more effectively implement them. In addition, a broker or dealer with market access will 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 will 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. The review will be required to be conducted in accordance with written procedures and will be required to be documented. In addition, the Chief Executive Officer (or equivalent officer) of the broker or dealer will be required, on an annual basis, to certify that the risk management controls and supervisory procedures comply with Rule 15c3-5, and that the regular review described above has been conducted.

DATES: Effective Date: [insert date that is 60 days from publication in the <u>Federal Register</u>].

Compliance Date: [insert date that is six months from effective date].

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.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background

Given the increased 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 ("MPID"), 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. New Rule 15c3-5 is designed to ensure that broker-dealers 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.

On January 26, 2010, Proposed Rule 15c3-5 was published for public comment in the Federal Register.[1] The Commission received 47 comment letters on Proposed Rule 15c3-5 from broker-dealers, markets, institutional and individual investors, technology providers, and other

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1 See Securities Exchange Act Release No. 61379 (January 19, 2010), 75 FR 4007 (January 26, 2010) (File No. S7-03-10) ("Proposing Release").

market participants.[2] Nearly all of the commenters supported the overarching goal of the proposed rulemaking – to assure that broker-dealers with market access have effective controls and procedures reasonably designed to manage the financial, regulatory, and other risks of that activity. As further discussed below, however, several commenters recommended that the proposal be amended or clarified in certain respects. As a result, the Commission is adopting Rule 15c3-5 substantially as proposed, but with certain narrow modifications as discussed below. As proposed, Rule 15c3-5 would require brokers or dealers with access to trading directly on an exchange or 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.

The development and growth of automated electronic trading have 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 year, the Commission has taken a broad and critical look at market structure practices in light of the rapid development in trading technology and strategies. The Commission has proposed several rulemakings, including this rulemaking, to address specific vulnerabilities in the current market structure.[3] In addition, this past January, the Commission published a concept release on equity

2 Copies of comments received on the proposal are available on the Commission's Internet website, located at http://www.sec.gov/comments/s7-03-10/s70310.shtml, and in the Commission's Public Reference Room at its Washington, DC headquarters.

3 See, e.g., Securities Exchange Act Release Nos. 60684 (September 18, 2009), 74 FR 48632 (September 23, 2009) (Proposal to Eliminate Flash Order Exception from Rule 602 of Regulation NMS) (File No. S7-21-09); 60997 (November 13, 2009), 74 FR 61208 (November 23, 2009) (Proposal to Regulate Non-Public Trading Interest) (File No. S7-

market structure designed to further the Commission's broad review of market structure to assess whether its rules have kept pace with, among other things, changes in trading technology and practices.[4]

The recent proliferation of sophisticated, high-speed trading technology has changed the way broker-dealers trade for their own accounts and as agents for their customers.[5] 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.[6]

Under these 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 MPID or other mechanism or mnemonic used to identify a market participant for the purposes of electronically accessing an exchange or ATS. Generally, direct market access refers to an arrangement whereby a broker-dealer permits customers to enter

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27-09); 61908 (April 14, 2010), 75 FR 21456 (April 23, 2010) (Proposed Large Trader Reporting System) (File No. S7-10-10); and 62174 (May 26, 2010), 75 FR 32556 (June 8, 2010) (Proposed Consolidated Audit Trail) (File No. S7-11-10).

4 See Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594 (January 21, 2010) (File No. S7-02-10) ("Concept Release").

5 The Commission notes that high frequency trading has been estimated to account for more than 50 percent of the U.S. equities market volume. See Concept Release, 75 FR at 3606.

6 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, 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.").

orders into a trading center but such orders flow through the broker-dealer's trading systems prior to reaching the trading center. In contrast, sponsored access generally refers to an arrangement whereby a broker-dealer permits customers to enter orders into a trading center that bypass the broker-dealer's trading system and are routed directly to a trading center, in some cases supported by a service bureau or other third party technology provider.[7] "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. 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 access is legally responsible for all trading activity that occurs under its MPID.[8]

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,[9] help preserve the confidentiality of sophisticated, proprietary

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7 See, e.g., Nasdaq Rule 4611(d)(1)(A). The Commission notes that Rule 15c3-5 will effectively prohibit any access to trading on an exchange or ATS, whether sponsored or otherwise, where pre-trade controls are not applied.

8 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). 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.

9 Highly automated trading systems deliver extremely high-speed, or "low latency" order responses and executions in some cases measured in times of less than 1 millisecond.

trading strategies, and reduce trading costs by lowering operational costs,[10] commissions, and exchange fees.[11]

Current self-regulatory organization ("SRO") rules and interpretations governing electronic access to markets have sought to address the risks of this activity.[12] However, the Commission 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

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

11 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.

12 See Proposing Release, 75 FR at 4010 – 4011 and 4029 – 4031 for a more detailed description of previous SRO guidance and rules. 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, this past January, the Commission approved 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. 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 to the Proposing Release. Nasdaq has delayed the implementation of this rule until 360 days after its approval. See Securities Exchange Act Release Nos. 61770 (March 24, 2010), 75 FR 16224 (March 31, 2010) (SR-NASDAQ-2010-039); and 62491 (July 13, 2010), 75 FR 41918 (July 19, 2010) (SR-NASDAQ-2010-086).

proprietary account or as agent for its customers, including traditional agency brokerage and through direct market access or sponsored access arrangements.

The Commission 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),[13] 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 believes that risk management controls and supervisory procedures that are not applied on a pre-trade basis or that, with certain limited exceptions, 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.

Market participants recognize the risks associated with naked sponsored access, with one commenter noting, for example, that the potential systemic risk is now "too large to ignore."[14]

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13 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).

14 See letter to Elizabeth M. Murphy, Secretary, Commission, from John Jacobs, Director of Operations, Lime Brokerage LLC, March 29, 2010 ("Lime Letter") at 1 ("[T]he potential for systemic risk posed by unregulated entities accessing the public markets directly and

Today, order placement rates can exceed 1,000 orders per second with the use of high-speed, automated algorithms.[15] 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 risk controls could prevent this outcome from occurring by blocking unintended orders from being routed to an exchange or ATS.

As noted in the Proposing Release, while incidents involving algorithmic or other trading errors in connection with market access occur with some regularity,[16] the Commission also is

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without any supervision is an issue too large to ignore, with estimates that naked access may account for somewhere between 10% - 38% of all US equity market trading activity, and most likely a much greater participation percentage for orders placed."); See also letter to Elizabeth M. Murphy, Secretary, Commission, from Jose Marques, Managing Director, Global Head of Electronic Equity Trading, Deutsche Bank Securities Inc., March 31, 2010 ("Deutsche Bank Letter") at 2 ("[W]e are cognizant of the market and systemic risks that regulators perceive in unchecked market access, and agree that uniform guidance from the SEC as to the responsibilities of market access is needed.").

15 See letter to Elizabeth M. Murphy, Secretary, Commission, from John Jacobs, Director of Operations, Lime Brokerage LLC, February 17, 2009 (commenting on a proposed rule change filed by The NASDAQ Stock Market LLC to adopt a modified sponsored access rule (File No. SR-NASDAQ-2008-104)).

16 Proposing Release, 75 FR at 4009. For example, it was reported that, on September 30, 2008, shares of Google fell as much as 93% in value due to an influx of erroneous orders onto an exchange from a single market participant. See 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"). 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. John Hintze, Risk Revealed in Post-Trade Monitoring, Securities Industry News, September 8, 2009 ("SWS Trading Incident"). Another recent example occurred on January 4, 2010, when it was reported that shares of Rambus, Inc. suffered an intra-day price drop of approximately thirty-five percent due to erroneous trades causing stock and options exchanges to break trades. 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-

concerned about preventing other, potentially 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. In addition, the inter-connectedness of the financial markets can exacerbate market movements, whether they are in response to actual market sentiment or trading errors.

For instance, on May 6, 2010, the financial markets experienced a brief but severe drop in prices, falling more than 5% in a matter of minutes, only to recover a short time later.[17] This incident provides a striking example of just how quickly and severely today's financial markets

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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"). More recently, single stock circuit breakers have been triggered for trading in shares of The Washington Post Company (WPO) and Progress Energy, Inc. (PGN) on June 16, 2010 and on September 27, 2010, respectively, due to severe price movements caused by order entry errors. In addition, certain exchanges provide a searchable history of erroneous trade cancellations on their website, which indicate that erroneous trades occur with some regularity. See http://www.nasdaqtrader.com/Trader.aspx?id=MarketSystemStatusSearch.

17. See Findings Regarding the Market Events of May 6, 2010, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues at http://www.sec.gov/news/studies/2010/marketevents-report.pdf. See also Preliminary Findings Regarding the Market Events of May 6, 2010, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues at http://www.sec.gov/sec-cftc-prelimreport.pdf. The Commission has taken steps to address the market vulnerabilities evidenced by the events of May 6th such as by working with the exchanges and FINRA to implement coordinated circuit breakers for individual stocks and to clarify the process for breaking erroneous trades. See Securities Exchange Act Release Nos. 62283 (September 10, 2010), 75 FR 56608 (September 16, 2010); 62884 (September 10, 2010), 75 FR 56618 (September 16, 2010); 62251 (June 10, 2010), 75 FR 34183 (June 16, 2010); and 62252 (June 10, 2010), 75 FR 34186 (June 16, 2010); see also Securities Exchange Act Release Nos. 62885 (September 10, 2010), 75 FR 56641 (September 16, 2010); and 62886 (September 10, 2010), 75 FR 56613 (September 16, 2010). The Commission will continue to explore additional ways in which these vulnerabilities can be addressed.

can move across a wide range of securities and futures products. If a price shock in one or more securities were to occur as a result of computer or human error, for example, it could spread rapidly across the financial markets, potentially with systemic implications. To address these risks, the Commission believes broker-dealers, as the entities through which access to markets is obtained, should implement effective controls reasonably designed to prevent errors or other inappropriate conduct from potentially causing a significant disruption to the markets.

The Commission believes that Rule 15c3-5 should 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 reasonably designed to limit financial exposure and ensure compliance with applicable regulatory requirements to be implemented on a market-wide basis. As described below, 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. 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.

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.[18] Moreover, by establishing a single set of broker-dealer obligations with respect to market access risk management controls across markets, Rule 15c3-5 will provide uniform

18 See Proposing Release, Appendix, 75 FR at 4029 – 4031 (noting current SRO guidance with regard to internal procedures and controls to manage the financial and regulatory risks associated with market access for members that provide market access to customers).

standards that will be interpreted and enforced in a consistent manner and, as a result, reduce the potential for regulatory arbitrage.[19]

II. Rule 15c3-5

The Commission is adopting 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 reasonably designed to limit financial exposure and ensure compliance with applicable regulatory requirements 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. 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. Rule 15c3-5 will 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, such as legal and operational risks, related to market access. The Rule will apply to trading in all securities on an exchange or

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19 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 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.").

ATS,[20] including equities, options, exchange-traded funds, debt securities, and security-based swaps.[21] Further, it will require that the broker or dealer with market access have direct and exclusive control of the risk management controls and supervisory procedures, while permitting the reasonable and appropriate allocation of specific risk management controls and supervisory procedures to a customer that is a registered broker-dealer so long as the broker-dealer providing market access has a reasonable basis for determining that such customer, based on its position in the transaction and relationship with the ultimate customer, can more effectively implement them. Finally, and importantly, Rule 15c3-5 will require those controls to be implemented on a pre-trade basis, which will necessarily eliminate the practice of broker-dealers providing "unfiltered" or "naked" access to any exchange or ATS. As a result, the Commission believes Rule 15c3-5 should substantially mitigate a particularly serious vulnerability of the U.S. securities markets.

After careful review and consideration of the comment letters, the Commission has determined to adopt Rule 15c3-5 substantially as proposed, but with certain narrow modifications made in response to concerns expressed by commenters as discussed below. Consistent with the Proposing Release, Rule 15c3-5 is organized as follows: (1) relevant definitions, as set forth in Rule 15c3-5(a); (2) the general requirement to maintain risk management controls and supervisory procedures in connection with market access, as set forth

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20 Under Section 763 of the Dodd-Frank Wall Street Reform and Customer Protection Act ("Dodd-Frank Act"), the Commission has new authority over security-based swap execution facilities. The Commission will consider possible application of risk management controls and supervisory procedures to trading on security-based swap execution facilities and other venues that facilitate the trading of such products.

21 The Dodd-Frank Act, in Section 761, amended the definition of security to include security-based swaps. As such, the Commission notes that Rule 15c3-5 will apply to a broker or dealer with access to trading security-based swaps on a national securities exchange that makes security-based swaps available to trade.

in Rule 15c3-5(b); (3) the more specific requirements to maintain certain financial and regulatory risk management controls and supervisory procedures, as set forth in Rule 15c3-5(c); (4) the mandate that those controls and supervisory procedures, with certain limited exceptions, be under the direct and exclusive control of the broker-dealer with market access, as set forth in 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 Rule 15c3-5(e). This release first gives a general description of Rule 15c3-5 as adopted and then, in turn, discusses the specific provisions of Proposed Rule 15c3-5, the comments received on each provision, and any modifications to the provision from the Proposing Release.

A. Summary of Rule 15c3-5

Rule 15c3-5 will 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 Rule will require that broker-dealers with access to trading securities on an exchange or ATS, as a result of being a member or subscriber thereof, and broker-dealer operators of an ATS that provide access to their ATS to a non-broker-dealer, 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.[22] Broker-dealers that provide outbound routing

22 The Commission notes that the term "regulatory requirements" references existing regulatory requirements applicable to broker-dealers in connection with market access,

services to an exchange or ATS in order for those trading centers to meet the requirements of Rule 611 of Regulation NMS will not be required to comply with the Rule with respect to such routing services, except with regard to paragraph (c)(1)(ii) of the Rule (regarding prevention of erroneous orders).

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 regulatory risk management controls and supervisory procedures must 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-dealer will 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.[23]

The financial and regulatory risk management controls and supervisory procedures required by Rule 15c3-5 must be under the direct and exclusive control of the broker-dealer with market access, with certain limited exceptions permitting allocation to a customer that is a

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and is not intended to substantively expand upon them. The specific content of the "regulatory requirements" would, of course, adjust over time as laws, rules, and regulations are modified.

23 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.

registered broker-dealer of specified functions that, based on its position in the transaction and relationship with the ultimate customer, it can more effectively implement. In addition, a broker-dealer with market access will 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-dealer will be required to review, no less frequently than annually, the business activity of the broker-dealer in connection with market access to assure the overall effectiveness of its risk management controls and supervisory procedures. Such review will be required to be conducted in accordance with written procedures and will be required to be documented. The broker-dealer will be required to preserve a copy of its written procedures, and documentation of each review, as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act,[24] and Rule 17a-4(b) under the Exchange Act, respectively.[25]

In addition, the Chief Executive Officer (or equivalent officer) of the broker-dealer will be required, on an annual basis, to certify that the risk management controls and supervisory procedures comply with Rule 15c3-5, and that the regular review described above has been conducted. Such certifications will be required to be preserved by the broker-dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act.[26]

B. Definitions

As proposed, Rule 15c3-5 sets forth two defined terms: "market access" and "regulatory requirements." The term "market access" is central to Proposed Rule 15c3-5, as it determines

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24 Id.

25 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.

26 Id.

which broker-dealers are subject to Rule and the scope of the required financial and regulatory risk management controls and supervisory procedures. In the Proposing Release, the Commission proposed to define the term "market access" 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.[27] In the Proposing Release, the Commission explained that "market access" is intentionally defined broadly 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 for more traditional agency activities. In addition, the proposed definition would encompass trading in all securities on an exchange or ATS, including equities, options, exchange-traded funds, debt securities, and security-based swaps.

1. Non-Broker-Dealer ATS Subscribers

By its terms, the proposed rule would not have applied to non-broker-dealer market participants, including non-broker-dealer subscribers to ATSs.[28] In addition, as proposed, the definition of "market access" was limited by the phrase "as a result of being a member or subscriber of the exchange or ATS, respectively." Accordingly, a broker-dealer that operates an ATS and provides non-broker-dealer market participants access to its ATS would not have been included within the proposed definition of market access, because such access would not result from that broker-dealer being a subscriber to the ATS, but rather from its being the ATS operator.

27 Proposed Rule 15c3-5(a)(1).

28 See Proposing Release, 75 FR at 4012 n. 35 (stating that "Proposed Rule 15c3-5 would not apply to non-broker-dealers, including non-broker-dealers that are subscribers of an ATS.").

With regard to exchanges, the Exchange Act requires members to be registered broker-dealers.[29] Accordingly, the proposed rule was intended to ensure that all orders submitted to an exchange would flow through broker-dealer systems subject to Rule 15c3-5 prior to such orders entering an exchange. While the majority of ATS subscribers are broker-dealers, the current ATS regulatory regime does not require a subscriber to be a broker-dealer.[30] As proposed, since a non-broker-dealer subscriber to an ATS would not have been subject to the proposed rule, orders it submits directly to an ATS to which it subscribes would not have flowed through a broker-dealer system subject to Proposed Rule 15c3-5 before entering the ATS.

In the Proposing Release, the Commission requested comment on whether the broker-dealer operator of an ATS should be required to implement risk management controls and supervisory procedures with regard to a non-broker-dealer subscriber's access to its ATS. Nine commenters specifically addressed non-broker-dealer access to trading in securities on ATSs in response to this request.[31] Generally, these commenters believed that all orders entered on an

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29 See 15 U.S.C. 78f(c)(1) ("A national securities exchange shall deny membership to (A) any person, other than a natural person, which is not a registered broker or dealer or (B) any natural person who is not, or is not associated with, a registered broker or dealer.").

30 See 17 CFR 242.300(b).

31 See letters to Elizabeth M. Murphy, Secretary, Commission, from Marcia E. Asquith, Senior Vice President and Corporate Secretary, FINRA, March 25, 2010 ("FINRA Letter"); Christopher Lee, Global Head of Market Access, and Paul Willis, Global Compliance Officer, Fortis Bank Global Clearing N.V. London Branch, March 26, 2010 ("Fortis Letter"); J. Ronald Morgan, Managing Director, Goldman, Sachs & Co., and Timothy T. Furey, Managing Director, Goldman Sachs Execution & Clearing, L.P., March 20, 2010 ("Goldman Letter"); Timothy J. Mahoney, Chief Executive Officer, Marybeth Shay, Senior Managing Director Sales and Marketing, and Vivian A. Maese, General Counsel and Corporate Secretary, BIDS Trading, March 29, 2010 ("BIDS Letter"); P. Mats Goebels, Managing Director and General Counsel, Investment Technology Group, Inc., March 29, 2010 ("ITG Letter"); Peter Kovac, Chief Operating Officer and Financial and Operations Principal, EWT LLC, March 29, 2010 ("EWT Letter"); John A. McCarthy, General Counsel, GETCO, April 1, 2010 ("GETCO Letter"); Jeffery S. Davis, Vice President and Deputy General Counsel, The Nasdaq

exchange or ATS should be subject to equivalent regulatory treatment, and urged the Commission to address this issue. For example, FINRA noted that the same regulatory and financial risks associated with broker-dealer access arrangements are present when a non-broker-dealer subscriber enters orders and accesses an ATS.[32]

Six commenters recommended that the broker-dealer operator of the ATS should be required to implement the required risk management controls and supervisory procedures with regard to order flow from non-broker-dealer subscribers.[33] In general, these commenters believed that the broker-dealer operator of an ATS is best positioned to implement the risk management controls and supervisory procedures required under the proposed rule for order flow entered into its ATS by non-broker-dealer subscribers. For example, one commenter noted that, when receiving orders from non-broker-dealer subscribers, the ATS's sponsoring broker-dealer is the only broker-dealer in the chain of order flow from the subscriber to the ATS.[34] Similarly, FINRA believed that, because ATSs themselves have regulatory obligations as registered broker-dealers and FINRA members, it is appropriate to impose risk management obligations on ATSs to the extent that non-registered entities are permitted to access its ATS.[35] Two other commenters agreed that an ATS should be required to implement risk management controls and

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OMX Group ("Nasdaq Letter"); Ann Vlcek, Managing Director and Associate General Counsel, SIFMA, April 16, 2010 ("SIFMA Letter").

32 See FINRA Letter at 3-4.

33 See FINRA Letter at 3-4; Fortis Letter at 5; Goldman Letter at 1 n. 3; BIDS Letter at 4; ITG Letter at 9; SIFMA Letter at 7.

34 See ITG Letter at 9.

35 See FINRA Letter at 3-4.

supervisory procedures with regard to order flow from non-broker-dealer subscribers, but they believed this obligation stems from its status as a market center rather than as a broker-dealer.[36]

Several commenters put forth additional ideas as to how to address non-broker-dealer subscriber access to an ATS. One commenter suggested that the broker-dealer that clears the trades that occur on an ATS for a non-broker-dealer subscriber should be required to implement the risk controls with regard to such orders.[37] Another commenter proposed that the Commission amend the ATS regulatory structure to require ATS subscribers to be broker-dealers.[38] Yet another commenter suggested that the Commission directly subject the non-broker-dealer subscribers to the proposed rule.[39] The Commission received no comments suggesting that non-broker-dealer subscriber access to an ATS should be outside the scope of the proposed rule.

The Commission agrees that similar regulatory and financial risks are present when a non-broker-dealer subscriber directly accesses an ATS as when a broker-dealer accesses an exchange or ATS. Accordingly, the Commission believes that such access should be subject to the requirements of the proposed rule to ensure that all orders that enter an ATS are subject to effective risk management controls and supervisory procedures reasonably designed to limit financial exposure and ensure compliance with applicable regulatory requirements. Specifically, the Commission believes that the broker-dealer operator of an ATS should be required to implement the financial and regulatory risk management controls and supervisory procedures required by the Rule with regard to access by non-broker-dealer subscribers to its ATS.

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36 See Fortis Letter at 5; BIDS Letter at 4.

37 See EWT Letter at 2.

38 See GETCO Letter at 7.

39 See Nasdaq Letter at 2.

As noted above, because Rule 15c3-5 will not apply to non-broker-dealer subscribers, several commenters suggested alternative ways to subject non-broker-dealer ATS subscribers to the proposed rule. The Commission believes, however, that the broker-dealer operator of an ATS is the best positioned broker-dealer to implement the risk management controls, particularly the pre-trade controls, required under the proposed rule. In addition, the Commission believes the broker-dealer operator of an ATS can effectively achieve the purposes of the Rule. Requiring the broker-dealer operator of an ATS to implement the risk management controls and supervisory procedures required by the proposed rule with respect to non-broker-dealer subscribers should ensure that all order flow entered on an ATS is subject to the Rule's financial and regulatory risk management controls and supervisory procedures.[40]

Accordingly, the term "market access" in Rule 15c3-5(a)(1), as adopted, is defined to include "access to trading in securities on an alternative trading system provided by a broker-dealer operator of an alternative trading system to a non-broker-dealer." A broker-dealer operator of an ATS, therefore, would have "market access" if it provides non-broker-dealer subscribers access to its ATS. Such a broker-dealer ATS operator would be subject to Rule 15c3-5 and would be required, among other things, to 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.

The Commission believes any broker-dealer with direct access to trading on an exchange or ATS, or that provides other market participants access to trading on an exchange or ATS, should establish effective risk management controls reasonably designed to prevent breaches of

40 As discussed in greater detail, infra, a broker-dealer subscriber of an ATS will be able to utilize the risk management tools and software provided by the ATS to fulfill the requirements of the Rule.

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.

2. "Regulatory Requirements"

Under Proposed Rule 15c3-5(a)(2), the term "regulatory requirements" was defined to include all federal securities laws, rules and regulations, and rules of SROs, that are applicable in connection with market access. In the Proposing Release, the Commission stated that it intends this definition to encompass all of a broker-dealer's regulatory requirements that arise in connection with its market access.[41] "Regulatory requirements" is a key term that controls the scope of the regulatory risk management controls and supervisory procedures required by Proposed Rule 15c3-5(c)(2). While several commenters addressed the scope of the term "regulatory requirements" in the context of the proposal to require risk management controls and supervisory systems,[42] a few commenters expressed concern regarding the specific definition of "regulatory requirements." Two commenters requested that the Commission clarify that the definition does not expand or alter the current obligations of broker-dealers with market access or that provide other market participants with access to trading on an exchange or ATS.[43] The Commission emphasizes 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 (a concern noted by some commenters). As discussed below in Section II.E, these regulatory requirements would include, for example, pre-trade

41 See Proposing Release, 75 FR at 4012.

42 These comments are addressed in Section II.E. below.

43 SIFMA Letter at 6; letter to Elizabeth M. Murphy, Secretary, Commission, from Joseph M. Velli, Chairman and Chief Executive Officer, ConvergEx Group, April 9, 2010 ("ConvergEx Letter") at 6.

requirements such as exchange trading rules relating to special order types, trading halts, odd-lot orders, and SEC rules under Regulation SHO and Regulation NMS, as well as post-trade obligations to monitor for manipulation and other illegal activity. The specific content of the "regulatory requirements" would, of course, adjust over time as laws, rules and regulations are modified.

C. Requirement to Maintain Risk Management Controls and Supervisory Procedures

Proposed Rule 15c3-5(b) sets forth the general requirement that any broker-dealer with access to trading on an exchange or ATS must establish risk management controls and supervisory procedures reasonably designed to manage the associated risks. Specifically, Proposed Rule 15c3-5(b) provides that a broker-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. Proposed Rule 15c3-5(b) requires the controls and procedures to be documented in writing, and requires the broker-dealer 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.[44]

1. "Reasonably Designed" Controls and Procedures

Proposed Rule 15c3-5(b) requires that the risk management controls and supervisory procedures of a broker-dealer subject to the rule be "reasonably designed" to manage the risks associated with market access. Commenters generally supported the proposed "reasonably

[44] See 17 CFR 240.17a-4(e)(7).

designed" standard in the rule.[45] In the Proposing Release, the Commission noted that 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.[46] Accordingly, Rule 15c3-5 does not employ a "one-size-fits-all" standard for determining compliance with the rule.[47] For example, a broker-dealer that only handles order flow from retail clients may very well develop different risk management controls and supervisory procedures than a broker-dealer that mostly services order flow from sophisticated high frequency traders.[48]

2. Application to Traditional Agency Brokerage and Proprietary Trading

As noted above, the Commission expressed the view in the Proposing Release that the financial and regulatory risk management controls and supervisory procedures described in the

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45 See, e.g., EWT Letter at 4; SIFMA Letter at 2; letters to Elizabeth M. Murphy, Secretary, Commission, from Jeffrey W. Rubin, Chair, Committee on Federal Regulation of Securities, American Bar Association, April 5, 2010 ("ABA Letter") at 5; Edward J. Joyce, President and Chief Operating Officer, Chicago Board Options Exchange, Incorporated ("CBOE Letter") at 3.

46 In agreeing with the approach of the proposed rule, one commenter noted that "[a]n effective risk management system should be tailored to the business of the broker-dealer, taking into account a comprehensive view of the firm's activities, including the individual circumstances of various customers and clients, and a quantitative analysis of the trading goals and strategies employed across all asset classes for each entity placing orders." See EWT Letter at 4.

47 ABA Letter at 5 (requesting that the Commission clearly state that the proposed "reasonably designed" standard is not meant to be a one-size-fits-all test that would unreasonably burden smaller broker-dealers). See also letter to Elizabeth M. Murphy, Secretary, Commission, from Edward Wedbush, President, and Jeff Bell, Executive Vice President, Wedbush Securities Inc., March 31, 2010 ("Wedbush Letter") at 1 (stating that "the requirements of the Proposed Rule should not be applied on a one size fits all basis.").

48 The Commission agrees with a commenter that noted that "[r]isk controls must be tailored to the particular nature of the market access, the arrangements between the market participants and the market venue, and the client's trading strategy." Goldman Letter at 2.

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.[49] Accordingly, the proposed term "market access" includes all such activities.

Certain commenters suggested that the scope of the proposed rule is too far-reaching in that it encompasses broker-dealer activities that do not raise risks as significant as those that occur in "unfiltered" sponsored access arrangements.[50] One commenter believed that the proposed rule would lead to duplicative, unnecessary, and costly regulation.[51] Another commenter, while acknowledging the risks posed by unfiltered sponsored access arrangements, questioned the need for the rule to cover other market access arrangements.[52] In contrast, one commenter stated that Rule 15c3-5 should apply equally to customer and proprietary trading activity, and "should not just be applicable to those members offering third party access."[53] Another commenter similarly noted that uniform principles with respect to market access are warranted, and that any final rule on market access should not advantage a broker-dealer's proprietary business over its customer business.[54] Yet another commenter noted that subjecting

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

50 See, e.g., ABA Letter at 2-3; CBOE Letter at 1; letter to Elizabeth M. Murphy, Secretary, Commission, from Kimberly Unger, Executive Director, The Securities Traders Association of New York, Inc., March 29, 2010 ("STANY Letter") at 2.

51 STANY Letter at 2.

52 CBOE Letter at 2.

53 Fortis Letter at 4.

54 Letter to Elizabeth M. Murphy, Secretary, Commission, from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, Managed Funds Association ("MFA"), March 29, 2010 ("MFA Letter") at 2. MFA recognized that different types of filters and control settings for proprietary orders and customer orders may be warranted due to the different types of risks presented by such orders. Id. See

proprietary trading of broker-dealers to Rule 15c3-5 would create "common expectations for all firms to police themselves in order to limit potential market impacting events."[55]

The Commission continues to believe that the risks associated with market access – 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. The Commission believes that to effectively address these risks, Rule 15c3-5 must apply broadly to all access to trading on an exchange or ATS.

In addition, the Commission, consistent with our understanding of current broker-dealer best practices, continues to believe that, in many cases, particularly with respect to proprietary trading and more traditional agency brokerage activities, that Rule 15c3-5 should be substantially satisfied by existing risk management controls and supervisory procedures already implemented by broker-dealers.[56] For these broker-dealers, Rule 15c3-5 should have a minimal impact on current business practices and, therefore, should not impose significant additional costs on those

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also Wedbush Letter at 4 ("Certain pre-trade risk filters should be applied to all orders whether sponsored or not, thereby eliminating the performance or speed differential, and effectively encouraging firms to utilize these controls.").

55 GETCO Letter at 2.

56 See Proposing Release, Appendix, 75 FR at 4029 – 4031 (noting current SRO guidance with regard to internal procedures and controls to manage the financial and regulatory risks associated with market access for members that provide market access to customers).

broker-dealers that currently employ a prudent approach to risk management.[57] Rule 15c3-5 will assure that broker-dealer controls and procedures are appropriately strengthened, as necessary, so that consistent standards are applied for all types of market access. By requiring all forms of market access by broker-dealers to meet certain baseline standards for financial and regulatory risk management controls, Rule 15c3-5 should reduce risks to broker-dealers, the markets, and the financial system, and thereby enhance market integrity and investor protection.

3. Risk Management Controls Provided by Exchanges and ATSs

Several commenters addressed the role of market centers - exchanges and ATSs – in connection with the establishment of risk management controls.[58] Some commenters suggested that market centers, rather than broker-dealers with market access, should be responsible for implementing certain pre-trade risk management controls. These commenters generally argued that the market center is best positioned to implement pre-trade risk management controls such as those designed to prevent erroneous orders and assure compliance with SRO rules relating to trading halts and special order types.[59] Some commenters argued that applying pre-trade risk controls at the market center level would provide for uniform treatment of all orders entered on

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57 Id.

58 See Wedbush Letter at 4; Fortis Letter at 2; SIFMA Letter at 6; CBOE Letter at 4; Goldman Letter at 7; GETCO Letter at 6; ITG Letter at 3-4; Lime Letter at 6; Deutsche Bank Letter at 5-6; letters to Elizabeth M. Murphy, Secretary, Commission, from Richard D. Berliand, Managing Director and Head of Prime Services and Market Structure Group, and John J. Hogan, Managing Director and Chief Risk Officer, Investment Bank, J.P. Morgan Securities Inc., April 26, 2010 ("JP Morgan Letter") at 2-3; Jesse Lawrence, Director and Managing Counsel, Pershing LLC, March 24, 2010 ("Pershing Letter") at 3-4; Nicole Harner Williams, Vice President and Associate General Counsel, Penson Worldwide, Inc., March 29, 2010 ("Penson Letter") at 3; Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC, March 29, 2010 ("Newedge Letter") at 2, 4; John M. Damgard, President, Futures Industry Association, May 6, 2010, ("FIA Letter") at 2.

59 See, e.g., Pershing Letter at 3; Penson Letter at 3; Deutsche Bank Letter at 5; Goldman Letter at 7; ITG Letter at 3; Lime Letter at 6; JP Morgan Letter at 2.

that market center,[60] and would more equitably allocate risk management obligations among those that benefit from trading.[61] In this regard, commenters noted that certain exchanges currently provide users with an array of pre-trade risk controls, and urged the Commission to allow broker-dealers to rely on these exchange controls to comply with the Rule.[62] The Commission believes that market center-provided pre-trade risk controls can be useful risk management tools. The Commission continues to believe, however, that broker-dealers with market access should be responsible in the first instance for establishing and maintaining appropriate risk management controls under the Rule. The Commission notes, as discussed in Section F. below, that broker-dealers may be able to use market center-provided pre-trade risk controls as part of an overall plan to comply with the Rule. In addition, the Commission notes that market centers may independently implement pre-trade risk management controls to supplement those applied by broker-dealers.

4. Routing Brokers

In the Proposing Release, the Commission requested comment on whether any particular market access arrangement warranted different treatment under the proposed rule. In response, eight commenters expressed concern with the application of the proposed rule to broker-dealers that provide outbound order routing services to exchanges.[63] In addition, two of these

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60 See, e.g., Deutsche Bank Letter at 2; Lime Letter at 6; Wedbush Letter at 4; Pershing Letter at 3.

61 See, e.g., Newedge Letter at 2.

62 See, e.g., Wedbush Letter at 4. See also NYSE Letter at 3; BATS Letter at 2; BIDS Letter at 2.

63 See Nasdaq Letter at 4; CBOE Letter at 3; EWT Letter at 4; ConvergEx Letter at 5; GETCO Letter at 5; letters to Elizabeth M. Murphy, Secretary, Commission, from Eric W. Hess, General Counsel, Direct Edge Holdings, LLC, March 26, 2010 ("Direct Edge Letter") at 1-3; Eric J. Swanson, Senior Vice President and General Counsel, BATS Exchange, Inc., March 21, 2010 ("BATS Letter") at 3-4; Janet M. Kissane, Senior Vice

commenters noted the same concerns with respect to broker-dealers that provide outbound order routing services to ATSs.[64] As proposed, Rule 15c3-5 would have applied to routing brokers because they have "market access," as defined in Rule 15c3-5(a)(1).

Exchanges and ATSs use outbound order routing services provided by broker-dealers to, among other things, comply with the trade-through provisions of Rule 611 of Regulation NMS[65] for NMS stocks, and the trade-through provisions of Options Linkage Plan[66] for listed options, by routing orders to better-priced quotes at away markets. Some exchanges and ATSs use affiliated broker-dealers to perform this function, and others contract with an unaffiliated broker-dealer to do so.[67] In general, the outbound order routing service provided to exchanges by broker-dealers is regulated as a facility of the exchange, and therefore is subject to direct Commission oversight.[68]

President – Legal and Corporate Secretary, Office of the General Counsel, NYSE Euronext, March 29, 2010 ("NYSE Letter") at 4-5.

64 See, e.g., GETCO Letter at 5; CBOE Letter at 3.

65 See 17 CFR 242.611. Pursuant to Rule 611 of Regulation NMS, exchanges and ATSs are required to, among other things, establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on such exchange or ATS of protected quotations in NMS stocks. Exchanges and ATSs generally comply with this requirement, in part, by employing an affiliated or unaffiliated broker-dealer to route orders received by the exchange or ATS to other trading centers displaying protected quotations.

66 The Options Linkage Plan is a Commission-approved national market system plan. Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (Order Approving the National Market System Plan Relating to Options Order Protection and Locked/Crossed Markets Submitted by the Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NYSE Amex LLC, and NYSE Arca, Inc.) ("Options Linkage Plan").

67 See, e.g., Direct Edge Letter at 2; Nasdaq Letter at 4; NYSE Letter at 4.

68 See, e.g., The NASDAQ Stock Exchange LLC Rule 4758(b); BATS Exchange, Inc. Rule 2.11(a); and New York Stock Exchange, Inc. Rule 13. Several commenters noted that exchange routing brokers operate as facilities of exchanges. See Nasdaq Letter at 4;

Commenters noted that, under the proposal, orders submitted to an exchange would first have to flow through broker-dealer systems that are subject to the financial and regulatory risk controls required by proposed Rule 15c3-5, and suggested that requiring routing brokers to perform the same risk checks immediately thereafter would be duplicative.[69] These commenters suggested that subjecting routing brokers to proposed Rule 15c3-5 would impose unnecessary costs and inefficiencies without any corresponding benefits. In addition, some commenters, argued that routing brokers would not necessarily have the requisite knowledge to effectively implement the required pre-trade risk checks.[70]

The Commission is adopting Rule 15c3-5 to include an exception for broker-dealers that provide outbound routing services to an exchange or ATS for the sole purpose of accessing other trading centers with protected quotations on behalf the exchange or ATS in order to comply with Rule 611 of Regulation NMS, or a national market system plan for listed options. Under Rule 15c3-5, orders sent to an exchange or ATS for execution on that exchange or ATS are required to be subject to broker-dealer risk management controls immediately before submission to the exchange or ATS.[71] When providing outbound routing services to an exchange or ATS for the sole purpose of accessing other trading centers with protected quotations on behalf the exchange

NYSE Letter at 4; Direct Edge Letter at 1. Nasdaq stated that "exchange-operated broker-dealers are already heavily regulated as exchange facilities, including rule strictly limiting them to a single client, the exchange itself."

69 See Nasdaq Letter at 4; NYSE Letter at 5; BATS Letter at 4; Direct Edge Letter at 2-3; CBOE Letter at 3; GETCO Letter at 5.

70 See Direct Edge Letter at 2; ConvergEx Letter at 5; GETCO Letter at 5; BATS Letter at 4; EWT Letter at 4.

71 The Commission notes that, as adopted, Rule 15c3-5 requires a broker-dealer operator of an ATS to implement the financial and regulatory risk management controls required by the rule with regard to non-broker-dealer subscriber's access to its ATS. As discussed above, with this change, Rule 15c3-5 requires all orders that enter an ATS (i.e. orders entered by broker-dealer subscribers and non-broker-dealer subscribers) to flow through broker-dealer risk management controls subject to the proposed rule.

or ATS in order to comply with Rule 611 of Regulation NMS, or a national market system plan for listed options, routing brokers necessarily would only handle orders that have just passed through broker-dealer risk management controls subject to Proposed Rule 15c3-5. Accordingly, the Commission believes that excepting routing brokers employed by exchanges and ATSs to comply with Rule 611of Regulation NMS, or a national market system plan for listed options, from the requirements of Rule 15c3-5 should serve to encourage efficient routing services for the purpose of Regulation NMS compliance without increasing the risks associated with market access. The Commission notes, however, that routing brokers will not be exempt from the requirement in Rule 15c3-5(c)(1)(ii) 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. The Commission believes that requiring routing brokers to have controls reasonably designed to prevent the entry of erroneous or duplicative orders should help ensure that order handling by an exchange or ATS routing broker would not increase risk.

The Commission notes that the exception applies only to the extent a routing broker is providing services to an exchange or ATS for the purpose of fulfilling the compliance obligations of the exchange or ATS under Rule 611 of Regulation NMS, or a national market system plan for listed options. Routing services of an exchange or ATS routing broker that are not limited to compliance with Rule 611 of Regulation NMS may include a more complex order routing process involving new decision-making by the routing broker that warrant imposition of the full range of market access risk controls. Accordingly, the Commission believes that in these circumstances the exchange or ATS routing broker should be fully subject to Rule 15c3-5. The exception would not apply, for example, to a broker-dealer when it provides other routing services for the exchange or ATS, such as directed routing for exchange or ATS customers. In addition, the Commission emphasizes that this exception only applies to the requirements of Rule 15c3-5. Accordingly, this exception would not relieve a routing broker that is a member of an exchange of its obligation to comply with the rules of that exchange.

D. Financial Risk Management Controls and Supervisory Procedures

Proposed Rule 15c3-5(c) would have required a broker-dealer's risk management controls and supervisory procedures to include certain elements. Proposed Rule 15c3-5(c)(1) was intended to address financial risks, and would have required that the risk management controls and supervisory procedures be reasonably designed to systematically limit the financial exposure of the broker-dealer that could arise as a result of market access. Among other things, the controls and procedures must be reasonably designed to: (1) prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker-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; and (2) 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.

1. Individual Trading Center Credit Limits

Commenters generally agreed that systematic, pre-set credit or capital thresholds applied on a pre-trade basis are reasonable and appropriate financial risk management controls that should be in place for market access arrangements.[72] Some commenters, however, suggested

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72 See, e.g., Wedbush Letter at 4 ("Pre-trade filters benefit the entire industry by helping to prevent computerized trading malfunctions...."); Lime Letter at 5 ("Real-time pre-trade, order-placement controls are certainly a critical component to mitigate many of the risks

that the Commission clarify how a broker-dealer could reasonably set credit and capital thresholds under the proposed rule.[73] In particular, one commenter thought broker-dealers should have the flexibility to set credit limits for customers on a market-by-market basis.[74] The Commission believes that a broker-dealer that sets a reasonable aggregate credit limit for each customer could satisfy Rule 15c3-5(c)(1)(i) if the broker-dealer imposes that credit limit by setting sub-limits applied at each exchange or ATS to which the broker-dealer provides access that, when added together, equal the aggregate credit limit. This approach, however, would necessarily require that, when assessing the customer's credit exposure at one market center, the broker-dealer assume that the maximum credit limit has been reached by the customer at all other exchanges and ATSs to which it provides access. For example, if a reasonable aggregate credit limit for a customer is $1,000,000 and the broker-dealer provides it access to five exchanges or ATSs, the broker-dealer may set individual market center credit limits of $200,000 to be applied at the market center level, but that limit could not be increased to reflect any unused portion of the credit limits at other market centers.

2. More Finely-Tuned Credit Limits

A few commenters argued that the requirement to set finely-tuned credit or capital thresholds, where appropriate, is unclear, and the Commission should provide more detail or

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associated with market access."), SIFMA Letter at 2 ("SIFMA supports the general principle underlying the Proposal that pre-trade and post-trade controls and procedures are appropriate in sponsored access arrangements."), JP Morgan Letter at 2 ("We agree with the Commission that pre-trade controls need to be applied to all orders sent under a broker-dealer's MPID to an exchange or ATS.").

73 See, e.g., BIDS Letter at 3; SIFMA Letter at 8; ConvergEx Letter at 5.

74 BIDS Letter at 3 (suggesting that "it would be a reasonable procedure for a broker-dealer to set thresholds with reference to the aggregate trading potential of such customer that is known to the firm on a per market basis").

eliminate the requirement.[75] One commenter believed the requirement was vague, and expressed concern that a broker-dealer could be found to have violated the proposed rule if it did not finely-tune its credit or capital thresholds.[76] Another commenter thought the requirement is unclear, and questioned the need for it in light of an aggregate credit or capital threshold.[77] In contrast, one commenter agreed with the proposed rule that "an aggregate exposure threshold should be required for each account and, where appropriate, for specific industry sectors and/or securities."[78] Rule 15c3-5(c)(1)(i), the provision addressing more finely-tuned credit or capital thresholds, where appropriate, is intended to provide a broker-dealer flexibility in setting its credit and capital threshold consistent with the broker-dealer's business model and the goals of the Rule. A broker-dealer should assess its business and its customers to determine if it is appropriate to establish more tailored credit or capital limits by sector, security, or otherwise. This underscores the reasonable policies and procedures approach of the Rule and the Commission's recognition that a "one-size-fits-all" model for risk management controls and supervisory procedures in connection with market access is not appropriate.[79]

3. Reasonable Models for Credit or Capital Exposure of Outstanding Orders

Several commenters suggested more flexibility with respect to the proposed pre-order entry financial risk management controls in paragraph (c)(1)(i) of the Rule. One commenter suggested that the controls be applied on a rolling intra-day or post-close basis, with compliance

75 See, e.g., ITG Letter at 8; Deutsche Bank Letter at 3.

76 Deutsche Bank Letter at 3.

77 ITG Letter at 8.

78 Goldman Letter at 6.

79 See ABA Letter at 5 (requesting that the Commission clearly state that the proposed "reasonably designed" standard is not meant to be a one-size-fits-all test that would unreasonably burden smaller broker-dealers).

being calculated based on executed orders rather than orders routed but not yet executed.[80] In other words, a broker-dealer's controls would block the routing of additional orders and cancel any open orders only after the execution of orders exceeding the applicable credit or capital limit had occurred. Other commenters suggested additional variations on the proposed approach to compliance with credit and capital thresholds so as to reduce the potential impact on liquidity.[81] For example, commenters suggested that an algorithmic approach to determining the credit and capital threshold would be preferable.[82] One commenter suggested that the Commission should require "real-time trade flow controls which incorporate an algorithmic approach to resting orders, executions and cancellation rates in order to accomplish desired improvements in systemic risk management without adversely impacting liquidity in the marketplace."[83]

In the Proposing Release, the Commission stated 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."[84] The Commission continues to believe that broker-dealers should monitor compliance with applicable credit or capital thresholds based on

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80 Goldman Letter at 6.

81 Deutsche Bank Letter at 3 (suggesting that the Commission replace the pre-trade credit threshold with a threshold based on the total dollar value of open orders placed by a customer); STANY Letter at 5-6; letter to Elizabeth M. Murphy, Secretary, Commission, from Ted Myerson, Chief Executive Officer, Doug Kittelsen, Chief Technology Officer, and M. Gary LaFever, General Counsel, FTEN, Inc., March 29, 2010 ("FTEN Letter") at 4.

82 STANY Letter at 5-6; FTEN Letter at 4.

83 FTEN Letter at 4. See also STANY Letter at 5 (stating that "an analysis of the likelihood of an infraction occurring within the overall setting of the orders, executions and cancellation rates... would result in desired improvements in systemic risk controls without adversely impacting liquidity in the marketplace.").

84 Proposing Release, 75 FR at 4013.

orders entered, including the potential financial exposure resulting from open orders not yet executed. The Commission recognizes, however, that some active trading strategies predictably result in executions for only a small percentage of orders entered, and that requiring broker-dealers to assume that every order entered will be executed will, in some cases, significantly overestimate actual credit or capital exposures. Accordingly, the Commission believes that, while the reasonably designed risk management controls contemplated by Rule 15c3-5 should measure compliance based on orders entered, the credit or capital exposure assigned to those orders may be discounted, where appropriate, to account for the likelihood of actual execution as demonstrated by reasonable risk management models. Any broker-dealer relying on risk management models to discount the exposure of outstanding orders should monitor the accuracy of its models on an ongoing basis and make appropriate adjustments to its method of calculating credit or capital exposures as warranted. Broker-dealers providing market access also may wish to establish "early warning" mechanisms to alert them when the applicable credit or capital threshold is being approached, so that additional steps may be taken to assure the threshold is not breached.

4. Duplicative Orders

A few commenters expressed concern regarding the requirement in Proposed Rule 15c3-5(c)(1)(ii) that a broker-dealer have controls and procedures reasonably designed to prevent the entry of orders that indicate duplicative orders. One commenter noted that this aspect of the proposal could create operational difficulties in determining how to set the risk management parameters, and requested that the Commission either eliminate this requirement from the rule or clarify that a broker-dealer could apply reasonable standards to detect duplicative orders based on the activity of its customers.[85] Another commenter noted the difficulties in setting parameters to detect duplicative orders and suggested the Commission allow for flexibility in setting parameters so as not to disadvantage clients by rejecting orders that are not in fact duplicative.[86] The Commission emphasizes that the controls and procedures must be "reasonably designed" to prevent the entry of erroneous orders, including duplicative orders, which allows broker-dealers some flexibility in crafting them, so long as they are reasonably designed to achieve the stated goal. Among other things, the Commission believes broker-dealers should take into account the type of customer as well as the customer's trading patterns and order entry history in determining how to set such parameters.[87]

5. Rule 15c3-5(c)(1)

The Commission is adopting Rule 15c3-5(c)(1) as proposed. The Commission believes that, in today's fast electronic markets, effective controls with respect to financial risk incurred on exchanges and ATSs must be automated and applied on a pre-trade basis. These pre-trade controls should protect broker-dealers providing market access, as well as their customers and other market participants, by blocking orders that do not comply with applicable risk management controls from being routed to a securities market. As noted above, there is flexibility for the specific parameters 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 Rule. In many cases, particularly with

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85 NYSE Letter at 2.

86 SIFMA Letter at 9.

87 For example, a reasonably designed risk control to prevent the entry of duplicative orders for a high frequency trader may very well be different – in particular, more tolerant – than controls designed to perform the same function for individual investors at a retail brokerage firm.

respect to proprietary trading and more traditional agency brokerage activities, the 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 Rule should help to assure that 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" sponsored access.

Under 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-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-dealer will be required to set appropriate credit thresholds for each customer for which it provides market access, including broker-dealer customers,[88] and appropriate capital thresholds for proprietary trading by the broker-dealer itself. The Commission expects broker-dealers will 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 will monitor on an ongoing basis whether the credit thresholds remain appropriate, and promptly make adjustments to them, and its controls and procedures, as warranted.

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88 The broker-dealer providing market access may also wish to supplement the overall credit limit it places on the activity of its broker-dealer customers with assurances from those broker-dealer customers that they have implemented controls reasonably designed to assure that trading by their individual customers remains within appropriate pre-set credit thresholds.

In addition, because the controls and procedures must be reasonably designed to 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 the risk management controls and supervisory procedures should be designed such that 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 relying on a post-execution, after-the-fact determination. 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. As noted above, however, in appropriate cases reasonable risk management models may be used to discount the credit or capital exposure generated by outstanding but unexecuted orders.

Under 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, 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 systematic, pre-trade control reasonably designed to reject orders that are not reasonably related to the quoted price of the security would help prevent erroneously-entered orders from reaching the market.[89] As with the financial risk management controls and supervisory procedures relating to credit or capital thresholds, the broker-dealer also would be required to monitor on a regular basis whether its 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 in Rule 15c3-5(c) should not be viewed as a comprehensive list of those that should be utilized by broker-dealers. Instead, the Rule simply sets a uniform baseline standard for the types of financial risk management controls and supervisory procedures that a broker-dealer with market access should implement. A broker-dealer may, for a variety of reasons, implement financial risk management controls and supervisory procedures above and beyond those specifically described in the Rule, depending on the nature of its business, customer base, and other specific circumstances.

E. Regulatory Risk Management Controls and Supervisory Procedures

As noted above, Proposed Rule 15c3-5(c) requires a broker-dealer's risk management controls and supervisory procedures to include certain elements. Proposed Rule 15c3-5(c)(2) deals with regulatory compliance risk, and requires that the risk management controls and supervisory procedures be reasonably designed to ensure compliance with all regulatory

89 In this regard, the Commission notes that some markets provide price collars for market orders to help ensure that executions are reasonably related to the quoted price. See e.g. NYSE Arca Rule 7.31(a) and Nasdaq Rule 4751.

requirements that are applicable in connection with market access, including being reasonably designed to: (1) prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis; (2) prevent the entry of orders for securities that the broker-dealer, customer, or other person, as applicable, is restricted from trading; (3) restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker-dealer; (4) assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access.

Several commenters were concerned with the scope of the Rule, particularly to the extent it requires controls and procedures reasonably designed to ensure compliance with all regulatory requirements applicable in connection with market access.[90] These commenters requested that the Commission clarify that the proposed rule would not impose new regulatory obligations on broker-dealers that provide access to trading on an exchange or ATS.[91] The Commission notes that, as stated in the Proposing Release, it intends these controls and procedures to encompass existing regulatory requirements applicable to broker-dealers in connection with market access, and does not intend to substantively expand upon them.[92] The Commission also notes that the defined term "regulatory requirements" is limited to those "that are applicable in connection with

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90 ConvergEx Letter at 6; SIFMA Letter at 6; ITG Letter at 4.

91 ConvergEx Letter at 6 (stating that the Commission should "make clear that any controls be reasonably designed to ensure that the Market Access Broker complies with its regulatory obligations and not that such controls are required to make the Market Access Broker assume responsibility for preventing violative activity by a Sponsored Broker."); SIFMA Letter at 6 (stating that the Commission should clarify "that broker-dealers providing market access would not be liable for regulatory requirements that are only tangentially related to accessing the market, such as margin requirements, or violative behavior that depends on the intent of the sponsored customer.").

92 The specific content of the "regulatory requirements" will, of course, adjust over time as laws, rules and regulations are modified.

market access." Accordingly, the regulatory risk management controls and supervisory procedures required under Rule 15c3-5(c)(2) must address those regulatory requirements that flow from a broker-dealer having or providing access to trading securities on an exchange or ATS.[93]

In addition, commenters requested that the Commission specify which regulatory requirements must be satisfied on a pre-trade basis.[94] Certain provisions of Proposed Rule 15c3-5(c)(2) require the broker-dealer to "prevent the entry of orders" under certain circumstances, which would necessarily require the broker-dealer to implement its controls on a pre-trade basis. Specifically, Proposed Rule 15c3-5(c)(2)(i) requires the broker-dealer's controls 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. In addition, Proposed Rule15c3-5(c)(2)(ii) would require the broker-dealer's controls to be reasonably designed to prevent the entry of orders for securities that the broker-dealer, customer, or other person, as applicable, is restricted from trading. Regulatory requirements that must be satisfied on a pre-trade basis are those requirements that can effectively be complied with only before an order is entered on an exchange or ATS. Those where pre-trade compliance is required on an order-by-order basis include the marking and locate requirements of Regulation SHO, the conditions that must be

93 Regulatory requirements not connected with a broker-dealer's having or providing access to trading securities on an exchange or ATS, as a result of being a member or subscriber thereof, are not included within the scope of the Rule. Although a broad range of regulatory requirements may, to varying degrees, be connected to market access, the Commission would not expect broker-dealers, in response to the Rule, to formally reassess their compliance procedures with respect to rules such as those relating to trading in the over-the-counter market (other than on an ATS) or those relating to the delivery of customer account statements. The Commission emphasizes that, as indicated above, the Rule is intended neither to expand nor diminish the underlying substantive regulatory requirements otherwise applicable to broker-dealers.

94 ITG Letter at 4; SIFMA Letter 6.

satisfied under Regulation NMS before an order can be marked an "intermarket sweep order," various exchange rules applicable to particular order types, and compliance with trading halts. Some commenters also noted that certain regulatory obligations are complied with on a post-trade basis, such as surveillance for fraud and manipulation.[95] Whether compliance is pre-trade or post-trade, however, Proposed Rule 15c3-5(c)(2) would not impose new substantive regulatory requirements on the broker-dealer, but rather establish a clear requirement that the broker-dealer have appropriate mechanisms in place that are reasonably designed to effectively comply with its existing regulatory obligations in an automated high-speed trading environment.

In addition, several commenters asked the Commission to clarify that Rule 15c3-5 does not require broker-dealers to substantially change their existing monitoring or surveillance practices in order to comply with the Rule.[96] While the Commission is not in a position to provide broad assurances in this regard, it believes that in many cases the Rule should reinforce existing regulatory risk management controls already implemented by broker-dealers. Broker-dealers providing market access should review their regulatory risk management controls in light of the Rule, and make adjustments, as appropriate.

In this regard, some commenters requested that the Commission clarify how the proposed rule's requirement to assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access would affect a broker-dealer's surveillance procedures.[97] The Commission notes that the requirement in Rule 15c3-5 that the broker-dealer providing market access receive immediate post-trade execution reports is designed to assure the broker-dealer has the information immediately available to effectively control both its financial

95 ConvergEx Letter at 6; SIFMA Letter 6; ITG Letter at 4.

96 Goldman Letter at 6; Deutsche Bank Letter at 4; SIFMA Letter at 7.

97 Deutsche Bank Letter at 4.

and regulatory risks. This provision does not require, however, that post-trade surveillances for manipulation, fraud, and other matters occur immediately. These surveillances should occur in a timely fashion as warranted by the facts and circumstances.

A few commenters were concerned with the confidentiality of trading information received by a broker-dealer as a result of the Rule's requirements.[98] The Commission notes that the Rule requires only that appropriate surveillance personnel of the broker-dealer providing market access receive the immediate post-trade execution reports. In this regard, the Commission expects that broker-dealers will establish appropriate safeguards to assure that customer trading information is kept confidential and available only to appropriate personnel for regulatory compliance purposes. The Commission notes that Section 15(f) of the Exchange Act requires broker-dealers registered with the Commission to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker-dealer's business, to prevent the misuse in violation of the Exchange Act, or the rules or regulations thereunder, of material, nonpublic information by the broker-dealer or any person associated with it.[99] A broker-dealer that does not maintain appropriate confidentiality of customer order and trading information could potentially be at risk of violating the federal securities laws and regulations, including Section 15(f) of the Exchange Act.[100]

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98 MFA Letter at 2-3; BIDS Letter at 3-4; STANY Letter at 7; letter to Elizabeth M. Murphy, Secretary, Commission, from Ari Burstein, Senior Counsel, Investment Company Institute, March 29, 2010 ("ICI Letter") at 2-3.

99 15 U.S.C 78o(f).

100 Id. See, e.g., Securities Exchange Act Release No. 59555, Admin. Proceeding No. 3-13407 (March 11, 2009) (finding that Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") violated Section 15(f) of the Exchange Act by failing to maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of its business, to prevent misuse, in violation of the federal securities laws, of material, nonpublic information by Merrill Lynch or any person

The Commission is adopting Rule 15c3-5(c)(2) as proposed. As stated in the Proposing Release, 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.[101] As with the financial risk management controls and supervisory procedures, this provision will 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 Rule. In many cases, particularly with respect to proprietary trading and more traditional agency brokerage activities, the Rule should reinforce existing regulatory risk management controls already implemented by broker-dealers. However, the Commission believes that the Rule will 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" sponsored access.

Under 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 regulatory requirements that must be satisfied on a pre-order entry basis. Rule 15c3-5(c)(2)(ii) also will 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.

The Commission notes that, by requiring the regulatory risk management controls and procedures to be reasonably designed to prevent the entry of orders that fail to comply with

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associated with it, which allowed certain day traders to trade ahead of customer orders to the detriment of Merril Lynch's institutional customer).

101 The specific content of the "regulatory requirements" will, of course, adjust over time as laws, rules and regulations are modified.

regulatory requirements that apply on a pre-order entry basis, the 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 be reasonably designed to 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.[102] 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 be reasonably designed to 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 and procedures must be reasonably designed to prevent orders in such security from being submitted to an exchange or ATS for the account of that customer.

Under 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

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102 The Commission notes that Exchange Act Rule 203(b)(2)(i) provides an exception from the uniform locate requirement of Exchange Act Rule 203(b)(1) for a registered broker or dealer that receives a short sale order from another registered broker or dealer that is required to comply with Exchange Act Rule 203(b)(1). For example, where an introducing broker-dealer submits a short sale order for execution, either on a principal or agency basis, to another broker-dealer, the introducing broker-dealer has the responsibility of complying with the locate requirement. The broker-dealer that received the order from the introducing broker-dealer would not be required to perform the locate requirement. However, a broker or dealer would be required to perform a locate where it contractually undertook to do so or the short sale order came from a person that is not a registered broker-dealer. See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008, 48015 (August 6, 2004) (File No. S7-23-03).

access to persons and accounts pre-approved and authorized by the broker-dealer. The Commission believes that reasonably designed, 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 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, Rule 15c3-5(c)(2)(iv) will 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 will be able to identify the applicable customer associated with each such execution report. The Commission believes that immediate reports of executions will 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 Rule. As noted above, this provision does not require that post-trade surveillances for manipulation, fraud, and other matters occur immediately. These surveillances should occur in a timely fashion as warranted by the facts and circumstances.

F. 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. Several commenters requested that the Commission clarify what constitutes "direct and exclusive" control under Rule 15c3-5(d). 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. 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. Broker-dealers would have the flexibility to seek out risk management technology and software developed by third parties, but such technology and software would have to be independent of the market access customer or its affiliates. The broker-dealer would have to perform appropriate due diligence to assure that the reasonably designed controls and procedures are effective and otherwise consistent with the provisions of the Rule. The broker-dealer also could allow a third-party that is independent of its market access customers to supplement its own monitoring of the operation of its controls. In addition, the broker-dealer could permit third parties independent of its market access customers to perform routine maintenance or implement technology upgrades on its risk management controls, if the broker-dealer conducts appropriate due diligence regarding any changes to such controls and their implementation. In all circumstances, the broker-dealer with market access would remain fully responsible for the effectiveness of the risk management controls.

The Commission believes that, subject to the limited exception described below, appropriate broker-dealer personnel must have the direct and exclusive obligation to assure the effectiveness of, and the direct and exclusive ability to make appropriate adjustments to, the reasonably designed financial and regulatory risk management controls. This would allow only the broker-dealer providing market access to 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 to 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 broker-dealer with market access could not delegate the oversight of, or power to adjust, its controls to a third party.

The broker-dealer with market access, 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.[103] If the broker-dealer does not effectively control the risks associated with that activity, it jeopardizes not only its own financial viability, 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 a market access customer which, in effect, would be policing itself. Because the broker-dealer providing market access assumes the immediate financial risks of all orders, as well as regulatory compliance obligations,

[103] See supra note 8.

the Commission believes that it should have direct and exclusive control of the risk management controls and supervisory procedures.

1. Allocation of Certain Regulatory Compliance Obligations to Broker-Dealer Customers

Proposed Rule 15c3-5(d) would require broker-dealers with or providing market access to have direct and exclusive control of the specified risk management controls and supervisory procedures. In the Proposing Release, the Commission stated 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 broker-dealer could not delegate the oversight of its controls to a third party, or allow any third party to adjust them."[104] The Commission specifically requested comment on whether a market access arrangement where a broker-dealer provided another broker-dealer with market access should be treated differently under the rule and whether an allocation of responsibilities for implementing the risk management controls and supervisory procedures between such broker-dealers should be permitted.

Several commenters responded to the Commission's request for comments on this particular matter, and most supported some form of allocation of the required risk management controls and supervisory procedures among broker-dealers where multiple broker-dealers are involved in a market access arrangement.[105] Other commenters did not address the issue of

[104] Proposing Release, 75 FR at 4015.

[105] See Fortis Letter at 5; EWT Letter at 1; Deutsche Bank Letter at 2; Wedbush Letter at 2; GETCO Letter at 4-5 ; STANY Letter at 3; ABA Letter at 3-4; ConvergEx Letter at 4-8; SIFMA Letter; JP Morgan Letter at 4; Pershing Letter at 1-3; Penson Letter at 1-2; Lime Letter at 3-4; letters to Elizabeth M. Murphy, Secretary, Commission, from Sandor G. Lehoczky, Managing Director, Jane Street Holding, LLC, March 29, 2010 ("Jane Street Letter") at 1; David A. Marshall, Senior Vice President, Financial Markets Group, Federal Reserve Bank of Chicago, March 25, 2010 ("FRB Chicago Letter") at 4; letter to

allocation specifically, but emphasized that the broker-dealer with market access should be ultimately and fully responsible for activity that results from the use of its MPID, even if its market access customer is another broker-dealer.[106]

A few commenters specifically noted that it is commonplace in today's marketplace for market access arrangements to consist of multiple broker-dealers.[107] For instance, one commenter noted that today multiple broker-dealers can be involved in market access arrangements, such as where:

- an introducing broker-dealer routes customer orders to an exchange through the market access broker-dealer and clears through a separate clearing broker;
- a clearing broker provides order entry systems to introducing firms for use by the introducing firm's customers;
- an executing broker uses a market access broker-dealer to access an ATS and clears the trade through a separate prime broker; and
- a broker-dealer uses another broker-dealer for access to exchanges of which it is not a member.[108]

These commenters urged the Commission to permit the broker-dealer with market access to allocate some or all of the required risk management controls and supervisory procedures to other broker-dealers that are part of the market access arrangement.[109]

Mary L. Schapiro, Chairman, Commission, from Kenny Marchant, Randy Neugebauer, and Pete Sessions, Members of Congress, August 11, 2010 at 1 ("Marchant Letter").

106 FINRA Letter at 2; NYSE Letter at 2.

107 See e.g., SIFMA Letter at 3; ConvergEx Letter at 3; CBOE Letter at 2; EWT Letter at 3; Marchant Letter at 1.

108 See SIFMA Letter at 3.

109 See e.g., FINRA Letter at 4; ConvergEx Letter at 4-8; CBOE Letter at 3; EWT Letter at 3-4.

In addition, several commenters noted that the concept of broker-dealer allocation of regulatory functions is embedded within the current regulatory framework.[110] The examples most often cited by the commenters were NYSE Rule 382 and NASD Rule 3230,[111] and Regulation SHO.[112] Some commenters believed that NYSE Rule 382 and NASD Rule 3230 currently provide an efficient mechanism for the allocation of functions to the party best situated to ensure compliance with a particular regulatory requirement.[113] In light of these rules, some commenters suggested that the proposed Rule's requirement that the broker-dealer with market access have direct and exclusive control of the risk management controls and supervisory procedures, without providing for the reasonable allocation of the same, would be inconsistent or in tension with currently accepted broker-dealer practices and current SRO and SEC rules.[114]

Several commenters emphasized that the relative positions of the broker-dealers in a market access arrangement would impact the efficacy of the risk management control or supervisory procedure used to reasonably ensure a particular regulatory requirement. For instance, some commenters stressed that an introducing broker would be best situated to

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110 Pershing Letter at 2-3; Penson Letter at 2; STANY Letter at 3; Wedbush Letter at 2; Deutsche Bank Letter at 2-3; EWT Letter at 3; SIFMA Letter at 4.

111 NYSE Rule 382 and NASD Rule 3230, relating to Carrying Agreements, permit the introducing broker or dealer and the clearing broker or dealer, pursuant to a written agreement, to specifically allocate functions and responsibilities between the parties. These rules require that such agreements specifically account for the following functions: (1) opening, approving and monitoring of accounts, (2) extension of credit, (3) maintenance of books and records, (4) receipt and delivery of funds and securities, (5) safeguarding of funds and securities, (6) confirmations and statements and (7) acceptance of orders and execution of transactions.

112 The Commission notes that Regulation SHO provides an exception from the uniform locate requirement for a registered broker or dealer that receives a short sale order from another registered broker or dealer that is required to comply with Exchange Act Rule 203(b)(1). See supra note 102.

113 Pershing Letter at 3; Lime Letter at 4.

114 See, e.g., Pershing Letter at 2-3; Wedbush Letter at 2; ConvergEx Letter at 10-11.

implement the pre-trade controls required by the Rule because the introducing broker, by virtue of its direct relationship with the ultimate customer, would have the critical customer information necessary for compliance.[115] Based on a similar rationale, some commenters stated that the introducing broker would be better situated to identify scienter-based violations such as marking-the-close, wash sales, or other forms of manipulation.[116]

These commenters generally endorsed an allocation model similar to NYSE Rule 382 and NASD Rule 3230 that would permit the broker-dealers engaging in the market access arrangement to contractually allocate specific risk management controls and supervisory procedures based on which firm was better situated to perform the particular control or procedure.[117] However, other commenters suggested that the Commission take a more prescriptive approach and specify the particular functions that potentially could be allocated between broker-dealers in a market access arrangement.[118]

Some commenters offered additional arguments in support of the allocation of risk management controls and supervisory procedures among broker-dealers. One commenter suggested that the allocation of risk management controls and supervisory procedures would be appropriate because a broker-dealer using the MPID of another broker-dealer with market access would be a regulated entity whose trading activity would be identifiable and referable to the

115 BATS Letter at 3; ConvergEx Letter at 5; EWT Letter at 3; CBOE Letter at 3.

116 See e.g., ConvergEx at 7.

117 SIFMA Letter at 4; EWT Letter at 3; Pershing Letter at 1-3; Lime Letter at 4; Fortis Letter at 5; Wedbush Letter at 2, Deutsche Bank Letter at 2; GETCO Letter 4-5; STANY Letter at 3. See also ITG Letter at 6.

118 JP Morgan Letter at 2-4; FRB Chicago Letter at 4; letter to Elizabeth M. Murphy, Secretary, Commission, from Douglas J. Engmann, President, and C. Mark Bold, Senior Advisor, Engmann Options, Inc., March 16, 2010 ("Engmann Letter") at 2.

applicable SRO.[119] Other commenters believed that, while the allocation of risk management controls and supervisory procedures between broker-dealers should be permitted, the ultimate responsibility for compliance with the market access rule and any applicable regulatory requirements should remain with the broker-dealer with market access.[120]

Some commenters opined that where a broker-dealer provides access to another broker-dealer, the broker-dealer with market access should be able to reasonably rely upon the representations of the introducing broker that appropriate risk management controls and supervisory procedures are in place.[121] One commenter specifically noted that a broker-dealer with access should not be able to ignore "obvious red flags," but should be able to otherwise reasonably rely on an introducing broker to comply with its obligations to "supervise its business and conduct of its customers."[122]

Some commenters suggested that the reasonable reliance of the broker-dealer with market access should be based in part on its own policies and procedures that would ascertain the effectiveness of the risk management controls and supervisory procedures.[123] For instance, one commenter stated the broker-dealer with market access should have procedures to support its reasonable reliance, including representations and warranties from the broker-dealer that has

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119 See Penson Letter at 2.

120 SIFMA Letter at 4; Fortis Letter at 5. Fortis believed that "it is a broadly accepted principle of regulation that whilst performance of an obligation may be delegated, responsibility for that obligation cannot. Therefore it should be possible to delegate to a third party, including a client broker/dealer, all operational aspects of compliance with the proposed rules but not the ultimate responsibility for compliance with the proposed rules. In practice this should mean that the party to whom the rules apply directly must have procedures and monitoring in place on an ongoing basis to ensure that the proposed rules are followed." See also Lime Letter at 2-3; FINRA Letter at 2.

121 See SIFMA Letter at 4; Pershing Letter at 2; Penson Letter at 2.

122 Pershing Letter at 3.

123 See Lime Letter at 3; Fortis Letter at 5; SIFMA Letter at 4.

been allocated the risk management controls and supervisory procedures.[124] Another commenter agreed that the broker-dealer with market access should have procedures to ensure compliance with the Rule.[125] Another commenter suggested the introducing broker take responsibility for monitoring and managing the credit and capital thresholds of its customer.[126]

Three commenters, all SROs, indicated that broker-dealers with market access are already required to have supervisory policies related to orders generated as a result of market access.[127] FINRA asserted that it had "consistently taken the view that, under FINRA rules, a firm providing market access to a third party, including another broker-dealer, or otherwise allowing a third party to use the firm's [MPID] is responsible for the trading conducted pursuant to that relationship. Thus, for example, under NASD Rules 3010 and 3012, as well as Incorporated NYSE Rule 342, a member must control, monitor and supervise all orders for which it is the broker of record, including orders entered by customers through market access arrangements with the member. Members providing market access to customers must also have controls and supervisory procedures in place that are reasonably designed to ensure compliance with applicable regulatory requirements."[128]

FINRA also stated its belief that both the broker-dealer with market access and the broker-dealer being provided market access should retain the respective, independent obligations that would exist if they accessed the market directly.[129] FINRA explained that the independent

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124 See SIFMA Letter at 4.

125 See Fortis Letter at 5. See also Lime Letter at 4.

126 GETCO Letter 4-5.

127 FINRA Letter at 2; BATS Letter at 2-3; Nasdaq Letter at 2.

128 FINRA Letter at 2.

129 FINRA Letter at 2.

regulatory obligations of a broker-dealer that is provided market access should not alter the fact that the broker-dealer with market access is responsible for trading conducted using its MPID.[130]

NYSE expressed a view similar to FINRA that a broker-dealer with market access should be subject to the Rule with respect to all of its market access customers, including other broker-dealers.[131] NYSE also noted that the concerns identified by the Commission in connection with market access arrangements are just as relevant for broker-dealer customers as for other types of market participants.[132] In addition, NYSE explained that because each exchange is responsible for monitoring orders submitted by its member firms, and exchanges must be able to hold a specific party responsible for compliance with applicable exchange rules on each order, it would be impractical for the exchange to have to determine the regulatory status of the underlying market participant to discern whether the exchange is required to follow up with the broker-dealer with market access or the underlying broker-dealer customer.[133] NYSE stated that this inefficiency would be amplified if an exchange had to determine whether or not the broker-dealer customer was itself a member of the exchange.[134]

One commenter, however, took the position that a broker-dealer with market access should have no obligations to supervise another broker-dealer with which it has a contractual relationship under NYSE 342(a) and NASD 3010(b).[135] This is because the broker-dealer with market access would not know the customers of the introducing broker, and therefore would not be able to devise supervisory systems reasonably designed to ensure compliance with the

130 FINRA Letter at 2.

131 NYSE Letter at 2.

132 NYSE Letter at 2.

133 NYSE Letter at 2.

134 NYSE Letter at 2.

135 ConvergEx Letter at 7.

applicable regulatory requirements.[136] The commenter did, however, believe that the broker-dealer with market access should conduct reviews that are reasonably designed to ensure compliance with the SRO marketplace rules.[137]

Finally, several commenters expressed concern that the Rule would require every broker-dealer in the chain of a market access arrangement to implement pre-trade controls and thereby introduce redundancies and inefficiencies into the order routing process.[138] Some of these commenters were also concerned that if the Rule required multiple broker-dealers to implement pre-trade checks it could make these arrangements impractical and the benefits of volume aggregation to achieve tiered pricing, cooperative leveraging of broker-dealer technology, and non-member access to markets could be reduced or eliminated.[139] On the other hand, some commenters argued the rule properly should only be applicable to the broker-dealer with market access, because application to all broker-dealers involved in the execution and clearing of a trade would be unnecessary and duplicative.[140]

After careful consideration of the comments submitted with respect to the possible allocation of certain compliance responsibilities to broker-dealer customers, the Commission has determined to permit, subject to certain conditions, broker-dealers providing market access to reasonably allocate control over certain regulatory risk management controls and supervisory procedures to customers that are registered broker-dealers who, based on their position and relationship with an ultimate customer, can more effectively implement them.

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136 ConvergEx Letter at 7.

137 ConvergEx Letter at 5.

138 See BATS Letter at 3-4; EWT Letter at 4; Deutsche Bank Letter at 2; ABA Letter at 3-4; Marchant Letter at 1.

139 See e.g., Wedbush Letter at 2-3; Penson Letter at 3; Lime Letter at 4-5.

140 See FINRA Letter at 2.

Specifically, the Commission is modifying Proposed Rule 15c3-5(d) to permit a broker-dealer providing market access to reasonably allocate, by written contract, control over specific regulatory risk management controls and supervisory procedures to a customer that is a registered broker-dealer, so long as the broker-dealer providing market access has a reasonable basis for determining that such customer, based on its position in the transaction and relationship with an ultimate customer, has better access to that ultimate customer and its trading information such that it can more effectively implement the specified controls and procedures.[141] The Commission believes a broker-dealer providing market access could allocate to a customer that is a registered broker-dealer, consistent with this standard, control over those regulatory risk management controls and supervisory procedures encompassed by paragraph (c)(2) of Rule 15c3-5 that require specific knowledge of the ultimate customer and its trading activity that the broker-dealer providing market access would not have. These could include obligations under suitability and other "know your customer" rules,[142] since the broker-dealer with the direct customer relationship may have better access than the broker-dealer with market access to that ultimate customer's information to more effectively assess the ultimate customer's financial resources and investment objectives. For similar reasons, the broker-dealer providing market access could allocate to its customer that is a registered broker-dealer control over the mechanisms – required by paragraph (c)(2)(ii) of Rule 15c3-5 – for preventing the ultimate customer from trading securities such customer is restricted from trading. Control also could be allocated with respect to surveillance for manipulation or fraud in the ultimate customer's account – such as wash sales, marking the close, and insider trading – since the broker-dealer

141 The Commission notes that such broker-dealer that can more effectively implement the specified controls or procedures likely would also be able to more efficiently do so.

142 See, e.g., FINRA Rule 2010; NASD Rules 2310 and IM-2310-3; and NYSE Rule 405.

providing market access may only see aggregate trading by the broker-dealer customer in an omnibus or other account, and not trading at the individual customer account level. If a broker-dealer providing market access were to reasonably allocate control over these functions to a customer that is a registered broker-dealer, however, the Commission expects the broker-dealer providing market access to immediately provide its customer that is a registered broker-dealer with the post-trade executions reports it receives from exchanges and ATSs pursuant to paragraph (c)(2)(iv) of Rule 15c3-5, so that the broker-dealer customer can effectively surveil for fraud and manipulation in the accounts of the ultimate customers. Finally, in accordance with the requirements of Regulation SHO, the broker-dealer providing market access may rely on a registered broker-dealer customer's compliance with the locate requirement of Rule 203(b)(1) of Regulation SHO, unless the broker-dealer providing market access contractually undertook responsibility for compliance with the locate requirement.[143]

The foregoing is not an exhaustive list of the regulatory risk management controls and supervisory procedures for which control may be reasonably allocated to a customer that is a registered broker-dealer, but in all cases the broker-dealer providing market access must be prepared to demonstrate a reasonable basis for determining that the broker-dealer customer, based on its position in the transaction and relationship with an ultimate customer, has better access than the broker-dealer with market access to that ultimate customer and its trading information such that it can more effectively implement the specific function over which control is allocated.[144] This is consistent with one of fundamental principles underlying Rule 15c3-5, that the controls over the financial and regulatory risks associated with market access should be

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143 See 17 CFR 242.203(b)(1).

144 The Commission notes that, generally, a member of an SRO would be able to more effectively implement a regulatory obligation to comply with rules specific to a particular SRO than a broker-dealer that is not a member of such SRO.

overseen directly by the broker-dealers providing that access, given their responsibility for trading that occurs under their MPIDs and the fact that in general they are better positioned to more effectively implement those controls. To maximize the effectiveness of the reasonably designed risk management controls in connection with market access, however, paragraph (d)(1) of Rule 15c3-5 accommodates allocation of control over a regulatory risk management control or supervisory procedure in those circumstances where – and only where – another registered broker-dealer is better positioned to implement it than the broker-dealer providing market access.

Paragraph (d)(1) of Rule 15c3-5 also requires that any reasonable allocation of control contemplated thereby be in a written contract and specify the regulatory risk management controls and supervisory procedures over which control is being allocated. Paragraph (d)(2) of Rule 15c3-5 makes clear that any such allocation of control does not relieve the broker-dealer providing market access from any obligation under the Rule, including the overall responsibility to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of market access. Thus, the broker-dealer providing market access remains ultimately responsible for the performance of any regulatory risk management control or supervisory procedure for which control is allocated to a customer that is a registered broker-dealer under Rule 15c3-5(d).

Consistent with this approach, the Commission expects a broker-dealer that provides market access and desires to reasonably allocate control over specified functions to a customer that is a registered broker-dealer as described above, to:

(1) conduct a thorough due diligence review to establish a reasonable basis for determining that the registered broker-dealer customer to which control has been allocated has the capability and, based on its position in the transaction and relationship with an ultimate

customer, has better access than the broker-dealer with market access to that ultimate customer and its trading information such that it can more effectively implement the reasonably designed risk management controls and supervisory procedures that are specifically allocated to it;

(2) enter into a written contract with such registered broker-dealer customer that clearly articulates the scope of the arrangement and the specific responsibilities of each party, consistent with the foregoing discussion; and

(3) in accordance with Rule 15c3-5(e), establish, document, and maintain a system to regularly review the performance of the registered broker-dealer customer under such contract, and the effectiveness of the allocated controls and procedures, and promptly address any performance weaknesses, including termination of the allocation arrangement if warranted.

In the Proposing Release, the Commission expressed concern that 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.[145] In addition, the Commission noted that some broker-dealers providing sponsored access may simply rely on assurances from their customers that appropriate risk controls are in place and the Commission concluded 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.

While the Commission believes it is appropriate to permit the reasonable allocation of certain regulatory risk management controls and supervisory procedures, as

145 See Proposing Release, 75 FR at 4008.

described above, to a customer that is a registered broker-dealer, the Commission continues to be concerned about circumstances where broker-dealers providing market access simply rely on assurances from their customers that appropriate risk controls are in place. In the Commission's view these concerns are present even if the customer of the broker-dealer with market access is a broker-dealer. Accordingly, the Commission emphasizes that in any permitted allocation arrangement, the broker-dealer providing market access may not merely rely on another broker-dealer's attestation that it has implemented appropriate controls or procedures, or has agreed to be responsible for the same. Instead, as noted above, the broker-dealer providing market access should independently review, on an ongoing basis, the effectiveness of the reasonably designed controls or procedures allocated to a customer that is a registered broker-dealer and promptly address any weaknesses.

One commenter took the position that a broker-dealer with market access does not have a responsibility to supervise the activity of customers of an introducing broker, in part because it would not have a direct relationship with the ultimate customer and would be unable to discern salient facts such as the customer's financial condition, risk tolerance, trading strategies, objectives or account holdings.[146] While the Commission agrees, as discussed above, that a customer that is a registered broker-dealer may reasonably be allocated control of certain regulatory risk management controls and supervisory procedures that, based on its position in the transaction and relationship with the ultimate customer, it can more effectively implement, the

146 See ConvergEx Letter at 7.

Commission believes the broker-dealer providing market access should retain ultimate responsibility for trading activity that occurs by virtue of its MPID.[147]

Finally, the Commission notes that various commenters expressed concern that the Rule would require every broker-dealer in the chain of a market access arrangement to implement pre-trade controls which would introduce redundancies and inefficiencies into the order routing process.[148] The Commission emphasizes that the Rule is applicable to the broker-dealer with market access, not every broker-dealer in a market access arrangement. Under the Rule, the broker-dealer with market access is required to reasonably ensure that appropriate risk management controls and supervisory procedures are utilized in relation to its market access, including appropriate pre-trade controls. However, the Rule does not require multiple layers of pre-trade controls for any order and is not intended or designed to introduce any unnecessary or unwarranted redundancies and inefficiencies into the order routing process for market access arrangements.

2. Risk Management Systems Developed by Others

In the Proposing Release, the Commission specifically addressed the application of the Rule's "direct and exclusive control" provisions to the use of risk management technology developed by third parties. In relevant part, the Commission stated that:

> 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. Broker-dealers would have the flexibility to seek out risk management technology developed by third parties, but the Commission expects that the third

147 See FINRA Letter at 2; BATS Letter at 2-3; Nasdaq Letter at 2. See also, FINRA Rule 3310.

148 See BATS Letter at 3-4; EWT Letter at 4; Deutsche Bank Letter at 2; ABA Letter at 3-4.

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 broker or dealer to exclusively manage such controls. 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.[149]

Several commenters addressed the Commission's position with respect to risk management systems developed by third parties, as articulated in the Proposing Release. One commenter, for example, was unclear as to whether a broker-dealer providing market access could outsource the development of a risk management system to a third party technology service provider.[150] The commenter suggested that the Commission clarify that outsourcing to a technology service provider is permissible by removing the word "exclusive" from paragraph (d) of the proposed Rule.[151] Another commenter asked that the Commission clarify whether third party software could be under the control of a third party vendor, provided that the broker-dealer providing market access is able to control the parameters and thresholds applied by the

149 Proposing Release, 75 FR at 4015.

150 ConvergEx Letter at 11.

151 ConvergEx Letter at 11.

software.[152] Commenters also requested that the Commission clarify whether a broker-dealer providing market access could use risk management controls provided by exchanges and ATSs to fulfill its obligations under the Rule, provided that the broker-dealer providing market access could control the parameters of the risk management controls.[153] One commenter suggested it would be helpful "in understanding the contours of the 'direct and exclusive' control requirement" if the Commission provided a non-exclusive list of examples of third party arrangements that would be acceptable and unacceptable under the Rule.[154]

Two commenters agreed with the premise that a broker-dealer providing market access should be permitted to use third party risk management systems, provided that that broker-dealer is able to monitor trading activity in real-time and maintain control of the system.[155] One of these commenters asserted that this should include third party risk management systems provided by exchanges.[156] Another commenter noted that risk management software and controls provided by a market center are common and provide an efficient and effective means for broker-dealers to monitor and control their risk exposure.[157] Another commenter stated that to the extent that the Rule permits the use of exchange-provided risk management tools, the Commission should indicate whether a broker-dealer providing market access could rely on exchange representations regarding the efficacy of such tools without requiring further investigation or monitoring of those systems by the broker-dealer.[158] That commenter believed

152 SIFMA Letter at 5.

153 SIFMA Letter at 5; BIDS Letter at 3; Deutsche Bank Letter at 6; CBOE Letter at 4.

154 SIFMA Letter at 5-6.

155 Goldman Letter at 7; MFA Letter at 2.

156 Goldman Letter at 7.

157 BIDS Letter at 2.

158 Deutsche Bank Letter at 6.

independent verification should not be necessary unless the broker-dealer becomes aware of problems with the system.[159]

One commenter opined that a broker-dealer providing market access should not be permitted to utilize a risk management system provided by a customer or an affiliate of a customer.[160] However, the commenter also requested that the Commission clarify whether a broker-dealer providing market access could rely on the representations from a third-party provider of risk management systems regarding its affiliations.[161] Another commenter asked that the Commission clarify whether a third party that is an affiliate, but not a controlled affiliate, of a customer to which a broker-dealer provides market access, would be considered "independent" of the customer. That commenter did not believe that such non-controlled affiliates should be excluded from providing risk management software.[162] The commenter also requested that the Commission clarify whether "independence" would be "expected," as stated in the proposing Release, or required.[163]

Two commenters believed that a broker-dealer providing market access should be able to utilize risk management systems provided by customers or entities affiliated with customers.[164] One commenter opined that technology developed by customers or entities affiliated with customers can be just as effective as technology developed by independent third parties or broker-dealers.[165] The commenter also thought the Rule should allow the flexibility to use

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159 Deutsche Bank Letter at 6.

160 Goldman Letter at 7.

161 Goldman Letter at 7.

162 SIFMA Letter at 5.

163 SIFMA Letter at 5.

164 MFA Letter at 2; ConvergEx Letter at 11.

165 MFA Letter at 2.

customer technology to help to mitigate the potential that a broker-dealer's proprietary trading desk could gain a competitive advantage over its customer trading desk as a result of a negative impact on execution speed and latencies.[166]

Another commenter stated that the broker-dealer providing market access should be responsible for determining baseline limits for its customer but opined that "there are other entirely appropriate adjustments that occur (and should continue to occur) outside of the broker-dealer's exclusive control."[167] The commenter noted that it is not unusual for sophisticated customers to have front-end systems that permit such customers to independently tighten their aggregate credit, size or position limits, or impose additional or enhanced trading restrictions on a particular trader or group of traders.[168] Thus, the commenter concluded that, if the "baseline limits are established and enforced by the [broker-dealer providing market access], customers should be permitted to tighten risk management controls as they see fit."[169]

One commenter advised the Commission to permit a broker-dealer providing market access to purchase a risk management system from its customer, and then use that risk management system to monitor the customer's trading activity.[170] The commenter opined that, in such instances, the broker-dealer providing market access should be able to demonstrate that it has disabled the customer's control of the system, and that the acquired system is able to perform effectively, consistent with the Rule's standards.[171]

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166 MFA Letter at 2.

167 ConvergEx Letter at 11.

168 ConvergEx Letter at 11.

169 ConvergEx Letter at 11.

170 Lime Letter at 7.

171 Lime Letter at 7.

Finally, one commenter suggested that requiring a broker-dealer providing market access to use a risk management system independent from the customer "could destroy the business model" for certain market access arrangements involving brokers or options traders, given the trading delays those systems might require.[172]

After careful consideration of the comments submitted on the Rule's "direct and exclusive control" provisions in relation to third party providers of risk management technology, the Commission is adopting Rule 15c3-5(d) as proposed. As an initial matter, the Commission confirms the position taken in the Proposing Release that a broker-dealer providing market access can use risk management tools or technology provided by a third party that is independent of the customer, so long as it has direct and exclusive control over those tools or technology and performs appropriate due diligence. Specifically, the broker-dealer could "outsource" to an independent third party the design and building of the risk management tools or technology for the broker-dealer, and the performance of routine maintenance, so long as the broker-dealer performs appropriate due diligence as to their effectiveness. In addition, the risk management tools or technology could be located at the facilities of the independent third party, so long as the broker-dealer can directly monitor their operation and has the exclusive ability to adjust the controls. Further, the independent third party could, in response to specific direction from the broker-dealer on a case-by-case basis, make an adjustment to the controls as agent for the broker-dealer.[173]

172 Fortis Letter at 12.

173 The Commission notes that any adjustment to the controls by a third party as agent for the broker-dealer should be made pursuant to specific direction, on a case-by-case basis, from the broker-dealer rather than pursuant to standing instructions.

The independent third party could be another broker-dealer, an exchange or ATS, a service bureau, or other entity that is not an affiliate,[174] and is otherwise independent, of the market access customer. When evaluating whether a technology provider is independent of the customer, the Commission will look at the substance rather than the form of the relationship. For example, the Commission would not consider a third party independent from a customer just because it is technically not an affiliate, if it has a material business or other relationship with the customer which could interfere with the provision of effective risk management technology to the broker-dealer.

The Commission acknowledges that certain market access customers may have sophisticated and effective technology to manage the risks related to their particular trading strategies. However, the Commission believes that direct responsibility for having an effective system of reasonably designed risk management controls belongs with the broker-dealer providing market access, as the regulated entity through which access to the markets is obtained and the party responsible for trading occurring under its MPID. The Rule would not preclude the customer from having risk management controls that exceed those under the direct and exclusive control of the broker-dealer – however, as required above, the broker-dealer cannot rely on risk management technology that is designed, built, maintained or otherwise under the control of the customer or its affiliates. In addition, the Commission believes a reasonably designed system of risk management controls and supervisory procedures should rely on technology that is developed independent of the market access customer or its affiliates. Requiring such independence should reduce the risk that the effectiveness of these critical controls could be undermined by allowing market access customers to develop the tools to, in effect, police

174 An affiliate includes any person that, directly or indirectly, controls, is under common control with, or is controlled by, the customer.

themselves. One commenter asked whether a broker-dealer providing market access could rely on a customer representation of independence from the technology provider.[175] The Commission believes that simple reliance on a customer representation of independence is insufficient; instead, any broker-dealer providing market access that intends to rely on risk management technology developed by third parties should conduct an appropriate level of due diligence, including with respect to the independence of the developer from the market access customer or its affiliates.

The Commission recognizes that market access arrangements have developed in many different ways, and there has been a similarly varied response to the development and use of risk management technology. Accordingly, the Commission emphasizes that it is not requiring a "one-size-fits-all" approach to risk management. The direct and exclusive control provisions allow for a variety of reasonable risk management approaches, consistent with the Rule, and, as discussed above, will not require that a broker-dealer develop the risk management technology itself. Instead, the direct and exclusive control provisions require the broker-dealer providing market access to have the ability to directly monitor and the exclusive ability to adjust, as appropriate, the operation of the financial and regulatory risk management controls in real-time. As stated in the Proposing Release,[176] the direct and exclusive control provision is designed to eliminate the practice whereby the broker-dealer providing market access may rely on its customer, a third party service provider, or others, to establish and maintain the applicable risk controls. The Commission believes the potential risks presented by market access are too great to permit a broker-dealer to delegate the control of these critical risk management systems to the customer or another third party.

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175 Goldman Letter at 7.

176 Proposing Release, 75 FR at 4014.

The Commission reaffirms the position taken in the Proposing Release that the broker-dealer providing market access, consistent with the reasonably designed risk management system required by the Rule, could permit a third party that is independent of customers to supplement its own monitoring of the operation of its risk management controls.[177] The broker-dealer providing market access also could allow a third party that is independent of customers to perform routine maintenance or the implementation of technology upgrades on its risk management controls; but the broker or dealer with market access should conduct appropriate due diligence regarding any changes to such controls and their implementation to assure their continued effectiveness. One commenter asked whether a broker-dealer providing market access could rely on an exchange representation regarding the efficacy of exchange-provided risk management technology and software, and argued that independent verification should be unnecessary unless the broker-dealer becomes aware of a problem.[178] As noted above, the Commission believes that a broker-dealer relying on risk management technology developed by third parties should perform appropriate due diligence to help assure the controls are reasonably designed, effective, and otherwise consistent with the Rule. Mere reliance on representations of the third party technology developer – even if an exchange or other regulated entity – is insufficient to meet this due diligence standard.

G. Regular Review of Risk Management Controls and Supervisory Procedures

Proposed Rule 15c3-5(e) would require a broker-dealer with or providing market access to establish, document, and maintain a system for regularly reviewing the effectiveness of its reasonably designed risk management controls and supervisory procedures and for promptly

177 Proposing Release, 75 FR at 4015.

178 See Deutsche Bank Letter at 6.

addressing any issues. Proposed Rule 15c3-5(e)(1) would require, among other things, the broker-dealer to review, no less frequently than annually, the business activity of the broker-dealer in connection with market access to assure the overall effectiveness of its risk management controls and supervisory procedures, and to conduct that review in accordance with written procedures and document each such review. That provision also would require the broker-dealer to preserve a copy of its 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, Proposed Rule 15c3-5(e)(2) would require the Chief Executive Officer (or equivalent officer) of the broker-dealer, on an annual basis, to certify that its risk management controls and supervisory procedures comply with the Rule and that the broker-dealer conducted the regular review. These CEO certifications also are required to be preserved by the broker-dealer as part of its books and records in a manner consistent with Rule 17a-4(b) under the Exchange Act.

In the Proposing Release, the Commission stated that, when establishing the specifics of this regular review, it expects that each broker-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 Commission received eleven comment letters that discussed the proposed requirements for a regular review of the effectiveness of a broker-dealer's risk management controls and supervisory procedures, and particularly the annual certification of the CEO (or equivalent officer).[179] A few commenters indicated that the review and certification requirements would be burdensome and costly, and would divert supervisory resources from other projects.[180] One commenter expressed concern that various requirements for separate CEO certifications for different rules could be unwieldy and burdensome.[181] Others commenters recommended that the certification requirement be imposed on another officer (such as the Chief Risk Officer, Chief Compliance Officer, or an equivalent officer) or an outside firm.[182] A few commenters requested clarification as to whether the proposed CEO certification requirement would create a completely new obligation or whether it could be viewed as encompassed by existing certification processes, such as the FINRA Rule 3130 certification process.[183] In addition, several commenters recommended that broker-dealers should be able to satisfy the CEO certification requirement through the existing FINRA Rule 3130 certification or other existing certification processes.[184]

As proposed, Rule 15c3-5(e) is intended to assure that a broker-dealer with or providing market access implements supervisory review mechanisms to support the effectiveness of its risk management controls and supervisory procedures on an ongoing basis. In the Proposing Release, the Commission expressed the view that, because of the potential risks associated with

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179 See letters to Elizabeth M. Murphy, Secretary, Commission, from Samuel F. Lek, Chief Executive Officer, Lek Securities Corporation, February 21, 2010 ("Lek Letter") at 3; Christopher Carter, April 19, 2010 ("Carter Letter") at 7; Andrew C. Small, General Counsel, Scottrade, Inc., March 30, 2010 ("Scottrade Letter") at 1; ITG Letter at 9-10; Deutsche Bank Letter at 6-7; ABA Letter at 5-6; EWT Letter at 5; Engmann Letter at 3; Pershing Letter at 4; BIDS Letter at 4; Goldman Letter at 7.

180 See Lek Letter at 3; ITG Letter at 9-10; ABA Letter at 5-6; Carter Letter at 7.

181 Deutsche Bank Letter at 6-7.

182 See EWT Letter at 5; see also Carter Letter at 7.

183 See Engmann Letter at 3; Pershing Letter at 4; BIDS Letter at 4; Goldman Letter at 7.

184 See Engmann Letter at 3; Pershing Letter at 4; BIDS Letter at 4; ITG Letter at 9-10; Deutsche Bank Letter at 6-7; ABA Letter at 5-6; SIFMA Letter at 9; Scottrade Letter at 1.

market access, and the dynamic nature of both the securities markets and the businesses of individual broker-dealers, it is critical that a broker-dealer with market access charge its most senior management – specifically the CEO or an equivalent officer – with the responsibility to review and certify the efficacy of its controls and procedures at regular intervals.[185] The Commission believes that this certification requirement is an integral component of the risk management controls and supervisory procedures contemplated by Rule 15c3-5, and should help assure their effectiveness. As noted in the Proposing Release, the Commission also believes that the CEO certification requirement should serve to bolster broker-dealer compliance programs, and promote meaningful and purposeful interaction between business and compliance personnel.[186]

The Commission is adopting Rule 15c3-5(e) as proposed. In the Proposing Release, the Commission noted that Proposed Rule 15c3-5 is "intended to complement and bolster existing rules and guidance issued by the exchanges and by FINRA with respect to market access."[187] The Commission would expect, in many cases, the annual CEO certification required under Rule 15c3-5(e)(2) to be completed in conjunction with a firm's annual review and certification of its supervisory systems pursuant to FINRA Rule 3130. However, the CEO certification contemplated by the Rule is a separate and distinct certification from the FINRA 3130 certification or any other similar certification process.[188] That said, the Commission believes a FINRA member could combine in the same document the CEO certification required by Rule

185 Proposing Release, 75 FR at 4015.

186 See Proposing Release, 75 FR at 4015.

187 See Proposing Release, 75 FR at 4010.

188 The Commission also notes that Rule 15c3-5(e)(2) may apply to broker-dealers that are not FINRA members.

15c3-5(e)(2) with the FINRA 3130 or other required certifications, so long as the substance of each of the required certifications is contained in that document.

III. Paperwork Reduction Act

The Rule contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[189] In accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, the Commission submitted the provisions to the Office of Management and Budget ("OMB") for review. The title for the proposed 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.

In the Proposing Release, the Commission solicited comments on the collection of information requirements. The Commission noted that the estimates of the effect that the Rule would have on the collection of information were based on data from various industry sources. As discussed above, the Commission received 47 comment letters on the proposed rulemaking. Of the comment letters the Commission received, some commenters addressed the collection of information aspects of the proposal.[190]

A. Summary of Collection of Information

Rule 15c3-5 will 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)

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189 44 U.S.C. 3501 et seq.

190 See, e.g., Pershing Letter at 4; Fortis Letter at 9; STANY Letter at 4; Lek Letter at 3.

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 Rule will 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 will 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.[191]

In addition, the Rule will 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 Rule and for promptly addressing any issues. Among other things, the broker or dealer will 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

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191 See supra note 23.

controls and supervisory procedures and document that review. Such review will be required to be conducted in accordance with written procedures and will be required to be documented. The broker or dealer will 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,[192] and Rule 17a-4(b) under the Exchange Act, respectively.[193]

In addition, the Chief Executive Officer (or equivalent officer) of the broker or dealer, on an annual basis, will be required to certify that such risk management controls and supervisory procedures comply with the 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.[194]

B. Use of Information

The 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 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, will help ensure that such brokers or dealers have sufficiently effective controls and procedures in place to appropriately manage the risks associated with market access. The requirement to preserve a copy of its supervisory procedures and a written description of its risk

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192 Id.

193 See supra note 25.

194 Id.

management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) under the Exchange Act will help to assure that appropriate written records were made, and will be used by the Commission staff and SRO staff during an examination of the broker or dealer for compliance with the Rule.

The requirement to maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required under the Rule will help to ensure that the risk management controls and supervisory procedures remain effective. A broker-dealer will use these risk management controls and supervisory procedures to fulfill its obligations under the Rule, as well as to evaluate and help ensure its financial integrity more generally. The Commission and SROs will use this information in their exams of the broker or dealer, as well as for regulatory purposes. The 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, will help to assure that the regular review was in fact completed, and will be used by the Commission staff and SRO staff during an examination of the broker or dealer for compliance with the Rule. The 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 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 will help to ensure that senior management review the efficacy of its controls and procedures at regular intervals and that such review is documented. This certification will be used internally by the broker or dealer as evidence that it complied with the Rule and possibly for internal compliance audit purposes. The certification also will be used by Commission staff and SRO staff during an examination of the broker or dealer for compliance with the Rule or more generally with regard to evaluation of a broker or dealer's risk management control procedures and controls.

C. Respondents

In the Proposing Release, the Commission estimated that the "collection of information" associated with the Rule would apply to approximately 1,295 brokers-dealers that have market access or provide a customer or any other person with market access. Of these 1,295 brokers-dealers, the Commission estimated that there are 1,095 brokers-dealers that are members of an exchange. This estimate was based on broker-dealer responses to FOCUS report filings with the Commission from 2007 and 2008. The Commission estimated that the remaining 200 broker-dealers are subscribers to ATSs but are not exchange members. This estimate was based on a sampling of subscriber information contained in Exhibit A to Form ATS-R filed with the Commission.

The Commission continues to estimate that there are 1,095 brokers-dealers that are members of an exchange, and that there are an additional 200 broker-dealers that are subscribers to ATSs but are not exchange members. However, the Commission is revising its initial estimate of the total number of respondents in a different respect. As stated above, the Commission is well aware that the same regulatory and financial risks are present when a non-broker-dealer subscriber directly accesses an ATS as when a broker-dealer accesses an exchange or ATS. Accordingly, the Commission believes that a broker-dealer operator of an ATS should be required to implement the financial and regulatory risk management controls required by the rule with regard to non-broker-dealer subscriber's access to its ATS. The Commission notes that currently there are approximately 80 ATSs that are registered with the Commission and provide market access, and the broker-dealer operators of these ATSs should be included among the respondents. This number is based on the number of ATSs that have filed an initial operation report ("Form ATS") with the Commission and also currently submit quarterly reports of alternative trading system activities ("Form ATS-R").

With the 80 additional respondents, the Commission now estimates that the "collection of information" associated with the Rule will apply to approximately 1,375 brokers-dealers that have market access or provide a customer or any other person with market access.

In the Proposing Release, the Commission solicited comments on the estimated number of respondents. Several commenters stated that the Commission's estimate does not take into account how the Rule's enactment will subsequently change the number of registered brokers-dealers that provide market access. For example, one commenter believed that the number of registered broker-dealers would increase, because some algorithmic trading firms would need to register as broker-dealers in order to continue to implement their current trading strategies in the face of increased latency times.[195] On the other hand, various commenters asserted that the Rule will prevent small broker-dealers from using sponsored access as a means to aggregate trading volume, obtain tiered pricing from exchanges, and remain competitive with larger liquidity providers, and therefore will drive smaller liquidity providers from the market.[196] If true, this will potentially reduce the number of registered broker-dealers that provide market access.

In addition to making an adjustment in the number of respondents to account for broker-dealer ATS operators that provide market access to non-broker-dealers, as described above, the Commission acknowledges that the implementation of the Rule may introduce competitive effects that lead to a change in the number of registered brokers-dealers with market access.

195 See ABA Letter at 6-7.

196 See id. at 7, Jane Street Letter at 2.

However, the Commission notes that of the two speculative outcomes noted by commenters above, both caused by increased latency times, one would increase the number of registered broker-dealers, while the other would decrease the number. Although the Commission should anticipate either or both of these trends occurring, it is difficult to speculate which trend would predominate, if one does indeed take precedence over the other. The Commission ultimately believes that although the Rule may lead to short-term increases or decreases in the number of registered broker-dealers, such increases and decreases may offset each other over the longer term. Because of this, the Commission continues to believe that 1,375 brokers-dealers that have market access or provide a customer or any other person with market access is an appropriate estimate of the number of entities that will be subject to the rule for the current PRA analysis.

D. Total Initial and Annual Reporting and Recordkeeping Burdens

For the purposes of the PRA analysis, the Commission considered the burden on respondents to bring their risk management controls and supervisory procedures into compliance with the Rule. The Commission continues to note that among brokers-dealers with market access, there is currently no uniform standard for risk management controls and supervisory procedures. The extent to which a respondent will be burdened by the proposed collection of information under the Rule will 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. As stated in the Proposing Release, the Commission believes that in many cases, particularly with respect to proprietary trading, more traditional agency brokerage activities, and direct market access, the Rule may be substantially satisfied by a respondent's existing financial and regulatory risk management controls and current supervisory procedures. As noted in the Proposing Release, these brokers-dealers likely will only require limited updates to their systems to meet the requisite risk management controls specified in the Rule, and as such, will incur minimal additional reporting and recordkeeping burdens.

The Commission continues to believe that the majority of respondents have risk management systems with pre-trade financial and regulatory controls, although the use and range of those controls may vary among firms. As noted in the Proposing Release, 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 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 Rule will differ vastly depending on a broker-dealer's current risk management system and business model.

Rule 15c3-5 will also require a respondent to update its review and compliance procedures to comply with the 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.[197] Rule 15c3-5 will initially require a respondent to update its written compliance procedures to document the method in which the respondent plans to comply with the Rule.

1. Technology Development and Maintenance

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197 See supra note 57.

In the Proposing Release, the Commission estimated 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,[198] or approximately \$35,000 if outsourced.[199] This figure was a weighted estimate 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 expected that brokers-dealers with market access currently have the means to receive post-trade executions reports, at a minimum, on an end-of-day basis.

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198 This estimate was 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 estimated 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 × 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 × 0.5 months = 120 hours, while a three-month project to develop a risk control management system from scratch would require 240 hours/month × 3 months = 720 hours. Based on discussions with industry participants, the Commission estimated 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 × 120 hours) + (0.05 × 720 hours) = 150 hours.

199 See infra note 227.

The Commission noted in the Proposing Release that 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 noted that technology for risk management controls is generally purchased on a monthly basis. In the Proposing Release, the Commission's staff estimated 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 an estimate of the annual outsourcing cost, the Commission noted that for two connections to each of two different trading venues, the annual cost would be \$96,000.[200] The potential range of costs would vary considerably, depending upon the business model of the broker-dealer.

Moreover, the Commission noted that 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 estimated that the ongoing annualized burden for a potential respondent to maintain its risk management system

200 12 months × \$4,000 (estimated monthly cost for two connections to a trading venue) × 2 trading venues = \$96,000. This estimate was based on discussions with various industry participants. For purposes of this estimate, "connection" was 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 was based on discussions with various industry participants.

would be approximately 115 burden hours if performed in-house,[201] or approximately $26,800 if outsourced.[202] The Commission believed 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 estimated that the average initial cost would be approximately $16,000 per broker-dealer,[203] while the average ongoing cost would be approximately $20,500 per broker-dealer.[204]

The Commission also considered how permitting broker-dealers to allocate regulatory risk management controls to customers that are registered broker-dealers would affect the Commission's calculations of total initial and annual reporting and recordkeeping burdens.

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201 Based on discussions with industry participants, the Commission estimated 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 months × 160 hours = 1,920 hours per year. A team of 1.5 people therefore would work 1,920 hours × 1.5 people = 2,880 hours per year. Based on discussions with industry participants, the Commission estimated 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 × 2,880 hours = 115.2 hours.

202 See infra note 228.

203 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 × $11,517) + (0.05 × $102,500) = $16,066, or $16,000.

204 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.

Although commenters have noted that such market access arrangements consisting of multiple broker-dealers are commonplace,[205] establishing an estimate for the average additional technology burden is a challenging task. Numerous uncertainties, including the number of broker-dealers involved in any given transaction or contractual agreement, create difficulties in developing estimates.

After carefully evaluating the types of compliance responsibilities that could be allocated, the technological capabilities required, and the tasks associated with risk compliance allocation, the Commission determined that in estimating the additional initial and ongoing technology burdens, these considerations would not affect estimated burdens in a meaningful way. The Commission expects that any additional technology burdens that broker-dealers undertake to bring their sponsored broker-dealers "on board" will be offset by the sponsored broker-dealers' reduced technology burdens from using their sponsoring broker-dealers' risk management systems. While the Commission recognizes that the offsetting of technology burdens may not fully reflect all of the hours that broker-dealers may incur from preparing risk management systems for allocation, Commission staff believes that such an estimate is reasonable given the relatively small technology burdens that sponsored broker-dealers currently have as part of their status quo. The Commission is therefore retaining the hourly burden estimates and calculation methodology for technology development and maintenance as originally proposed.

In the Proposing Release, the Commission solicited comments on the burdens of technology development and maintenance. The Commission did not receive any comments that directly addressed the initial or ongoing burden for technology, as measured in hours, for a potential respondent to comply with the proposed requirement to establish, document, and

205 See supra note 107.

maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures.

However, two commenters did address the Commission's technology outsourcing cost estimates, asserting that they were too low. For example, one commenter believed that the Commission's initial and ongoing technology outsourcing cost estimates dramatically understated the actual costs that would be incurred, stating that maintenance from outside vendors would cost in excess of $1 million per year for services that include "fat finger," credit, and compliance controls.[206] Another commenter estimated that it will cost more than $2 million per year for a company to buy the appropriate systems.[207]

The Commission reiterates that technology outsourcing costs will vary depending on the size of the broker or dealer and the extent to which it already complies with the recordkeeping requirements described in the Rule. As stated above, Rule 15c3-5 does not employ a "one-size-fits-all" standard for determining compliance with the rule.[208] The Commission notes that its burden and outsourcing estimates are calculated as weighted averages, and that these estimates skew lower because the Commission estimates that, based on discussions with various industry participants, the majority of broker-dealers that provide market access, if they are not already fully compliant, are close to full compliance and are not expected to incur significant outsourcing costs. Numerous industry sources have stated that for many smaller brokers-dealers, third-party technology providers would take no longer than two or three days to program any compliance adjustments. While some respondents will indeed incur significantly higher technology outsourcing costs that would correspond to commenters' estimates, the Commission expects that

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206 See ConvergEx Letter at 9.

207 See Wedbush Letter at 5-6.

208 See supra note 47.

these respondents will be significantly outnumbered by brokers-dealers who will incur minimal outsourcing costs. The Commission therefore continues to believe that its burden estimates for technology outsourcing are reasonable, and retains them as originally proposed.

2. Legal and Compliance

In the Proposing Release, the Commission provided a separate set of burden estimates for legal and compliance obligations. The Commission noted that the majority of broker-dealers should already have compliance policies and supervisory procedures in place.[209] Accordingly, the Commission asserted 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 estimated 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,[210] and the modification or establishment of applicable compliance policies and procedures would require approximately 25 hours,[211] 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

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[209] See supra note 57.

[210] The Commission estimated that one compliance attorney and one compliance manager would each require 5 hours, for a total initial burden of 10 hours.

[211] The Commission estimated 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.

address any deficiencies found. The broker-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-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. On an annual basis, the Chief Executive Officer (or equivalent officer) of the broker-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-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 estimated in the Proposing Release 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 was expected to require 20 hours per year; and the Chief Executive Officer, who certifies the policies and procedures, was 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 believed 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 did not believe that a broker-dealer would have any recurring external costs associated with legal and compliance obligations.

After considering the effects of permitting broker-dealers to enter contractual arrangements to allocate certain risk compliance responsibilities to a customer that is a registered broker-dealer, the Commission has decided to include additional hourly burden estimates for legal and compliance staff to enter into such written contracts with other broker-dealer customers. The Commission notes the difficulty of estimating an average hourly burden for contract negotiations and preparation, because (1) the total number of contractual arrangements could vary greatly from broker-dealer to broker-dealer, and (2) not all broker-dealers will enter into such risk compliance allocation arrangements. Based on current industry sources, the Commission expects that on both an initial and ongoing basis, compliance attorneys will spend an average of 10 hours negotiating and preparing such risk compliance allocation contracts, while compliance managers will require an average of 5 hours on these tasks. The Commission again notes that its estimates are calculated as weighted averages, and that these estimates skew lower because it anticipates that the number of broker-dealers that do not enter into such allocation arrangements will likely greatly exceed the number of broker-dealers that do, even taking into account broker-dealers who will enter into multiple allocation arrangements for one transaction.

In the Proposing Release, the Commission solicited comments regarding the information burden associated with a system for reviewing the effectiveness of risk management controls. Several commenters asserted that the requirement for CEO certifications was overly burdensome and unnecessary.[212] Many of the same commenters noted that in particular, the CEO certification was duplicative because FINRA members are already required by FINRA Rule 3130 to perform annual reviews of their supervisory systems and obtain a certification from the CEO.[213]

The Commission believes that this certification requirement is an integral component of the risk management controls and supervisory procedures contemplated by Rule 15c3-5, and should help assure their effectiveness. As noted in the Proposing Release, the Commission also believes that the CEO certification requirement should serve to bolster broker-dealer compliance programs, and promote meaningful and purposeful interaction between business and compliance personnel.[214] The Commission would expect, in many cases, the annual CEO certification required under Rule 15c3-5(e)(2) to be completed in conjunction with a firm's annual review and certification of its supervisory systems pursuant to FINRA Rule 3130. However, the CEO certification contemplated by the Rule is a separate and distinct certification from the FINRA 3130 certification or any other similar certification process.[215] That said, the Commission

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212 See supra note 180.

213 See Engmann Letter at 2, Pershing Letter at 4, BIDS Letter at 4, ITG Letter at 9-10, Scottrade Letter at 1, Deutsche Letter at 6-7, ABA Letter at 5-6, SIFMA Letter at 9.

214 See Proposing Release, 75 FR at 4015.

215 The Commission also notes that Rule 15c3-5(e)(2) may apply to broker-dealers that are not FINRA members.

believes a FINRA member could combine in the same document the CEO certification required by Rule 15c3-5(e)(2) with the FINRA 3130 or other required certifications, so long as the substance of each of the required certifications is contained in that document.

One commenter disagreed with the Commission's finding that the ongoing legal and compliance obligations under the proposed rule would be handled internally, arguing that the CEO compliance certification requirement would likely require the hiring of a consultant to review controls because the Chief Executive is not likely to be a specialist in the area of risk management and the development of computerized controls.[216]

However, the Commission has in fact accounted for the likelihood that the Chief Executive Officer would not be a compliance specialist. In the Proposing Release, the Commission estimated that the initial legal and compliance burden for a CEO would constitute only 5 of the 35 total hours required,[217] on average, while internal compliance specialists would be responsible for the remainder of the initial burden.[218] Such a burden allocation anticipates that in practice, compliance experts will oversee the bulk of responsibilities for establishing credit and capital thresholds and for modifying compliance policies, while the Chief Executive Officer would retain the senior managerial responsibility to review the compliance experts' work and certify the controls' effectiveness. Moreover, the Commission reiterates that these compliance obligations are in fact consistent with the type of work that a broker-dealer typically handles internally, especially for other certification processes such as the FINRA 3130 process, as discussed above. The Commission is adopting Rule 15c3-5(e) as proposed, and with the

216 See Lek Letter at 3.

217 As stated above, the Commission now estimates that the total initial legal and compliance burden is 50 hours, and not 35.

218 See supra notes 210-211.

exception of the additional compliance burden from negotiating and preparing risk compliance allocation agreements, is retaining its legal and compliance burden per-broker-dealer estimates as proposed.

3. Total Burden

Under the Rule, the total initial burden for all respondents will be approximately 275,000 hours ([150 hours (for technology) + 50 hours (for legal and compliance)] × 1,375 brokers and dealers = 275,000 hours) and the total ongoing annual burden would be approximately 240,625 hours ([115 hours (for technology) + 60 hours (for legal and compliance)] × 1,375 brokers and dealers = 240,625 hours). For hardware and software expenses, the total initial cost for all respondents will be $22,000,000 ($16,000 per broker-dealer × 1,375 brokers and dealers = $22,000,000) and the total ongoing annual cost for all respondents would be $28,187,500 ($20,500 per broker-dealer × 1,375 brokers and dealers = $28,187,500). The estimates of the initial and annual burdens are based on discussions with potential respondents. It should be noted that the total burden estimate has been increased from the Proposing Release's total burden estimate to reflect the revised number of respondents affected under the Rule.

IV. Consideration of Costs and Benefits

The Commission is sensitive to the costs and benefits that result from its rules. In the Proposing Release, the Commission identified certain costs and benefits of the Rule as proposed, and requested comment on all aspects of the cost-benefit analysis, including the identification and assessment of any costs and benefits that were not discussed in the analysis. The Commission received several comments relating to the Commission's cost-benefit analysis. For the reasons discussed below, the Commission continues to believe that its estimates of the benefits and costs of Rule 15c3-5, as set forth in the Proposing Release, are appropriate.

A. Benefits

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 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 Rule will 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 Rule should be the reduction of systemic risk associated with market access through the elimination of "unfiltered" or "naked" access. As discussed in the Proposing Release, 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-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-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.[219]

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. Rule 15c3-5 should promote investor confidence as well as participation in the market by enhancing the fair and efficient operation of the U.S. securities markets. Among other things, the requirements of Rule 15c3-5 should promote fairness by establishing a level playing field for broker-dealers that provide access to trading on an exchange or ATS and help to ensure compliance with applicable regulatory requirements.

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

219 See Google Trading Incident, supra note 16. See also SWS Trading Incident and Rambus Trading Incident, supra note 16.

daily volume for equities traded in the U.S. markets.[220] 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.

The Commission sought comment on the benefits associated with the Proposed Rule. Most of the 47 comment letters expressed, to varying degrees, general agreement with the Rule's intent to decrease the potential for financial, regulatory, and systemic risks from sponsored access arrangements.[221]

B. Costs

The Commission also requested comment on the costs associated with the Rule. As already stated in the PRA section above, several commenters believed that the Commission did not take into account either the increase in trading costs to clients of exchange members, or the decrease in available liquidity in the market.[222] For example, one commenter asserted that the

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220 See supra note 13.

221 See Woodbine Letter at 1; Lek Letter at 1; Engmann Letter at 1; BATS Letter at 1; Pershing Letter at 1; Fortis Letter at 1; FINRA Letter at 1; Nasdaq Letter at 1; BIDS Letter at 1; FRB Chicago Letter at 1; STANY Letter at 1; MFA Letter at 1; NYSE Letter at 1; ICI Letter at 1; Penson Letter at 1; Lime Letter at 1; ITG Letter at 2; Jane Street Letter at 1; EWT Letter at 1; FTEN Letter at 1; Goldman Letter at 1; Scottrade Letter at 1; Deutsche Letter at 1; Wedbush Letter at 1; GETCO Letter at 2; ABA Letter at 1; SIFMA Letter at 2; Carter Letter at 2; JP Morgan Letter at 1; Newedge Letter at 1; FIA Letter at 3; letter to Elizabeth M. Murphy, Secretary, Commission, from Kevin Cuttica, Chief Executive Officer, and David T. DeArmey, Chief Operating Officer, Sun Trading LLC, March 26, 2010 ("Sun Letter") at 1.

222 See Fortis Letter at 14-15, STANY Letter at 5-6, Jane Street Letter at 2, Scottrade Letter at 1.

Rule is too far-reaching in its scope, because it addresses types of market access that do not pose significant risks, and will create duplicative, unnecessary and costly regulation in areas where additional regulation is unneeded.[223] Another commenter believed that the Rule will impose significant costs on some entities beyond just brokers and dealers that provide market access.[224] The commenter noted that the Rule's effect would be to increase latency times and decrease liquidity in the market as a whole.[225] Other commenters anticipated that the Rule will create new costs for broker-dealers, who will then be forced to pass these costs along to end-clients in the form of increased transaction costs.[226]

The Commission recognizes that, by requiring all orders to be subject to regulatory and financial risk controls, Rule 15c3-5 will likely impose market costs related to increased latency times, reduced liquidity, and increased trading costs for broker-dealers. The Commission recognizes that this could ultimately limit the algorithmic trading of some smaller proprietary trading firms, and potentially lower overall trading volume. To the extent that lowered trading volume leads to lower overall market liquidity, market participants may also incur additional costs due to lost trading opportunities and the possibility that smaller broker-dealers may not be able aggregate trade flow and obtain favorable tiered pricing.

Although the Commission acknowledges these potential costs, it also recognizes the significant benefits that the Rule provides to the markets, such as the protection of market integrity and efficiency. Although the Rule may indeed impose costs resulting from increased latency times and reduced liquidity, the Commission believes that such costs are justified by the

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223 See STANY Letter at 6.

224 See ABA Letter at 6.

225 See ABA Letter at 6-7.

226 See Carter Letter at 5.

benefits provided in preventing unfiltered market access and enhancing investor protection. The Rule requirements are intended to minimize unnecessary and inefficient systemic risk from the markets.

Regarding the comments that the Rule would create duplicative, unnecessary and costly regulation, the Commission continues to believe that, in many cases, particularly with respect to proprietary trading and more traditional agency brokerage activities, the Rule 15c3-5 may be substantially satisfied by existing risk management controls and supervisory procedures already implemented by broker-dealers. For these broker-dealers, Rule 15c3-5 should have a minimal impact on current business practices and, therefore, should not impose significant additional costs on these broker-dealers. Moreover, the Commission reiterates that the Rule does not require, and was never intended to require, multiple or duplicative layers of pre-trade controls for a single order. As stated in the Proposing Release, 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.

1. Technology Development and Maintenance

As described in the Proposing Release, broker-dealers with market access may comply with the Rule in several ways. 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 that many broker-dealers with market access would be able to substantially satisfy the 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, in the Proposing Release, the Commission estimated 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. In the Proposing Release, Commission staff estimated 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,[227] or \$66.0 million for 1,295 broker-dealers. The Commission further

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[227] See supra note 199. The Commission estimated 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 estimated that the average system development team consists of one or more programmer analysts, senior programmers, and senior systems analysts. The Commission estimated that the programmer analyst would work 40% of the total hours required for initial development, or 150 hours × 0.40 = 60 hours; the senior programmer would work 20% of the total hours, or 150 hours × 0.20 = 30 hours; and the senior systems analyst would work 40% of the total hours, or 150 hours × 0.40 = 60 hours. The total initial development cost for staff was estimated to be 60 hours × \$193 (hourly wage for a programmer analyst) + 30 hours × \$292 (hourly wage for a senior programmer) + 60 hours × \$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.

estimated that the total annual ongoing cost to maintain an in-house risk control management system is $47,300 per broker-dealer,[228] or $61.3 million for 1,295 broker-dealers.

For this Adopting Release, the Commission is updating the total annual initial and ongoing technology costs to reflect the revised number of respondents, which has been changed from 1,295 to 1,375 broker-dealers.[229] The Commission's per-broker-dealer cost estimates of $51,000 for initial costs and $47,000 for annual ongoing costs remain the same. Commission staff now estimates that the total initial cost for internal development teams to develop or

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The Commission estimated that the average initial hardware and software cost is $16,000 per broker-dealer. Industry sources estimated 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 estimated 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 × $11,517) + (0.05 × $102,500) = $16,066, or $16,000.

228 See supra note 202. The Commission estimated 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 estimated that the programmer analyst would work 40% of the total hours required for ongoing maintenance, or 115 hours × 0.40 = 46 hours; the senior programmer would work 20% of the total hours, or 115 hours × 0.20 = 23 hours; and the senior systems analyst would work 40% of the total hours, or 115 hours × 0.40 = 46 hours. The total ongoing maintenance cost for staff was estimated to be 46 hours × $193 (hourly wage for a programmer analyst) + 23 hours × $292 (hourly wage for a senior programmer) + 46 hours × $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 estimated that the average annual ongoing hardware and software cost is $20,500 per broker-dealer. Industry sources estimated 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.

229 See supra Section III.C.

substantially upgrade existing risk control systems would be approximately $70.1 million for 1,375 broker-dealers, while the total ongoing annual cost to maintain in-house risk control management systems would be approximately $65.0 million for 1,375 broker-dealers.

The Commission also considered how permitting broker-dealers to allocate risk compliance responsibilities to a customer that is a registered broker-dealer would affect the Commission's calculations of total initial and annual technology costs. As already noted above, the Commission determined that in estimating the additional initial and ongoing technology costs, these considerations would not affect estimated costs in a meaningful way. As concluded with the technology burdens, the Commission expects that any additional technology costs that broker-dealers accrue to add other broker-dealer transactions to their risk management systems will be justified by the sponsored broker-dealers' reduced technology costs from relying on other broker-dealers' risk management systems. Commission staff believes that such an assumption is reasonable given the relatively small technology burdens that sponsored broker-dealers currently have as part of their current risk compliance allocation arrangements.

As in the Proposing Release, we reiterate that the potential range of costs would vary considerably, depending upon the needs of the broker-dealer. Returning to the same example used in the Proposing Release, we provide an illustrative set of calculations for a scenario where 5% of respondents under the Rule need to build risk control management systems from scratch, while the other 95% only need to upgrade and modify their pre-existing risk control management systems.

If 69 broker-dealers – i.e., 5% of the 1,375 broker-dealers affected under the rule – were to build risk control management systems from scratch, the total initial technology cost would be approximately $18.7 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 $11,585,380 for 69 broker-dealers. The hardware and software cost to build a risk control management system from scratch would be $102,500 per broker-dealer, or $7,072,500 for 69 broker-dealers. The combined personnel, hardware, and software cost would be $18.7 million.

By contrast, if the remaining 1,306 broker-dealers were to upgrade and modify their pre-existing risk control management systems, the total initial technology cost for those 1,306 broker-dealers would be approximately $51.6 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 $36.5 million for 1,306 broker-dealers. The hardware and software cost to upgrade and modify a risk control management system would be $11,517 per broker-dealer, or $15.0 million for 1,306 broker-dealers. The combined personnel, hardware, and software cost would be $51.6 million.

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. In the Proposing Release, the Commission estimated $8,000 per month (i.e., connection to two trading venues), or $96,000 annually, for a startup contract.[230] For instance, the Commission estimates that if 69 broker-dealers (or, 5% of respondents) choose to purchase systems from a third-party vendor as an alternative to building a risk control management system from scratch,[231] the cost to the industry for initial startup contracts could be approximately $6,240,000.[232] 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 69 broker-dealers would be the same as the startup estimate of $6,624,000 per year.

The Commission requested comment on the technology cost estimates. Numerous commenters responded by asserting that the actual technology costs will be significantly higher than the estimates from the Proposing Release.[233] Of these, three commenters cited specific technology cost estimates of their own. One estimated that the cost to either build or buy the appropriate technology alone would be $500,000 to $1 million per year;[234] another asserted that maintenance from outside vendors would cost more than $1 million per year, while building a

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230 See supra Section III.D.1.

231 As stated previously, the Commission estimates that 5% of all broker-dealers will require development of a system from scratch. See supra note 198. Based on discussions with various industry participants, the Commission believes that a total of 69 broker-dealers is a reasonable estimate here.

232 69 broker-dealers × $96,000 (annual cost for a startup contract with a third-party technology provider or service bureau) = $6,624,000.

233 See Pershing Letter at 4, Fortis Letter at 18, STANY Letter at 4-5, Scottrade Letter at 1, Deutsche Letter at 6, Wedbush Letter at 5-6, ConvergEx Letter at 9, and CBOE Letter at 1, 4.

234 See Pershing Letter at 4.

solution in-house would cost roughly $750,000;[235] and another stated that the cost to build the appropriate systems would be more than $2 million per year.[236]

The Commission recognizes that technology and maintenance costs will vary depending on the size of the broker or dealer and the extent to which it already complies with the requirements described in the Rule. The Commission notes that, like its initial estimates for technology outsourcing costs, its initial estimates for in-house technology and maintenance costs are weighted averages, and that these estimates skew lower because the Commission estimates that, based on discussions with various industry participants, the majority of broker-dealers that provide market access, if they are not already fully compliant, are close to full compliance and are not expected to incur significant additional technology costs. Numerous industry sources have stated that, for brokers-dealers who perform technology maintenance in-house, it would take no longer than two or three days to program any compliance adjustments. The Commission therefore continues to believe that its cost estimates for technology are reasonable, and retains its technology cost-per-broker-dealer estimates as proposed. However, the industry-wide technology cost estimate has been increased to reflect the revised number of respondents affected under the Rule.

2. Legal and Compliance

Under the Rule, a broker or dealer will be obligated to comply with all applicable regulatory requirements such as exchange trading rules relating to special order types, trading halts, odd-lot orders, and SEC rules under Regulation SHO and Regulation NMS. 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

235 See ConvergEx Letter at 9.

236 See Wedbush Letter at 6.

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 the 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.

In the Proposing Release, the Commission estimated that the initial cost for a broker-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.[237] Specifically, the costs for setting credit and capital thresholds would be approximately $2,640,[238] and the modification or establishment of applicable compliance policies and procedures would be approximately $25,555 per broker-dealer.[239]

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237 The Commission has revised the number of respondents affected by the Rule. See supra Section III.C.

238 The Commission estimated that one compliance attorney and one compliance manager would each require 5 hours, for a total initial burden of 10 hours. See supra Section III.B.2. The total initial cost for staff was 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.

239 The Commission estimated 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 III.B.2. The total initial cost for staff was 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 Commission further estimated that the costs of the annual review, modification of applicable compliance policies and supervisory procedures, and preservation of such records 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;[240] a compliance manager who reviews, documents, and updates written compliance policies and procedures is expected to cost $5,160;[241] and the Chief Executive Officer, who certifies the policies and procedures, would cost $20,275.[242]

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 invited comments on whether large bank Chief Executive Officer total compensation is an appropriate proxy for broker-dealer Chief Executive Officer total compensation, but received none.

240 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.

241 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.

242 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 invited comments on whether large bank Chief Executive Officer total compensation is an appropriate proxy for broker-dealer Chief Executive Officer total compensation, but received none.

For this Adopting Release, the Commission is updating the total initial and ongoing legal and compliance costs to reflect the revised number of respondents, which has been changed from 1,295 to 1,375 broker-dealers.[243] Moreover, the Commission is revising its per-broker-dealer compliance cost estimates to account for the additional task of negotiating and preparing risk compliance allocation agreements. The Commission anticipates that compliance attorneys who prepare risk allocation agreements would cost an estimated \$2,700 per year,[244] while compliance managers who participate in this process would cost an estimated \$1,290 per year.[245] The Commission believes that the additional compliance costs for negotiating and preparing risk compliance allocation contracts will be the same for both initial and ongoing efforts.

Commission staff now estimates that the total initial cost for a broker-dealer to comply with the proposed requirement to establish, document, and maintain compliance policies and supervisory procedures would be approximately \$32,200 per broker-dealer,[246] or \$44.3 million for 1,375 broker-dealers. Meanwhile, the total annual ongoing cost to maintain in-house risk

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243 See supra Section III.C.

244 10 hours (allocation contracts hourly burden for a compliance attorney) × \$270 (hourly wage for a compliance attorney) = \$2,700. 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.

245 5 hours (allocation contracts hourly burden for a compliance manager) × \$258 (hourly wage for a compliance manager) = \$1,290. 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.

246 The new total initial compliance cost per broker-dealer is \$28,200 (Proposing Release estimate) + \$2,700 + \$1,290 (additional costs for allocation contracts) = \$32,190.

control management systems would be approximately $34,800 per broker-dealer,[247] or $47.9 million for 1,375 broker-dealers.

The Commission believed 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 did not believe that a broker-dealer would likely have any recurring external costs associated with legal and compliance obligations.

The Commission requested comment on the estimated costs of the legal and compliance obligations. One commenter asserted that the cost of compliance will exceed 10 to 20 times the amount projected by the Commission. The commenter noted that the cost of receiving and processing market data for hundreds of thousands of symbols (including options) alone will exceed the Commission's estimated compliance costs.[248] Moreover, the commenter believed that because it would be unlikely for a CEO to be a compliance specialist, a broker or dealer would more likely need to hire a consultant to review the controls, which would likely cost between $500,000 and $1 million per year.[249]

The Commission continues to believe that the cost to develop and maintain compliance policies and procedures will not be significant for most brokers-dealers. The Commission stresses that its estimate of the compliance cost represents an average of the cost associated with all compliance requirements referenced in the Rule and, on balance, believes that overall costs are accounted for in the $32,200 initial cost and the $34,800 ongoing annual costs per broker-

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247 The new total annual ongoing compliance cost per broker-dealer is $30,800 (Proposing Release estimate) + $2,700 + $1,290 (additional costs for allocation contracts) = $34,790.

248 See Lek Letter at 3.

249 Id.

dealer. Moreover, similar to the technology costs, the compliance cost is a weighted average that skews lower because most brokers and dealers who already maintain compliance policies and procedures will not face significantly greater costs. Although several broker-dealers may indeed incur a cost of compliance that will exceed the amount estimated in the Proposing Release, the Commission anticipates that these broker-dealers will be significantly outnumbered by brokers-dealers who will incur minimal additional costs. With the exception of the additional costs to account for negotiating and preparing risk compliance allocation agreements, the Commission retains its compliance cost estimates as previously stated in the Proposing Release.

As already stated above, the Commission has in fact accounted for the likelihood that the Chief Executive Officer would not be a compliance specialist. In the Proposing Release, the Commission estimated that the initial legal and compliance burden for a CEO would constitute only 5 of the 35 total hours required,[250] on average, while internal compliance specialists would be responsible for the remainder of the initial burden. Such a burden allocation anticipates that compliance experts will oversee the bulk of responsibilities for establishing credit and capital thresholds and for modifying compliance policies, while the Chief Executive Officer would retain the senior managerial responsibility to review and certify the controls' effectiveness. Moreover, the Commission reiterates that these compliance obligations are in fact consistent with the type of work that a broker-dealer typically handles internally, especially since broker-dealers typically rely on internal resources for other certification processes such as the FINRA 3130 process, as discussed above. The Commission is adopting Rule 15c3-5(e) as proposed, and is largely retaining its legal and compliance burden per-broker-dealer estimates as proposed.

3. Total Cost

250 As stated above, the Commission now estimates that the total initial legal and compliance burden is 50 hours, and not 35. See supra Section III.D.2.

The Commission believes that this Rule would have its greatest impact on broker-dealers that provide "unfiltered" or "naked" access, and that the majority of broker-dealers with market access are likely to be able to substantially satisfy the requirements of the Rule 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. Once again, we provide an illustrative set of calculations for a scenario where 5% of respondents under the Rule need to build risk control management systems from scratch, while the other 95% only need to upgrade and modify their pre-existing risk control management systems.

The Commission estimates that if 69 broker-dealers build risk management systems from scratch and modify their compliance procedures accordingly, the total initial cost could be approximately as much as $20.9 million. The cost to build the risk control management systems would be $18.7 million for 69 broker-dealers,[251] while the cost to initially develop or modify compliance procedures for the same would be approximately $32,200 per broker-dealer,[252] or $2.2 million for 69 broker-dealers. The total initial cost to build systems from scratch is thus estimated to be approximately $20.9 million.

By contrast, the Commission estimates that if the remaining 1,306 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 $93.6 million. The cost to upgrade the risk control management systems would be $51.6 million for 1,306

251 See supra Section IV.B.1.

252 See supra Section IV.B.2.

broker-dealers,[253] while the cost to initially develop or modify compliance procedures for the same would be approximately $32,200 per broker-dealer,[254] or $42.1 million for 1,306 broker-dealers. The total initial cost is thus estimated to be approximately $93.6 million.

The total annual initial cost for all 1,375 broker-dealers is estimated to be approximately $114.4 million.[255]

The total annual ongoing cost for all 1,375 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 $112.9 million. The annual technology cost to maintain a risk management control system would be approximately $47,300 per broker-dealer,[256] or $65 million for 1,375 broker-dealers, while the cost for annual review and modification of applicable compliance policies and procedures would be approximately $34,800 per broker-dealer,[257] or $47.9 million for 1,375 broker-dealers. The total annual ongoing cost for all 1,375 broker-dealers is estimated to be approximately $112.9 million. It should be noted that the total cost estimate has been increased from the Proposing Release's total cost estimate to reflect the revised number of respondents affected under the Rule.

The Commission believes that in many cases broker-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

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253 See supra Section IV.B.1.

254 See supra Section IV.B.2.

255 $20.9 million (initial cost for 69 broker-dealers building a system from scratch) + $93.6 million (initial cost for 1,306 broker-dealers upgrading pre-existing systems) = approximately $114.4 million.

256 See supra note 228.

257 See supra notes 240, 241, and 242.

substantially satisfy the requirements of the 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.

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

Section 3(f) of the Exchange Act[258] 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 Act[259] 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 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

In the Proposing Release, we considered in turn the impact 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.

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258 15 U.S.C. 78c(f).

259 15 U.S.C. 78w(a)(2).

There are approximately 5,178 registered broker-dealers, of which 890 are small broker-dealers.[260] The Commission estimates that 1,295 brokers or dealers would have market access as defined under the proposed rule.[261] In addition, the Commission estimates that 80 brokers or dealers operate registered, active ATSs, bringing the total estimate of broker-dealers that would be subject to the requirements of the rule to 1,375. Of these 1,375 brokers or dealers, the Commission estimates that approximately 21 of those are 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 smaller broker-dealers, who are both their competitors and their customers.

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 "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 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 Rule will require brokers or dealers that offer market access, including those providing sponsored or direct market access to customers, to implement appropriate risk

260 These numbers are based on the Commission's staff review of 2007 and 2008 FOCUS Report filings reflecting registered broker-dealers. The number does not include broker-dealers that are delinquent on FOCUS Report filings.

261 Proposing Release, 75 FR at 4018.

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 the costs overall will create or increase any burdens of entry into 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 dealer 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.

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. The Commission within the past few years has approved applications by 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. Moreover, on March 12, 2010, Direct Edge received formal approval from the Commission for its platforms to operate as facilities to two newly created national securities exchanges. We believe that competition among trading centers has been facilitated by Rule 611 of Regulation NMS,[262] which encourages quote-based competition between trading centers; Rule 605 of Regulation NMS,[263] which empowers investors and broker-dealers to compare execution quality statistics across trading centers; and Rule 606 of Regulation NMS,[264] 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.

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262 17 CFR 242.611.

263 17 CFR 242.605.

264 17 CFR 242.606.

The Commission solicited comments regarding the effect of the Rule on competition among market centers and broker-dealers. A number of commenters argued that the Rule will lead to small liquidity providers being driven from the market and an increased concentration of firms providing market access, thus reducing the available choice for end-clients.[265] Specifically, one commenter noted in particular that without sponsored access, smaller broker-dealers will be unable to compete with larger market participants because direct exchange connectivity and lower latency times are cost-prohibitive for smaller competitors.[266] Moreover, smaller broker-dealers rely on trade flow aggregation to reach the most favorable fee tiers and overcome the handicap of uncompetitive pricing.[267]

The Commission acknowledges that the Rule may indeed have adverse competitive effects on small broker-dealers. The Commission nevertheless places particular emphasis on the significant benefits that the Rule provides to the markets, such as the protection of market integrity and efficiency. Although the Rule may indeed lead to a consolidation among smaller brokers and dealers that would in turn potentially reduce competition among broker-dealers and increase trading costs for consumers, the Commission believes that such costs are justified by the benefits provided to investors, and the financial system as a whole, in preventing unfiltered market access. After careful consideration of the relevant facts and comments received, the Commission has determined that any burden on competition imposed by Rule 15c3-5 is necessary or appropriate in the furtherance of the purposes of the Exchange Act noted above.

B. Capital Formation

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265 See Fortis Letter at 16, Jane Street Letter at 2.

266 See Jane Street Letter at 2.

267 Id.

A purpose of Rule 15c3-5 is to strengthen investor confidence and, in doing so, to give investors greater incentive to participate in the markets, resulting in the promotion of capital formation. In deciding to adopt the Rule, the Commission has given significant consideration to the potential undermining of public confidence in the securities markets resulting from disorderly markets that could result from inadequate risk management controls and unfiltered sponsored access. The Commission believes that the mitigation of the risk of disorderly markets 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. 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, thus promoting capital formation.

One commenter contended that the Rule's measures alone will likely have an insignificant effect on market integrity and protection of the public interest, as they are targeted towards systemic risk and not investor protection.[268] The Commission disagrees with the commenter's delineation between systemic risk and investor protection and the implicit assumption that the two are mutually exclusive. The Commission strongly believes that by helping to prevent unfiltered sponsored access, the Rule reduces the risk of disorderly markets. The Rule is expected to bolster investors' confidence that the markets are less likely to experience such unpredictable events, thus increasing market participants' incentive to remain invested in the markets and bolstering capital formation.

C. Efficiency

[268] See Fortis Letter at 14.

By addressing broker-dealer obligations with respect to market access risk controls across markets, and by having the effect of prohibiting "unfiltered" or "naked" access, the Rule would provide uniform standards that would be interpreted and enforced in a consistent manner. 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 help prevent erroneous and unintended trades from occurring and thereby contribute to market efficiency. For example, Rule 15c3-5 requires that a broker-dealer with market access implement pre-trade risk management controls that, among other things, prevent the entry of erroneous or duplicative orders. These types of pre-trade risk management controls should serve to limit the number of erroneous or unintended orders from entering an exchange or ATS, thereby limiting the occurrence of erroneous or unintended executions. The Commission believes that certainty of an execution is integral to the operations of an efficient market. By limiting the potential for erroneous executions, Rule 15c3-5 should serve to enhance market efficiency by minimizing the number of trades that are subsequently broken and enhance price efficiency by ensuring that publicly reported transaction prices are valid.

VI. Final Regulatory Flexibility Analysis

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act ("RFA"),[269] regarding Rule 15c3-5 under the Securities Exchange Act of 1934.

A. Need for Rule 15c3-5

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 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 or sponsored access arrangements. For this reason, 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 as well as when a broker-dealer operator of an ATS provides access to its ATS to a non-broker-dealer. The Commission, however, is particularly concerned about the quality of broker-dealer risk controls in sponsored access

269 5 U.S.C. 604(a).

arrangements, where the customer order flow does not pass through the broker-dealer's systems prior to entry on an exchange or ATS.

B. Significant Issues Raised by Public Comment

In the Proposing Release, the Commission requested comment on matters discussed in the IRFA.[270] While the Commission did receive comment letters that discussed the overall number of respondents that would be affected by the proposed new rule,[271] the Commission did not receive any comments that specifically addressed the number of small entities that would be affected.

Several commenters stated that the Rule would have an impact on smaller broker-dealers. The commenters noted that sponsored access is a competitive tool for small broker-dealers that serves to level the playing field between smaller and larger market participants.[272] By prohibiting unfiltered sponsored access, the Rule would prevent small broker-dealers from offering reduced latency times that larger entities are able to offer through direct exchange connectivity.[273] Moreover, some commenters believed that the Rule would hinder small broker-dealers from aggregating trade flow with others to reach more favorable fee tiers.[274] The commenters asserted that as a result, the new rule may have the unintended negative effect of driving small liquidity providers out of the market and reducing overall marketplace liquidity.[275]

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270 See Proposing Release, 75 FR at 4028.

271 See supra Section III.C.

272 See, e.g., Jane Street Letter at 1-2; Scottrade Letter at 1; Wedbush Letter at 3-4; ABA Letter at 6-7; and Carter Letter at 4-5.

273 See Jane Street Letter at 1-2; Wedbush Letter at 3-4; Carter Letter at 4-5.

274 See Jane Street Letter at 1-2.

275 See Jane Street Letter at 1-2; Scottrade Letter at 1.

Another commenter noted that for some smaller proprietary trading firms, the expanded risk management requirements in the Rule would make it impossible for their current business models to be successful. In particular, the commenter asserted that increased latency times required to send the firms' orders through a broker-dealer's risk management systems would render their trading algorithms ineffective. As a result, this type of business model would no longer be viable.[276]

The Commission recognizes that small broker-dealers are faced with significant competitive concerns from larger market participants, and that the new rule will eliminate speed advantages gained through unfiltered sponsored access. However, the Commission notes that all broker-dealers will be prohibited from offering unfiltered sponsored access, not just small broker-dealers. The Rule may affect the efficacy of market participant trading algorithms. However, the Commission continues to believe that the potentially negative competitive effects on small broker-dealers are justified by the benefits of eliminating the substantial market risks that sponsored access imposes on all market participants, regardless of their size. As the Commission previously stated in the Initial Regulatory Flexibility Analysis in the Proposal, only a small number of the broker-dealers would be classified as "small businesses."[277] Given the relative importance of safeguarding against the risk of disorderly markets, the competitive effects that the Rule may impose on that small number of respondents is appropriate.

C. 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

276 See ABA Letter at 7.

277 See Proposing Release, 75 FR at 4027.

"small business."[278] 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."[279] In addition, the Commission estimates that there were 200 brokers or dealers that were subscribers to ATSs but not members of an exchange.[280] 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 procedures in place. The extent to which such small brokers or dealers would be affected economically under the 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 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 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 Rule. The 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

278 17 CFR 240.0-10(c).

279 See Proposing Release, 75 FR at 4027.

280 Id.

significant cost or burden because the Commission understands that such technology allows the broker or dealer to exclusively manage such controls.[281]

D. Reporting, Recordkeeping, and Other Compliance Requirements

The Rule will require brokers or dealers to establish, document, and maintain certain risk management controls and supervisory procedures reasonably designed to limit financial exposure and ensure compliance with applicable regulatory requirements 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. The financial and regulatory risk management controls and supervisory procedures required by the Rule must be under the direct and exclusive control of the broker or dealer with market access. The Rule, however, permits a broker-dealer providing market access to reasonably allocate, by written contract, control over specific regulatory risk management controls and supervisory procedures to a customer that is a broker-dealer, so long as the broker-dealer providing market access has a reasonable basis for determining that such customer, based on its position in the transaction and relationship with an ultimate customer, has better access than the broker-dealer with market access to that ultimate customer and its trading information such that it can more effectively implement the specified controls or procedures than the broker-dealer providing market access. Each such broker or dealer will 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. Such regular review will be required to be conducted in accordance with written procedures and would be required to be documented. The broker or dealer will be required to preserve a copy of such written procedures, and documentation of each

281 The Commission's understanding is based on discussions with various industry participants.

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) will 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 will 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 Rule will 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, 60 hours of compliance staff time for brokers or dealers depending on their business model.[282] The Commission believes that the business models of small brokers or dealers would necessitate less than the average of 60 hours.

E. Agency Action to Minimize Effects on Small Entities

Pursuant to Section 3(a) of the Regulatory Flexibility Act,[283] 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

282 See supra Section III.D.2.

283 5 U.S.C. 603(c).

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 Rule is designed to mitigate, as discussed in detail throughout this release, significant financial and regulatory risks, the Commission believes that small entities should be covered by the Rule. The proposed rule includes performance standards. The Commission also believes that the Rule is flexible enough for small broker-dealers to comply with the Rule without the need for the establishment of differing compliance or reporting requirements for small entities, or exempting them from the Rule's requirements.

VII. 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 adopts 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.

Text of Rule 15c3-5

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 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 (i) 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; or (ii) access to trading in securities on an alternative trading system provided by a broker-dealer operator of an alternative trading system to a non-broker-dealer.

(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). A broker-dealer that routes orders on behalf of an exchange or alternative trading system for the purpose of accessing other trading centers with protected quotations in compliance with Rule 611 of Regulation NMS (§242.611) for NMS stocks, or in compliance with a national market system plan for listed options, shall not be required to comply with this rule with regard to such routing services, except with regard to paragraph (c)(1)(ii) of this section.

(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 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.

(1) Notwithstanding the foregoing, a broker or dealer that is subject to paragraph (b) of this section may reasonably allocate, by written contract, after a thorough due diligence review, control over specific regulatory risk management controls and supervisory procedures described in paragraph (c)(2) of this section to a customer that is a registered broker or dealer, provided that such broker or dealer subject to paragraph (b) of this section has a reasonable basis for determining that such customer, based on its position in the transaction and relationship with an ultimate customer, has better access than the broker or dealer to that ultimate customer and its trading information such that it can more effectively implement the specified controls or procedures.

(2) Any allocation of control pursuant to paragraph (d)(1) of this section shall not relieve a broker or dealer that is subject to paragraph (b) of this section from any obligation under this section, including the overall responsibility to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of market access.

(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).

(f) The Commission, by order, may exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any broker or dealer, if the Commission determines that such exemption is necessary or appropriate in the public interest consistent with the protection of investors.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: November 3, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63240 / November 3, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-11393

In the Matter of MASSACHUSETTS FINANCIAL SERVICES COMPANY, JOHN W. BALLEN AND KEVIN R. PARKE Respondents.	ORDER MODIFYING DISTRIBUTION PLAN AND DIRECTING DISBURSEMENT

On July 19, 2006, the Commission published a notice of the proposed Plan of Distribution proposed by the Division of Enforcement in connection with this proceeding (Exchange Act Release No. 54175). The Commission received comments and, on July 24, 2007, the Plan of Distribution was approved after certain clarifying modifications were made. See Exchange Act Release No. 56122 (July 24, 2007) (Order Approving Modified Distribution Plan). The Order approving the Modified Plan of Distribution was subsequently revised. See Exchange Act Release No. 56527 (September 25, 2007) (Revised Order Approving Modified Distribution Plan).

The Modified Plan of Distribution ("Plan") provides that a Fair Fund consisting of disgorgement and civil penalties, plus amounts from third parties and any accrued interest, be transferred in portions to Deutsche Bank to be distributed by the Fund Administrator to injured investors according to the methodology set forth in the Plan. Pursuant to the Plan, and following a series of Orders Directing Disbursement, the Independent Distribution Consultant ("IDC") and the Fund Administrator, in a series of thirteen tranches, distributed $312,042,489.07 to injured investors.[1] There is a significant amount remaining in the Fair Fund after those amounts were distributed, which is considered Residual Distributions pursuant to the Plan. Paragraph 20 of the Plan provides that any Residual Distributions shall be distributed pro rata to the MFS Funds, based on each Fund's percentage of Losses estimated from all Funds during the Period to which this matter relates.

A significant portion of the Residual Distributions is comprised of amounts that were distributed but which were not claimed (i.e. checks that were not presented for payment within the time period prescribed by the Plan and checks that were returned to the Fund Administrator as undeliverable). Consistent with the Plan's primary objective to distribute funds directly to affected investors at the time of the misconduct and with the concurrence of the IDC and MFS, the Plan is modified in the following respects:

A. <u>Additional Steps:</u> The IDC and the Fund Administrator will take the following additional steps ("Additional Steps") relating to the distribution: (1) make further commercially reasonable efforts to locate investors who are entitled to a check in the amount of $5,000 or more and whose original check was returned as undeliverable; (2) reissue and mail checks to any investors located as a result of the efforts described in (1) above; (3) reissue and mail all checks in the amount of $100 or more to investors who failed to present those checks for payment within the time prescribed by the Plan and whose check was not otherwise previously reissued; (4) reissue checks totaling $82,510.02 to certain Southwest Securities, Inc. accountholders whose accounts were undercompensated as a result of administrative error.

B. <u>Stale Dates for Reissued Checks:</u> Checks reissued as a result of the Additional Steps shall have a stale date of 60 days after issuance. The IDC may, in his discretion, reissue a check which was issued pursuant to the Additional Steps (to replace a lost or damaged check, for example), but only if the request for reissuance is made before the stale date of the original reissued check (i.e. within 60 days after original reissuance). Any check so reissued will have a stale date no later than 30 days after the stale date of the original reissued check. Except as provided in this paragraph, the IDC will not reissue any other checks. The procedures in Paragraph 11 of the Plan which provide for Proof of Possible Entitlement and Dispute Forms shall not be applicable to any reissued check.

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[1] *See* Exchange Act Rel. Nos. 34-56527 (November 5, 2007), 34-56743 (December 6, 2007), 34-57177 (January 9, 2008), 34-57276 (February 6, 2008), 34-57396 (February 28, 2008), 34-57687 (April 18, 2008), 34-57783 (May 6, 2008), 34-57915 (June 4, 2008), 34-57980 (June 17, 2008), 34-58090 (July 2, 2008), 34-58320 (August 6, 2008), 34-58412 (August 22, 2008), 34-59048 (December 3, 2008), 34-59741 (April 9, 2009).

C. Remaining Uncashed Checks to be Returned to Residual: Any checks issued pursuant to the Additional Steps which remain uncashed after their stale date or which are returned as undeliverable, shall be cancelled and returned to the Qualified Settlement Fund as Residual Distributions to be distributed as part of the Second Residual Distribution, described in Paragraph G, below.

D. Costs of Additional Steps: MFS will pay, but shall be reimbursed from the Fair Fund for actual costs attributable to the Additional Steps which are found not to be unreasonable by the IDC, including without limitation, costs and fees of the Fund Administrator. MFS will pay, but shall be reimbursed from the Fair Fund for the Fees and Expenses of the IDC which are attributable to the Additional Steps which are found not to be unreasonable by the Commission staff. Such reimbursable costs, however are not to exceed $475,000 ("Total Reimbursable Amount"). Costs incurred by the Fund Administrator which are not attributable to the Additional Steps, as determined by the IDC, shall be borne by MFS in accordance with Paragraph 2(b) of the Plan and shall not be reimbursed from the Qualified Settlement Fund. Fees and expenses of the IDC which are not attributable to the Additional Steps, as determined by the staff of the Commission, shall be borne by MFS in accordance with the Order Instituting Administrative and Cease and Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act of 1940 and Section 9(b) and 9(f) of the Investment Company Act of 1940 and Making Findings and imposing Remedial Sanctions and a Cease and Desist Order, dated February 5, 2004, ("February 2004 Order") and shall not be reimbursed from the Qualified Settlement Fund. Costs attributable to the Additional Steps but which exceed the Total Reimbursable Amount shall not be reimbursed.

E. Amount to be Reserved From Residual: The amount of $35,657,789 will be reserved from the Fair Fund ("Reserved Amount") to pay (1) any reissues which result from the Additional Steps; (2) the reimbursable costs of the Additional Steps as described above; and (3) estimated tax liabilities of the Fund.

F. First Residual Distribution: The current balance of the Qualified Settlement Fund less the Reserved Amount shall be considered Residual Distributions and shall be distributed to the affected MFS Funds in accordance with the Plan. Those Residual Distributions may be made while the Additional Steps are being taken.

G. Second Residual Distribution: After the stale date for all checks reissued as a result of the Additional Steps, any funds from the Reserved Amount remaining in the Qualified Settlement Fund, shall be considered Residual Distributions. Upon certification that a validated payment file has been received by Commission staff and the distribution information has also been received by the affected mutual funds, the Secretary shall issue an Order to Disburse those Residual Distributions pursuant to the Plan.

Accordingly, IT IS ORDERED that:

A. Pursuant to Rule 1104 of the Fair Fund Rules, 17 C.F.R. §201.1104, that the Distribution Plan is modified as described above, and approved with such modification; and

B. the Commission staff shall transfer $17,353,284.98 of the Fair Fund to Deutsche Bank and the Fund Administrator shall include such monies in its distributions to the affected MFS Funds, as provided for in the Plan of Distribution and in paragraph C, below.

C. The Fund Administrator shall disburse the Residual Distributions as described above in Paragraph F to the affected MFS Funds, in the amount stated in the validated payment file of $38,631,356.04, as provided for in the Plan of Distribution as hereby modified.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 242

[Release No. 34-63247; File No. S7-08-09]

RIN 3235-AK35

Regulation SHO

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; extension of compliance date.

SUMMARY: The Commission is extending for a limited period of time the compliance date for the amendments to Rule 201 and Rule 200(g) of Regulation SHO under the Securities Exchange Act of 1934 ("Exchange Act"). Rule 201 adopts a short sale-related circuit breaker that, if triggered, will impose a restriction on the prices at which securities may be sold short ("short sale price test restriction"). The amendments to Rule 200(g) provide that a broker-dealer may mark certain qualifying short sale orders "short exempt." The Commission is extending the compliance date for the amendments to Rule 201 and Rule 200(g) to give certain exchanges additional time to modify their current procedures for conducting single-priced opening, reopening, and closing transactions for covered securities that have triggered Rule 201's circuit breaker in a manner that is consistent with the goals and requirements of Rule 201. Further, the extended compliance period will give industry participants additional time for programming and testing for compliance with the requirements of the Rule.

DATES: The effective date for Rule 201 (17 CFR 242.201) and Rule 200(g) (17 CFR 242.200(g)) remains March 10, 2010. The compliance date for both Rules has been extended from November 10, 2010 to February 28, 2011.

FOR FURTHER INFORMATION CONTACT: Josephine Tao, Assistant Director, or Angela Moudy, Attorney-Advisor, Division of Trading and Markets, at (202) 551-5720, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

I. Introduction

On February 26, 2010, the Commission adopted amendments to Rule 201 and Rule 200(g) of Regulation SHO.[1] Rule 201 requires that a trading center establish, maintain, and enforce written policies and procedures reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid if the price of that covered security decreases by 10% or more from its closing price as determined by the listing market for the covered security as of the end of regular trading hours on the prior day.[2] In addition, the Rule requires that the trading center establish, maintain, and enforce written policies and procedures reasonably designed to impose this short sale price test restriction for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.[3] The amendments to Rule 200(g) provide that broker-dealers may mark certain short sale orders "short exempt."[4]

Commission staff has been working with the markets and their participants since Rule 201 was adopted to resolve operational issues relating to implementation of the Rule. As part of these efforts, we have become aware that certain exchanges require additional time to address

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1 Exchange Act Release No. 61595 (Feb. 26, 2010), 75 FR 11232 (Mar. 10, 2010) ("Rule 201 Adopting Release").

2 See 17 CFR 242.201(b)(1)(i).

3 See 17 CFR 242.201(b)(1)(ii).

4 See 17 CFR 242.200(g)(2).

their procedures for conducting single-priced opening, reopening, and closing transactions ("single-priced transactions") for covered securities that have triggered the Rule's circuit breaker. Specifically, we have been advised that certain exchanges may encounter difficulties in applying Rule 201, which uses the national best bid as a reference point, to their single-priced transactions. These transactions involve the queuing and ultimate execution of multiple orders at a single price, and the single equilibrium price determined through this process is based on orders on the exchange, without any reference to the national best bid at the time of execution. Due to potential operational concerns, we are providing additional time for exchanges that currently conduct single-priced transactions through a formalized and transparent process to address this issue in a manner that would be consistent with the requirements and goals of Rule 201's short sale price test restriction.[5]

In addition, we believe that an extended compliance period may benefit industry participants by providing more time for programming and testing for compliance with the Rule's requirements. We have been informed that there have been some delays in the programming process, due in part to certain information, which was necessary to effectively program for compliance with Rule 201, being provided by various parties, including exchanges and data vendors, on dates that were later than originally anticipated. As a result, we have been informed that there may be an increased risk of technical or market problems if full implementation of Rule 201 is required by November 10, 2010.

As a result of these considerations, and in order to avoid any potential adverse effects on the markets from implementation of Rule 201 under the circumstances, we have determined to extend the compliance date to February 28, 2011 because we understand that this would provide

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[5] A significant percentage of total trading volume can be executed in single-priced transactions. For example, one exchange executes approximately 25% of its total trading volume in its opening and closing transactions.

the exchanges and other industry participants with sufficient time to resolve the issues surrounding implementation of Rule 201.

II. Conclusion

For the reasons cited above, the Commission, for good cause, finds that notice and solicitation of comment regarding the extension of the compliance date set forth herein are impractical, unnecessary, or contrary to the public interest.[6] The Commission notes that the compliance date is a few days away, and that a limited extension of the compliance date will facilitate the orderly implementation of Rule 201. In light of this time constraint, full notice and comment could not be completed prior to the November 10, 2010 compliance date. All industry participants will receive additional time to comply with Rule 201 and Rule 200(g) beyond the compliance date originally set forth in the Rule 201 Adopting Release. Further, the Commission recognizes that it is imperative for industry participants to receive notice of the extended compliance date, and providing immediate effectiveness upon publication of this release will allow industry participants to adjust their implementation plans accordingly.[7]

The Commission identified certain costs and benefits associated with the amendments to Rule 201 and Rule 200(g) of Regulation SHO in the Rule 201 Adopting Release. The extension of the compliance date for the amendments to Rule 201 and Rule 200(g) of Regulation SHO will

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6 See Section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) (stating that an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are "impractical, unnecessary, or contrary to the public interest"). This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are "impractical, unnecessary or contrary to the public interest," a rule "shall take effect at such time as the federal agency promulgating the rule determines"). Also, because the Regulatory Flexibility Act (5 U.S.C. 601 – 612) only requires agencies to prepare analyses when the Administrative Procedures Act requires general notice of rulemaking, that Act does not apply to the actions that we are taking in this release.

7 The compliance date extensions set forth in this release are effective upon publication in the Federal Register. Section 553(d)(1) of the Administrative Procedure Act allows effective dates that are less than 30 days after publication for a "substantive rule which grants or recognizes an exemption or relieves a restriction." 5 U.S.C. 553(d)(1).

delay the benefits of the Rules, but the Commission believes that the limited extension is necessary and appropriate because it will provide (1) certain exchanges additional time to modify their current procedures for conducting single-priced transactions for covered securities that have triggered Rule 201's circuit breaker in a manner that is consistent with the goals and requirements of Rule 201, and (2) industry participants additional time for programming and testing for compliance with the requirements of Rule 201 and Rule 200(g). The extension also will delay the costs of complying with the amendments.[8] The Commission believes that the extension does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, because, as noted above, the extension will give exchanges additional time to modify certain of their current procedures, and industry participants additional time for programming and testing, in a manner that is consistent with the goals and requirements of the amendments to Rule 201 and Rule 200(g) of Regulation SHO.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: November 4, 2010

[8] The Commission identified in the Rule 201 Adopting Release certain ongoing costs associated with the amendments to Rule 201 and Rule 200(g) of Regulation SHO. Because of the extension of the compliance date, such costs could be avoided from November 10, 2010 to February 28, 2011.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-63237; File No. S7-33-10]

RIN 3235-AK78

Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

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

ACTION: Proposed rule.

SUMMARY: The Commission is proposing rules and forms to implement Section 21F of the Securities Exchange Act of 1934 ("Exchange Act") entitled "Securities Whistleblower Incentives and Protection" and seeking comment thereon. The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted on July 21, 2010 ("Dodd-Frank"), established a whistleblower program that requires the Commission to pay an award, under regulations prescribed by the Commission and subject to certain limitations, to eligible whistleblowers who voluntarily provide the Commission with original information about a violation of the federal securities laws that leads to the successful enforcement of a covered judicial or administrative action, or a related action. Dodd-Frank also prohibits retaliation by employers against individuals that provide the Commission with information about potential securities violations.

DATES: Comments should be submitted on or before December 17, 2010.

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); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-33-10 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 Number S7-33-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing 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: In the Division of Enforcement: Sarit Klein (202) 551-4577. In the Office of the General Counsel: Brian A. Ochs (202) 551-5067, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Background

Section 922 of Dodd-Frank added new Section 21F to the Exchange Act, entitled "Securities Whistleblower Incentives and Protection."[1] Section 21F directs that the Commission pay awards, subject to certain limitations and conditions, to whistleblowers who voluntarily provide the Commission with original information about a violation of the securities laws that leads to a successful enforcement of an action brought by the Commission that results in monetary sanctions exceeding $1,000,000, and of certain related actions.

We are proposing Regulation 21F to implement Section 21F of the Exchange Act. As described in detail below, the rules contained in proposed Regulation 21F define certain terms critical to the operation of the Whistleblower Program, outline the procedures for applying for awards and the Commission's procedures for making decisions on claims, and generally explain the scope of the whistleblower program to the public and to potential whistleblowers. In this proposal, we have taken several steps to address Congress's suggestion that the Commission's whistleblower rules be clearly defined and user-friendly.[2] First, to the extent possible, we have tried to adopt a plain English approach in writing the rules contained in Regulation 21F. Second, Regulation

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[1] Pub. L. No. 111-203, § 922(a), 124 Stat 1841 (2010).

[2] See Dodd Frank §922(d)(1), which specifies that a study of the whistleblower program by the Inspector General of the Commission shall consider whether the final rules and regulations have made the program "clearly defined and user-friendly."

21F as proposed would provide a complete and self-contained set of rules relating to the whistleblower program. This means that in some places, we have proposed rules within the Regulation that largely restate key provisions of the statute. Although we recognize that this approach leads to some duplication between the statue and the rules, we believe that overall it will assist potential whistleblowers and add clarity, by providing in one place all the relevant provisions applicable to whistleblower claims.

In fashioning these proposed rules, the Commission has considered and weighed a number of potentially competing interests that are presented in implementing the statute. Among them was the potential for the monetary incentives provided to whistleblowers by Section 21F of the Exchange Act to reduce the effectiveness of a company's existing compliance, legal, audit and similar internal processes for investigating and responding to potential violations of the federal securities laws. With this possible tension in mind, we have included provisions in the proposed rules intended not to discourage whistleblowers who work for companies that have robust compliance programs to first report the violation to appropriate company personnel, while at the same time preserving the whistleblower's status as an original source of the information and eligibility for an award. At the same time, the proposed rules would not prohibit a whistleblower in a compliance function from reporting information to the Commission where the company did not provide the information to the Commission within a reasonable time or acted in bad faith.

Another important policy issue raised by the statute is the potential for the monetary incentives provided by Section 21F to invite submissions from attorneys, independent auditors, and compliance personnel who may attempt to use information they obtain through their positions to make whistleblower claims. This exclusion focuses on those groups with established professional obligations that play a critical role in achieving compliance with the federal securities laws. Our proposed rules include certain exclusions for these professionals and others under the definition of "independent knowledge," and we seek comment on whether the proposed exclusions are appropriate and whether they should be extended to other types of privileged communications or other types of professionals who frequently have access to confidential client information.

Finally, we have attempted to maximize the submission of high-quality tips and to enhance the utility of the information reported to the Commission. More frequent reporting of high-quality information promotes greater deterrence by enhancing the efficiency and effectiveness of the Commission's enforcement program. To achieve this goal, the proposed rules would impose certain procedural requirements designed to deter false submissions, including a requirement that the information be submitted under penalty of perjury, and requiring an anonymous whistleblower to be represented by counsel who must certify to the Commission that he or she has verified the whistleblower's identity.

II. Description of the Proposed Rules

A. Proposed Rule 21F-1 – General

Proposed Rule 21F-1 provides a general, plain English description of Section 21F of the Exchange Act. It sets forth the purposes of the rules and states that the Commission's Whistleblower Office administers the whistleblower program. In addition, the proposed rule states that, unless expressly provided for in the rules, no person is authorized to make any offer or promise, or otherwise to bind the Commission with respect to the payment of an award or the amount thereof.

B. <u>Proposed Rule 21F-2 – Definition of a Whistleblower</u>

The term "whistleblower" is defined in Section 21F(a)(6) of the Exchange Act.[3] Consistent with this language, Proposed Rule 21F-2(a) would define a whistleblower as an individual who, alone or jointly with others, provides information to the Commission relating to a potential violation of the securities laws. A whistleblower must be a natural person; a company or another entity is not eligible to receive a whistleblower award. This definition tracks the statutory definition of a "whistleblower," except that the proposed rule uses the term "potential violation." Because the statute requires the Commission to afford confidential treatment to information "which could reasonably be expected to reveal the identity of a whistleblower,"[4] it is important to be able to determine whether a person is a "whistleblower" at the time he or she submits information to the Commission. If the term "whistleblower" were defined to include only individuals who provide the Commission with information about actual, proven securities violations, then either the Commission would be required to determine at the time information is submitted whether the alleged conduct constitutes a violation of the securities laws, or the status of the person as a "whistleblower" would be unknown. We do not believe that this is the intended result.

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3 15 U.S.C. 78u-6(a)(6).

4 15 U.S.C. 78u-6(h)(2).

In addition, use of the term "potential violation" makes clear that the whistleblower anti-retaliation protections set forth in Section 21F(h)(1) of the Exchange Act do not depend on an ultimate adjudication, finding or conclusion that conduct identified by the whistleblower constituted a violation of the securities laws. As noted in the Senate Report accompanying the legislation, "[t]he Whistleblower Program aims to motivate those with inside knowledge to come forward and assist the Government;"[5] affording broad anti-retaliation protections to whistleblowers furthers this legislative purpose.

Paragraph (b) of Proposed Rule 21F-2 would further make clear that the anti-retaliation protections set forth in Section 21F(h)(1) of the Exchange Act apply irrespective of whether a whistleblower satisfies all the procedures and conditions to qualify for an award under the Commission's whistleblower program. We believe the statute extends the protections against employment retaliation in Section 21F(h)(1) to any individual who provides information to the Commission about potential violations of the securities laws regardless of whether the whistleblower fails to satisfy all of the requirements for award consideration set forth in the Commission's rules.

Proposed Rule 21F-2(c) makes clear, however, that, in order to be eligible to be considered for an award, a whistleblower must submit original information to the Commission in accordance with all the procedures and conditions described in Proposed Rules 21F-4, 21F-8, and 21F-9.

[5] S. Rep. No. 111-176 at 110 (2010).

Request for Comment:

1. In other provisions of these Proposed Rules - e.g., Proposed Rule 21F-15 - we propose that whistleblowers not be paid awards based on monetary sanctions arising from their own misconduct, based on the notion that the statue is not intended to reward persons for blowing the whistle on their own misconduct. Consistent with this approach, should we define the term "whistleblower" to expressly state that it is an individual who provides information about potential violations of the securities laws "by another person"?

C. Proposed Rule 21F-3 - Payment of Award

Proposed Rule 21F-3 summarizes the general requirements for the payment of awards set forth in Section 21F(b)(1) of the Exchange Act.[6] As set forth in the statute, paragraph (a) states that, subject to the eligibility requirements in the Regulations, the Commission will pay an award or awards to one or more whistleblowers who voluntarily provide the Commission with original information that leads to the successful enforcement by the Commission of a federal court or administrative action in which the Commission obtains monetary sanctions totaling more than $1,000,000. Paragraph (b) of this proposed rule describes the circumstances under which the Commission will also pay an award to the whistleblower based upon monetary sanctions that are collected from a "related action." Payment based on the "related action" will occur if the whistleblower's original information led the Commission to obtain monetary sanctions totaling more than $1,000,000, the related action is based upon the same original information that led to the successful enforcement of the Commission action, and the

[6] 15 U.S.C. 78u-6(b)(1).

related action is brought by the Attorney General of the United States, an appropriate regulatory agency, a self-regulatory organization, or a state attorney general in a criminal case.

Paragraph (c) of Proposed Rule 21F-3 explains that the Commission must determine whether the original information that the whistleblower gave to the Commission also led to the successful enforcement of a related action using the same criteria used to evaluate awards for Commission actions. To help make this determination, the Commission may seek confirmation of the relevant facts regarding the whistleblower's assistance from the authority that brought the related action. However, the proposed rule states that the Commission will deny an award to a whistleblower if the Commission determines that the criteria for an award are not satisfied or if the Commission is unable to obtain sufficient and reliable information about the related action.

Paragraph (d) provides that the Commission will not make an award in a related action if an award already has been granted to the whistleblower by the Commodity Futures Trading Commission ("CFTC") for that same action pursuant to its whistleblower award program under section 23 of the Commodity Exchange Act.[7] Rule 21F-3(d) also provides that, if the CFTC has previously denied an award in a related action, the whistleblower will be collaterally estopped from relitigating any issues before the Commission that were necessary to the CFTC's denial.

This provision serves two purposes. First, it would ensure that a whistleblower will not obtain a double recovery on the same related action. For example, if the CFTC makes an award of 10 percent to 30 percent on a criminal action brought by the U.S.

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[7] 7 U.S.C. 26.

Department of Justice, the whistleblower would be precluded from obtaining a second recovery of 10 percent to 30 percent from the SEC on the same action. Any other reading of the interplay of the SEC and CFTC whistleblower award provisions – which were both established by Dodd-Frank and which are substantially identical in their substantive terms – would produce the highly anomalous result of allowing the whistleblower to effectively receive a 20 percent minimum to 60 percent maximum recovery on the same related action. The SEC and CFTC whistleblower provisions, however, embody a clear Congressional determination that a whistleblower award on a successful action should lie within the 10 percent to 30 percent range.

Second, this provision would ensure that once the CFTC decides an issue of fact or law necessary to its determination to deny a whistleblower an award on a related action, the whistleblower will be precluded from relitigating the same issue before the Commission. For example, if the CFTC determines that the whistleblower's information did not lead to the successful enforcement of a related action, the whistleblower may not attempt to circumvent this adverse determination by relitigating the same issue before the Commission. The application of collateral estoppel principles in these circumstances would promote the orderly and consistent resolution of a whistleblower's claims, and would ensure that the subset of whistleblowers who can pursue both SEC and CFTC award claims on a related action are not unfairly afforded "two bites at the apple" relative to the majority of whistleblowers who would not have this dual opportunity.[8]

[8] See Restatement Second of Judgments, Sec. 29 cmt. b (explaining that "[a] party who has had a full and fair opportunity to litigate an issue has been accorded the elements of due process" and "there is no good reason for refusing to treat the issue as settled so far as he is concerned" in subsequent actions).

D. Proposed Rule 21F- 4 – Other Definitions

Although the statute defines several relevant terms, Proposed Rule 21F-4 would define some additional terms that are important to understanding the scope of the whistleblower award program, in order to provide greater clarity and certainty about the operation and scope of the program.

Proposed Rule 21F-4(a) – Voluntary submission of information.

Under Section 21F(b)(1) of the Exchange Act,[9] whistleblowers are eligible for awards only when they provide original information to the Commission "voluntarily." Proposed Rule 21F-4(a)(1) would define a submission as voluntary if a whistleblower provides the Commission with information before receiving any formal or informal request, inquiry, or demand from the Commission, Congress, any other federal, state or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information in the whistleblower's submission is relevant.

The first step in most Commission enforcement investigations is the opening of an informal inquiry. At this stage, because the staff has not yet been granted the authority to issue subpoenas, information is frequently requested from companies and members of the public on a "voluntary" basis in the sense that there is generally no legal requirement that the recipient of the request provide the information or even respond to the request. After a formal investigation is opened and the staff obtains subpoena authority, the staff retains discretion to seek documents or other information without legal compulsion, and often does so.

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9 15 U.S.C. 78u-6(b)(1).

Proposed Rule 21F-4(a)(1) would make clear that, in order to have acted "voluntarily" under the statute, a whistleblower must do more than merely provide the Commission with information that is not compelled by subpoena (or by a court order following a Commission action to enforce a subpoena) or by other applicable law.[10] Rather, the whistleblower or his representative (such as an attorney) must come forward with the information before receiving any formal or informal request, inquiry, or demand from the Commission staff or from any other authority described in the proposed rule about a matter to which the whistleblower's information is relevant.[11]

A request, inquiry, or demand that is directed to an employer is also considered to be directed to employees who possess the documents or other information that is within the scope of the request to the employer. Accordingly, a subsequent whistleblower submission from any such employee will not be considered "voluntary" for purposes of the rule, and the employee will not be eligible for award consideration,

10 Various books and records provisions of the federal securities laws and rules generally require regulated entities to furnish records to the Commission upon request. See, e.g., Section 17(a) and Rule 17a-4(j) under the Exchange Act (15 U.S.C. 78q(a) and 17 CFR 240.17a-4(j)).

11 The list of authorities set forth in the proposed rule does not include an employer's personnel (such as legal counsel, compliance, or audit staff) conducting an internal investigation, compliance review, audit, or similar function. Thus, Proposed Rule 21F-4(a)(1) would credit a whistleblower with "voluntarily" providing information if the individual were to approach the Commission staff after being questioned about possible violations by such persons, unless, as noted, the individual's information is within the scope of a request, inquiry, or demand directed to the employer by one of the designated authorities . The objective of this approach is to implement Section 21F in a way that encourages and permits persons with knowledge of securities violations to come forward to the Commission, other responsible Government authorities, and other bodies of an official nature. We have included other provisions in these proposed rules that are intended to facilitate the operation of company compliance processes, audits, and internal investigations. See Proposed Rules 21F-4(b)(4) and (b)(7). Further, because there is no assurance that an employer will ultimately disclose to the Commission potential violations uncovered in the course of an internal investigation or similar process, a rule that precluded employees with knowledge of unlawful conduct from coming forward as whistleblowers merely because they were questioned about the conduct by company personnel could undermine the purposes of Section 21F.

unless the employer fails to provide the employee's documents or information to the requesting authority in a timely manner.[12]

This approach is consistent with the statutory purpose of creating a strong incentive for whistleblowers to come forward early with information about possible violations of the securities laws rather than wait until Government or other official investigators "come knocking on the door."[13] This approach is also consistent with the approach federal courts have taken in determining whether a private plaintiff, suing on behalf of the Government under the qui tam provisions of the False Claims Act, "voluntarily" provided information about the false or fraudulent claims to the Government before filing suit.[14]

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12 Production of documents or information in a timely manner turns on the production schedule required, or otherwise agreed to, by the requesting authority. Further, employees will not be permitted to thwart the aim of Section 21F by causing an employer to fail to respond to a request in a timely manner, and then claiming that their whistleblower submission was therefore made "voluntarily" within the meaning of the proposed rule.

13 See S. Rep. No. 111-176 at 110 (2010) ("The Whistleblower Program aims to motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated securities laws ....").

14 See United States ex rel. Barth v. Ridgedale Electric, Inc., 44 F.3d 699 (8th Cir. 1994); United States ex rel. Paranich v. Sorgnard, 396 F.3d 326 (3d Cir. 2005); United States ex rel. Fine v. Chevron, USA, Inc., 72 F.3d 740 (9th Cir. 1995), cert. denied, 517 U.S.1233 (1996) (rejecting argument that provision of information to the Government is always voluntary unless compelled by subpoena) . The qui tam provisions of the False Claims Act include a "public disclosure bar," which, as recently amended, requires a court to dismiss a private action or claim if substantially the same allegations or transactions as alleged in the action or claim were publicly disclosed in certain fora, unless the Government opposes dismissal or the plaintiff is an "original source" of the information. 31 U.S.C. 3730(e)(4). An "original source" is further defined, in part, with reference to whether the plaintiff "voluntarily" disclosed the information to the Government before filing suit. Id. Because the qui tam provisions of the False Claims Act have played a significant role in the development of whistleblower law generally, and because some of the terminology used by Congress in Section 21F has antecedents in the False Claims Act, precedent under the False Claims Act can provide helpful guidance in the interpretation of Section 21F of the Exchange Act. At the same time, because the False Claims Act and Section 21F serve different purposes are structured differently, and the two statutes may use the same words in different contexts, we do not view False Claims Act precedent as necessarily controlling or authoritative in all circumstances for purposes of Section 21F.

Disclosure to the Government should also not be considered voluntary if the individual has a clear duty to report violations of the type at issue.[15] Thus, for example, Section 21F(c)(2) of the statute[16] prohibits awards to members, officers, or employees of an appropriate regulatory agency, the Department of Justice, a self-regulatory organization, the Public Company Accounting Oversight Board, a law enforcement organization, or to persons who obtain their information as a result of an audit of financial statements and who would be subject to the requirements of Section 10A of the Exchange Act. The Commission anticipates that there may be other similarly-situated persons who are under a pre-existing legal duty to report information about violations to the Commission or to any of the other authorities described in subsection (a)(1) of the proposed rule. Proposed Rule 21F-4(a)(2) provides that submissions from such individuals will not be considered voluntary for purposes of Section 21F. For example, a Government contracting officer would not be considered for a whistleblower award if the officer discovered and reported fraud on a Government contract that was material to the contractor's earnings.[17] Depending on the particular regulations or other authorities that governed, a city officer or employee with responsibility for the city's pension fund might have a pre-existing legal duty to report fraud in connection with the fund's management or financial reporting to appropriate city authorities. Proposed Rule

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15 See United States ex rel. Biddle v. Board of Trustees of The Leland Stanford, Jr. University, 161 F.3d 533 (9th Cir. 1998), cert. denied, 526 U.S. 1066 (1999) (government employee whose duties required that he report knowledge of contract fraud to superiors could not "voluntarily" supply information to government for purposes of False Claims Act because employee was obligated to alert superiors to contractor wrongdoing); United States ex rel. Schwedt v. Planning Research Corp., 39 F. Supp. 2d 28 (D.D.C. 1999) (same).

16 15 U.S.C. 78u-6(c)(2).

17 See Biddle, 161 F.3d 533; Schwedt, 39 F. Supp. 2d 28.

21F-4(a)(2) also includes a similar exclusion for information that the whistleblower is contractually obligated to report to the Commission or to other authorities. This exclusion is intended to preclude awards to persons who provide information pursuant to preexisting agreements that obligate them to assist Commission staff or other investigative authorities.

Request for Comment:

2. Does Proposed Rule 21F-4(a)(1) appropriately define the circumstances when a whistleblower should be considered to have acted "voluntarily" in providing information about securities law violations to the Commission? Are there other circumstances not clearly included that should be in the rule?

3. Should the Commission exclude from the definition of "voluntarily" situations where the information was received from a whistleblower after he received a request, inquiry, or demand from a foreign regulatory authority, law enforcement organization or self-regulatory organization? Similarly, should the Commission exclude from the definition of "voluntarily" situations where the information was received from a whistleblower where the individual was under a pre-existing legal duty to report the information to a foreign regulatory authority, law enforcement organization or self-regulatory organization?

4. Is it appropriate for the proposed rule to consider a request or inquiry directed to an employer to be directed at individual employees who possess the documents or other information that is within the scope of the

request? Should the class of persons who are covered by this rule be narrowed or expanded? Will the carve-out that permits such an employee to become a whistleblower if the employer fails to disclose the information the employee provided in a timely manner promote compliance with the law and the effective operation of Section 21F?

5. The standard described in Proposed Rule 21F-4(a)(1) would credit an individual with acting "voluntarily" in certain circumstances where the individual was aware of fraudulent conduct for an extended period of time, but chose not to come forward as a whistleblower until after he became aware of a governmental investigation or examination (such as by observing document requests being served on his employer or colleagues, but before he received an inquiry, request, or demand himself, assuming that he was not within the scope of an inquiry directed to his employer). Is this an appropriate result, and, if not, how should the proposed rule be modified to account for it?

6. Is the exclusion set forth in Proposed Rule 21F-4(a)(2) for information provided pursuant to a pre-existing legal or contractual duty to report violations appropriate? Should specific circumstances where there are pre-existing duties to report violations to investigating authorities be set forth in the rule, and if so, what are they? For example, should the rule preclude submissions from all Government employees?

Proposed Rule 21F-4(b) – Original Information.

Paragraph (1) of Proposed Rule 21F-4(b) begins with the definition of "original information" set forth in Section 21F(a)(3) of the Exchange Act.[18] "Original information" means information that is derived from the whistleblower's independent knowledge or analysis; is not already known to the Commission from any other source, unless the whistleblower is the original source of the information; and is not exclusively derived from an allegation made in a judicial or administrative hearing,[19] in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information. Paragraph (1) also requires that "original information" be provided to the Commission for the first time after July 21, 2010 (the date of enactment of Dodd-Frank). Although Dodd-Frank authorizes the Commission to pay whistleblower awards on the basis of original information that is submitted in writing prior to the effective date of final rules implementing Section 21F (assuming that all of the other requirements for an award are met), Dodd-Frank does not authorize the Commission to apply Section 21F retroactively to pay awards based upon information submitted before the effective date of the statute.[20]

Paragraphs (2) through (7) of Proposed Rule 21F-4(b) define some of the constituent terms in the definition of "original information," so as to further describe when a whistleblower provides "original information."

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18 15 U.S.C. 78u-6(a)(3).

19 We would interpret the term "judicial or administrative hearing" as used in Section 21F(a)(3) to include hearings in arbitration proceedings.

20 Section 924(b) of Dodd-Frank directs that "Information provided to the Commission in writing by a whistleblower shall not lose the status of original information ... solely because the whistleblower provided the information prior to the effective date of the regulations, if the information is provided by the whistleblower after the effective date of this subtitle."

Paragraph (2) of Proposed Rule 21F-4(b) defines "independent knowledge" as factual information in the whistleblower's possession that is not obtained from publicly available sources. Publicly available sources may include both sources that are widely disseminated (such as corporate press releases and filings, media reports, and information on the internet), and sources that, though not widely disseminated, are generally available to the public (such as court filings and documents obtained through Freedom of Information Act requests). Importantly, the proposed definition of "independent knowledge" does not require that a whistleblower have direct, first-hand knowledge of potential violations. Instead, knowledge may be obtained from any of the whistleblower's experiences, observations, or communications (subject to the exclusion for knowledge obtained from public sources). Thus, for example, under Proposed Rule 21F-4(b)(2), a whistleblower would have "independent knowledge" of information even if that knowledge derives from facts or other information that has been conveyed to the whistleblower by third parties.[21]

The Commission preliminarily believes that defining "independent knowledge" in this manner best effectuates the purposes of Section 21F. An individual may learn

[21] Until this year, the "public disclosure bar" provisions of the False Claims Act defined an "original source" of information, in part, as "an individual who [had] direct and independent knowledge of the allegations of the information on which the allegations [were] based...." 31 U.S.C. 3130(e)(4) (prior to 2010 amendments). Courts interpreting these terms generally defined "direct knowledge" to mean first-hand knowledge from the relator's own work and experience, with no intervening agency. E.g., United States ex rel. Fried v. West Independent School District, 527 F.3d 439 (5th Cir. 2008); United States ex rel. Paranich v. Sorgnard, 396 F.3d 326 (3d Cir. 2005). See generally John T. Boese, Civil False Claims and Qui Tam Actions § 4.02[D][2] (citing cases). Earlier this year, Congress amended the "public disclosure bar" to, among other things, remove the requirement that a relator have "direct and independent knowledge" of information, replacing that standard with one that instead requires only "knowledge that is independent and materially adds to the publicly-disclosed allegations or transactions..." 31 U.S.C. 3130(e)(4), Pub. L. No. 111-148 §10104(h)(2), 124 Stat. 901 (Mar. 23, 2010). Many practitioners have observed that, with this amendment, the False Claims Act now permits qui tam actions based upon "second-hand knowledge." E.g., Robert T. Rhoad and Matthew T. Fornataro, Whistling While They Work: Limiting Exposure in the Face of PPACA's Invitation to Employee Whistleblower Lawsuits, 22 Health Lawyer 19 (Aug. 2010).

about potential violations of the securities laws without being personally involved in the conduct. If an individual voluntarily comes forward with such information, and the information leads the Commission to a successful enforcement action (as defined in Proposed Rule 21F-4(c)), that individual should be eligible to receive a whistleblower award.

Under Section 21F(a)(3)(A) of the Exchange Act,[22] the original information provided by a whistleblower can include information that is derived from independent knowledge and also from independent "analysis." Proposed Rule 21F-4(b)(3) would define "independent analysis" to mean the whistleblower's own analysis, whether done alone or in combination with others. The proposed rule thus recognizes that analysis – which may include academic or professional studies – can be the product of collaboration among two or more individuals. "Analysis" would mean the whistleblower's examination and evaluation of information that may be generally available, but which reveals information that is not generally known or available to the public. This definition recognizes that there are circumstances where individuals can review publicly available information, and, through their additional evaluation and analysis, provide vital assistance to the Commission staff in understanding complex schemes and identifying securities violations.

Proposed Rule 21F-4(b)(4) provides that information will not be considered to derive from an individual's "independent knowledge" or "independent analysis" in seven circumstances. The first two exclusions apply to attorneys and to persons such as accountants and experts when they assist attorneys on client matters, because of the prominent role that attorneys play in all aspects of practice before the Commission and

22 15 U.S.C. 78u-6(a)(3)(A).

the special duties they owe to clients. The first proposed exclusion is for information that was obtained through a communication that is subject to the attorney-client privilege.[23] Compliance with the federal securities laws is promoted when individuals, corporate officers, and others consult with counsel about potential violations, and the attorney-client privilege furthers such consultation. This important benefit could be undermined if the whistleblower award program created monetary incentives for counsel to disclose information about potential securities violations that they learned of through privileged communications.

The exception for information obtained through privileged attorney-client communications would not apply in circumstances where the attorney is permitted to disclose the substance of a communication that would otherwise be privileged. This would include, for example, circumstances where the privilege has been waived, or where disclosure of confidential information to the Commission without the client's consent is permitted pursuant to either 17 CFR §205.3(d)(2) or the applicable state bar ethical rules.[24]

This exclusion is not intended to preclude an individual who has independent knowledge of facts indicating potential securities violations from becoming a whistleblower if that individual chooses to consult with an attorney. Facts in the possession of such an individual do not become privileged simply because he or she consulted with an attorney. Rather, this exclusion from independent knowledge or analysis only means that an attorney cannot make a whistleblower submission on his or

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23 See Proposed Rule 21F-4(b)(4)(i).

24 See Model Rules of Professional Conduct 1.6(b), 1.13(c).

her own behalf that is based upon information the attorney obtained through a privileged communication with a client.

The second exclusion applies when a would-be whistleblower obtains information as a result of the legal representation of a client on whose behalf the whistleblower's services, or the services of the whistleblower's employer or firm, have been retained, and the person seeks to make a whistleblower submission for his or her own benefit. The second exclusion would, for example, preclude an attorney from using information obtained in connection with the attorney's representation of a client to make a whistleblower submission for the attorney's own benefit. This exclusion would not be limited to information obtained through privileged communications, but would instead extend to any information obtained by the attorney in the course and as a result of representation of the client. For example, under the proposed rule, an attorney who obtained evidence of securities violations through document discovery from an opposing party in litigation could not use that information to make a whistleblower submission on his or her own behalf. However, the attorney could use the information to make a submission on behalf of the client in whose litigation the discovery was obtained. The Commission believes that this limitation is generally consistent with attorneys' ethical obligations,[25] and is a reasonable measure to prevent creating financial incentives for attorneys to take undue advantage of clients. The language of the exclusion is also intended to apply to other members or employees of a firm in which the attorney works, as well as to other persons who are retained, or whose

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[25] See Model Rule of Professional Conduct 1.6, comment 3 ("The confidentiality rule ... applies not only to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law.).

company or firm is retained, to perform services in relation to, or to assist, an attorney's representation of a client (e.g., accountants and experts). As with the previous exclusion, this exclusion would not apply where the attorney is permitted to make a disclosure pursuant to 17 CFR §205.3(d)(2), the applicable state bar ethical rules, or otherwise.

The third proposed exclusion applies to persons who obtain information through the performance of an engagement required under the securities laws by an independent public accountant, if that information relates to a violation by the engagement client or the client's directors, officers or other employees.[26] Section 21F(c)(2)(C) of the Exchange Act excludes from award eligibility "any person who obtained the information provided to the Commission through an audit of a company's financial statements, and making a whistleblower submission would be contrary to the requirements of Section 10A of the Exchange Act."[27] Section 10A requires registered public accounting firms with respect to an audit of the issuer to include audit procedures to detect illegal acts.[28] It also prescribes requirements for the auditor if the auditor detects or otherwise becomes aware of information indicating an illegal act, which in certain circumstances can include reporting directly to the Commission. In addition to these requirements, there are other Commission-required engagements by an independent public accountant, such as audits of broker-dealers[29] and custody exams

26 Proposed Rule 21F-4(b)(4)(iii).

27 15 U.S.C. 78u-6(c)(2)(C).

28 See 15 U.S.C. 78j-1.

29 See 17 CFR 240.17a-5(h)(2).

of investment advisers,[30] that require the external accountant to report instances of noncompliance. Professional standards for independent public accountants also prescribe responsibilities when a possible illegal act is detected.[31]

In light of these pre-existing requirements, and consistent with the role of an independent public accountant, we are proposing to exclude from the definitions of "independent knowledge and "independent analysis" any would-be whistleblowers whose information was gained through the performance of an engagement required under the securities laws by an independent public accountant.[32] This proposed exclusion applies to the employees of the independent public accountant and would not apply to the client's employees who perform an accounting function, even if they were interacting with the company's outside auditor. This proposed exclusion only would apply if the information relates to a violation by the engagement client or the client's directors, officers or other employees. It would not exclude information with respect to the independent public accountant's performance of the engagement itself, such as a violation of the accountant's requirements with respect to the engagement.

The fourth proposed exclusion applies when a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity receives information about potential violations, and the information was communicated to the person with the

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30 See 17 CFR 275.206(4)-2(a)(3)(ii)(C).

31 See AU Section 317, Illegal Acts by Clients.

32 This would include reviews performed by an independent public accountant of interim financial statements included in quarterly reports on Form 10-Q (17 CFR 249.308(a)) pursuant to Rule 10-01(d) of Regulation S-X (17 CFR 210.10-01(d)). The Commission anticipates this exclusion would also apply to information gained through another engagement by the independent public accountant for the same client, given that the independent public accountant would generally already have an obligation to consider the information gained in the separate engagement in connection with the Commission-required engagement.

reasonable expectation that the person would take appropriate steps to cause the entity to respond to the violation.[33] The fifth proposed exclusion is closely related, and applies any other time that information is obtained from or through an entity's legal, compliance, audit, or similar functions or processes for identifying, reporting, and addressing potential non-compliance with applicable law.[34] However, each of these two exclusions ceases to be applicable, with the result that an individual may be deemed to have "independent knowledge," and therefore may become a whistleblower, if the entity does not disclose the information to the Commission within a reasonable time or if the entity proceeds in bad faith.

Compliance with the federal securities laws is promoted when companies implement effective legal, audit, compliance, and similar functions. The rationale for these proposed exclusions is the concern that Section 21F not be implemented in a way that would create incentives for persons who obtain information through such functions, as well as other responsible persons who are informed of wrongdoing, to circumvent or undermine the proper operation of the entity's internal processes for responding to violations of law. Accordingly, the proposed rule would limit the circumstances in which such persons may use that knowledge to become whistleblowers. This would include officers, directors, employees, and consultants who learn of potential violations as part

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[33] Proposed Rule 21F-4(b)(4)(iv). Under the federal Whistleblower Protection Act, 5 U.S.C. 2302(b)(8), a disclosure to a supervisor who is in a position to remedy the wrongdoing, is treated as a protected disclosure for purposes of the federal Whistleblower Protection Act, 5 U.S.C. 2302(b)(8). E.g., Reid v. Merit Systems Protection Board, 508 F.3d 674 (Fed. Cir. 2007); Hooven-Lewis v. Caldera, 249 F.3d 259 (4th Cir. 2001). Borrowing and building upon this concept, the proposed rule would preclude such supervisors and similarly-situated others from seeking whistleblower awards based upon information they obtain when persons with knowledge of potential wrongdoing come to them in an effort to redress the violations.

[34] Persons excluded under this provision would include those retained to assist in such processes; e.g., forensic accountants retained by outside counsel responsible for conducting an internal investigation.

of their corporate responsibilities in the expectation that they will take steps to address the violations, as well as persons who gain knowledge about misconduct otherwise from or through the various processes that companies employ to identify problems and advance compliance with legal standards. The latter group would include not only persons directly responsible for compliance-related processes, but other persons as well. For example, an employee who learns about potential violations only because a compliance officer questions him about the conduct, and not from any other source, would not be considered to have "independent knowledge" for purposes of the proposed rule, and therefore could not become a whistleblower (unless, as is explained below, the company does not disclose the conduct to the Commission within a reasonable time or proceeds in bad faith).[35]

Internal compliance and similar functions, when effective, can constrain the opportunities for unlawful activity. In some cases, an entity's compliance program will fail to lead the entity to respond appropriately to violations. Under the proposed rule, if the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith, these exclusions would no longer apply, thereby making an individual who knows this undisclosed information eligible to become a whistleblower by providing "independent knowledge" of the violations.

This approach is intended to strike a balance between two competing goals. On the one hand, it is designed to facilitate the operation of effective internal compliance

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35 This proposed exclusion would not, however, apply to individuals with knowledge of potential violations who report their knowledge to supervisors, compliance or legal personnel. In fact, as is further explained below, such individuals would be given a 90-day grace period after reporting their information internally to make a whistleblower submission to the Commission and have their submission deemed effective as of the date of their internal report.

programs by not creating incentives for company personnel to seek a personal financial benefit by "front running" internal investigations and similar processes that are important components of effective company compliance programs. On the other hand, it would permit such persons to act as whistleblowers in circumstances where the company knows about material misconduct but has not taken appropriate steps to respond. Accordingly, in determining whether these persons would be considered to have provided "independent knowledge" and would be eligible for whistleblower awards, the proposed rule focuses on whether the entity proceeded in bad faith or did not disclose the information to the Commission within a reasonable time.[36]

In determining whether an entity acted in bad faith, the Commission will, among other things, consider whether the entity or any personnel who were responsible for responding to allegations of misconduct took affirmative steps to hinder the preservation of evidence or a timely and appropriate investigation. For example, an effort by company officials to destroy documents or to interfere with witnesses would constitute bad faith conduct. Similarly, if a company engaged in a sham investigation of allegations, then the company's response would constitute bad faith.

The determination of what is a "reasonable time" in this context will necessarily be a flexible concept that will depend on all of the facts and circumstances of the particular case. In some cases – for example, an ongoing fraud that poses substantial risk of harm to investors – a "reasonable time" for disclosing violations to the Commission may be almost immediate. Nonetheless, given the competing concerns just described, the Commission preliminarily believes that the proposed rule should not

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36 This provision does not impose new reporting requirements in addition to those already existing under the federal securities laws.

define one fixed period that would represent a "reasonable time" in all cases. We anticipate that in evaluating any whistleblower submissions by personnel covered by these exclusions, we will review all of the circumstances of the case after the fact in order to determine whether the company disclosed the misconduct to the Commission within a reasonable time or proceeded in bad faith.

Further, if we determine that the whistleblower played a role in causing the company not to disclose the violations, or to delay in disclosing them, we will take this fact into consideration in our determination of whether to consider the whistleblower eligible for an award. A whistleblower will not be permitted to claim that the company did not disclose information to the Commission in a reasonable time if the whistleblower bears some responsibility for that failure.

The following chart illustrates the fourth and fifth exclusions from "independent knowledge:"

Source of Employee's Knowledge	**Does it Qualify as "Independent Knowledge"?**
Employee receives information because he/she is reasonably expected to take appropriate steps to respond to the violation because of his/her legal, compliance, audit or supervisory responsibilities	Employee will <u>not</u> be deemed to have independent knowledge of the information <u>unless</u> (1) the entity did not disclose the violation to the Commission within a reasonable period of time, or (2) acts in bad faith
Employee learns of information through company's legal, compliance, audit or similar functions or processes for identifying or addressing potential non-compliance with laws	Same as above
Employee otherwise lawfully learns of information through his/her work-related functions	Employee will generally be deemed to have independent knowledge of the information [Note: if employee elects to report internally first, he/she will receive the benefit of a "90-day look-back" for subsequent submission of information to SEC (<u>See</u> Proposed Rule 21F-4(b)(7))]

The sixth exclusion from "independent knowledge" is for information that was obtained by a means or in a manner that violates applicable federal or state criminal law. The policy rationale for this proposed exclusion is that a whistleblower should not be rewarded for violating a federal or state criminal law. While Congress clearly intended through Section 21F to provide greater incentives for whistleblowers to come forward with information about wrongdoing, we think it is questionable that Congress intended to encourage whistleblower assistance to a law enforcement authority where the assistance itself is undertaken in violation of federal or state criminal law.

Finally. in order to prevent evasion of the rules, the seventh proposed exclusion would apply to anyone who obtained their information from persons subject to the first six exclusions.

Request for Comment:

7. Is it appropriate to include knowledge that is not direct, first-hand knowledge, but is instead learned from others, as "independent knowledge," subject only to an exclusion for knowledge learned from publicly-available sources?

8. Is there a different or more specific definition of "analysis" that would better effectuate the purposes of Section 21F?

9. Is it appropriate to exclude from the definition of "independent knowledge" or "independent analysis" information that is obtained through a communication that is protected by the attorney-client privilege? Are there other ways these rules should address privileged communications? For

example, should other specific privileges be identified (spousal privilege, physician-patient privilege, clergy-congregant privilege, or others)? Should the exclusion apply broadly to information that is obtained through communications that are subject to any common law evidentiary privileges recognized under the laws of any state?

10. Is it appropriate to exclude from the definition of independent knowledge" or "independent analysis" information that is obtained through the performance of an engagement required under the securities laws by an independent public accountant, if that information relates to a violation by the engagement client or the client's directors, officers or other employees? Are there other ways that our rules should address the roles of accountants and auditors?

11. Should the exclusion for "independent knowledge" or "independent analysis" go beyond attorneys and auditors, and include other professionals who may obtain information about potential securities violations in the course of their work for clients? If so, are there appropriate ways to limit the nature or extent of the exclusion so that any recognition of relationships of professional trust does not undermine the purposes of Section 21F?

12. Apart from persons who obtain information through privileged communications, and professionals who have access to client information, are there still other categories of persons who should not be considered for whistleblower awards based upon their professional duties or the

manner in which they may acquire information about potential securities violations? If such exclusions are appropriate, what limits, if any, should be placed on them in order not to undermine the purposes of Section 21F? Is the exclusion for knowledge obtained through violations of criminal law appropriate?

13. Do the proposed exclusions for information obtained by a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity under an expectation that the person would cause the entity to take steps to respond to the violation, and for information otherwise obtained from or through an entity's legal, compliance, audit, or similar functions strike the proper balance? Will the carve-out for situations where the entity does not disclose the information within a reasonable time promote effective self-policing functions and compliance with the law without undermining the operation of Section 21F? Should a "reasonable time" be defined in the rule and, if so, what period should be specified (e.g., three months, six months, one year)? Does this provide sufficient incentives for people to continue to utilize internal compliance processes? Are there alternative or additional provisions the Commission should consider that would promote effective self-policing and self-reporting while still being consistent with the goals and text of Section 21F?

14. Is the proposed exclusion for information obtained by a violation of federal or state criminal law appropriate? Should the exclusion extend to violations of the criminal laws of foreign countries? What would be the

policy reasons for either extending the exclusion to violations of foreign criminal law or not? Are there any other types of criminal violations that should be included? If so, on what basis?

15. How should our rules treat information that may be provided to us in violation of judicial or administrative orders such as protective orders in private litigation? Should we exclude from whistleblower awards persons who provide information in violation of such orders? What would be the policy reason for this proposed exclusion?

Under the statutory definition of "original information," a whistleblower who provides information that the Commission already knows from another source has not provided original information, unless the whistleblower is the "original source" of that information. Paragraphs (5) and (6) of Proposed Rule 21F-4(b) describe how the Commission proposes to interpret and apply the term "original source" as used in the definition of "original information." Under the proposed rule, a whistleblower is an "original source" of the same information that the Commission obtains from another source if the other source obtained the information from the whistleblower or his representative. The whistleblower bears the burden of establishing that he is the original source of information.

In Commission investigations, one way that this situation may arise is if the staff receives a referral from another authority such as the Department of Justice, a self-regulatory organization, or another organization that is identified in the proposed rule. In these circumstances, the proposed rule would credit the whistleblower with being the "original source" of information on which the referral was based as long as the whistleblower "voluntarily" provided the information to the other authority within the meaning of these rules; i.e., the whistleblower or his representative must have come forward and given the other authority the information before receiving any request, inquiry, or demand to which the information was relevant. If a whistleblower claims to be the original source of information provided to the Commission by one of these authorities or another entity such as the whistleblower's employer, the Commission may seek assistance and confirmation from the other authority or entity in determining whether the whistleblower is the original source of the information.

Paragraph (6) of Proposed Rule 21F-4(b) addresses circumstances where the Commission already possesses some information about a matter at the time that a whistleblower provides additional information about the same matter. The whistleblower will be considered the "original source" of any information that is derived from his independent knowledge or independent analysis and that materially adds to the information that the Commission already possesses. The standard is modeled after the definition of "original source" that Congress included in the False Claims Act through amendments earlier this year.[37]

As is described elsewhere in these proposed rules, a whistleblower will need to submit his information as well as a Form WB-DEC in order to start the process and establish the whistleblower's eligibility for award consideration.[38] A whistleblower who provides information to another authority first will need to follow these same procedures and submit the necessary forms to the Commission in order to perfect his status as a whistleblower under the Commission's whistleblower program. However, under

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37 31 U.S.C. 3730(e)(4)(B), Pub. L. No. 111-148 §10104(h)(2), 124 Stat. 901 (Mar. 23. 2010).

38 See Proposed Rule 21F-9.

paragraph (7) of Proposed Rule 21F-4(b), as long as the whistleblower submits the necessary forms to the Commission within 90 days after he provided the same information to the other authority, the Commission will consider the whistleblower's submission to be effective as of that earlier date. As noted above, the whistleblower must establish that he is the original source of the information provided to the other authority as well as the date of his submission, but the Commission may seek confirmation from the other authority in making this determination. The objective of this procedure is to provide further incentive for persons with knowledge of securities violations to come forward (consistent with the purposes of Section 21F) by assuring potential whistleblowers that they can provide information to appropriate Government or regulatory authorities, and their "place in line" will be protected in the event that other whistleblowers later provide the same information directly to the Commission.

For similar reasons, proposed rule 21F-4(b)(7) extends the same protection to whistleblowers who provide information about potential violations to the persons specified in Rules 21F-4(b)(4)(iv) and (v) (i.e., personnel involved in compliance or similar functions, or who are informed about potential violations with the expectation that they will take steps to address them), and who, within 90 days, submit the necessary whistleblower forms to the Commission. Compliance with the federal securities laws is promoted when companies have effective programs for identifying, correcting, and self-reporting unlawful conduct by company officers or employees. The objective of this provision is to support, not undermine, the effective functioning of company compliance and related systems by allowing employees to take their concerns about potential violations to appropriate company officials first while still preserving their rights under the Commission's whistleblower program. This objective is also important because internal compliance and reporting systems are essential sources of information for companies about misconduct that may not be securities-related (e.g., employment discrimination or harassment complaints), as well as for securities-related complaints. The Commission does not intend for its rules to undermine effective company processes for receiving reports on potential violations that may be outside of the Commission's enforcement interest, but are nonetheless important for companies to address.

Given the policy interest in fostering robust corporate compliance programs, we considered the possible approach of requiring potential whistleblowers to utilize in-house complaint and reporting procedures, thereby giving employers an opportunity to address misconduct, before they make a whistleblower submission to the Commission. Among our concerns was the fact that, while many employers have compliance processes that are well-documented, thorough, and robust, and offer whistleblowers appropriate assurances of confidentiality, others lack such established procedures and protections.

We emphasize, however, that our proposal not to require a whistleblower to utilize internal compliance processes does not mean that our receipt of a whistleblower complaint will lead to internal processes being bypassed. We expect that in appropriate cases, consistent with the public interest and our obligation to preserve the confidentiality of a whistleblower, our staff will, upon receiving a whistleblower complaint, contact a company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back. The company's actions in these circumstances will be considered in accordance with the Commission's Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions.[39] This has been the approach of the Enforcement staff in the past, and the Commission expects that it will continue in the future. Thus, in this respect, we do not expect our receipt of whistleblower complaints to minimize the importance of effective company processes for addressing allegations of wrongful conduct.[40]

The Commission's primary goal, consistent with the congressional intent behind Section 21F, is to encourage the submission of high-quality information to facilitate the effectiveness and efficiency of the Commission's enforcement program. At the same time, we also want to implement Section 21F in a way that encourages strong company compliance programs. Therefore, we request comment on all aspects of the intersection between Section 21F and established internal systems for the receipt, handling, and response to complaints about potential violations of law. We particularly seek recommendations on structures, processes, and incentives that we should consider implementing in order to strike the right balance between the Commission's need for a strong and effective whistleblower awards program, and the importance of preserving robust corporate structures for self-policing and self-reporting.

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39 Exchange Act Release No. 44969 (October 23, 2001).

40 See Rule 21F-6. In addition, as discussed below, in order to encourage whistleblowers to utilize internal reporting processes, we expect to give credit in the calculation of award amounts to whistleblowers who utilize established internal procedures for the receipt and consideration of complaints about misconduct.

Request for comment. The Commission requests comment on all aspects of the definition of "original source" set forth in Proposed Rule 21F-4(b)(4) and (5).

16. Is the provision that would credit individuals with providing original information to the Commission as of the date of their submission to another Governmental or regulatory authority, or to company legal, compliance, or audit personnel, appropriate? In particular, does the provision regarding the providing of information to a company's legal, compliance, or audit personnel appropriately accommodate the internal compliance process?

17. Is the 90-day deadline for submitting Forms TCR and WB-DEC to the Commission (after initially providing information about violations or potential violations to another authority or the employer's legal, compliance, or audit personnel) the appropriate timeframe? Should a longer time period apply in instances where a whistleblower believes that the company has or will proceed in bad faith? Would a 90-day deadline for submitting the TCR and WB-DEC also be appropriate in circumstances where an individual provides information to an SEC staff member? Would a shorter time frame be appropriate? Should there be different time frames for disclosures to other authorities and disclosures to an employer's legal, compliance or audit personnel?

18. Should the Commission consider other ways to promote continued robust corporate compliance processes consistent with the requirements of Section 21F? If so, what alternative requirements should be adopted?

Should the Commission consider a rule that, in some fashion, would require whistleblowers to utilize employer-sponsored complaint and reporting procedures? What would be the appropriate contours of such a rule, and how could it be implemented without undermining the purposes of Section 21F? Are there other incentives or processes the Commission could adopt that would promote the purposes of Section 21F while still preserving a critical role for corporate self-policing and self-reporting?

19. Would the proposed rules frustrate internal compliance structures and systems that many companies have established in response to Section 10A(m) of the Exchange Act, as added by Section 301 of the Sarbanes-Oxley Act of 2002, and related exchange listing standards? If so, consistent with Section 21F, how can the potential negative impact on compliance programs be minimized?

Proposed Rule 21F-4(c) – Information that Leads to Successful Enforcement.

Under Section 21F, a whistleblower's eligibility for an award depends in part on whether the whistleblower's original information "led to the successful enforcement" of the Commission's action or a related action. Proposed Rule 21F-4(c) defines when original information "led to successful enforcement."

The Commission's enforcement practice generally proceeds in several stages. First, the staff opens an investigation based upon some indication of potential violations of the federal securities laws. Second, the staff conducts its investigation to gather additional facts in order to determine whether there is sufficient basis to recommend enforcement action. If so, the staff may recommend, and the Commission may authorize, the filing of an action. The definition in Proposed Rule 21F-4(c) would consider the significance of the whistleblower's information to both the decision to open an investigation and the success of any resulting enforcement action. The proposed rule would distinguish between situations where the whistleblower's information causes the staff to begin an investigation, and situations where the whistleblower provides information about conduct that is already under investigation. In the latter case, awards would be limited to the rare circumstances where the whistleblower provided essential information that the staff would not have otherwise obtained in the normal course of the investigation. Paragraphs (1) and (2) of Proposed Rule 21F-4(c) reflect these considerations.

Paragraph (1) of Proposed Rule 21F-4(c) applies to situations where the staff is not already reviewing the conduct in question, and establishes a two-part test for determining whether original information voluntarily provided by a whistleblower led to successful enforcement of a Commission action. First, the information must have caused the staff to commence an examination, open an investigation, reopen an investigation that had been closed, or to inquire concerning new and different conduct as part of an open examination or investigation.[41] This does not necessarily contemplate that the whistleblower's information will be the only information that the staff obtains before deciding to proceed. However, the proposed rule would apply when the whistleblower gave the staff information about conduct that the staff is not already

[41] The proposed rule includes examinations within its scope in recognition of the fact that, in some cases involving regulated entities, tips about potentially unlawful conduct are directed in the first instance to staff of the Commission's Office of Compliance Inspections and Examinations, and after some additional consideration by examination staff may then lead to an investigation.

investigating or examining, and that information was a principal motivating factor behind the staff's decision to begin looking into the whistleblower's allegations.

Second, if the whistleblower's information caused the Commission staff to start looking at the conduct for the first time, the proposed rule would require that the information "significantly contributed" to the success of an enforcement action filed by the Commission. The proposed rule includes this requirement because the Commission believes that it is not the intent of Section 21F to authorize whistleblower awards for any and all tips about conduct that led to the opening of an investigation if the resulting investigation concludes in a successful enforcement action. Rather, implicit in the requirement that a whistleblower's information "led to ... successful enforcement" is the further expectation that the information, because of its high quality, reliability, and specificity, had a meaningful connection to the Commission's ability to successfully complete its investigation and to either obtain a settlement or prevail in a litigated proceeding.

Ultimately, successful enforcement of a judicial or administrative action depends on the staff's ability to establish unlawful conduct by a preponderance of evidence. Thus, in order to "lead to successful enforcement," the "original information" provided by a whistleblower should be connected to evidence that plays a significant role in successfully establishing the Commission's claim. For example, the "led to" standard of Proposed Rule 21F-4(c)(1) would be met if a whistleblower were to provide the Commission staff with strong, direct evidence of violations that supported one or more claims in a successful enforcement action. To give another example, a whistleblower whose information did not provide this degree of evidence in itself, but who played a critical role in advancing the investigation by leading the staff directly to evidence that provided important support for one or more of the Commission's claims could also receive an award, in particular if the evidence the whistleblower pointed to might have otherwise been difficult to obtain. A whistleblower who only provided vague information, or an unsupported tip, or evidence that was tangential and did not significantly help the Commission successfully establish its claims, would not meet the standard of this proposed rule.

If information that a whistleblower provides to the Commission consists of "independent analysis" rather than "independent knowledge," the evaluation of whether this analysis "led to successful enforcement" similarly would turn on whether it significantly contributed to the success of the action. This would involve, for example, considering the degree to which the analysis, by itself and without further investigation, indicated a high likelihood of unlawful conduct that was the basis, or was substantially the basis, for one or more claims in the Commission's enforcement action. The purpose of this provision is to ensure that the analysis provided to the Commission results in the efficiency and effectiveness benefits to the enforcement program that were intended by Congress.

Paragraph (2) of Proposed Rule 21F-4(c) sets forth a separate, higher standard for cases in which a whistleblower provides original information to the Commission about conduct that is already under examination or investigation by the Commission, Congress, any other federal, state, or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board. In this situation, the information will be considered to have led to the successful enforcement of a judicial or administrative action if the information would not have otherwise been obtained and was essential to the success of the action.[42] Although the Commission believes that awards under Section 21F generally should be limited to cases where whistleblowers provide original information about violations that are not already under investigation,[43] there may be rare circumstances where information received from a whistleblower in relation to an ongoing investigation is so significant to the success of a Commission action that a whistleblower award should be considered. For example, a whistleblower who has not been questioned by the staff in an investigation, but who nonetheless has access to, and comes forward with a document that had been concealed from the staff, and that establishes proof of wrongdoing that is critical to the Commission's ability to sustain its burden of proof, provides the type of assistance that should be considered for an award without regard to whether the staff was already investigating the conduct at the time the document was provided. We anticipate applying Proposed Rule 21F-4(c)(2) in a strict fashion, however, such that awards under this standard would be rare.

In considering the relationship between information obtained from a whistleblower and the success of an enforcement action, the Commission will apply the same standards in both settled and litigated actions. Specifically, in a litigated action the whistleblower's information must significantly contribute, or, in the case of conduct that is already under investigation, be essential, to the success of a claim on which the

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42 The proposed rule also makes clear that paragraph (2) of Proposed Rule 21F-4(c) does not apply when a whistleblower provides information to the Commission about a matter that is already under investigation by another authority if the whistleblower is the "original source" for that investigation under Proposed Rule 21F-4(b)(4). In those circumstances, paragraph (1) of Proposed Rule 21F-4(c) would govern the Commission's analysis.

43 See Lacy v. United States, 221 Ct. Cl. 526 (1979); cf. United States ex rel. Merena v. Smith-Kline Beecham Corp., 205 F.3d 97 (3d Cir 2000).

Commission prevails in litigation. For example, if a court finds in favor of the Commission on a number of claims in an enforcement action, but rejects the claims that are based upon the information the whistleblower provided, the whistleblower would not be considered eligible to receive an award.[44] Similarly, in a settled action the Commission would consider whether the whistleblower's information significantly contributed, or was essential, to allegations included in the Commission's federal court complaint, or to factual findings in the Commission's administrative order.

Request for Comment:

20. Is the proposed standard for when original information voluntarily provided by a whistleblower "led to" successful enforcement action appropriate?

21. In cases where the original information provided by the whistleblower caused the staff to begin looking at conduct for the first time, should the standard also require that the whistleblower's information "significantly contributed" to a successful enforcement action?

    a. If not, what standards should be used in the evaluation?

    b. If yes, should the proposed rule define with greater specificity when information "significantly contributed" to enforcement action? In what way should the phrase be defined?

22. Is the proposal in Paragraph (c)(2), which would consider that a whistleblower's information "led to" successful enforcement even in cases

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44 As discussed below, however, if the Commission prevails on a claim that is based upon the information the whistleblower provided, and if all the conditions for an award are otherwise satisfied, the award to the whistleblower would be based upon all of the monetary sanctions obtained as a result of the action. See Proposed Rule 21F-4(d).

where the whistleblower gave the Commission original information about conduct that was already under investigation, appropriate? Should the Commission's evaluation turn on whether the whistleblower's information would not otherwise have been obtained and was essential to the success of the action? If not, what other standard(s) should apply?

Proposed Rule 21F-4(d) – Action

Proposed Rule 21F-4(d) defines the term "action." For purposes of calculating whether monetary sanctions in a Commission action exceed the $1,000,000 threshold required for an award payment pursuant to Section 21F of the Exchange Act, as well as determining the monetary sanctions on which awards are based,[45] the Commission proposes to interpret the term "action" to mean a single captioned civil or administrative proceeding. This approach to determining the scope of an "action" is consistent with the most common meaning of the term,[46] and is driven by the plain text of Section 21F. Section 21F(a)(1) defines a "covered judicial or administrative action" as "any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1,000,000."[47] When the conditions for an award are satisfied in connection with a "covered judicial or administrative action," the Commission must pay an award or awards in an aggregate amount equal to not less than 10 percent

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45 See Proposed Rule 21F-5.

46 E.g., SEC v. McCarthy, 322 F.3d 650, 656 (9th Cir. 2003)("An 'action' is defined as 'a civil or criminal judicial proceeding.'").

47 15 U.S.C. 78u-6(a)(1).

and not more than 30 percent "in total, of what has been collected of the monetary sanctions imposed in the action ...."[48]

Two implications follow from this interpretation. First, the "action" would include all defendants or respondents, and all claims, that are brought within that proceeding without regard to which specific defendants or respondents, or which specific claims, were included in the action as a result of the information that the whistleblower provided. For example, if a whistleblower provided information concerning insider trading by a single individual, and, after an investigation, the Commission brought an action against that individual and others in a single captioned proceeding in federal court, then the sanctions collected from all the defendants in the action would be added up to determine whether the $1,000,000 threshold has been met. Similarly, if a corporate accounting employee provided the Commission with information about a fraudulent accounting practice, and, after investigation, the Commission brought an action that also included unrelated claims discovered during the investigation, the $1,000,000 threshold amount for an award would be determined based upon the total monetary sanctions obtained in the action. This approach would effectuate the purposes of Section 21F by enhancing the incentives for individuals to come forward and report potential securities law violations to the Commission,[49] and would avoid the challenges associated with attempting to allocate monetary sanctions involving multiple

48 15 U.S.C. 78u-6(b).

49 This approach offers enhanced potential incentives for whistleblowers when compared to other similar programs because those programs have typically limited awards to successful claims that the whistleblower actually identified. See Rockwell International Corp. v. United States, 549 U.S. 457 (2007) (False Claims Act); John Doe v. United States, 65 Fed. Cl. 184 (2005) (Customs moiety statute, 19 U.S.C. 1619); Internal Revenue Manual 25.2.2.2.8.A (under IRS whistleblower program, collected proceeds only include proceeds from the single issue identified by the whistleblower, or substantially similar improper activity).

individuals and claims based upon the select individuals and claims reported by whistleblowers.

Second, this proposed approach to interpreting the term "action" also would mean that the Commission would not aggregate sanctions that are imposed in separate judicial or administrative actions for purposes of determining whether the $1,000,000 threshold is satisfied, even if the actions arise out of a single investigation. For example, if a whistleblower's submission leads to two separate enforcement actions, each with total sanctions of $600,000, then no whistleblower award would be authorized because no single action will have obtained sanctions exceeding $1,000,000.

Request for comment:

23. The Commission requests comment on the proposed definition of the word "action." Are there other ways to define an "action" that are consistent with the text of Section 21F and that will better effectuate the purposes of the statute?

Proposed Rules 21F-4(e) – Monetary Sanctions. Proposed Rule 21F-4(e) defines "monetary sanctions" to mean any money, including penalties, disgorgement, and interest, ordered to be paid and any money deposited into a disgorgement fund or other fund pursuant to Section 308(b) of the Sarbanes-Oxley Act of 2002 as a result of a Commission action or a related action. This definition tracks the definition of the same term found in Section 21F of the Exchange Act.[50] The Commission interprets the reference in the statute to "penalties, disgorgement, and interest" to be examples of monetary sanctions, and not exclusive. Thus, regardless of how designated, the

50 15 U.S.C. 78u-6(a)(4).

Commission will consider all amounts that are "ordered to be paid" in an action as "monetary sanctions" for purposes of Section 21F.

Proposed Rule 21F-4(f) – Appropriate Regulatory Agency.

Section 3(a)(34) of the Exchange Act[51] designates the Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision as "appropriate regulatory agencies" for specified entities and functions.[52] For example, when a national bank is a municipal securities dealer, the Comptroller of the Currency is designated as the appropriate regulatory agency; when a state member bank of the Federal Reserve System is a municipal securities dealer, the Federal Reserve Board is designated as the appropriate regulatory agency.

Proposed Rule 21F-4(f) would make clear that the Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (as well as any other agencies that may be added to Section 3(a)(34) of the Exchange Act by future amendment) are deemed to be "appropriate regulatory agencies" for all purposes under Section 21F of the Exchange Act.[53] This means, in particular, that the Commission would consider a member, officer, or employee of one of the designated agencies to be

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[51] 15 U.S.C. 78c(a)(34).

[52] Title III of Dodd-Frank abolishes the Office of Thrift Supervision and transfers its functions to other agencies one year after the date of enactment, unless the transfer date is extended.

[53] Section 21F alternately uses the terms "appropriate regulatory agency" and "appropriate regulatory authority." Compare Section 21F(c)(2)(A)(i) (15 U.S.C. 78u-6(c)(2)(A)(i)) with Section 21F(h)(2)(D)(i)((II) (15 U.S.C. 78u-6(h)(2)(D)(i)((II)). Because we do not believe that Congress intended this differing terminology to reflect substantive distinctions, the proposed rules use the term "appropriate regulatory agency" in all instances.

ineligible to receive a whistleblower award under any circumstances, even if the information that the person possesses is unrelated to the agency's regulatory function. This interpretation would place members, officers, and employees of appropriate regulatory agencies on equal footing with those of other organizations, such as the Public Company Accounting Oversight Board and law enforcement organizations, who are also statutorily ineligible to receive whistleblower awards.[54]

Request for comment:

24. Is the proposed definition of "appropriate regulatory agency" appropriate? Are there other definitions that that should be adopted instead?

Proposed Rule 21F-4(g) – Self-Regulatory Organization. Section 3(a)(26) of the Exchange Act[55] designates national securities exchanges, registered securities associations, and registered clearing agencies as self-regulatory organizations, and the Municipal Securities Rulemaking Board as a self-regulatory organization solely for purposes of Sections 19(b) and (c) of the Exchange Act (relating to rulemaking).[56] Consistent with the approach taken with regard to the definition of "appropriate regulatory agency" (see discussion above), Proposed Rule 21F-4(g) would make clear that the Municipal Securities Rulemaking Board is considered to be a "self-regulatory organization" for all purposes under Section 21F.

Request for comment:

25. Is the proposed definition of "self-regulatory organization" appropriate? Are there other definitions that that should be adopted instead?

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54 See Section 21F(c)(2)(A), 15 U.S.C. 78u-6(c)(2)(A).

55 15 U.S.C. 78c(a)(26).

56 15 U.S.C. 78s(b) and (c).

E. Proposed Rule 21F-5 - Amount of Award

Proposed Rule 21F-5 states that, if all conditions are met, the Commission will pay an award of at least 10 percent and no more than 30 percent of the total monetary sanctions collected in successful Commission and related actions. This range is specified in Section 21F(b)(1) of the Exchange Act. Where multiple whistleblowers are entitled to an award, paragraph (b) states that the Commission will independently determine the appropriate award percentage for each whistleblower, but total award payments, in the aggregate, will equal between 10 and 30 percent of the monetary sanctions collected in the Commission's action and the related action. Thus, for example, one whistleblower could receive an award of 25 percent of the collected sanctions, and another could receive an award of 5 percent, but they could not each receive an award of 30 percent. Since the Commission anticipates that the timing of award determinations and the value of a whistleblower's contribution could be different for the Commission's action and for related actions, the proposed rule would provide that the percentage awarded in connection with a Commission action may differ from the percentage awarded in related actions.

Request for Comment:

24. Is the provision stating that the percentage amount of an award in a Commission action may differ from the percentage awarded in a related action appropriate?

F. Proposed Rule 21F-6 – Criteria for Determining Amount of Award.

Assuming that all of the conditions for making an award to a whistleblower have been satisfied, Proposed Rule 21F-6 sets forth the criteria that the Commission would take into consideration in determining the amount of the award. Paragraphs (a) through (c) of the proposed rule recite three criteria that Section 21F of the Exchange Act requires the Commission to consider, and paragraph (d) adds a fourth criterion.

Paragraph (a) requires the Commission to consider the significance of the information provided by a whistleblower to the success of the Commission action or related action. Paragraph (b) requires the Commission to consider the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in the Commission action or related action. Paragraph (c) requires the Commission to consider its programmatic interest in deterring violations of the securities laws by making awards to whistleblowers that provide information that leads to successful enforcement actions. Paragraph (d) would permit the Commission to consider whether an award otherwise enhances its ability to enforce the federal securities laws, protect investors, and encourage the submission of high quality information from whistleblowers.

The Commission anticipates that the determination of awards amounts pursuant to paragraphs (a)-(d) will involve highly individualized review of the circumstances surrounding each award. To allow for this, the Commission preliminarily believes that the four criteria afford the Commission broad discretion to weigh a multitude of considerations in determining the amount of any particular award. Depending upon the facts and circumstances of each case, some of the considerations may not be applicable or may deserve greater weight than others.

The permissible considerations include, but are not limited to, those set forth below. These considerations 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:

- the character of the enforcement action, including whether its subject matter is a Commission priority, whether the reported misconduct involves regulated entities or fiduciaries, the type and severity of the securities violations, the age and duration of misconduct, the number of violations, and the isolated, repetitive, or ongoing nature of the violations;
- the dangers to investors or others presented by the underlying violations involved in the enforcement action, including the amount of harm or potential harm caused by the underlying violations, the type of harm resulting from or threatened by the underlying violations, and the number of individuals or entities harmed;
- the timeliness, degree, reliability, and effectiveness of the whistleblower's assistance;
- the time and resources conserved as a result of the whistleblower's assistance;
- whether the whistleblower encouraged or authorized others to assist the staff who might otherwise not have participated in the investigation or related action;
- any unique hardships experienced by the whistleblower as a result of his or her reporting and assisting in the enforcement action;
- the degree to which the whistleblower took steps to prevent the violations from occurring or continuing;

- the efforts undertaken by the whistleblower to remediate the harm caused by the violations, including assisting the authorities in the recovery of the fruits and instrumentalities of the violations;
- whether the information provided by the whistleblower related to only a portion of the successful claims brought in the Commission or related action;[57]
- the culpability of the whistleblower including whether the whistleblower acted with scienter, both generally and in relation to others who participated in the misconduct; and
- whether, and the extent to which, a whistleblower reported the potential violation through effective internal whistleblower, legal or compliance procedures before reporting the violation to the Commission.

This last consideration is not a requirement for an award above the 10 percent statutory minimum and whistleblowers will not be penalized if they do not avail themselves of this opportunity for fear of retaliation or other legitimate reasons. The Commission will consider higher percentage awards for whistleblowers who first report violations through their compliance programs. Corporate compliance programs play a role in preventing and detecting securities violations that could harm investors. If these programs are not utilized or working, our system of

[57] As described elsewhere in these rules, if the information provided by a whistleblower relates to only a portion of a successful enforcement action, the Commission proposes to look to the entirety of the action (including all defendants or respondents, all claims, and all monetary sanctions obtained) in determining whether the action is eligible for an award (because it meets the $1,000,000 threshold) and the total dollar amount of sanctions on which the whistleblower's award will be based. However, under paragraph (a) of Proposed Rule 21F-6, the fact that the whistleblower's information related to only a portion of the overall action would be a factor in determining the amount of the whistleblower's award. Thus, if the whistleblower's information supported only a small part of a larger case, that would be a reason for making an award based upon a smaller percentage amount than otherwise would have been awarded.

securities regulation will be less effective. Accordingly, the Commission believes that encouraging whistleblowers to report securities violations to their corporate compliance programs is consistent with the Commission's investor protection mission.

Request for comment:

27. Should the Commission identify, by rule, additional criteria that it will consider in determining the amount of an award? If so, what criteria should be included? Should we include as a criterion the consideration of whether, and the extent to which, a whistleblower reported the potential violation through effective internal whistleblower, legal or compliance procedures before reporting the violation to the Commission? Should we include any of the other considerations described above?

28. Should we include the role and culpability of the whistleblower in the unlawful conduct as an express criterion that would result in reducing the amount of an award within the statutorily-required range? Should culpable whistleblowers be excluded from eligibility for awards? Would such an exclusion be consistent with the purposes of Section 21F?

G. Proposed Rule 21F-7 - Confidentiality of Submissions

Proposed Rule 21F-7 reflects the confidentiality requirements set forth in Section 21F(h)(2) of the Exchange Act[58] with respect to information that could reasonably be expected to reveal the identity of a whistleblower. As a general matter, it is the Commission's policy and practice to treat all information obtained during its

[58] 15 U.S.C. 78u-6(h)(2).

investigations as confidential and nonpublic. Disclosures of enforcement-related information to any person outside the Commission may only be made as authorized by the Commission and in accordance with applicable laws and regulations. Consistent with Section 21F(h)(2), the proposed rule explains that the Commission will not reveal the identity of a whistleblower or disclose other information that could reasonably be expected to reveal the identity of a whistleblower, except under circumstances described in the statute and the rule.[59] As is further explained below, there may be circumstances in which disclosure of information that identifies a whistleblower will be legally required or will be necessary for the protection of investors.

Paragraph (a)(1) of the proposed rule would authorize disclosure of information that could reasonably be expected to reveal the identity of a whistleblower when disclosure is required to a defendant or respondent in a federal court or administrative action that the Commission files or in another public action or proceeding filed by an authority to which the Commission may provide the information. For example, in a related action brought as a criminal prosecution by the Department of Justice, disclosure of a whistleblower's identity may be required, in light of the requirement of the Sixth Amendment of the Constitution that a criminal defendant have the right to be confronted with witnesses against him.[60] Paragraph (a)(2) would authorize disclosure to the Department of Justice, an appropriate regulatory agency, a self regulatory organization, a state attorney general in connection with a criminal investigation, any appropriate state regulatory authority, the Public Company Accounting Oversight Board,

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59 Under Section 21F(h)(2), whistleblower-identifying information is also expressly exempted from the provisions of the Freedom of Information Act, 5 U.S.C. 552.

60 See U.S. Const. Amend. VI.

or foreign securities and law enforcement authorities when it is necessary to achieve the purposes of the Exchange Act and to protect investors. With the exception of foreign securities and law enforcement authorities, each of these entities is subject to the confidentiality requirements set forth in Section 21F(h) of the Exchange Act. Since foreign securities and law enforcement authorities are not bound by these confidentiality requirements, the proposed rule states that the Commission may determine what assurances of confidentiality are appropriate prior to disclosing such information. Paragraph (a)(3) would authorize disclosure in accordance with the Privacy Act of 1974.

Because many whistleblowers may wish to provide information anonymously, paragraph (b) of the proposed rule states that anonymous submissions are permitted with certain specified conditions. Paragraph (b)(1) would require that anonymous whistleblowers be represented by an attorney and that the attorney's contact information be provided to the Commission at the time of the whistleblower's initial submission. The purpose of this requirement is to prevent fraudulent submissions and to facilitate communication and assistance between the whistleblower and the Commission's staff. Any whistleblower may be represented by counsel - - whether submitting information anonymously or not.[61] Paragraph (b)(2) would require that anonymous whistleblowers and their counsel follow the required procedures outlined in Proposed Rule 21F-9. Paragraph (b)(3) would require that anonymous whistleblowers disclose their identity, pursuant to the procedures outlined in Proposed Rule 21F-10, before the Commission will pay any award. We emphasize that anonymous

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[61] See Section 21F(d)(1), 15 U.S.C. 78u-6(d)(1). Under the statute, however, an anonymous whistleblower seeking an award is required to be represented by counsel. Section 21F(d)(2), 15 U.S.C. 78u-6(d)(2).

whistleblowers have the same rights and responsibilities as other whistleblowers under Section 21F of the Exchange Act and these proposed rules, unless expressly exempted.

Pursuant to Rule 102(e) of the Commission's Rules of Practice,[62] the Commission may deny the privilege of practicing before the Commission to any person who, after notice and opportunity for hearing, is found not to possess the requisite qualifications to represent others, to be lacking in character or integrity, to have engaged in unethical or improper professional conduct, or to have willfully violated or willfully aided and abetted the violation of any provision of the federal securities laws or rules. Practice before the Commission is defined to include transacting any business with the Commission.[63] The Commission cautions attorneys that representation of whistleblowers will constitute practice before the Commission. Accordingly, misconduct by an attorney representing a whistleblower can result in the attorney being subject to disciplinary sanctions under any of the conditions set forth in Rule 102(e).

Request for Comment:

29. Because representation of whistleblowers constitutes practice before the Commission by an attorney, should the Commission consider adopting rules governing conduct by attorneys engaged in this type of practice? In some contexts, courts have disallowed excessive fee requests to attorneys for whistleblowers.[64] Should we adopt a rule regarding fees in

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62 17 CFR § 201.102(e).

63 17 CFR § 102(f).

64 United States v. Overseas Shipholding Group, Inc., 2010 WL 4104663 at *7 (1st Cir. 2010) (limitations on fees "are particularly appropriate in situations such as this where awarding an excessive fee to the attorney would itself undermine the objectives of the federal statutory scheme. The whole

the representation of whistleblower clients? Would such a rule encourage or discourage whistleblower submissions?

H. Proposed Rule 21F-8 – Eligibility

Paragraph (a) of Proposed Rule 21F-8 makes clear that providing information in the form and manner required by these rules is a fundamental criterion of eligibility for a whistleblower award.[65] However, in order to prevent undue hardship, the Commission, in its sole discretion, may waive any of these procedural requirements based upon a showing of extraordinary circumstances.

The specific procedures required for submitting original information and making a claim for a whistleblower award are described in Proposed Rules 21F-9 through 21F-11. Proposed Rule 21F-8(b) contains several additional procedural requirements, which are designed to assist the Commission in evaluating and using the information provided. These include that the whistleblower, upon request, agree to provide explanations and other assistance including, but not limited to, providing all additional information in the whistleblower's possession that is related to the subject matter of his submission. In order to accommodate whistleblowers who elect to submit information anonymously, the staff will have discretion to make special arrangements to meet these procedural requirements.

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purpose of the discretionary award to whistleblowers under this statute is to create incentives for the whistleblower to take risks that may disadvantage the whistleblower in his relationship to his employer. The amount of the fee that will be siphoned off by the lawyer significantly affects the size of that award and the power of the incentive. The court in administering this statute is obligated to ensure his excessive legal fees will not diminish the statutory incentive.").

65 See Section 21F(c)(2)(D), which prohibits the Commission from paying an award to any whistleblower "who fails to submit information to the Commission in such form as the Commission may, by rule, require. 15 U.S.C. 78u-6(c)(2)(D).

Paragraph (b) of the proposed rule also would require whistleblowers, if requested by the staff, to provide testimony or other acceptable evidence relating to whether they are eligible for or otherwise satisfy any of the conditions for an award. Because Section 21F(c)(2) of the Exchange Act statutorily excludes certain persons from receiving whistleblower awards,[66] and Section 21F further conditions the grant of an award on factors that are unique to each individual whistleblower (e.g., that the individual act "voluntarily" and provide information that meets all the criteria of "original information"), this provision is designed to ensure that the staff has authority to confirm that whistleblowers meet all of the necessary eligibility criteria and conditions. It is anticipated that the staff may seek such confirming evidence at any point after a whistleblower files Form WB-DEC (as set forth in Proposed Rule 21F-9), including, without limitation, in connection with the claims review process described in Proposed Rules 21F-10 and 21F-11.

Finally, paragraph (b) of proposed rule 21F-8 would authorize the staff to require that a whistleblower enter into a confidentiality agreement in a form acceptable to the Whistleblower Office, including a provision that a violation may result in the whistleblower being ineligible for an award.[67] In some cases, a confidentiality agreement may be required if it becomes necessary or advisable for the staff to share non-public information with a whistleblower either during the course of the investigation (for example, to obtain the whistleblower's assistance in interpreting documents), or as part of the claims process set forth in Proposed Rules 21F-10 and 21F-11.

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66 15 U.S.C. 78u-6(c)(2).

67 Section 21F(e) of the Exchange Act authorizes the Commission to require that a whistleblower enter into a contract. 15 U.S.C. 78u-6(e).

Paragraph (c) of Proposed Rule 21F-8 recites the categories of individuals who are ineligible for an award, many of which are set forth in Section 21F(c)(2). These include persons who are, or were at the time they acquired the original information, a member, officer, or employee of the Department of Justice, an appropriate regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board, or any law enforcement organization; anyone who is convicted of a criminal violation that is related to the Commission action or to a related action for which the person otherwise could receive an award; any person who obtained the information provided to the Commission through an audit of a company's financial statements, and making a whistleblower submission would be contrary to the requirements of Section 10A of the Exchange Act, 15 U.S.C. § 78j-1);[68] and any person who in his whistleblower submission, his other dealings with the Commission, or his dealings with another authority in connection with a related action, knowingly and willfully makes any false, fictitious, or fraudulent statement or representation, or uses any false writing or document, knowing that it contains any false, fictitious, or fraudulent statement or entry. Paragraph (c)(2) of Proposed Rule 21F-8 also would make foreign officials ineligible to receive a whistleblower award. The payment of awards to foreign officials could have negative repercussions for United States foreign relations, including creating a

[68] As noted above, Section 10A of the Exchange Act requires that a registered public accounting firm engaged in an audit of financial statements of an issuer required under the Exchange Act take certain steps if the auditor detects or otherwise becomes aware of information indicating an illegal act, which in certain circumstances can include reporting directly to the Commission. The Commission interprets the exclusion in Section 21F(c)(2)(C) to apply to persons who obtain information through the performance of an audit that is subject to the requirements of Section 10A, whether or not the audit results in the accounting firm making a report to the Commission. In addition to this statutory exclusion, the Commission is proposing, through the definition of "original information," a broader exclusion for persons who obtain information through the performance of an engagement required under the securities laws by an independent public accountant. See Proposed Rule 21F-4(b)(4)(iii).

perception that the United States is interfering with foreign sovereignty, potentially undermining foreign government cooperation under existing treaties (including multilateral and bilateral mutual legal assistance treaties),[69] encouraging corruption, and raising concerns about protection of foreign officials who become whistleblowers. In order to prevent evasion of these exclusions, paragraph (c)(5) of the proposed rule also provides that persons who acquire information from ineligible individuals are ineligible for an award. In addition, paragraph (c)(6) would make any person ineligible who is the spouse, parent, child, or sibling of a member or employee of the Commission, or who resides in the same household as a member or employee of the Commission, in order to prevent the appearance of improper conduct by Commission employees.

Paragraph (d) of Proposed Rule 21F-8 reiterates that a determination that a whistleblower is ineligible to receive an award for any reason does not deprive the individual of the anti-retaliation protections set forth in Section 21F(h)(1) of the Exchange Act.[70]

Request for Comment.

30. We request comment on the manner of submission requirements set forth in Proposed Rule 21F-8(b). Are these requirements appropriate? Should there be different or additional requirements to supplement the submission of information as set forth in Proposed Rule 21F-9?

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69 For example, Article 8(4) of the United Nations Convention Against Corruption requires that party states consider establishing measures and systems to facilitate the reporting by public officials of acts of corruption to appropriate authorities, when such acts come to their notice in the performance of their functions.

70 See Proposed Rule 21F-2.

31. We also request comment on the ineligibility criteria set forth in Proposed Rule 21F-8(c). Are there other statuses or activities that should render an individual ineligible for a whistleblower award?

I. <u>Proposed Rule 21F-9 - Procedures for Submitting Original Information</u>

The Commission proposes a two-step process for the submission of original information under the whistleblower award program. In general, the first step would require the submission of information either on a standard form or through the Commission's online database for receiving tips, complaints and referrals. The second step would require the whistleblower to complete a Whistleblower Office form, signed under penalties of perjury, in which the whistleblower would be required to make certain representations concerning the veracity of the information provided and the whistleblower's eligibility for a potential award. The use of standardized forms and the electronic database will greatly assist the Commission in managing and tracking the thousands of tips that it receives annually. This will also better enable the Commission to connect tips to each other so as to make better use of the information provided, and to connect tips to requests for payment under the whistleblower provisions. The purpose of requiring a sworn declaration is to help deter the submission of false and misleading tips and the resulting inefficient use of the Commission's resources. The requirement should also mitigate the potential harm to companies and individuals that may be caused by false or spurious allegations of wrongdoing.

1. Form TCR and Instructions

Paragraph (a) of Proposed Rule 21F-9 requires the submission of information in one of two ways. A whistleblower may submit the information electronically through the

Commission's Electronic Data Collection System available on the Commission's website or by completing and submitting proposed Form TCR - *Tip, Complaint or Referral.*[71] Form TCR, and the instructions thereto, are designed to capture basic identifying information about a complainant and to elicit sufficient information to determine whether the conduct alleged suggests a violation of the federal securities laws. Proposed items A1 through A3 of Form TCR would request the whistleblower's name and contact information, including a physical address, email address and telephone number. Proposed item A4 would ask the whistleblower to indicate his occupation. In instances where a whistleblower submits information anonymously, the identifying information for the whistleblower would not be required, but proposed Items B1 through B4 of the form would require the name and contact information of the whistleblower's attorney. This information may also be included in the case of whistleblowers whose identities are known and who are represented by counsel in the matter. Proposed Items C1 through C4 would request basic identifying information for the individual(s) or entit(ies) to which the complaint relates. Proposed Items D1 through D9 are designed to elicit details concerning the alleged securities violation. Proposed Items D1 and D2 would ask the whistleblower to provide the date of the occurrence and describe the nature of the complaint. Proposed Items D3 and D4 would ask whether the complaint relates to an entity of which the whistleblower is or was an officer,

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71 The Commission anticipates that, by the time final rules are adopted to implement Section 21F, potential whistleblowers will be able to submit information to the Commission online through the Electronic Data Collection System, an interactive, web-based database for submission of tips, complaints and referrals. Whistleblowers who wish to submit their information in paper format would be required to use proposed Form TCR. Both methods of submission are designed to elicit substantially similar information concerning the individual submitting the information and the violation alleged. For purposes of these rules, the Commission is only discussing proposed Form TCR. On _____, 2010, the Commission separately submitted a request to the Office of Management and Budget for Paperwork Reduction Act approval of the Electronic Data Collection System.

director, employee, consultant or contractor and, if so, whether the whistleblower has taken any prior action regarding the complaint, what actions were taken and the date on which the action(s) were taken. Proposed Item D5 would ask about the type of security or investment involved, the name of the issuer and the ticker symbol or CUSIP number, if applicable. Proposed Item D6 would ask the whistleblower to state in detail all facts pertinent to the alleged violation. Proposed Item D7 would ask for a description of all supporting materials in the whistleblower's possession and the availability and location of any additional supporting materials not in the whistleblower's possession. Item D8 would ask for an explanation of how the whistleblower obtained the information that supports the claim. Proposed Item D9 would provide the whistleblower with an opportunity to provide any additional information the whistleblower thinks may be relevant to his submission. The questions posed on proposed Form TCR are designed to elicit the minimum information required for the Commission to make a preliminary assessment concerning the likelihood that the alleged conduct suggests a violation of the securities laws. Moreover, the proposed instructions to Form TCR are designed to assist the whistleblower and facilitate the completion of the form.

2. *Form WB-DEC and Instructions*

In addition to submitting information in the form and manner required by paragraph (a), the Commission proposes in paragraph (b) of Proposed Rule 21F-9 to require that whistleblowers who wish to be considered for an award in connection with the information they provide to the Commission also complete and provide the Commission with proposed Form WB-DEC, *Declaration Concerning Original Information Provided Pursuant to §21F of the Securities Exchange Act of 1934.* Proposed Form

WB-DEC would require a whistleblower to answer certain threshold questions concerning the whistleblower's eligibility to receive an award. The form also would contain a statement from the whistleblower acknowledging that the information contained in the Form WB-DEC, as well as all information contained in the whistleblower's submission, is true, correct and complete to the best of the whistleblower's knowledge, information and belief. Moreover, the statement would acknowledge the whistleblower's understanding that the whistleblower may be subject to prosecution and ineligible for an award if, in the whistleblower's submission of information, other dealings with the Commission, or dealings with another authority in connection with a related action, the whistleblower knowingly and willfully makes any false, fictitious, or fraudulent statements or representations, or uses any false writing or document knowing that the writing or document contains any false, fictitious, or fraudulent statement or entry.

In instances where information is provided by an anonymous whistleblower, proposed paragraph (c) of Proposed Rule 21F-9 would require the attorney representing the whistleblower to provide the Commission with a separate Form WB-DEC certifying that the attorney has verified the identity of the whistleblower, and will retain the whistleblower's original, signed Form WB-DEC in the attorney's files. The proposed certification from counsel is an important element of the whistleblower program to help ensure that the Commission is working with whistleblowers whose identities have been verified by their counsel. The proposed certification process also would provide a mechanism for anonymous whistleblowers to be advised by their counsel regarding their preliminary eligibility for an award.

Proposed Items A1 through A3 of Form WB-DEC would request the whistleblower's name and contact information. In the case of submissions by an anonymous whistleblower, the form would require the name and contact information of the whistleblower's attorney instead of the whistleblower's identifying information in proposed Items B1 though B4. This section could also be completed in cases where a whistleblower's identity is known but the whistleblower is represented by an attorney in the matter. Proposed Items C1 through C3 would request information concerning the information submitted by the whistleblower to the SEC. Item C1 would require the whistleblower to indicate the manner in which the information was submitted to the Commission. Proposed Item C2 would ask for the Tip, Complaint or Referral ("TCR") number assigned to the whistleblower's submission. The Commission expects that the TCR number would be generated automatically in cases where the whistleblower submits his information online through the Commission's Electronic Data Collection System or, in the case of hard copy submissions, would be provided to the whistleblower in a written confirmation sent by the Commission staff. In instances where a whistleblower submits both forms in hard copy and thus does not have access to the TCR number at the time of submission, the forms would be linked together by virtue of having been included in the same mailing. Proposed Items C3 would ask a whistleblower to identify any communications the whistleblower or his counsel may have had with the Commission concerning the matter since submitting the information. Proposed Item C4 asks whether the whistleblower has provided the same information being provided to the Commission to any other agency or organization and, if so, requests details concerning the submission, including the name and contact information for the point of contact at the agency or organization, if known. Proposed Items D1 through D9 would require the whistleblower to make certain representations concerning the whistleblower's eligibility for an award. Finally, the form would require the sworn declarations from the whistleblower and the whistleblower's counsel discussed above. In proposed Item E, the whistleblower would be required to declare under penalty of perjury that the information contained on Form WB-DEC, and all information submitted to the SEC is true, correct and complete to the best of the whistleblower's knowledge, information and belief. In addition, the whistleblower would acknowledge his understanding that he may be subject to prosecution and ineligible for a whistleblower award if, in the whistleblower's submission of information, other dealings with the SEC, or dealings with another authority in connection with a related action, the whistleblower knowingly and willfully makes any false, fictitious, or fraudulent statements or representations, or uses any false writing or document knowing that the writing or document contains any false, fictitious, or fraudulent statement or entry.

The counsel certification in proposed Item F would require an attorney for an anonymous whistleblower to certify that the attorney has verified the identity of the whistleblower who completed Form WB-DEC in connection with the information submitted to the SEC by viewing the whistleblower's valid, unexpired government issued identification, that the attorney has reviewed the whistleblower's Form WB-DEC for completeness and accuracy, and that the attorney will retain an original, signed copy of the Form WB-DEC completed by the whistleblower in his or her records.

As explained above, the Commission proposes to allow two alternative methods of submission of a whistleblower's information. A whistleblower would have the option of submitting the information electronically through the Commission's Electronic Data Collection System or by sending or faxing Form TCR to the Whistleblower Office.

Form WB-DEC could be submitted electronically, in accordance with instructions set forth on the Commission's website or, alternatively, by mailing or faxing the form to the Whistleblower Office.

3. *Perfecting whistleblower status for submissions made before effectiveness of the rules*

As previously discussed, Section 924(b) of Dodd-Frank states that information provided to the Commission in writing by a whistleblower after the date of enactment but before the effective date of these proposed rules retains the status of original information. The Commission has already received numerous tips from potential whistleblowers after the date of enactment of Dodd-Frank. Proposed Rule 21F-9(d) would provide a mechanism by which whistleblowers who fall into this category could perfect their status as whistleblowers under the Commission's award program once final rules are adopted. Paragraph (d)(1) requires a whistleblower who provided original information to the Commission in a format or manner other than that required by paragraph (a) of Rule 21F-9 to either submit the information electronically through the Commission's Electronic Data Collection System or to submit a completed Form TCR within one hundred twenty (120) days of the effective date of the proposed rules and to otherwise follow the procedures set forth in paragraph (b) of Proposed Rule 21F-9. If the whistleblower provided the original information to the Commission in the format or manner required by paragraph (a) of Rule 21F-9, paragraph (d)(2) would require the whistleblower to submit Form WB-DEC within one hundred twenty (120) days of the effective date of the proposed rules in the manner set forth in paragraph (b) of Proposed Rule 21F-9.

Request for Comment:

32. Although the Commission is proposing alternative methods of submission, we expect that electronic submissions would dramatically reduce our administrative costs, enhance our ability to evaluate tips (generally and using automated tools), and improve our efficiency in processing whistleblower submissions. Accordingly, we solicit comment on whether it would be appropriate to eliminate the fax and mail option and require that all submissions be made electronically. Would the elimination of submissions by fax and mail create an undue burden for some potential whistleblowers?

33. Is there other information that the Commission should elicit from whistleblowers on Proposed Forms TCR and WB-DEC? Are there categories of information included on these forms that are unnecessary, or should be modified?

34. Is the requirement that an attorney for an anonymous whistleblower certify that the attorney has verified the whistleblower's identity and eligibility for an award appropriate? Is there an alternative process the Commission should consider that would accomplish its goal of ensuring that it is communicating with a legitimate whistleblower?

35. Is the Commission's proposed process for allowing whistleblowers 120 days to perfect their status in cases where the whistleblower provided

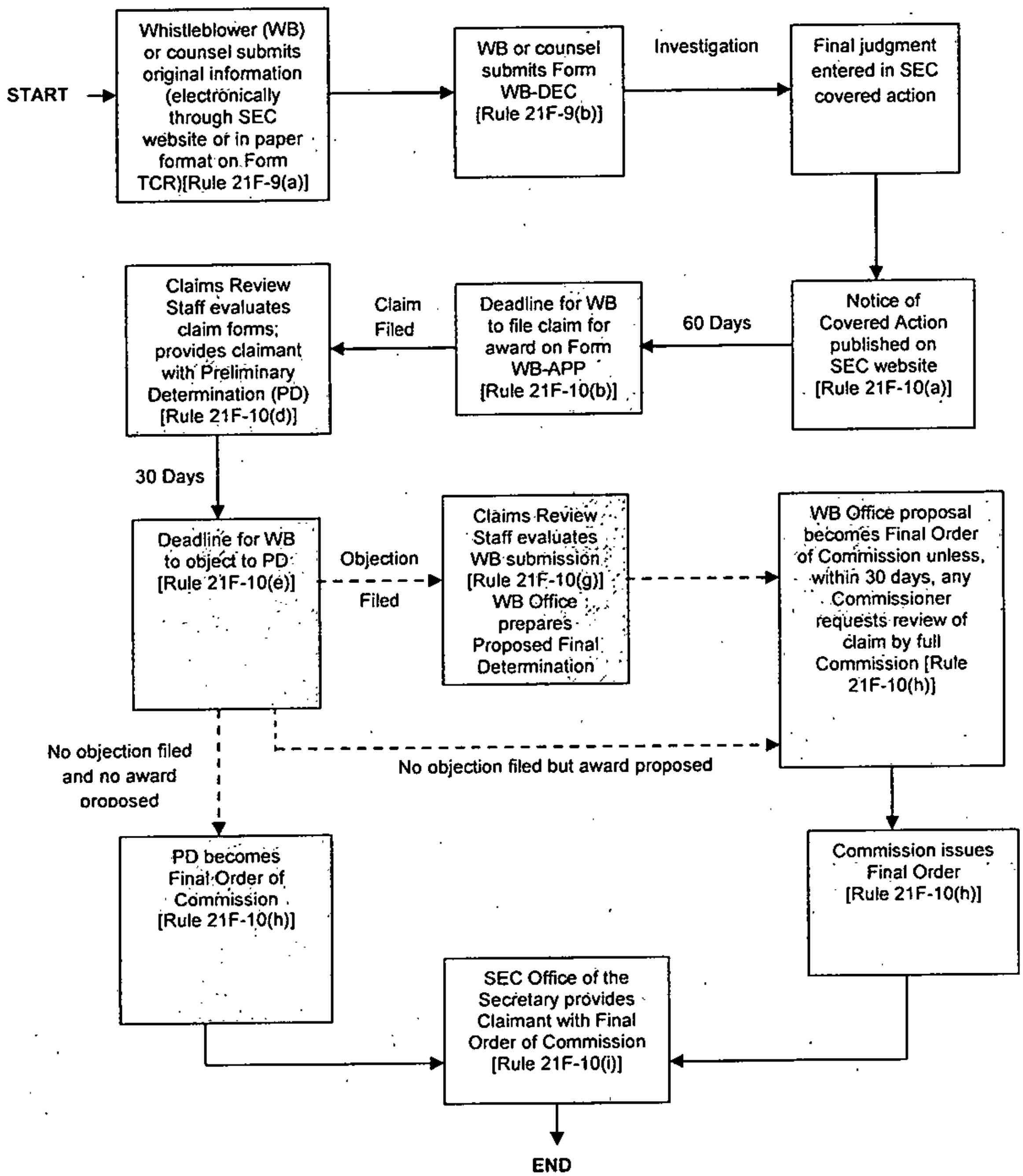
original information to the Commission in writing after the date of enactment of Dodd-Frank but before adoption of the proposed rules reasonable? Should the period be made shorter (e.g., 30 or 60 days) or longer (e.g., 180 days)?

36. Are there any ways we can streamline and make the required procedures more user-friendly?

J. Proposed Rule 21F-10 - Procedures for Making a Claim for a Whistleblower Award in SEC Actions that Result in Monetary Sanctions In Excess of $1,000,000

Proposed Rule 21F-10 describes the steps a whistleblower would be required to follow in order to make a claim for an award in relation to a Commission action. In addition, the rule describes the Commission's proposed claims review process, which includes the proposed administrative appeals process.

The following flow chart represents a general overview of the proposed process:



The proposed process would begin with the publication of a "Notice of a Covered Action" ("Notice") on the Commission's website. Whenever a judicial or administrative action brought by the Commission results in the imposition of monetary sanctions exceeding $1,000,000, the Whistleblower Office will cause this Notice to be published on the Commission's website subsequent to the entry of a final judgment or order in the action that by itself, or collectively with other judgments or orders previously entered in the action, exceeds the $1,000,000 threshold. If the monetary sanctions are obtained without a judgment or order -- as in the case of a contribution made pursuant to Section 308(b) of the Sarbanes-Oxley Act of 2002 -- the Notice would be published within thirty (30) days of the deposit of monetary sanctions into a disgorgement or other fund pursuant to Section 308(b) that causes total monetary sanctions in the action to exceed $1,000,000. The Commission's proposed rule requires claimants to file their claim for an award within sixty (60) days of the date of the Notice.[72] A claimant's failure to timely file a request for a whistleblower award would bar that individual later seeking a recovery.[73] The Commission anticipates that, at the time a Notice of Covered Action is posted, the staff will also attempt to contact persons who have filed a Form WB DEC in relation to the case, in order to give them additional notice of the opportunity to submit a claim for award.

Paragraph (b) of Proposed Rule 21F-10 describes the procedure for making a claim for an award. Specifically, a claimant would be required to submit a claim for an award on proposed Form WB-APP, *Application for Award for Original Information Provided Pursuant to §21F of the Securities Exchange Act of 1934*. Proposed Form WB-APP, and the instructions thereto, will elicit information concerning a whistleblower's eligibility to receive an award at the time the whistleblower files his claim. The purpose of the form is, among other things, to provide an opportunity for the

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72 All references to "days" refer to calendar days.

73 See, e.g., Yuen v. U.S., 825 F.2d 244 (9th Cir. 1987) (taxpayer barred from recovery due to failure to timely file a written request for refund).

whistleblower to "make his case" for why he is entitled to an award by describing the information and assistance he has provided and its significance to the Commission's successful action. Proposed Items A1 through A3 require the claimant to provide basic identifying information, including first and last name and contact information. Proposed Items B1 through B4 would request the name and contact information for the whistleblower's attorney, if applicable. Proposed Items C1 and C2 would request information concerning the original tip or complaint underlying the claim, including the TCR number, the date the information was submitted and the subject of the tip, complaint or referral. Proposed Items D1 through D3 would request information concerning the Notice of Covered Action to which the claim relates, including the date of the notice, notice number, and the name and case number of the matter to which the notice relates. Proposed Items E1 through E3 would request information concerning related actions. A whistleblower would be required to complete Section D in cases where the whistleblower's claim was submitted in connection with information submitted to another agency or organization in a related action (the questions pertaining to related actions are explained in the discussion of proposed Rule 21F-11, below). Proposed Items F1 through F9 would require the claimant to make certain representations concerning the claimant's eligibility to receive an award at the time the claim is made. In Item G, a claimant may set forth the grounds for the claimant's belief that he is entitled to an award in connection with the information submitted to the Commission, or to another agency or organization in a related action. Finally, item H would contain a declaration, to be signed by the claimant, certifying that the information contained on the form is true, correct and complete to the best of the claimant's knowledge, information and belief. The declaration would further acknowledge the claimant's understanding that he may be subject to prosecution and ineligible for a whistleblower award for knowingly and willfully making any false, fictitious, or fraudulent statements or representations in his or her submission or dealings with the SEC or other authority.

Paragraph (b) of Proposed Rule 21F-10 provides that a claim on Form WB-APP, including any attachments, must be received by the Whistleblower Office within sixty (60) days of the date of the Notice of Covered Action in order to be considered for an award.

Paragraph (c) requires a whistleblower who submitted information to the Commission anonymously to disclose his identity to the Commission on proposed Form WB-APP and to verify his identity in a form and manner that is acceptable to the Whistleblower Office prior to the payment of an award. This requirement is derived from Subsection 21F(d)(2)(B) of the Exchange Act.[74]

Paragraph (d) of Proposed Rule 21F-10 describes the Commission's claims review process. The claims review process would begin once the time for filing any appeals of the Commission's judicial or administrative action has expired, or where an appeal has been filed, after all appeals in the action have been concluded.
Under the proposed process, the Whistleblower Office and designated Commission staff (defined in Proposed Rule 21F-10 as the "Claims Review Staff")[75] would evaluate all timely whistleblower award claims submitted on Form WB-APP. In connection with this process, the Whistleblower Office could require that claimants provide additional

74 15 U.S.C. 78u-6(d)(2)(B).

75 Designated staff would likely include, but need not be limited to, Commission staff members who were responsible for investigating and prosecuting the covered action.

information relating to their eligibility for an award or satisfaction of any of the conditions for an award, as set forth in Proposed Rule 21F-8(b).[76] Following that evaluation, the Whistleblower Office would send any claimant a Preliminary Determination setting forth a preliminary assessment as to whether the claim should be allowed or denied and, if allowed, setting forth the proposed award percentage amount.

The proposed rule would allow a claimant the opportunity to contest the Preliminary Determination made by the Claims Review Staff. Under paragraph (e) of Proposed Rule 21F-10, the claimant could take any of the following steps:

- Within thirty (30) days of the date of the Preliminary Determination, the claimant may request that the Whistleblower Office make available for the claimant's review the materials that formed the basis of the Claims Review Staff's Preliminary Determination. The Whistleblower Office would make these materials available to the claimant subject to any redactions necessary to comply with any statutory restrictions or protect the Commission's law enforcement and regulatory functions. The Whistleblower Office also could require the claimant to sign a confidentiality agreement (as described in Rule 21F-8) prior to providing these materials.
- Within thirty (30) days of the date of the Preliminary Determination, or if a request to review materials is made pursuant to paragraph (1) above, then within thirty (30) days of the Whistleblower Office making those materials available for the claimant's review, a claimant may submit a written response to the Whistleblower Office setting forth the grounds for the claimant's objection to either the denial of

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76 This is not intended to limit the authority of the staff to require confirmation of eligibility or the satisfaction of other conditions at any earlier time. See discussion of Proposed Rule 21F-8(d).

an award or the proposed amount of an award. The claimant may also include documentation or other evidentiary support for the grounds advanced in his response.

- Within thirty (30) days of the date of the Preliminary Determination, the claimant may request a meeting with the Whistleblower Office. However, such meetings are not required and the Whistleblower Office may in its sole discretion decline the request.

Paragraph (f) of Proposed Rule 21F-10 makes clear that if a claimant fails to submit a timely response pursuant to paragraph (e), then the Preliminary Determination of the Claims Review Staff would be deemed the Final Order of the Commission (except where the Preliminary Determination recommended an award, in which case the Preliminary Determination will be deemed a Proposed Final Determination, which would make it subject to review by the Commission under paragraph (h). In addition, a claimant's failure to submit a timely response to a Preliminary Determination where the determination was to deny an award would constitute a failure to exhaust the claimant's administrative remedies, and the claimant would be prohibited from pursuing a judicial appeal.[77]

Paragraph (g) of Proposed Rule 21F-10 describes the procedure in cases where a claimant submits a timely response pursuant to Paragraph (f). In such cases, the Claims Review Staff would consider the issues and grounds advanced in the claimant's response, along with any supporting documentation provided by the claimant, and would prepare a Proposed Final Determination. Paragraph (h) provides that the

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77 See, e.g., Benoit v. U.S. Dept. of Agriculture, 608 F.3d 17, 21-24 (DC Cir. 2010) (dismissing appeal because petitioners failed to exhaust administrative remedies with respect to their monetary claims against the government).

Whistleblower Office would notify the Commission of the Proposed Final Determination, but would not make the Proposed Final Determination public. Within thirty (30) days thereafter, any Commissioner would be able to request that the Proposed Final Determination be reviewed by the Commission. If no Commissioner requests such a review within the 30-day period, then the Proposed Final Determination would become the Final Order of the Commission. In the event a Commissioner requests a review, the Commission would review the record that the staff relied upon in making its determination, including the claimant's previous submissions to the Whistleblower Office. On the basis of its review of the record, the Commission would issue its Final Order, which the Commission's Secretary will provide to the claimant.

The objective of this administrative appeals process is to provide a transparent award determination process and provide whistleblowers full opportunity to make a written statement to the Commission for its consideration when it makes eligibility and award determinations. The proposed administrative process would enable a whistleblower to appeal to the Commission a preliminary determination by the Whistleblower Office concerning the percentage amount of an award; however, this process would in no way limit the Commission's discretion to make a determination with respect to the amount of an award. Under Section 21F(f) of the Exchange Act, determinations of the amount of an award are not appealable to the courts when the Commission has followed the statutory requirement to award between 10 and 30 percent of the monetary sanctions collected.

K. Proposed Rule 21F-11 – Procedures for Determining Awards Based Upon a Related Action

Proposed Rule 21F-3(b) discussed above explains that the Commission is required to pay an award on amounts collected in certain related actions. Proposed Rule 21F-11 sets forth the procedures for determining awards based upon related actions. Paragraph (a) informs a whistleblower who is eligible to receive an award following a Commission action that results in monetary sanctions totaling more than $1,000,000 that the whistleblower may also be eligible to receive an award based on the monetary sanctions that are collected from a related action.

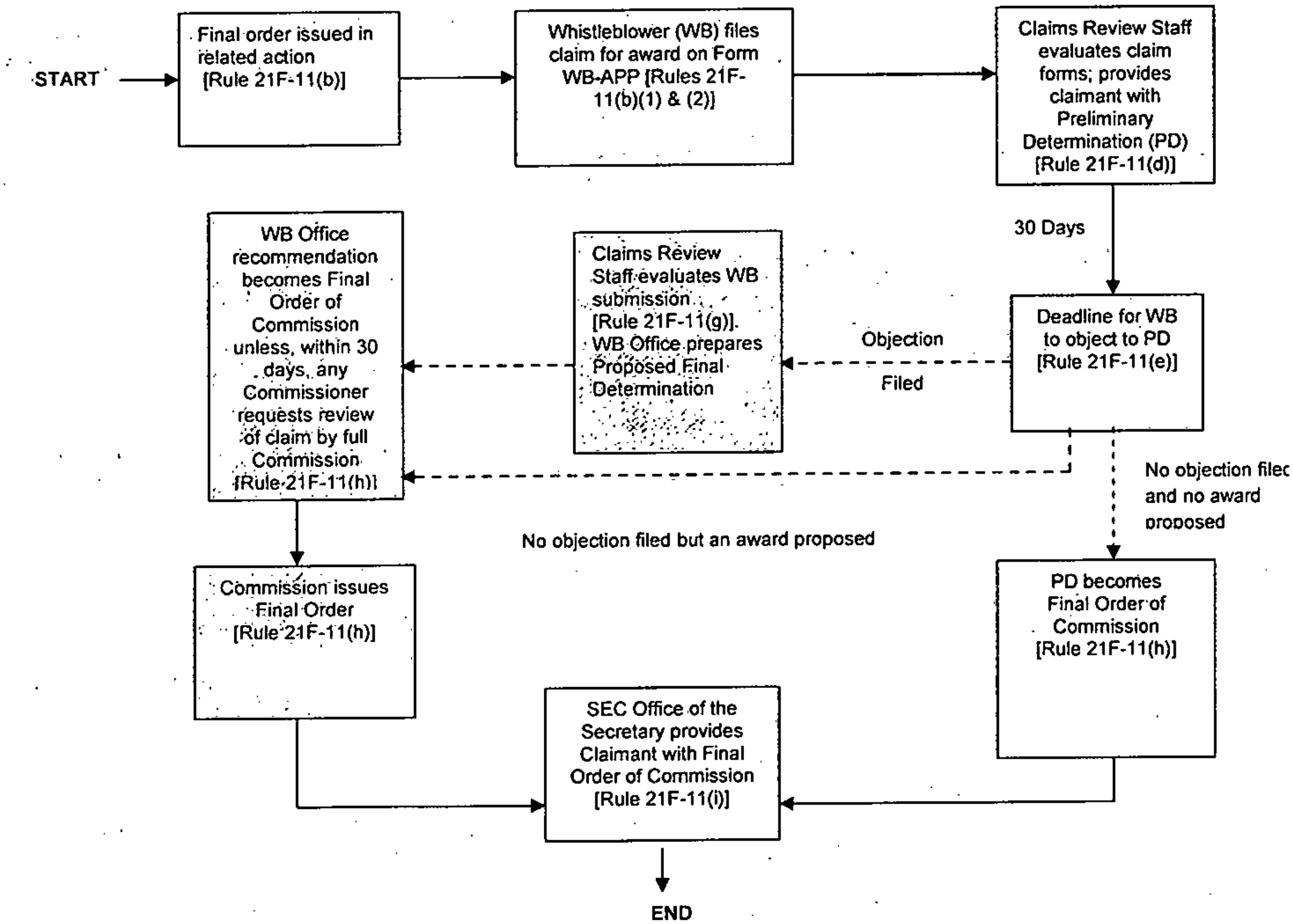
Paragraph (b) of Proposed Rule 21F-11 describes the procedures for making a claim for an award in a related action. The process essentially mirrors the procedure for making a claim in connection with a Commission action and requires the claimant to submit the claim on Form WB-APP. In addition to the questions previously described in our discussion of proposed Rule 21F-10, the claimant in a related action would be required to complete Section D of proposed form WB-APP. Proposed Items D1 through D4 request the name of the agency or organization to which the whistleblower provided the information and the date the information was provided, the name and telephone number for a contact at the agency or organization, if available, and the case name, action number and date the related action was filed.

Paragraph (b) of Proposed Rule 21F-11 sets forth the deadline by which a claimant must file his or her Form WB-APP in a related action. Specifically, under proposed paragraph (b)(1), if a final order imposing monetary sanctions has been entered in a related action at the time the claimant submits the claim for an award in connection with a Commission action, the claimant would be required to submit the claim for an award in that related action on the same Form WB-APP used for the Commission action. Under proposed paragraph (b)(2), if a final order imposing monetary sanctions in a related action has not been entered at the time the claimant submits a claim for an award in connection with a Commission action, then the claimant would be required to submit the claim on Form WB-APP within sixty (60) days of the issuance of a final order imposing sanctions in the related action.

The Whistleblower Office may request additional information from the claimant in connection with the claim for an award in a related action to demonstrate that the claimant directly (or through the Commission) voluntarily provided the governmental agency, regulatory authority or self-regulatory organization the same original information that led to the Commission's successful covered action, and that this information led to the successful enforcement of the related action. In addition, the Whistleblower Office may, in its discretion, seek assistance and confirmation from the other agency in making this determination.

Paragraphs (d) through (i) of Proposed Rule 21F-11 describe the Commission's claims review process in related actions. The Commission proposes to utilize the same claims review process in related actions that it will utilize in connection with claims submitted in connection with a covered Commission action.

The following represents an overview of the proposed process:



L. <u>Proposed Rule 21F-12 - Appeals</u>

Section 21F of the Exchange Act provides for certain rights of appeal of orders of the Commission with respect to whistleblower awards.[78] Paragraph (a) of Proposed Rule 21F-12 tracks this provision and describes claimants' appeal rights. A decision of the Commission regarding the amount of an award is not appealable when the Commission has followed the statutory mandate to award between 10 and 30 percent of

[78] 15 U.S.C. 78u-6(f).

the monetary sanctions collected. A decision regarding whether or to whom to make an award may be appealed to an appropriate court of appeals within 30 days after the Commission issues its final decision. Under Section 25(a)(1) of the Exchange Act,[79] appeals of final orders of the Commission entered pursuant to the Exchange Act may be made to the United States Court of Appeals for the District of Columbia Circuit, or to the circuit where the aggrieved person resides or has his principal place of business.

Paragraph (b) of Proposed Rule 21F-12 designates the materials that shall be included in the record on any appeal. They include the Whistleblower Office's Preliminary Determination, any materials submitted by the claimant or claimants (including the claimant's Forms TCR, WB-DEC, WB-APP, and materials filed in response to the Preliminary Determination), and any other materials that supported the Final Order of the Commission, with the exception of any internal deliberative process materials that are prepared exclusively to assist the Commission in deciding the claim, such as the staff's Proposed Final Determination in the event it does not become the Final Order.

M. <u>Proposed Rule 21F-13 – Procedures Applicable to Payment of Awards</u>

Proposed Rule 21F-13 (a) addresses the timing for payment of an award to a whistleblower. Any award made pursuant to the rules would be paid from the Securities and Exchange Commission Investor Protection Fund (the "Fund") established by Section 21F(g) of the Exchange Act.[80] Paragraph (b) provides that a recipient of a whistleblower award would be entitled to payment on the award only to the extent that a

[79] 15 U.S.C. 78y(a)(1).

[80] 15 U.S.C. 78u-6(g).

monetary sanction is collected in the Commission action or in a related action upon which the award is based. This requirement is derived from Section 21F(b)(1) of the Exchange Act,[81] which provides that an award is based upon the monetary sanctions collected in the Commission action or related action.

Paragraph (c) states that any payment of an award for a monetary sanction collected in a Commission action would be made following the later of either the completion of the appeals process for all whistleblower award claims arising from the Notice of Covered Action for that action, or the date on which the monetary sanction is collected. Likewise, the payment of an award for a monetary sanction collected in a related action would be made following the later of either the completion of the appeals process for all whistleblower award claims arising from the related action, or the date on which the monetary sanction is collected. This provision is intended to cover situations where a single action results in multiple whistleblowers claims. Under this scenario, if one whistleblower appeals a Final Determination of the Commission denying the whistleblower's claim for an award, the Commission would not pay any awards in the action until that whistleblower's appeal has been concluded, because the disposition of that appeal could require the Commission to reconsider its determination and thereby could affect all payments for that action.

Paragraph (d) of Proposed Rule 21F-13 describes how the Commission would address situations where there are insufficient amounts available in the Fund to pay an award to a whistleblower or whistleblowers within a reasonable period of time of when payment should otherwise be made. In this situation, the whistleblower or whistleblowers would be paid when amounts become available in the Fund, subject to

81 15 U.S.C. 78u-6(b)(1).

the terms set forth in proposed paragraphs (d)(1) and (d)(2). Under proposed paragraph (d)(1), where multiple whistleblowers are owed payments from the Fund based on awards that do not arise from the same Notice of Covered Action or related action, priority in making payment on these awards would be determined based upon the date that the collections for which the whistleblowers are owed payments occurred. If two or more of these collections occur on the same date, those whistleblowers owed payments based on these collections would be paid on a pro rata basis until sufficient amounts become available in the Fund to pay their entire payments. Under proposed paragraph (d)(2), where multiple whistleblowers are owed payments from the Fund based on awards that arise from the same Notice of Covered Action or related action, they would share the same payment priority and would be paid on a pro rata basis until sufficient amounts become available in the Fund to pay their entire payments.

As noted above, whistleblower awards will be paid solely from the Fund. Section 21F(g)(3) of the Exchange Act establishes the mechanism for funding the Fund. In most circumstances, the Fund will be funded with monetary sanctions that are collected by the Commission in its judicial and administrative actions and that are not distributed to victims of a violation of the securities laws underlying such actions. However, if the balance of the Fund is not sufficient to satisfy a whistleblower award, the law requires that there be deposited into or credited to the Fund an amount equal to the unsatisfied portion of the award from any monetary sanction collected by the Commission in the Commission action on which the award is based. Therefore, it is possible for there to be circumstances in which monies that otherwise might have been distributed to victims pursuant to a Commission action could be required to be deposited into or credited to the Fund to pay a whistleblower award. In this situation, there would be a tension between the competing interests of paying an award to a whistleblower (as provided for in Section 21F) and compensating victims with monies collected from wrongdoers (as recognized in Section 308 of the Sarbanes-Oxley Act).

Request for Comment:

37. We request comment on the significance of the tension between the interests of whistleblowers and victims in this circumstance, the likelihood that this situation would arise, and whether there is anything that the Commission can or should do to mitigate this tension.

N. Proposed Rule 21F-14 - No Amnesty

Proposed Rule 21F-14 provides notice that the provisions of Section 21F of the Exchange Act do not provide amnesty to individuals who provide information to the Commission relating to a violation of the securities laws. Whistleblowers who have not participated in misconduct will of course not need amnesty. However, some whistleblowers who provide original information that significantly aids in detecting and prosecuting sophisticated securities fraud schemes may themselves be participants in the scheme who could be subject to Commission enforcement actions. These individuals will not be immune from prosecution. Rather, the Commission will analyze the unique facts and circumstances of each case in accordance with its Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions, 17 C.F.R. § 202.12, to determine whether, how much, and in what manner to credit cooperation by whistleblowers who have participated in misconduct.

This Policy Statement provides an incentive to report information to the Commission notwithstanding that the whistleblower program does not provide amnesty.

O. Proposed Rule 21F-15 – Awards to Whistleblowers who Engage in Culpable Conduct

Proposed Rule 21F-15 states that in determining whether the required $1,000,000 threshold has been satisfied for purposes of making an award to a whistleblower, the Commission will not count any monetary sanctions that the whistleblower is ordered to pay, or that are ordered against any entity whose liability is based substantially on conduct that the whistleblower directed, planned, or initiated. The Commission also will not add those amounts to the total monetary sanctions collected in the action for purposes of calculating any payment to the culpable individual. The rationale for this limitation is to prevent wrongdoers from financially benefiting by, in essence, blowing the whistle on their own misconduct. Because the common understanding of a whistleblower is one who reports misconduct by another person, we are preliminarily of the view that it would not be consistent with the purposes of the statute to pay awards to persons based on monetary sanctions arising from their own misconduct. A logical corollary to this principle is that a whistleblower also should not be paid an award based on monetary sanctions paid by an entity whose liability resulted from the whistleblower's conduct.

Request for Comment: We request comment on whether the limitations provided in Proposed Rule 21F-15 are appropriate.

38. For example, in determining whether the $1,000,000 threshold for a covered action has been met, should we exclude monetary sanctions ordered against an entity whose liability is based substantially on conduct

that the whistleblower directed, planned, or initiated? Should we exclude those amounts from monetary sanctions collected for purposes of making payments to whistleblowers?

39. Is the proposed exclusion of monetary sanctions ordered against an entity whose liability is based substantially on conduct that the whistleblower directed, planned, or initiated appropriate? Is the proposed exclusion sufficient to permit the Commission to deny awards in cases where the payment of an award would be against public policy? Should we instead exclude any wrongdoer from being eligible to receive an award categorically, or in particular circumstances? Should an individual's level of culpability be considered as a factor in determining whether the person is eligible for an award? Are there other ways in which we should limit the payment of awards to culpable individuals?

P. Proposed Rule 21F-16 - Staff Communications with Whistleblowers

Proposed Rule 21F-16(a) provides that no person may take any action to impede a whistleblower from communicating directly with the Commission staff about a potential securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement (other than agreements dealing with information covered by § 240.21F-4(b)(4)(i) & (ii) of this chapter related to the legal representation of a client) with respect to such communications. As noted, the Congressional purpose underlying Section 21F of the Exchange Act is to encourage whistleblowers to report potential violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees. Efforts to impede a whistleblower's direct communications with Commission staff about a potential securities law violation, however, would appear to conflict with this purpose. For example, an attempt to enforce a confidentiality agreement against a whistleblower to prevent his or her communications with Commission staff about a potential securities law violation could inhibit those communications even when such an agreement would be legally unenforceable,[82] and would undermine the effectiveness of the countervailing incentives that Congress established to encourage whistleblowers to disclose potential violations to the Commission. Proposed Rule 21F-16(a) is designed to prevent this result. The proposed rule would not, however, address the effectiveness or enforceability of confidentiality agreements in situations other than communications with the Commission about potential securities law violations. Proposed Rule 21F-16(a) is not intended to prevent a professional or religious organization from responding to a breach of a recognized common-law or statutory privilege (e.g., psychiatrist-patient, priest-penitent) by one of its members.

Proposed Rule 21F-16(b) would clarify the staff's authority to communicate directly with whistleblowers who are directors, officers, members, agents, or employees of an entity that has counsel, and who have initiated communication with the Commission related to a potential securities law violation. The proposed rule would make clear that the staff is authorized to communicate directly with these individuals without first seeking the consent of the entity's counsel. The objective of proposed Rule

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[82] See, e.g., In re JDS Uniphase Corp. Sec. Litig., 238 F.Supp.2d 1127, 1137 (N.D.Cal.2002) ("To the extent that [the confidentiality] agreements preclude former employees from assisting in investigations of wrongdoing that have nothing to do with trade secrets or other confidential business information, they conflict with public policy in favor of allowing even current employees to assist in securities fraud investigations."); Chambers v. Capital Cities/ABC, 159 F.R.D. 441, 444 (S.D.N.Y.1995) (holding that "it is against public policy for parties to agree not to reveal ... facts relating to alleged or potential violations of [federal] law").

21F-16 is to implement several important policies inherent in Section 21F in a manner consistent with the state bar ethics rules governing the professional responsibilities of lawyers.

Every jurisdiction that regulates the professional responsibility of lawyers has adopted some variation of ABA Model Rule 4.2, which provides: "In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order."[83]

In the context of organizational entities represented by lawyers,[84] a difficulty in applying the various state versions of ABA Model Rule 4.2 is identifying those actors within the entity – such as directors or officers – that are the embodiment of the represented entity such that the proscription against contact applies.[85] This is so in part

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[83] MODEL RULES OF PROF'L CONDUCT R. 4.2. The primary purpose of ABA Model Rule 4.2 is to protect the attorney-client relationship and to protect represented persons, in the absence of their lawyers, from being taken advantage of by lawyers who are not representing their interests.

[84] See generally Upjohn Co. v. United States, 449 U.S. 383 (1981).

[85] Comment 7 to ABA Model Rule 4.2 addresses this issue:

> In the case of a represented organization, this Rule prohibits communications with a constituent of the organization who supervises, directs or regularly consults with the organization's lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability. Consent of the organization's lawyer is not required for communication with a former constituent. If a constituent of the organization is represented in the matter by his or her own counsel, the consent by that counsel to a communication will be sufficient for purposes of this Rule. Compare Rule 3.4(f). In communicating with a current or former constituent of an organization, a lawyer must not use methods of obtaining evidence that violate the legal rights of the organization.

because the various state bar ethics rules have differing definitions of which organizational constituents are covered by Rule 4.2.[86]

As explained above, however, Section 21F of the Exchange Act evinces a Congressional purpose to facilitate the disclosure of information to the Commission relating to potential securities law violations and to preserve the confidentiality of those who do so.[87] This Congressional policy would be significantly impaired were the Commission required to seek the consent of an entity's counsel before speaking with a whistleblower who contacts us and who is a director, officer, member, agent, or employee of the entity. Similarly, whistleblowers falling within these categories could be less inclined to report possible securities law violations if they believed there was a risk that the Commission staff might be required to request consent of the entity's counsel – thus disclosing the whistleblower's identity – before speaking to him or her.

For this reason, Section 21F necessarily authorizes the Commission to communicate directly with these individuals without first obtaining the consent of the entity's counsel. Proposed Rule 21F-16(b) would clarify this authority by providing that, in the context of whistleblower-initiated contacts with the Commission, all discussions with a director, officer, member, agent, or employee of an entity that has counsel are "authorized by law"[88] and, will therefore not require consent of the entity's counsel as might otherwise be required by rules of professional conduct.[89]

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[86] Comment 5 to the ABA Model Rule 4.2 specifically carves out a potential exception for "investigative activities of lawyers representing governmental entities, directly or through investigative agents, prior to the commencement of criminal or civil enforcement proceedings." The commentary, and most state professional responsibility rules, do not specify which governmental investigative activities are exempt.

[87] See, e.g., Exchange Act Section 21F (b)-(d) and (h), 15 U.S.C 78u-6 (b)-(d) and (h).

[88] As noted, ABA Model Rule 4.2 allows for contacts with represented persons without the consent of the person's lawyer if such contacts are "*authorized by law*." Every state bar ethics rules, in

Request for Comment: We request comment on whether the provisions dealing with whistleblowers' communications with the Commission staff provided in Proposed Rule 21F-16 are appropriate.

40. Should these provisions be narrowed and, if so, why and in what manner? Would these provisions encourage whistleblowers to provide information to the Commission regarding potential securities law violations? Are there additional measures that the Commission could consider to encourage and facilitate whistleblowers' communications with Commission staff?

41. Should the Commission consider rules to address other potential issues that may arise from state bar professional responsibility rules when the Commission staff receives information about potential securities law violations from whistleblowers? For example, are there circumstances where the staff's receipt of information from whistleblowers potentially conflicts with the state bar professional responsibility rules that are modeled on ABA Model Rules of Professional Responsibility 4.4(a) and 8.4(a)? If so, should the Commission consider promulgating rules to address these potential conflicts?

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accordance with ABA Model Rule 4.2, has some variation of an authorized by law exception. Thus, in the context of communications initiated by a whistleblower who is also the director, officer, member, agent, or employee of an entity that has counsel, the proposed rule would make clear that contacts and communications between these individuals and the staff are "authorized by law."

89 The proposed rule is not intended, and will not be used, to obtain otherwise privileged information about the entity. See SEC Division of Enforcement Manual § 3.3.1.

III. GENERAL REQUEST FOR COMMENT

We request and encourage any interested person to submit comments on any aspect of our Proposed Rules. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

In addition, the Commission is seeking comment on whether it should promulgate rules regarding the interpretation or implementation of the anti-retaliation provisions of Section 21(h) of the Exchange Act. If so, what specific rules should the Commission consider promulgating?

42. Should the anti-retaliation protections set forth in Section 21F(h)(1) of the Exchange Act be applied broadly to any person who provides information to the Commission concerning a potential violation of the securities laws, or should they be limited by the various procedural or substantive prerequisites to consideration for a whistleblower award? Should the application of the anti-retaliation provisions be limited or broadened in any other ways? For example, should the Commission consider promulgating a rule to exclude frivolous or bad faith whistleblower claims from the protections afforded by the anti-retaliation provisions? If so, what rules should be adopted to address these problems?

43. Are there rule proposals that the Commission should consider promulgating to ensure that the anti-retaliation provisions are not used to protect employees from otherwise appropriate employment actions (i.e.,

employment actions that are not based on reporting potential securities law violations)?

IV. PAPERWORK REDUCTION ACT

Certain provisions of the proposed rule contain "collection of information" requirements within the meaning of the Paperwork Reduction Act ("PRA") of 1995.[90] An agency may not sponsor, conduct, or require a response to an information collection unless a currently valid Office of Management and Budget ("OMB") control number is displayed. The Commission is submitting the proposed collections of information to OMB for review in accordance with the PRA.[91] The titles for the collections of information are: (1) Form TCR (Tip, Complaint or Referral), (2) Form WB-DEC (Declaration Concerning Original Information Provided Pursuant to § 21F of the Securities Exchange Act of 1934), and (3) Form WB-APP (Application for Award for Original Information Provided Pursuant to § 21F of the Securities Exchange Act of 1934). Under Proposed Rules 21F-9, 10, and 11, all three proposed forms would be necessary to implement Section 21F of the Exchange Act; the forms allow a whistleblower to provide information to the Commission and its staff regarding (i) potential violations of the securities laws and (ii) the whistleblower's eligibility for and entitlement to an award.

A. Summary of Collection of Information

Proposed Form TCR, submitted pursuant to Proposed Rule 21F-9, would request the following information:

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90 44 U.S.C. 3501 et seq.

91 44 U.S.C. 3507(d) and 5 CFR 1320.11.

(1) Background information regarding the person submitting the TCR, including the person's name contact information, and occupation;

(2) If the person is represented by an attorney, the name and contact information for the person's attorney (in cases of anonymous submissions the person must be represented by an attorney);

(3) Information regarding the person or entity that is the subject of the tip, complaint or referral, including contact information;

(4) Information regarding the tip, complaint or referral, including the date of occurrence of the event being described, whether the person is complaining about an entity with which he is or was associated as an officer, director, employee, consultant or contractor, whether the person has taken any prior actions regarding his complaint, facts in support of the allegations, any additional relevant information, a description of all supporting materials, an explanation of why the allegations described constitute a violation of the federal securities laws, and, if relevant, the name of the issuer, and the name and type of security or investment involved;

(5) A description of how the person submitting the original information learned about and/or obtained the information submitted and, if any information was obtained from a public source, a description of such source.

Proposed Form WB-DEC, submitted pursuant to Proposed Rule 21F-9, would require the following information:

(1) Background information regarding the person submitting the TCR, including the person's name and contact information;

(2) If the person is represented by an attorney, the name and contact information for the attorney (in cases of anonymous submissions the person must be represented by an attorney);

(3) Details concerning the tip or complaint, including (A) the manner in which the information was submitted to the SEC, (B) the TCR number (required if the person submitted his information through the SEC website) and date submitted to the SEC, (C) the individual or entity to which the tip, complaint or referral relates, (D) whether the person or his counsel has had communications with the SEC concerning his matter, (E) the relevant SEC staff member with whom they communicated, and (F) if the person or his counsel provided the information to another agency or organization, the details of that communication, and the name and contact information for the point of contact at the agency or organization, if known;

(4) A certification that the person submitting the original information: (A) is not, or was not at the time the person acquired the original information submitted to the Commission, a member, officer or employee of (i) the Securities and Exchange Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision; (ii) the

Department of Justice; (iii) the Public Company Accounting Oversight Board; (iv) any law enforcement organization; (v) any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board; or (vi) a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in Section 3(a)(52) of the Exchange Act of 1934, 15 U.S.C. 78c(a)(52); (B) did not gain the information through the performance of an engagement required under the securities by an independent public accountant; (C) did not provided the information pursuant to a cooperation agreement with the SEC or another agency or organization; (D) is not a spouse, parent, child, or sibling of a member or employee of the Commission, and does not reside in the same household as a member or employee of the Commission; (E) did not acquire the information from any person described in Subsection (4)(A) through (D) above; (F) is not currently a subject or target of a criminal investigation, or has not been convicted of a criminal violation in connection with the information upon which the application for the award is based; and (G) provided the information before he (or anyone representing him) received any request, inquiry or demand from the SEC, Congress, or any other federal, state or local authority, or any self regulatory organization, or the Public Company Accounting Oversight Board;

(5) A declaration, signed under penalty of perjury under the laws of the United States, that the information provided to the Commission pursuant to Proposed Rule 21F-9 of this Subpart is true, correct and complete to the best of the person's knowledge, information and belief; and

(6) A counsel certification, certifying that the attorney has verified the identity of the whistleblower who completed Form WB-DEC by viewing the whistleblower's valid, unexpired government issued identification, reviewed the whistleblower's Form WB-DEC for completeness and accuracy, and will retain for his records an original, signed copy of the Form WB-DEC completed by the whistleblower.

Proposed Form WB-APP, submitted pursuant to Proposed Rule 21F-10, would require the following information:

(1) The applicant's name, address and contact information;

(2) The applicant's social security number, if any;

(3) If the person is represented by an attorney, the name and contact information for the attorney (in cases of anonymous submissions the person must be represented by an attorney);

(4) Details concerning the tip or complaint, including (A) the manner in which the information was submitted to the SEC, (B) the subject of the tip, complaint or referral, (C) the TCR number, and (D) the date the TCR was submitted to the SEC;

(5) Information concerning the Notice of Covered Action to which the claim relates, including (A) the date of the Notice, (B) the Notice number, and (C) the Case name and number;

(6) For related actions, (A) the name and contact information for the agency or organization to which the person provided the original information; (B) the date the person provided his information, (C) the date the agency or organization filed the related action, (D) the case name and number of the related action, and (E) the name and contact information for the point of contact at the agency or organization, if known;

(7) A certification of the person's eligibility to receive an award as described in Subsection (4) concerning Form WB-DEC above;

(8) An explanation of the reasons that the person believes he is entitled to an award in connection with his submission of information to the Commission, or to another agency in a related action including any additional information and supporting documents that may be relevant in light of the criteria for determining the amount of an award set forth in Proposed Rule 21F-6 of this subpart, and any supporting documents; and

(9) A declaration under penalty of perjury under the laws of the United States that the information provided in Form WB-APP is true, correct and complete to the best of the person's knowledge, information and belief.

B. Proposed Use of Information

The collection of information on proposed Forms TCR, WB-DEC and WB-APP would be used to permit the Commission and its staff to collect information from whistleblowers regarding alleged violations of the federal securities laws and to determine claims for whistleblower awards.

C. Respondents

The likely respondents to proposed Forms TCR and WB-DEC would be those individuals who alone, or jointly with others, have provided the Commission staff with information relating to a potential violation of the securities laws, and those who wish to be eligible for whistleblower awards under this Subpart, respectively.

The likely respondents to proposed Form WB-APP would be those individuals who have provided the Commission staff with information relating to a potential violation of the securities laws by filing Forms TCR and WB-DEC signed under penalty of perjury, and who believe they are entitled to an award under this Subpart.

D. Total Annual Reporting and Recordkeeping Burden

i. Proposed Form TCR

The Commission estimates that it would receive approximately 30,000 completed Forms TCR and electronic submissions through the Electronic Data Collection System each year.[92] Of those 30,000 submissions, the Commission estimates that it would receive approximately 3,000 Forms TCR each year.[93] Each respondent would submit

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92 This number is a staff estimate based upon the volume of tips, complaints or referrals received by the Commission on a monthly basis during the past year. The staff believes that the volume of tips, complaints and referrals the Commission has received more recently, and particularly in the months since the passage of Dodd-Frank, provides a more accurate basis for estimating future volumes.

93 This number is a staff estimate based upon the expectation that roughly 10 percent of all tips received by the Commission would be submitted in hard copy on proposed Form TCR. The staff

only one Form TCR and would not have a recurring obligation. The Commission also estimates that it will take a whistleblower, on average, one hour to complete Form TCR. The completion time will depend largely on the complexity of the alleged violation and the amount of information the whistleblower possesses in support of the allegations. As a result, the Commission estimates that the estimated annual PRA burden of Form TCR is 3,000 hours.

ii. Proposed Form WB-DEC

Each whistleblower who has completed a Form TCR or made an electronic submission of information through the Electronic Data Collection System and wishes to be eligible for an award under the Program would be required to provide a Form WB-DEC to the Commission. The Commission estimates that it would receive a Form WB-DEC in roughly 50 percent of the cases in which the Commission receives a Form TCR or an electronic submission of information.[94] As noted above, the Commission estimates that it would receive approximately 30,000 combined electronic submissions and submission on Form TCR each year. Thus, the Commission estimates that it would receive approximately 15,000 Forms WB-DEC each year. Each respondent would submit only one Form WB-DEC and would not have a recurring obligation. The Commission also estimates that it would take a whistleblower, on average, 0.5 hours to

anticipates that most whistleblowers would elect to submit their information electronically. The electronic submission of information would provide whistleblowers with increased ease of use and will allow whistleblowers to submit more detailed information in roughly the same amount of time it would take them to complete a hard copy Form TCR. Moreover, the Commission should be able to use the information submitted electronically more effectively and efficiently. For example, the Commission will be able to conduct electronic searches of information without first having to convert the data into an electronic format.

[94] This number is a staff estimate. Because this is a new program, the staff does not have prior relevant data on which it can base its estimate.

complete Form WB-DEC. As a result, the Commission estimates that the annual PRA burden of Form WB-DEC is 7,500 hours.

iii. Proposed Form WB-APP

Each whistleblower who believes that he is entitled to an award because he provided original information to the Commission that led to successful enforcement of a covered judicial or administrative action, or a related action, would be required to submit a Form WB-APP to be considered for an award. A whistleblower could only submit a Form WB-APP after there has been a "Notice of Covered Action" published on the Commission's website pursuant to Proposed Rule 21F-10. The Commission estimates that it would post approximately 130 such Notices each year.[95] The Commission then estimates that it would receive approximately 117 Forms WB-APP each year.[96] The Commission also estimates that it would take a whistleblower, on average, two hours to complete Form WB-APP. The completion time would depend largely on the complexity of the alleged violation and the amount of information the whistleblower possesses in support of his application for an award. As a result, the Commission estimates that the annual PRA burden of Form WB-APP is 234 hours.

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[95] This number is a staff estimate based upon the average number of actions during the past five years in which the Commission recovered monetary amounts, including penalties, disgorgement or prejudgment interest, in excess of $1,000,000 and the assumption that there should be an increase (roughly 30 percent) in the number of such actions as a result of the whistleblower program.

[96] This number is a staff estimate based upon several expectations: first, that the Commission would receive Forms WB-APP in approximately 30 percent of cases in which it posts a Notice of Covered Action because we expect that we will continue to bring a substantial number of enforcement cases that are not based on whistleblower information; and second, that we will receive approximately 3 Forms WB-APP in each of those cases. Because this is a new program, the staff does not have prior relevant data on which it can base these estimates.

iv. Involvement and Cost of Attorneys

Under the Proposed Rules, a whistleblower who discloses his identity may elect, and an anonymous whistleblower is required, to retain counsel to represent the whistleblower in the Whistleblower Program. The Commission expects that in most of those instances the whistleblower's counsel will complete, or assist in the completion, of some or all of the required forms on behalf of the whistleblower. The Commission also expects that in the vast majority of cases in which a whistleblower is represented by counsel, the whistleblower will enter into a contingency fee arrangement with counsel, providing that counsel will be paid for the representation through a fixed percentage of any recovery by the whistleblower under the Program. Thus, most whistleblowers will not incur any direct, quantifiable expenses for attorneys' fees for the completion of the required forms.

The Commission anticipates that a small number of whistleblowers (no more than five percent of all whistleblowers) will enter into hourly fee arrangements with counsel.[97] In those cases, a whistleblower will incur direct expenses for attorneys' fees for the completion of the required forms. To estimate those expenses, the Commission makes the following assumptions:

(i) The Commission will receive approximately 3,000 Forms TCR, 15,000 Forms WB-DEC, and 117 Forms WB-APP annually[98];

(ii) Whistleblowers will pay hourly fees to counsel for the submission of approximately 150 Forms TCR, 750 Forms WB-DEC, and 6 Forms WB-APP annually;[99]

97 This estimate in based, in part, on the Commission's belief that most whistleblowers likely will not retain counsel to assist them in preparing the forms.

98 The bases for these assumed amounts are explained in Sections V.D.i., V.D.ii. and V.D.iii. above.

99 These amounts are based on the assumption, as noted above, that no more than 5 percent of all whistleblowers will be represented by counsel pursuant to an hourly fee arrangement. The estimate of

(iii) Counsel retained by whistleblowers pursuant to an hourly fee arrangement will charge on average $400 per hour[100]; and

(iv) Counsel will bill on average: (i) 2 hours to complete a Form TCR, (ii) .5 hours to complete a Form WB-DEC, and (iii) 10 hours to complete a Form WB-APP.[101]

Based on those assumptions, the Commission estimates that each year whistleblowers will incur the following total amounts of attorneys' fees for completion of the Whistleblower Program forms: (i) $120,000 for the completion of Form TCR; (ii) $150,000 for the completion of Form WB-DEC; and (iii) $24,000 for the completion of Form WB-APP.

E. <u>Mandatory Collection of Information</u>

A whistleblower would be required to complete either a Form TCR or submit his information electronically and to complete both Forms WB-DEC and WB-APP to qualify for a whistleblower award.

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the number of Forms TCR submitted by attorneys on behalf of whistleblowers may turn out to be high because it is likely that most attorneys will submit tips electronically, rather than use the hard-copy Form TCR. However, in the absence of any historical data to rely upon, the Commission assumes that attorneys will submit hard-copy Forms TCR in the same percentages as all whistleblowers.

100 The Commission uses this hourly rate for estimating the billing rates of securities lawyers for purposes of other rules. Absent historical data for the Commission to rely upon in connection with the whistleblower program, the Commission believes that this billing rate estimate is appropriate, recognizing that some attorneys representing whistleblowers may not be securities lawyers and may charge different average hourly rates.

101 The Commission expects that counsel will likely charge a whistleblower for additional time required to gather from the whistleblower or other sources relevant information needed to complete Forms TCR and WB-APP. Accordingly, the Commission estimates that on average counsel will bill a whistleblower two hours for the completion of Form TCR and ten hours for completion of Form WB-APP (even though the Commission estimates that a whistleblower will be able to complete Form TCR in one hour and Form WB-APP it two hours).

F. Confidentiality

As explained above, the statute provides that the Commission must maintain the confidentiality of the identity of each whistleblower, subject to certain exceptions. Section 21F(h)(2) states that, except as expressly provided:

- [T]he Commission and any officer or employee of the Commission shall not disclose any information, including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower, except in accordance with the provisions of section 552a of title 5, United States Code, unless and until required to be disclosed to a defendant or respondent in connection with a public proceeding instituted by the Commission [or certain specific entities listed in paragraph (C) of Section 21F(h)(2)].

Section 21F(h)(2) also allows the Commission to share information received from whistleblowers with certain domestic and foreign regulatory and law enforcement agencies. However, the statute requires the domestic entities to maintain such information as confidential, and requires foreign entities to maintain such information in accordance with such assurances of confidentiality as the Commission deems appropriate.

In addition, Section 21F(d)(2) provides that a whistleblower may submit information to the Commission anonymously, so long as the whistleblower is represented by counsel. However, the statute also provides that a whistleblower must disclose his or her identity prior to receiving payment of an award.

Request for Comment: Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comments to:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the Commission's estimate of burden of the proposed collections of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- Evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The Commission requests comment and supporting empirical data on the burden and cost estimates for the proposed rule, including the costs that potential whistleblowers may incur.

Persons wishing to submit comments on the collection of information requirements of the proposed rule 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 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. S7-33-10. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-33-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy , 100

F Street, NE, Washington, DC 20549-0213. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication.

V. COST- BENEFIT ANALYSIS

A. Introduction

The Commission is proposing rulemaking to implement the provisions of new Section 21F of the Exchange Act, added by Section 922 of Dodd-Frank to provide additional incentives and protections to whistleblowers who provide information relating to violations of the securities laws. Before Dodd-Frank, the Commission regularly received tips, complaints and referrals concerning securities law violations. Tips have provided, and continue to provide, the Commission with valuable information regarding potential violations of the federal securities laws, as well as information about new market trends, products or practices that may help the agency in support of its mission.

In establishing the new whistleblower program in Section 21F, Congress sought to create and enhance incentives and protections for whistleblowers providing information leading to successful Commission enforcement actions.[102] Although whistleblowers can be motivated by other factors,[103] the statute creates new and substantial financial incentives for individuals to provide the Commission with information regarding potential violations of the federal securities laws. The statutory

102 See S. Rep. No. 111-176 at 110 (2010) ("The Whistleblower Program aims to motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated the securities laws...").

103 The incentives to whistleblowers include not only the monetary award, but also a desire to cleanse the conscience or prevent harm to others. See Anthony Heyes and Sandeep Kapur, An Economic Model of Whistleblower Policy, 25 J.L. ECON. & ORG. 157 at 159, 164, 171.

requirements for an award -- that whistleblowers are entitled to an award only if they voluntarily provide original information, and then only if that information leads to a successful enforcement action -- are designed to encourage whistleblowers to provide high-quality tips and continuing cooperation. Moreover, the statutory provisions permitting anonymous submissions and prohibiting retaliation against whistleblowers should encourage submissions from employees of companies possibly engaged in misconduct.[104] Overall, enhanced whistleblower incentives should likely result in more frequent reporting of misconduct, which will result in greater deterrence of securities law violations and more effective and efficient enforcement on the part of the Commission.[105]

The incentives created by the statute also present some significant challenges. First, the statute could provide financial incentives for attorneys and others to breach the attorney-client privilege in order to seek an award. This would interfere with the ability of companies and individuals to share information with an attorney while seeking legal advice. Second, the statute could provide financial incentives for employees to report violations to the Commission rather than follow their employers' internal compliance procedures. This could undermine the effectiveness of internal compliance programs. Third, the statute could result in an increase in spurious allegations, forcing

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104 Specifically, Dodd-Frank makes it unlawful for any employer to "discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment." The statute also provides that any individual who alleges retaliation under the Act may bring an action in the appropriate federal district court. Moreover, the statute allows any individual to submit information anonymously through a lawyer. As a result, in many cases, employers will be unaware when their employees submit tips to the Commission.

105 See Alexander Dyck et al., "Who Blows the Whistle on Corporate Fraud?" working paper (2009) (reporting that "having access to . . . monetary rewards has a significant impact on the probability a stakeholder becomes a whistleblower."), available at http://faculty.chicagobooth.edu/luigi.zingales/research/papers/whistle.pdf.

innocent companies and individuals to incur substantial cost to investigate into and defend against the false allegations. Finally, the statute could result in award payments to individuals who have violated the federal securities laws. This could result in perverse incentives by potentially encouraging violations of the law.

Although many of the requirements of the whistleblower award program are established by the statute, Congress required the Commission to issue rules and regulations necessary or appropriate to implement the Program. In that regard, the Commission has exercised its discretion in this rulemaking to propose rules that contain several key definitional or interpretive provisions that help define the scope of the program, and procedures that whistleblowers will be required to follow to submit information to the Commission and to apply for awards under the Program, as described below.

Proposed Rule 21F-4 defines three terms -- (i) "Voluntary Submission of Information," (ii) "Independent Knowledge," and (iii) "Information that Leads to Successful Enforcement" – that together play a significant role in determining whether a whistleblower is eligible for an award. Proposed Rule 21F-4(a) defines "Voluntary Submission of Information" to state that a whistleblower must provide information to the Commission prior to receiving a request from the Commission or other relevant authority. The proposed definition also provides that a whistleblower "will be considered to have received a request, inquiry or demand if documents or information from [the whistleblower] are within the scope of a request, inquiry, or demand that [the whistleblower's] employer receives unless, after receiving the documents or information from [the whistleblower, the] employer fails to provide [the whistleblower's] documents or information to the requesting authority in a timely manner." This proposed definition requires that, to be eligible for an award, a whistleblower or his representative provide his information regarding a potential violation before he or his company receives a request, inquiry or demand from the Commission or other investigatory authority.

Proposed Rule 21F-4(b)(4) states that a whistleblower will not be considered to have provided "independent knowledge" if "[the whistleblower] obtained the knowledge or the information upon which [his] analysis is based: (i) through a communication that was subject to the attorney-client privilege, unless the disclosure of that information is otherwise permitted by §205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise; (ii) as a result of the legal representation of a client on whose behalf [the whistleblower's] services, or the services of [the whistleblower's] employer or firm, have been retained, and [the whistleblower] seek[s] to use the information to make a whistleblower submission for [his] own benefit unless disclosure is authorized by §205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise; (iii) through the performance of an engagement required under the securities laws by an independent public accountant, if that information relates to a violation by the engagement client or the client's directors, officers or other employees; (iv) because [the whistleblower was] a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity, and the information was communicated to [the whistleblower] with the reasonable expectation that [he] would take steps to cause the entity to respond appropriately to the violation, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith; or (v) otherwise from or through an entity's legal, compliance, audit or other similar functions or processes for identifying, reporting and addressing potential non-compliance with law, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith; (vi) [b]y a means or in a manner that violates applicable federal or state criminal law."

Proposed Rule 21F-4(c) defines "Information that Leads to Successful Enforcement" such that a whistleblower is only entitled to an award if (i) the whistleblower provides information that causes the staff "to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning new or different conduct as part of a current examination or investigation" and the information "significantly contributed to the success of the action" or (ii) the whistleblower provides information regarding "conduct that was already under examination or investigation" and the information "would not otherwise have been obtained and was essential to the success of the action."

Proposed Rule 21F-6 sets forth the criteria for determining the amount of the award to be made to a whistleblower. Three of the stated criteria are derived from the statute, but the proposed rule also includes a fourth factor: whether the award otherwise enhances the Commission's ability to enforce the federal securities laws, protect investors, and encourage the submission of high quality information from whistleblowers.

Proposed Rule 21F-8 states additional criteria for eligibility for an award. A number of these are derived from the statute, but the proposed rule also provides that a whistleblower may be required to provide various types of cooperation to the staff or enter a confidentiality agreement. In addition to certain statutory exclusions from eligibility, the proposed rule also excludes any person who is, or was at the time of acquiring information, a member, officer, or employee of a foreign government or certain other foreign entities.

Proposed rules 21F-9, 10, and 11 set forth the procedures for submitting original information and making a claim for an award. First, pursuant to Proposed Rule 21F-9(a), a whistleblower must complete either Form TCR or submit information electronically through the Electronic Data Collection System. Second, pursuant to Proposed Rule 21F-9(b), a whistleblower must complete and submit Form WB-DEC, sworn under penalty of perjury. A whistleblower wishing to submit a hard-copy Form TCR would be required to submit Form WB-DEC at the same time as he or she submits a Form TCR. A whistleblower wishing to submit information electronically could submit Form WB-DEC electronically or in hard copy within 30 days of the Commission's receipt of the whistleblower's electronic submission of information.

The proposed rules also require potential whistleblowers to complete a third form in the claims phase to establish potential eligibility for an award under the Program. Pursuant to Proposed Rules 21F-10 and 21F-11, a whistleblower must complete Form WB-APP to apply for an award for a covered judicial or administrative action by the Commission or a related action.

Proposed Rule 21F-15 would provide, that "[i]n determining whether the required $1,000,000 threshold has been satisfied ... for purposes of making any award [to a whistleblower], the Commission will not take into account any monetary sanctions that the whistleblower is ordered to pay." Likewise, Proposed Rule 21F-15 would provide that the Commission will not take into account any monetary sanctions "that are ordered against any entity whose liability is based substantially on conduct that the whistleblower directed, planned, or initiated." Proposed Rule 21F-15 further would provide that "if the Commission determines that a whistleblower is eligible for an award, any amounts that the whistleblower or such an entity pay in sanctions as a result of the action or related actions will not be included within the calculation of the amounts collected for purposes of making payments [to the whistleblower]."

Proposed Rule 21F-16(b) states that if a whistleblower who is a director, officer, member, agent, or employee of an entity that has counsel has initiated communications with the Commission relating to a potential securities law violation, the staff is authorized to communicate directly with the whistleblower regarding the subject of the communication without seeking the consent of the entity's counsel.

We are sensitive to the costs and benefits of our rules. As discussed above, many of the key elements of the whistleblower program have been established by the statute, and our proposed rules implementing the statute in some respects largely track statutory provisions. The cost-benefit analysis that follows focuses on the benefits and costs related to those rules on which we exercised discretion, and not on the overall benefits and costs of the statutory regime for whistleblower incentives and protections.

B. Benefits

We have sought to structure the definitions in Proposed Rule 21F-4 so as to encourage whistleblowers to provide the Commission with high-quality information – tips indicating a high likelihood of a substantial securities violation – that we might not otherwise have received in a timely manner.

We have also sought to strike the right balance in defining terms so as not to be overly restrictive or overly broad. Overly restrictive definitions could render the program ineffective as only a small fraction of potential tippers and complainants would qualify for monetary rewards. By contrast, overly broad definitions could result in inefficient use of the Investor Protection Fund—especially in cases in which the Commission already possesses information sufficient to bring a successful enforcement action. From an economic perspective of enforcement, the primary value of the Whistleblower Program is reduced economic cost of collecting necessary information early on and before the Commission can obtain the information on its own. The primary economic cost of the Program includes the out-of-pocket costs as well as opportunity costs, which include losses due to fraud and costs of enforcement. Consequently, the proposed definitions together should provide benefits in that they create strong incentives, in the form of eligibility for a monetary award, for whistleblowers to provide information to the Commission or other authorities and to provide the information early, rather than waiting to receive a request or inquiry from a relevant authority.[106] This may be a particular result of the definition of "voluntary submission of information" in Proposed Rule 21F-4; that rule would deny eligibility for an award to a whistleblower who has valuable information regarding potential violations of the federal securities laws if he has received a subpoena or other request relating to the alleged violations in question – even if the subpoena or request does not call for the production of the valuable information.

106 As also noted above, the proposed definitions are consistent with the legislative intent behind the Act. See S. Rep. No. 111-176 at 110 (2010) ("The Whistleblower Program aims to motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated the securities laws…").

The definition of "information that leads to successful enforcement" in Proposed Rule 21F-4(c) may also have the benefit of encouraging submission of high-quality information that is particularly useful to successful enforcement actions. By requiring that the whistleblower provide information that either "significantly contributed" to the success of an action (if the whistleblower has provided information that has led the Commission to begin investigating that matter), or that "would not otherwise have been obtained and was essential to the success of the action" (if the information related to a matter already under examination or investigation), this proposed definition should help to screen out less significant tips from eligibility for awards, and as a result, lead to a more efficient use of Commission resources and the Investor Protection Fund. Further, by requiring this level of connection to the success of an action, the proposed rule may have the benefit of encouraging whistleblowers to provide more and better information. Similarly, the criterion contained in Proposed Rule 21F-6(d), which allows the Commission to consider its ability to enforce the securities laws, protect investors and encourage high quality information as a criterion in determining the amount of an award to be paid, may have the benefit of encouraging better quality information, thus furthering effective enforcement and investor protection.

As noted, the Commission recognizes that whistleblower awards, as provided for by the statute, could potentially create incentives for employees of companies to submit information regarding potential violations to the Commission rather than to compliance personnel or through compliance procedures.[107] This in turn could undermine the

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[107] See Rewarding Whistleblowers: The Costs and Benefits of an Incentive-Based Compliance Strategy, Robert Howse and Ronald J. Daniels, University of Pennsylvania Departmental Papers (School of Law), 1995, page 527.

effectiveness of internal company compliance processes. We have sought to address and mitigate that concern, in part, through the proposed definition of "Independent Knowledge" in Proposed Rule 21F-4(b)(2). While the restrictions in this definition would limit the pool of eligible whistleblowers and thereby reduce the number of potentially useful informants, the definition could have the benefit of limiting potential interference with the integrity of corporate compliance programs of companies, which could reduce the overall efficiency of day-to-day compliance operations.

As with the proposed definition of "Independent Knowledge" addressed above, the Commission believes that the procedures relating to the timing of the submission of "original information" could mitigate costs that the Whistleblower Program might impose on companies and their compliance programs and procedures. Importantly, the proposed procedures will allow a potential whistleblower to provide information to legal or compliance personnel within his or her company, and wait for up to 90 days, without compromising his or her eligibility for an award under the Program. This would also allow a company a reasonable period of time to investigate and respond to potential securities laws violations (or at least begin an investigation) prior to reporting them to the Commission or an appropriate regulator. Therefore, this approach is consistent with the Commission's efforts to encourage companies to create and implement strong corporate compliance programs.

One economic benefit of providing this grace period is that the individual could be mistaken about securities laws, and the compliance personnel would likely be better informed about whether certain conduct constitutes a violation of securities laws. Without this grace period, individuals, regardless of whether their judgments regarding certain violations were correct, could be motivated to report a suspicious finding as soon as possible. The overall effect could be an overflow of noisy signals -- that is, a large number of tips of varying quality -- causing the Commission to incur costs to process and validate the information. Allowing for this proposed grace period, we believe, provides a mechanism by which some of those erroneous cases may be eliminated before reaching the Commission, without otherwise adversely affecting the incentives on the part of potential whistleblowers.

The Commission also recognizes that whistleblower awards could create incentives for attorneys or others to breach the attorney-client privilege by submitting tips disclosing privileged communications. The Commission has attempted to address this concern through the proposed definition of "Independent Knowledge," which excludes information obtained through communications protected by the attorney-client privilege. Thus, a whistleblower who submits such information would not have provided the Commission with "Original Information" and thus would not be eligible for an award. The benefit of this proposed definition is that it helps preserve and protect the integrity of the attorney-client privilege and removes financial incentive encouraging individuals to breach the privilege.

Proposed Rule 21F-8 may have the benefit of encouraging cooperation by whistleblowers, which should help the effectiveness and efficiency of Commission enforcement. Similarly, we believe that Proposed Rule 21F-15, on balance, will have the same result. We recognize that there is a cost associated with providing monetary awards to individuals who have engaged in securities violations. Yet, these individuals frequently have the most significant and relevant information that will aid in detecting and prosecuting sophisticated securities fraud schemes. By excluding from the award calculation any monetary sanctions that the whistleblower is ordered to pay or that are ordered against the entity whose liability is substantially derived from the whistleblower's conduct, the proposed rules limit the awards to highly culpable whistleblowers more than the awards to less culpable whistleblowers.

Likewise, Proposed Rule 21F-16(b), by authorizing communications between the Commission staff and a whistleblower without seeking consent of the counsel of an entity with whom the whistleblower is employed, is intended to have the benefit of encouraging whistleblowers to communicate with the Commission without the fear that their communications will lead to disclosure of their identity to their employer.

The procedures contained in the Proposed Rules should result in certain benefits. The Commission's objective in proposing these rules is to devise an efficient mechanism to implement the statutory whistleblower program that will allow the Commission to receive high-quality information regarding securities law violation in a timely, organized, useful manner. As an initial matter, the proposed procedures regarding the submission of information and the required Forms are designed to elicit from whistleblowers critical information regarding the potential violations at issue. The proposed Forms that would be required to provide clear and uniform guidance to whistleblowers regarding the information that the Commission deems necessary to investigate the potential violations and to determine eligibility for awards under the program.

In addition, the proposed requirement that whistleblowers must complete Form WB-DEC, under penalty of perjury, will encourage whistleblowers who wish to participate in the Whistleblower Program to submit truthful information and discourage them from submitting false information. As such, this procedure will allow the Commission to place greater reliance on the accuracy of information it receives from whistleblowers, which should allow the Commission to prioritize the review and investigation of that information more effectively and efficiently. The requirement should also mitigate the potential harm to companies and individuals that may be caused by false or spurious allegations of wrongdoing. In addition, the requirement that Form WB-DEC be submitted within 30 days of submission of the Form TCR is designed to provide staff with the opportunity to better evaluate the TCR in light of the fact that it is joined by a sworn statement regarding its accuracy. Accordingly, the Proposed Rules should result in a decrease in the amount of Commission resources devoted to false or unsubstantiated leads.[108]

Moreover, proposed Form WB-APP requires the submission of information that is necessary for the Commission to determine award eligibility. While requiring an additional form imposes a cost on potential whistleblowers, determining the appropriate level of award for each instance of qualified whistleblower is critical to successful implementation of the whistleblower rule. The Commission needs to collect pertinent information from the whistleblower to determine the strength of his case. This information will need to be evaluated in conjunction with the Commission's enforcement action to determine the significance of the whistleblower's contribution.

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108 Dyck et al. (2009). The staff reviews and evaluates all TCRs, regardless of whether they are accompanied by a whistleblower declaration. However, because the declaration would aid in assessing reliability, the staff may consider whether a whistleblower has submitted a declaration in prioritizing the investigation of TCRs and the allocation of the Division of Enforcement's limited resources.

In addition, the Commission has included procedural elements in the proposed rules to provide a fair process for consideration of whistleblower award claims, and, given the possibility of judicial review, to provide a clearly defined record on appeal. These procedures should also encourage greater participation in the program. While a monetary reward is typically not the sole motivation for potential whistleblowers, having a robust clearly described process for determining grants of monetary rewards should help incentivize those individuals who seek to benefit economically from providing information to the Commission.

C. Costs

The Proposed Rules may impose certain costs on prospective whistleblowers. As an initial matter, the procedures would require potential whistleblowers to complete certain forms to establish eligibility for an award under the Program. As noted above, the Commission recognizes that it will take time and effort on the part of whistleblowers to complete and submit the proposed forms. In addition, any whistleblower wishing to submit one of the required forms in hard copy would need to arrange for delivery and pay the postage or other delivery costs.

It is also possible that the proposed procedures could discourage some whistleblowers with valuable information from submitting their information to the Commission. Some prospective whistleblowers could find the procedures burdensome or confusing, and as a result, they might elect not to provide information to the Commission. In these Proposed Rules, the Commission has attempted to mitigate the potential for burden or confusion in the procedures, but such costs cannot be eliminated.

The 30-day time limit proposed for submitting a Form WB-DEC also imposes costs on whistleblowers in that it would require them to act within a certain period of time if they wish to be eligible for an award under the Program. The Commission has proposed the 30-day time limit based on a balance of those costs against the need to have the WB-DEC submitted close enough in time with the submission through the Electronic Data Collection System so that: (i) the Commission can track and tie together each submission through the electronic system with the related Form WB-DEC and (ii) the Commission will receive notice that a submission through the electronic system is a submission under the whistleblower program.

The proposed 90-day limit on submission of Form WB-DEC also would impose costs on whistleblowers in that it requires them to act within a certain period of time if they wish certain benefits under the Program. The Commission has proposed the 90 day time limit based on a balance of those costs against the concern that companies investigating allegations of potential securities law violations will view the time limit as the time they may wait before reporting violations to the Commission. To be clear, the Commission does not intend any time period in these Proposed Rules to inform companies on time limits for reporting violations to the Commission.

In addition, the definitional and scope provisions described above may also result in costs if they discourage potential whistleblowers from coming forward. As discussed above, the proposed definitions of "voluntary submission of information", "independent knowledge," and "information that leads to successful enforcement" together would result in heightening the standards for eligibility for an award. It is possible that restrictions from eligibility could in some cases discourage some whistleblowers from submitting potentially useful information.

In particular, the proposed definition of "voluntary submission of information" excludes from eligibility any whistleblower who has a legal obligation to provide the information regarding potential violations to the Commission. This element of the definition could result in instances in which the Commission does not receive important information regarding potential violations from a potential whistleblower – that is, situations where a potential whistleblower has a legal obligation to provide the information and does not, but he would have if eligible for an award.

Similarly, other types of ineligibility created by our proposed rules – for example, the provisions in Proposed Rule 21F-8 that exclude from eligibility certain foreign officials or individuals who obtain information from other categories of ineligible persons – may also cause those persons not to come forward with information in their possession about securities law violations. Although we have attempted to craft these rules to strike a balance that is consistent with the purposes of the statute, these provisions may result in some foregone opportunities for effective enforcement action.

> Request for Comments: We request comments and empirical data on all aspects of this cost-benefit analysis, including identification and quantification of any additional costs or benefits of, or suggested alternatives to, the proposed rule.

VI. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF COMPETITION AND CAPITAL FORMATION

Section 23(a)(2)[109] of the Securities Exchange Act of 1934 requires the Commission, in promulgating rules under the Exchange Act, to consider the impact that

[109] 15 U.S.C. 78w(a)(2).

any rule may have on competition and 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. Further, Section 3(f) of the Exchange Act[110] requires the Commission, when engaging in rulemaking where it 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 will promote efficiency, competition, and capital formation.

As with the cost-benefit analysis, we focus our consideration of burden on competition and promotion of competition and capital formation to the areas of these Proposed Rules over which the Commission has exercised discretion and do not consider the elements of the Whistleblower Program established by Congress.

In considering the impact on capital formation of our proposed rules, we consider the extent to which they affect allocation of capital and secondarily how they affect investors' choices of investments and portfolio allocations. For issuers, this includes considering the extent to which the rules foster an information environment and market structures that lead to securities prices based upon efficient allocation of capital. From this perspective, one of the issues that may affect capital formation in the economy is investor confidence in the sense of investors trusting in the fairness of financial markets, of which their perception of the effectiveness and comprehensiveness of the regulatory regime is an important part. If investors fear theft, fraud, manipulation, insider trading, or conflicted investment advice, their trust in the markets will be low, both in the primary market for issuance or in the secondary market for trading. This would increase the

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110 15 U.S.C. 78c(f).

cost of raising capital, which would impair capital formation – in the sense that it will be less than it would or should be if rules against such abuses were in effect and properly enforced and obeyed.

For reasons stated in the cost-benefit analysis, we believe the Proposed Rules would result in an efficient and effective implementation of the statutory whistleblower program. As such, we believe the Proposed Rules would serve to reduce potential securities law violations. As a result, investor reliance on the veracity of issuer filings with the Commission may increase incrementally, which would contribute to lowering the cost of raising capital generally. Those provisions in the Proposed Rules that are designed to promote and protect the use of corporate compliance programs would further the requirements of the Sarbanes-Oxley Act of 2002 and other statutory provisions that encourage or mandate such programs. Thus, we believe that we have structured the Proposed Rules so as to improve investor confidence in the market and therefore expect that the impact of the Proposed Rules on the efficiency of capital formation will be positive.

The Commission does not believe the elements of the proposed rules over which the Commission exercised discretion would impose any undue burdens on competition. The relevant market for competition analysis here is the market for securities issuers competing to raise capital from investors. Because the proposed rules are expected to further deterrence of financial fraud, there may be a general improvement in the fairness of competition for capital from investors – and consequently improvement in the ability of companies that abide by the law to compete with companies that do not. To the extent that the Proposed Rules impose costs on companies, many of these follow from the statutory mandate to implement the Whistleblower Program generally and are imposed on all companies. The Commission believes any costs associated with compliance with the proposed rules, as structured, would be limited and, therefore, would not impose undue burden on competition.

Furthermore, the Proposed Rules are structured to encourage the submission of high quality information regarding securities law violations in a manner that is effective and efficient. As a result of expected improvement in competition and expected increase in capital formation, we believe the Proposed Rules should generally increase the efficiency of the economy. In addition, the proposed rules should increase the efficiency by which the Commission's Enforcement program obtains information about potential securities law violations.

We request comment (including empirical data and other factual support) on whether the Proposed Rules, if adopted, would affect efficiency, competition, and capital formation.

VII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA),[111] the Commission solicits data to determine whether the proposed rule 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);
- A major increase in costs or prices for consumers or individual industries; or

111 Pub. L. No. 104-121, tit.II, 110 Stat. 857 (1996).

- Significant adverse effects on competition, investment or innovation.

Commentators should provide empirical data on (a) the potential annual effect on the economy; (b) any increase in costs or prices for consumers or individual industries; and (c) any potential effect on competition, investment or innovation.

VIII. REGULATORY FLEXIBILITY ACT CERTIFICATION

Section 603(a) of the Regulatory Flexibility Act[112] requires the Commission to undertake an initial regulatory flexibility analysis of the 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.[113]

Small entity is defined in 5 U.S.C. 601(6) to mean "small business," "small organization," and "small governmental jurisdiction" as defined in 5 U.S.C. 601(3) – (5). The definition of "small entity" does not include individuals. The Proposed Rules apply only to an individual, or individuals acting jointly, who provide information to the Commission relating to the violation of the securities laws. Companies and other entities are not eligible to participate in the Program as whistleblowers. Consequently, the persons that would be subject to the proposed rule are not "small entities" for purposes of the Regulatory Flexibility Act.

For the reasons stated above, the Commission certifies, pursuant to 5 U.S.C. 605(b), that the proposed rules and forms to implement the whistleblower provisions of Section 21F of the Exchange Act would not have a significant economic impact on a substantial number of small entities.

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112 5 U.S.C. 603(a).

113 5 U.S.C. 605(b).

IX. STATUTORY AUTHORITY

The Commission proposes the new rules and forms contained in this document under the authority set forth in Sections 3(b), 21F and 23(a) of the Exchange Act.

List of Subjects

17 CFR Parts 240 and 249

Securities

TEXT OF THE PROPOSED RULES

In accordance with the foregoing, 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 is amended by adding the following citation in numerical order 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, 78-i, 78j, 78j,-1, 78k, 78k-1, 78 *l*, 78m, 78n, 78 *o*, 78 *o*-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78 *ll*, 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.

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Section 240.21F is also issued under Pub. L. No. 111-203, §922(a), 124 Stat. 1841 (2010).

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2. By adding § 240.21F-1 through § 240.21F-16 to read as follows:

§ 240.21F-1 General.

Section 21F of the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78u-6), entitled "Securities Whistleblower Incentives and Protection," requires the Securities and Exchange Commission ("Commission") to pay awards, subject to certain limitations and conditions, to whistleblowers who provide the Commission with original information about violations of the federal securities laws. These rules describe the whistleblower program that the Commission has established to implement the provisions of Section 21F, and explain the procedures you will need to follow in order to be eligible for an award. You should read these procedures carefully because the failure to take certain required steps within the time frames described in these rules may disqualify you from receiving an award for which you otherwise may be eligible. Unless expressly provided for in these rules, no person is authorized to make any offer or promise, or otherwise to bind the Commission with respect to the payment of any award or the amount thereof. The Securities and Exchange Commission's Whistleblower Office administers our whistleblower program. Questions about the program or these rules should be directed to the SEC Whistleblower Office, 100 F Street, N.E., Washington, DC, 20549.

§ 240.21F-2 Definition of a Whistleblower.

(a) You are a whistleblower if, alone or jointly with others, you provide the Commission with information relating to a potential violation of the securities laws. A whistleblower must be an individual. A company or another entity is not eligible to be a whistleblower.

(b) The retaliation protections afforded to whistleblowers by the provisions of paragraph (h)(1) of Section 21F of the Exchange Act (15 U.S.C. 78u-6(h)(1)) apply irrespective of whether a whistleblower satisfies the procedures and conditions to qualify for an award. Moreover, for purposes of the anti-retaliation provision of paragraph (h)(1)(A)(i) of Section 21F, 15 U.S.C. 78u-6(h)(1)(A)(i), the requirement that a whistleblower provide "information to the Commission in accordance" with Section 21F (15 U.S.C. 78u-6) is satisfied if an individual provides information to the Commission that relates to a potential violation of the securities laws.

(c) To be eligible for an award, however, a whistleblower must submit original information to the Commission in accordance with the procedures and conditions described in § 240.21F-4, -8, and -9 of this chapter.

§ 240.21F-3 Payment of awards.

(a) Subject to the eligibility requirements described in § 240.21F-2 and § 240.21F-8 of this chapter, and to § 240.21F-14 of this chapter, the Commission will pay an award or awards to one or more whistleblowers who:

(1) Voluntarily provide the Commission

(2) With original information

(3) That leads to the successful enforcement by the Commission of a federal court or administrative action

(4) In which the Commission obtains monetary sanctions totaling more than $1,000,000.

The terms voluntarily, original information, leads to successful enforcement, action, and monetary sanctions are defined in § 240.21F-4 of this chapter.

(b) The Commission will also pay an award based on amounts collected in certain "related actions." A related action is a judicial or administrative action that is brought by:

(1) The Attorney General of the United States;

(2) An appropriate regulatory agency;

(3) A self-regulatory organization; or

(4) A state attorney general in a criminal case

and is based on the same original information that the whistleblower voluntarily provided to the Commission, and that led the Commission to obtain monetary sanctions totaling more than $1,000,000. The terms appropriate regulatory agency and self-regulatory organization are defined in § 240.21F-4 of this Chapter.

(c) In order for the Commission to make an award in connection with a related action, the Commission must determine that the same original information that the whistleblower gave to the Commission also led to the successful enforcement of the related action under the same criteria described in these rules for awards made in connection with Commission actions. The Commission may seek assistance and confirmation from the authority bringing the related action in making this determination. If the Commission determines that the criteria for an award are not satisfied, or if the Commission is unable to obtain sufficient and reliable information about the related action to make a conclusive determination, the Commission will deny an award in connection with the related action. Additional procedures apply to the payment of awards in related actions. These are described in § 240.21F-11 and § 240.21F-13.

(d) The Commission will not make an award to you for a related action if you have already been granted an award by the Commodity Futures Trading Commission ("CFTC") for that same action pursuant to its whistleblower award program under section 23 of the Commodity Exchange Act, 7 U.S.C. 26. Similarly, if the CFTC has previously denied an award to you in a related action, you will be collaterally estopped from relitigating any issues before the Commission that were necessary to the CFTC's denial.

§ 240.21F-4 Other Definitions.

(a) *Voluntary submission of information.*

(1) Your submission of information is made voluntarily within the meaning of § 240.21F of this chapter if you provide the Commission with the information before you or anyone representing you (such as an attorney) receives any request, inquiry, or demand from the Commission, the Congress, any other federal, state, or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information in your submission is relevant. If the Commission or any of these other authorities make a request, inquiry, or demand to you or your representative first, your submission will not be considered voluntary, and you will not be eligible for an award, even if your response is not compelled by subpoena or other applicable law.

(2) For purposes of this paragraph, you will be considered to have received a request, inquiry or demand if documents or information from you are within the scope of a request, inquiry, or demand that your employer receives unless, after receiving the

documents or information from you, your employer fails to provide your documents or information to the requesting authority in a timely manner.

(3) In addition, your submission will not be considered voluntary if you are under a pre-existing legal or contractual duty to report the securities violations that are the subject of your original information to the Commission or to any of the other authorities described in paragraph (1) of this section.

(b) *Original information*

(1) In order for your whistleblower submission to be considered original information, it must be:

(i) Derived from your independent knowledge or independent analysis;

(ii) Not already known to the Commission from any other source, unless you are the original source of the information;

(iii) Not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless you are a source of the information; and

(iv) Provided to the Commission for the first time after July 21, 2010 (the date of enactment of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*).

(2) Independent knowledge means factual information in your possession that is not derived from publicly available sources. You may gain independent knowledge from your experiences, communications and observations in your business or social interactions.

(3) Independent analysis means your own analysis, whether done alone or in combination with others. Analysis means your examination and evaluation of

information that may be generally available, but which reveals information that is not generally known or available to the public.

(4) The Commission will not consider information to be derived from your independent knowledge or independent analysis if you obtained the knowledge or the information upon which your analysis is based:

(i) Through a communication that was subject to the attorney-client privilege, unless disclosure of that information is otherwise permitted by § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise;

(ii) As a result of the legal representation of a client on whose behalf your services, or the services of your employer or firm, have been retained, and you seek to use the information to make a whistleblower submission for your own benefit, unless disclosure is authorized by § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise;

(iii) Through the performance of an engagement required under the securities laws by an independent public accountant, if that information relates to a violation by the engagement client or the client's directors, officers or other employees;

(iv) Because you were a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity, and the information was communicated to you with the reasonable expectation that you would take steps to cause the entity to respond appropriately to the violation, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith; or

(v) Otherwise from or through an entity's legal, compliance, audit or other similar functions or processes for identifying, reporting and addressing potential noncompliance with law, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith;

(vi) By a means or in a manner that violates applicable federal or state criminal law; or

(vii) From any of the individuals described in paragraphs (b)(4)(i) - (vi) of this section.

(5) The Commission will consider you to be an original source of the same information that we obtain from another source if the information satisfies the definition of original information and the other source obtained the information from you or your representative. In order to be considered an original source of information that the Commission receives from Congress, any other federal, state, or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board, you must have voluntarily given such authorities the information within the meaning of these rules. You must establish your status as the original source of information to the Commission's satisfaction. In determining whether you are the original source of information, the Commission may seek assistance and confirmation, from one of the other authorities described above, or from another entity (including your employer), in the event that you claim to be the original source of information that an authority or another entity provided to the Commission.

(6) If the Commission already knows some information about a matter from other sources at the time you make your submission, and you are not an original source of that information under paragraph (b)(5) of this section, the Commission will consider you an original source of any information you provide that is derived from your

independent knowledge or analysis and that materially adds to the information that the Commission already possesses.

(7) If you provide information to Congress, any other federal, state, or local authority, any self-regulatory organization, the Public Company Accounting Oversight Board, or to any of the persons described in paragraphs (b)(4)(iv) and (v) of this section, and you, within 90 days, submit the same information to the Commission pursuant to § 240.21F-9 of this chapter, as you must do in order for you to be eligible to be considered for an award, then, for purposes of evaluating your claim to an award under §§ 240.21F-10 and 240.21F-11 of this chapter, the Commission will consider that you provided information as of the date of your original disclosure, report or submission to one of these other authorities or persons. You must establish the effective date of any prior disclosure, report, or submission, to the Commission's satisfaction. The Commission may seek assistance and confirmation from the other authority or person in making this determination.

(c) *Information that leads to successful enforcement*

The Commission will consider that you provided original information that led to the successful enforcement of a judicial or administrative action in the following circumstances:

(1) If you gave the Commission original information that caused the staff to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning new or different conduct as part of a current examination or investigation, and your information significantly contributed to the success of the action; or

(2) If you gave the Commission original information about conduct that was already under examination or investigation by the Commission, Congress, any other federal, state, or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board (except in cases where you were an original source of this information as defined in paragraph (b)(4) of this section), and your information would not otherwise have been obtained and was essential to the success of the action.

(d) Action means a single captioned judicial or administrative proceeding.

(e) Monetary sanctions means any money, including penalties, disgorgement, and interest, ordered to be paid and any money deposited into a disgorgement fund or other fund pursuant to Section 308(b) of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7246(b), as a result of a Commission action or a related action.

(f) Appropriate regulatory agency means the Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and any other agencies that may be defined as appropriate regulatory agencies under Section 3(a)(34) of the Exchange Act (15 U.S.C. § 78c(a)(34)).

(g) Self-regulatory organization means any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board, and any other organizations that may be defined as self-regulatory organizations under Section 3(a)(26) of the Exchange Act (15 U.S.C. § 78c(a)(26)).

§ 240.21F-5 Amount of award.

(a) If all of the conditions are met for a whistleblower award in connection with a Commission action or a related action, the Commission will then decide the amount of the award pursuant to the procedures set forth in §§ 240.21F-10 and 240.21F-11 of this chapter. The amount will be at least 10 percent and no more than 30 percent of the monetary sanctions that the Commission and the other authorities are able to collect. The percentage awarded in connection with a Commission action may differ from the percentage awarded in connection with a related action.

(b) If the Commission makes awards to more than one whistleblower in connection with the same action or related action, the Commission will determine an individual percentage award for each whistleblower, but in no event will the total amount awarded to all whistleblowers as a group be less than 10 percent or greater than 30 percent of the amount the Commission or the other authorities collect.

§ 240.21F-6 Criteria for determining amount of award.

In determining the amount of an award, the Commission will take into consideration:

(a) The significance of the information provided by a whistleblower to the success of the Commission action or related action;

(b) The degree of assistance provided by the whistleblower and any legal representative of the whistleblower in the Commission action or related action;

(c) The programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws; and

(d) Whether the award otherwise enhances the Commission's ability to enforce the federal securities laws, protect investors, and encourage the submission of high quality information from whistleblowers.

§ 240.21F-7 Confidentiality of submissions.

(a) The law requires that the Commission not disclose information that could reasonably be expected to reveal the identity of a whistleblower, except that the Commission may disclose such information in the following circumstances:

(1) When disclosure is required to a defendant or respondent in connection with a federal court or administrative action that the Commission files or in another public action or proceeding that is filed by an authority to which we provide the information, as described below;

(2) When the Commission determines that it is necessary to accomplish the purposes of the Exchange Act and to protect investors, it may provide your information to the Department of Justice, an appropriate regulatory agency, a self regulatory organization, a state attorney general in connection with a criminal investigation, any appropriate state regulatory authority, the Public Company Accounting Oversight Board, or foreign securities and law enforcement authorities. Each of these entities other than foreign securities and law enforcement authorities is subject to the confidentiality requirements set forth in Section 21F(h) of the Exchange Act, 15 U.S.C. 78u-6(h). The Commission may determine what assurances of confidentiality it deems appropriate in providing such information to foreign securities and law enforcement authorities.

(3) The Commission may make disclosures in accordance with the Privacy Act of 1974 (5 U.S.C. § 552a).

(b) You may submit information to the Commission anonymously. If you do so, however, you must also do the following:

(1) You must have an attorney represent you in connection with both your submission of information and your claim for an award, and your attorney's name and contact information must be provided to the Commission at the time you submit your information;

(2) You and your attorney must follow the procedures set forth in § 240.21F-9 of this chapter for submitting original information anonymously; and

(3) Before the Commission will pay any award to you, you must disclose your identity and your identity must be verified as set forth in § 240.21F-10 of this chapter.

§ 240.21F-8 Eligibility.

(a) To be eligible for a whistleblower award, you must give the Commission information in the form and manner that the Commission requires. The procedures for submitting information and making a claim for an award are described in § 240.21F-9 to § 240.21F-11 of this chapter. You should read these procedures carefully because you need to follow them in order to be eligible for an award, except that the Commission may, in its sole discretion, waive any of these procedures based upon a showing of extraordinary circumstances.

(b) In addition to any forms required by these rules, the Commission may also require that you provide certain additional information. If requested by Commission staff, you may be required to:

(1) Provide explanations and other assistance in order that the staff may evaluate and use the information that you submitted;

(2) Provide all additional information in your possession that is related to the subject matter of your submission in a complete and truthful manner, through follow-up meetings, or in other forms that our staff may agree to;

(3) Provide testimony or other evidence acceptable to the staff relating to whether you are eligible, or otherwise satisfy any of the conditions, for an award; and

(4) Enter into a confidentiality agreement in a form acceptable to the Whistleblower Office, including a provision that a violation may lead to your ineligibility to receive an award.

(c) You are not eligible to be considered for an award if you do not satisfy the requirements of paragraphs (a) and (b) of this section. In addition, you are not eligible if:

(1) You are, or were at the time you acquired original information, a member, officer, or employee of the Department of Justice, an appropriate regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board, or any law enforcement organization;

(2) You are, or were at the time you acquired original information, a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in Section 3(a)(52) of the Exchange Act (15 U.S.C. 78c(a)(52));

(3) You are convicted of a criminal violation that is related to the Commission action or to a related action (as defined in § 240.21F-4 of this chapter) for which you otherwise could receive an award;

(4) You obtained the information that you gave the Commission through an audit of a company's financial statements, and making a whistleblower submission would be contrary to the requirements of Section 10A of the Exchange Act (15 U.S,C. § 78j-1)); or

(5) You acquired the information you gave the Commission from any of the individuals described in paragraphs (c)(1), (2), (3) or (4) of this section;

(6) You are the spouse, parent, child, or sibling of a member or employee of the Commission, or you reside in the same household as a member or employee of the Commission; or

(7) In your whistleblower submission, your other dealings with the Commission, or your dealings with another authority in connection with a related action, you knowingly and willfully make any false, fictitious, or fraudulent statement or representation, or use any false writing or document, knowing that it contains any false, fictitious, or fraudulent statement or entry.

§ 240.21F-9 Procedures for submitting original information.

The submission of original information to the Commission is a two-step process:

(a) First, you will need to submit your information to us. You may submit your information:

(1) online, through the Commission's Electronic Data Collection System, or;

(2) By completing Form TCR (*Tip, Complaint or Referral)* (referenced in § 249.1800 of this chapter) and mailing or faxing the form to the SEC Whistleblower Office, 100 F Street NE, Washington, DC 20549-XXXX, Fax (202) XXX-XXXX.

(b) Second, in addition to submitting your information pursuant to paragraph (a) of this section, you will also need to complete and provide to the Commission a *Form*

WB-DEC, Declaration Concerning Original Information Provided Pursuant to §21F of the Securities Exchange Act of 1934, signed under penalty of perjury. Your Form WB-DEC must be submitted as follows:

(1) If you submit your information online, your FORM WB-DEC (referenced in § 249.1801 of this chapter) must be submitted either:

(a) Electronically (in accordance with the instructions set forth on the Commission's website); or

(b) By mailing or faxing the signed form to the SEC Whistleblower Office. Your Form WB-DEC (referenced in § 249.1801 of this chapter) must be received within thirty (30) days of the Commission's receipt of your information in the Electronic Data Collection System.

(2) If you submit a Form TCR (referenced in § 249.1800 of this chapter), your Form WB-DEC (referenced in § 249.1801 of this chapter) must be submitted by mail or fax at the same time as the Form TCR.

(c) Notwithstanding paragraph (b) of this section, if you submitted your original information to the Commission anonymously, then you must provide your attorney with the completed and signed Form WB-DEC (referenced in § 249.1801 of this chapter). In addition, your attorney must also provide the Commission with a separate Form WB-DEC certifying that he or she has verified your identity, has reviewed the form for completeness and accuracy, and will retain the signed original of your Form WB-DEC in his or her records. Such certification must be submitted in the manner described in paragraph (b) of this section.

(d) If you submitted original information in writing to the Commission after July 21, 2010 (the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act) but before the effective date of these rules, you will be eligible for an award only if:

(1) In the event that you provided the original information to the Commission in a format or manner other than that described in paragraph (a) of this section, you either submit your information online through the Commission's Electronic Data Collection System or complete Form TCR (referenced in § 249.1800 of this chapter) within one hundred twenty (120) days of the effective date of these rules and otherwise follow the procedures set forth in paragraph (b) of this section; or

(2) In the event that you provided the original information to the Commission in the format or manner described in paragraph (a) of this section you submit a Form WB-DEC (referenced in § 249.1801 of this chapter) within one hundred twenty (120) days of the effective date of this section in the manner set forth in paragraph (b) of this section.

§ 240.21F-10 Procedures for making a claim for a whistleblower award in SEC actions that result in monetary sanctions in excess of $1,000,000.

(a) Whenever a Commission action results in monetary sanctions totaling more than $1,000,000, the Whistleblower Office will cause to be published on the Commission's website a "Notice of Covered Action." Such Notice will be published subsequent to the entry of a final judgment or order that alone, or collectively with other judgments or orders previously entered in the Commission action, exceeds $1,000,000; or, in the absence of such judgment or order, within thirty (30) days of the deposit of monetary sanctions exceeding $1,000,000 into a disgorgement or other fund pursuant to Section 308(b) of the Sarbanes-Oxley Act of 2002. A claimant will have sixty (60) days from the date of the Notice of Covered Action to file a claim for an award based on that action, or the claim will be barred.

(b) To file a claim for a whistleblower award, you must file Form WB-APP, *Application for Award for Original Information Provided Pursuant to §21F of the Securities Exchange Act of 1934* (referenced in § 249.1802 of this chapter). You must sign this form as the claimant and submit it to the Whistleblower Office by mail or fax. All claim forms, including any attachments, must be received by the Whistleblower Office within sixty (60) calendar days of the date of the Notice of Covered Action in order to be considered for an award.

(c) If you provided your original information to the Commission anonymously, you must disclose your identity on the Form WB-APP (referenced in § 249.1802 of this chapter), and your identity must be verified in a form and manner that is acceptable to the Whistleblower Office prior to the payment of any award.

(d) Once the time for filing any appeals of the Commission's judicial or administrative action has expired, or where an appeal has been filed, after all appeals in the action have been concluded, the Whistleblower Office and designated staff ("Claims Review Staff") will evaluate all timely whistleblower award claims submitted on Form WB-APP (referenced in § 249.1802 of this chapter) in accordance with the criteria set forth in these rules. In connection with this process, the Whistleblower Office may require that you provide additional information relating to your eligibility for an award or satisfaction of any of the conditions for an award, as set forth in § 240.21F-(8)(b) of this chapter. Following that evaluation, the Whistleblower Office will send you a Preliminary

Determination setting forth a preliminary assessment as to whether the claim should be allowed or denied and, if allowed, setting forth the proposed award percentage amount.

(e). You may contest the Preliminary Determination made by the Claims Review Staff by submitting a written response to the Whistleblower Office setting forth the grounds for your objection to either the denial of an award or the proposed amount of an award. You may also include documentation or other evidentiary support for the grounds advanced in your response.

(1) Before determining whether to contest a Preliminary Determination, you may:

(i) Within thirty (30) days of the date of the Preliminary Determination, request that the Whistleblower Office make available for your review the materials that formed the basis of the Claims Review Staff's Preliminary Determination. The Whistleblower Office will make these materials available to you subject to any redactions necessary to comply with any statutory restrictions or protect the Commission's law enforcement and regulatory functions. The Whistleblower Office may also require you to sign a confidentiality agreement, as set forth in § 240.21F-(8)(b) of this chapter, prior to providing these materials.

(ii) Within thirty (30) calendar days of the date of the Preliminary Determination, request a meeting with the Whistleblower Office; however, such meetings are not required and the office may in its sole discretion decline the request.

(2) If you decide to contest the Preliminary Determination, you must submit your written response and supporting materials within thirty (30) calendar days of the date of the Preliminary Determination, or if a request to review materials is made pursuant to

paragraph (e)(1) of this section, then within thirty (30) calendar days of the Whistleblower Office making those materials available for your review.

(f) If you fail to submit a timely response pursuant to paragraph (e) of this section, then the Preliminary Determination will become the Final Order of the Commission (except where the Preliminary Determination recommended an award, in which case the Preliminary Determination will be deemed a Proposed Final Determination for purposes of paragraph (h) of this section). Your failure to submit a timely response contesting a Preliminary Determination will constitute a failure to exhaust administrative remedies, and you will be prohibited from pursuing an appeal pursuant to § 240.21F-12 of this chapter.

(g) If you submit a timely response pursuant to paragraph (e) of this section, then the Claims Review Staff will consider the issues and grounds advanced in your response, along with any supporting documentation you provided, and will make its Proposed Final Determination.

(h) The Whistleblower Office will then notify the Commission of each Proposed Final Determination. Within thirty 30 days thereafter, any Commissioner may request that the Proposed Final Determination be reviewed by the Commission. If no Commissioner requests such a review within the 30-day period, then the Proposed Final Determination will become the Final Order of the Commission. In the event a Commissioner requests a review, the Commission will review the record that the staff relied upon in making its determinations, including your previous submissions to the Whistleblower Office, and issue its Final Order.

(i) The Office of the Secretary of the SEC will provide you with the Final Order of the Commission.

§ 240.21F-11 Procedures for determining awards based upon a related action.

(a) If you are eligible to receive an award following a Commission action that results in monetary sanctions totaling more than $1,000,000, you also may be eligible to receive an award based on the monetary sanctions that are collected from a related action (as defined in § 240.21F-3 of this chapter).

(b) You must also use Form WB-APP (referenced in § 249.1802 of this chapter) to submit a claim for an award in a related action. You must sign this form as the claimant and submit it to the Whistleblower Office by mail or fax as follows:

(1) If a final order imposing monetary sanctions has been entered in a related action at the time you submit your claim for an award in connection with a Commission action, you must submit your claim for an award in that related action on the same Form WB-APP (referenced in § 249.1802 of this chapter) that you use for the Commission action.

(2) If a final order imposing monetary sanctions in a related action has not been entered at the time you submit your claim for an award in connection with a Commission action, you must submit your claim on Form WB-APP (referenced in § 249.1802 of this chapter) within sixty (60) days of the issuance of a final order imposing sanctions in the related action.

(c) The Whistleblower Office may request additional information from you in connection with your claim for an award in a related action to demonstrate that you directly (or through the Commission) voluntarily provided the governmental agency, regulatory authority or self-regulatory organization the same original information that led to the Commission's successful covered action, and that this information led to the successful enforcement of the related action. The Whistleblower Office may, in its discretion, seek assistance and confirmation from the other agency in making this determination.

(d) Once the time for filing any appeals of the final judgment or order in a related action has expired, or if an appeal has been filed, after all appeals in the action have been concluded, the Claims Review Staff will evaluate all timely whistleblower award claims submitted on Form WB-APP (referenced in § 249.1802 of this chapter) in connection with the related action. The evaluation will be undertaken pursuant to the criteria set forth in these rules. In connection with this process, the Whistleblower Office may require that you provide additional information relating to your eligibility for an award or satisfaction of any of the conditions for an award, as set forth in § 240.21F-(8)(b) of this chapter. Following this evaluation, the Whistleblower Office will send you a Preliminary Determination setting forth a preliminary assessment as to whether the claim should be allowed or denied and, if allowed, setting forth the proposed award percentage amount.

(e) You may contest the Preliminary Determination made by the Claims Review Staff by submitting a written response to the Whistleblower Office setting forth the grounds for your objection to either the denial of an award or the proposed amount of an award. You may also include documentation or other evidentiary support for the grounds advanced in your response.

(1) Before determining whether to contest a Preliminary Determination, you may:

(i) Within thirty (30) days of the date of the Preliminary Determination, request that the Whistleblower Office make available for your review the materials that formed the basis of the Claims Review Staff's Preliminary Determination. The Whistleblower Office will make these materials available to you subject to any redactions necessary to comply with any statutory restrictions or protect the Commission's law enforcement and regulatory functions. The Whistleblower Office may also require you to sign a confidentiality agreement, as set forth in § 240.21F-(8)(b) of this chapter, prior to providing these materials.

(ii) Within thirty (30) days of the date of the Preliminary Determination, request a meeting with the Whistleblower Office; however, such meetings are not required and the office may in its sole discretion decline the request.

(2) If you decide to contest the Preliminary Determination, you must submit your written response and supporting materials within thirty (30) calendar days of the date of the Preliminary Determination, or if a request to review materials is made pursuant to paragraph (e)(1)(i) of this section, then within thirty (30) calendar days of the Whistleblower Office making those materials available for your review.

(f) If you fail to submit a timely response pursuant to paragraph (e) of this section, then the Preliminary Determination will become the Final Order of the Commission (except where the Preliminary Determination recommended an award, in which case the Preliminary Determination will be deemed a Proposed Final Determination for purposes of paragraph (h) of this section). Your failure to submit a timely response contesting a Preliminary Determination will constitute a failure to exhaust administrative remedies, and you will be prohibited from pursuing an appeal pursuant to § 240.21F-12 of this chapter.

(g) If you submit a timely response pursuant to paragraph (e) of this section, then the Claims Review Staff will consider the issues and grounds that you advanced in your response, along with any supporting documentation you provided, and will make its Proposed Final Determination.

(h) The Whistleblower Office will notify the Commission of each Proposed Final Determination. Within thirty 30 days thereafter, any Commissioner may request that the Proposed Final Determination be reviewed by the Commission. If no Commissioner requests such a review within the 30-day period, then the Proposed Final Determination will become the Final Order of the Commission. In the event a Commissioner requests a review, the Commission will review the record that the staff relied upon in making its determinations, including your previous submissions to the Whistleblower Office, and issue its Final Order.

(i) The Office of the Secretary of the SEC will provide you with the Final Order of the Commission.

§ 240.21F-12 Appeals.

(a) Section 21F of the Exchange Act, 15 U.S.C. 78u-6, commits determinations of whether, to whom, and in what amount to make awards to the Commission's discretion. A determination of whether or to whom to make an award may be appealed within 30 days after the Commission issues its final decision to the United States Court of Appeals for the District of Columbia Circuit, or to the circuit where the aggrieved person resides or has his principal place of business. Where the Commission followed the statutory mandate that it award not less than 10 percent and not more than 30 percent of the monetary sanctions collected in the Commission or related action, the Commission's determination regarding the amount of an award (including the allocation of an award as between multiple whistleblowers) is not appealable.

(b) The record on appeal shall consist of the Whistleblower Office's Preliminary Determination, any materials submitted by the claimant or claimants (including the claimant's Form TCR (referenced in § 249.1800 of this chapter) or any electronic submission made by the whistleblower, the Forms WB-DEC (referenced in § 249.1801 of this chapter) and WB-APP (referenced in § 249.1802 of this chapter), and materials filed in response to the Preliminary Determination), and any other materials that supported the Final Order of the Commission, with the exception of internal deliberative process materials that are prepared exclusively to assist the Commission in deciding the claim (including the staff's Draft Final Determination in the event that the Commissioners reviewed the claim and issued the Final Order).

§ 240.21F-13 Procedures applicable to the payment of awards.

(a) Any award made pursuant to these rules will be paid from the Securities and Exchange Commission Investor Protection Fund (the "Fund").

(b) A recipient of a whistleblower award is entitled to payment on the award only to the extent that a monetary sanction is collected in the Commission action or in a related action upon which the award is based.

(c) Payment of a whistleblower award for a monetary sanction collected in a Commission action or related action shall be made following the later of:

(1) The date on which the monetary sanction is collected; or

(2) The completion of the appeals process for all whistleblower award claims arising from:

(i) The Notice of Covered Action, in the case of any payment of an award for a monetary sanction collected in a Commission action; or

(ii) The related action, in the case of any payment of an award for a monetary sanction collected in a related action.

(d) If there are insufficient amounts available in the Fund to pay the entire amount of an award payment within a reasonable period of time from the time for payment specified by paragraph (c) of this section, then subject to the following terms, the balance of the payment shall be paid when amounts become available in the Fund, as follows:

(1) Where multiple whistleblowers are owed payments from the Fund based on awards that do not arise from the same Notice of Covered Action (or related action), priority in making these payments will be determined based upon the date that the collections for which the whistleblowers are owed payments occurred. If two or more of these collections occur on the same date, those whistleblowers owed payments based on these collections will be paid on a pro rata basis until sufficient amounts become available in the Fund to pay their entire payments.

(2) Where multiple whistleblowers are owed payments from the Fund based on awards that arise from the same Notice of Covered Action (or related action), they will share the same payment priority and will be paid on a pro rata basis until sufficient amounts become available in the Fund to pay their entire payments.

§ 240.21F-14 No Amnesty.

The Securities Whistleblower Incentives and Protection provisions do not provide amnesty to individuals who provide information to the Commission. The fact that you may become a whistleblower and assist in Commission investigations and enforcement actions does not preclude the Commission from bringing an action against you based upon your own conduct in connection with violations of the federal securities laws. If such an action is determined to be appropriate, however, the Commission will take your cooperation into consideration in accordance with its Policy Statement Concerning Cooperation by Individuals in [SEC] Investigations and Related Enforcement Actions (17 CFR § 202.12).

§ 240.21F-15 Awards to Whistleblowers Who Engage in Culpable Conduct.

In determining whether the required $1,000,000 threshold has been satisfied (this threshold is further explained in § 240.21F-10 of this chapter) for purposes of making any award, the Commission will not take into account any monetary sanctions that the whistleblower is ordered to pay, or that are ordered against any entity whose liability is based substantially on conduct that the whistleblower directed, planned, or initiated. Similarly, if the Commission determines that a whistleblower is eligible for an award, any amounts that the whistleblower or such an entity pay in sanctions as a result of the action or related actions will not be included within the calculation of the amounts collected for purposes of making payments.

§ 240.21F-16 Staff Communications with Whistleblowers.

(a) No person may take any action to impede a whistleblower from communicating directly with the Commission staff about a potential securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement (other than agreements dealing with information covered by § 240.21F-4(b)(4)(i) & (ii) of this chapter related to the legal representation of a client) with respect to such communications.

(b) If you are a whistleblower who is a director, officer, member, agent, or employee of an entity that has counsel, and you have initiated communication with the Commission relating to a potential securities law violation, the staff is authorized to communicate directly with you regarding the subject of your communication without seeking the consent of the entity's counsel.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249 is amended by adding the following citations in numerical order to read as follows:

Authority: 15 U.S.C. 78a, *et seq.* and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

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Section 249.1800 is also issued under Pub. L. No. 111.203, §922(a), 124 Stat 1841 (2010).

Section 249.1801 is also issued under Pub. L. No. 111.203, §922(a), 124 Stat 1841 (2010).

Section 249.1802 is also issued under Pub. L. No. 111.203, §922(a), 124 Stat 1841 (2010).

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4. Add Subpart S to read as follows:

Subpart S -- Whistleblower Forms

Sec. 249.1800 Form TCR, Tip, Complaint or Referral

Sec. 249.1801 Form WB-DEC, Declaration of Original Information Submitted Pursuant to Section 21F of the Securities Exchange Act of 1934

Sec. 249.1802 Form WB-APP, Application for Award for Original Information Submitted Pursuant to Section 21F of the Securities Exchange Act of 1934.

§ 249.1800 Form TCR, Tip, Complaint or Referral.

This form may be used by anyone wishing to provide the SEC with information concerning a violation of the federal securities laws. The information provided may be disclosed to federal, state, local, or foreign agencies responsible for investigating, prosecuting, enforcing, or implementing the federal securities laws, rules, or regulations consistent with the confidentiality requirements set forth in Section 21F(h)(2) of the Exchange Act, 15 U.S.C. 78u-6(h)(2), and § 240.21F-7 of this chapter.

§ 249.1801 Form WB-DEC, Declaration of Original Information Submitted Pursuant to Section 21F of the Securities Exchange Act of 1934.

This form must be used by persons who provide the SEC with information concerning a violation of the federal securities laws and who wish to be considered for a whistleblower award pursuant to the SEC's whistleblower program. The information provided will enable the Commission to determine your eligibility for payment of an award pursuant to Section 21F of the Securities Exchange Act of 1934, 15 U.S.C. 78u-6. This information may be disclosed to Federal, state, local, or foreign agencies responsible for investigating, prosecuting, enforcing, or implementing the federal securities laws, rules, or regulations consistent with the confidentiality requirements set forth in Section 21F(h)(2) of the Exchange Act, 15 U.S.C. 78u-6(h)(2), and § 240. 21F-7 of this chapter. Furnishing the information is voluntary, but a decision not to do so may result in you not being eligible for award consideration.

§249.1802 Form WB-APP, Application for Award for Original Information Submitted Pursuant to Section 21F of the Securities Exchange Act of 1934.

This form must be used by persons making a claim for a whistleblower award in connection with information provided to the SEC or to another agency in a related action. The information provided will enable the Commission to determine your eligibility for payment of an award pursuant to Section 21F of the Securities Exchange Act of 1934, 15 U.S.C. 78u-6. This information may be disclosed to Federal, state, local, or foreign agencies responsible for investigating, prosecuting, enforcing, or implementing the federal securities laws, rules, or regulations consistent with the confidentiality requirements set forth in Section 21F(h)(2) of the Exchange Act, 15 U.S.C. 78u-6(h)(2) and § 240.21F-7 of this chapter. Furnishing the information is voluntary, but a decision not to do so may result in you not being eligible for award consideration.

Note: The text of these Forms does not, and this amendment will not, appear in the Code of Federal Regulations.

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

FORM TCR
TIP, COMPLAINT OR REFERRAL

A. INFORMATION ABOUT YOU

1. Last Name	First	M.I.

2. Street Address	Apartment/ Unit #

City	State/ Province	ZIP/ Postal Code	Country
3. Telephone	Alt. Phone	E-mail Address	Preferred method of communication:

4. Your Occupation

B. ATTORNEY'S INFORMATION (If Applicable - See Instructions)

1. Attorney's Name

2. Firm Name

3. Street Address

City	State/ Province	ZIP/ Postal Code	Country
4. Telephone	Fax	E-mail Address	

C. TELL US ABOUT THE INDIVIDUAL OR ENTITY YOU HAVE A COMPLAINT AGAINST

Individual/Entity 1: 1. Type: ☐ Individual ☐ Entity	If an individual, specify profession: If an entity, specify type:

2. Name

3. Street Address	Apartment/ Unit #

City	State/ Province	ZIP/ Postal Code	Country
4. Phone	E-mail Address	Internet address	

Individual/Entity 2:

1. Type: ☐ Individual ☐ Entity

If an individual, specify profession:

If an entity, specify type:

2. Name

3. Street Address

Apartment/ Unit #

City	State/ Province	ZIP/ Postal Code	Country

4. Phone	E-mail Address	Internet Address

D. TELL US ABOUT YOUR COMPLAINT

1. Occurrence Date (mm/dd/yyyy): / /

2. Nature of complaint:

3. Are you complaining about an entity of which you are or were an officer, director, employee, consultant or contractor? YES ☐ NO ☐

4a. Have you taken any prior action regarding your complaint? YES ☐ NO ☐

4b. If you answered "yes" to question 4a, please provide details. Use additional sheets if necessary.

4c. Date on which you took the action(s) described in question 4b (mm/dd/yyyy): / /

5a. Type of security or investment, if relevant

5b. Name of issuer or security, if relevant

5c. Security/ Ticker Symbol or CUSIP no.

6. State in detail all facts pertinent to the alleged violation. Explain why you believe the acts described constitute a violation of the federal securities laws. Use additional sheets if necessary.

7. Describe all supporting materials in your possession and the availability and location of any additional supporting materials not in your possession. Use additional sheets, if necessary.

8. Describe how you obtained the information that supports this claim. If any information was obtained from a public source, identify the source with as much particularity as possible. Attach additional sheets if necessary.

9. Provide any additional information you think may be relevant.

Privacy Act Statement

This notice is given under the Privacy Act of 1974. The Privacy Act requires that the Securities and Exchange Commission (SEC) inform individuals of the following when asking for information. This form may be used by anyone wishing to provide the SEC with information concerning a violation of the federal securities laws. If you are submitting information for the SEC's whistleblower award program pursuant to Section 21F of the Securities Exchange Act of 1934 (Exchange Act), the information provided will enable the Commission to determine your eligibility for payment of an award. The information provided may be disclosed to federal, state, local, or foreign agencies responsible for investigating, prosecuting, enforcing, or implementing the federal securities laws, rules, or regulations consistent with the confidentiality requirements set forth in Section 21F(h)(2) of the Exchange Act and Rule 21F-7 thereunder.
If you are submitting information for the SEC's whistleblower award program anonymously, you must be represented by an attorney and you must provide the information requested about your attorney on this form. Otherwise, furnishing the information requested herein is voluntary.

Questions concerning this form may be directed to the SEC Whistleblower Office, 100 F Street, NE, Washington, D.C. 20549-XXXX, Tel. (800) XXX-XXXX, Fax (202) XXX-XXXX

Submission Procedures

- After manually completing this Form TCR, please send it by mail or delivery to the SEC Whistleblower Office, 100 F. Street, NE, Washington, D.C. 20549-XXXX, or by facsimile to (202) XXX-XXXX.

- You have the right to submit information anonymously. If you are submitting anonymously and you want to be considered for a whistleblower award, however, you *must* be represented by an attorney in this matter and Section B of this form must be completed. Otherwise, you may, but are not required, to have an attorney. If you are not represented by an attorney in this matter, you may leave Section B blank.

- **If you are submitting information for the SEC's whistleblower award program, you *must* submit your information either using this Form TCR or electronically through the SEC's**

Electronic Data Collection System, available on the SEC web site at [insert link]. In addition to submitting your information by either of these methods, you must also submit a declaration on Form WB-DEC. The Form WB-DEC can be printed out from our web site or obtained from the SEC Whistleblower Office, and it must be manually signed by you under penalty of perjury. To learn more about this program and its special requirements, please visit the Whistleblower Office's website at [INSERT LINK].

Instructions for Completing Form TCR:

Section A: Information about You

Questions 1-3: Please provide the following information about yourself:

- Last name, first name, and middle initial
- Complete address, including city, state and zip code
- Telephone number and, if available, an alternate number where you can be reached
- Your e-mail address (to facilitate communications, we strongly encourage you to provide your email address), and
- Your preferred method of communication.

Question 4: State which of the following best describes your occupation:

- accountant, attorney, auditor, broker-dealer, compliance officer, financial representative, foreign officer, fund manager, investment advisor, investor, other company officer or senior manager, registered representative, trader, transfer agent, underwriter, government official (federal, state, or local), law enforcement personnel (federal, state, or local), or other (specify).

Section B: Information about Your Attorney. Complete this section only if you are represented by an attorney in this matter. You must be represented by an attorney, and this section must be

completed, if you are submitting your information anonymously and you want to be considered for the SEC's whistleblower award program.

Questions 1-4: Provide the following information about the attorney representing you in this matter:

- Attorney's name
- Firm name
- Complete address, including city, state and zip code
- Telephone number and fax number, and
- E-mail address

Section C: Tell Us about the Individual and/or Entity You Have a Complaint Against. If your complaint relates to more than two individuals and/or entities, you may attach additional sheets.

Question 1: Choose one of the following that best describes the individual or entity to which your complaint relates:

- **For Individuals**: accountant, analyst, attorney, auditor, broker, compliance officer, employee, executive officer or director, financial planner, fund manager, investment advisor, stock promoter, trustee, unknown, or other (specify).
- **For Entity**: bank, broker-dealer, clearing agency, day trading firm, exchange, Financial Industry Regulatory Authority, insurance company, investment company, Individual Retirement Account or 401(k) custodian/administrator, market maker, municipal securities dealers, mutual fund, newsletter company/investment publication companies, on-line trading firm, private fund company (including hedge fund, private equity fund, venture capital fund, or real estate fund), private/closely held company, SEC or other federal agency, transfer agent/paying agent/registrar, underwriter, unknown, or other (specify).

Questions 2-4: For each subject, provide the following information, if known:

- Full name

- Complete address, including city, state and zip code
- Telephone number,
- E-mail address, and
- Internet address, if applicable

Section D: Tell Us about Your Complaint

Question 1: State the date (mm/dd/yyyy) that the alleged conduct began.

Question 2: Choose the option that you believe best describes the nature of your complaint. If you are alleging more than one violation, please list all that you believe may apply. Use additional sheets if necessary.

- Theft/misappropriation (advance fee fraud; lost or stolen securities; hacking of account)
- Misrepresentation/omission (false/misleading marketing/sales literature; inaccurate, misleading or non-disclosure by Broker-Dealer, Investment Adviser and Associated Person; false/material misstatements in firm research that were basis of transaction)
- Offering fraud (Ponzi/pyramid scheme; other offering fraud)
- Registration violations (unregistered securities offering)
- Trading (after hours trading; algorithmic trading; front-running; insider trading, manipulation of securities/prices; market timing; inaccurate quotes/pricing information; program trading; short selling; trading suspensions; volatility)
- Fees/mark-ups/commissions (excessive or unnecessary administrative fees; excessive commissions or sales fees; failure to disclose fees; insufficient notice of change in fees; negotiated fee problems; excessive mark-ups/markdowns; excessive or otherwise improper spreads)
- Corporate disclosure/reporting/other issuer matter (audit; corporate governance; conflicts of interest by management; executive compensation; failure to notify shareholders of corporate events; false/misleading financial statements, offering documents, press releases, proxy materials; failure to file reports; financial fraud; Foreign Corrupt Practices Act violations; going private transactions; mergers and acquisitions; restrictive legends,

including 144 issues; reverse stock splits; selective disclosure – Regulation FD, 17 CFR 243; shareholder proposals; stock options for employees; stock splits; tender offers)

- Sales and advisory practices (background information on past violations/integrity; breach of fiduciary duty/responsibility (IA); failure to disclose breakpoints; churning/excessive trading; cold calling; conflict of interest; abuse of authority in discretionary trading; failure to respond to investor; guarantee against loss/promise to buy back shares; high pressure sales techniques; instructions by client not followed; investment objectives not followed; margin; poor investment advice; Regulation E (Electronic Transfer Act); Regulation S-P, 17 CFR 248, (privacy issues); solicitation methods (non-cold calling; seminars); suitability; unauthorized transactions)
- Operational (bond call; bond default; difficulty buying/selling securities; confirmations/statements; proxy materials/prospectus; delivery of funds/proceeds; dividend and interest problems; exchanges/switches of mutual funds with fund family; margin (illegal extension of margin credit, Regulation T restrictions, unauthorized margin transactions); online issues (trading system operation); settlement (including T+1 or T=3 concerns); stock certificates; spam; tax reporting problems; titling securities (difficulty titling ownership); trade execution.
- Customer accounts (abandoned or inactive accounts; account administration and processing; identity theft affecting account; IPOs: problems with IPO allocation or eligibility; inaccurate valuation of Net Asset Value; transfer of account)
- Comments/complaints about SEC, Self-Regulatory Organization, and Securities Investor Protection Corporation processes & programs (arbitration: bias by arbitrators/forum, failure to pay/comply with award, mandatory arbitration requirements, procedural problems or delays; SEC: complaints about enforcement actions, complaints about rulemaking, failure to act; Self-Regulatory Organization: failure to act; Investor Protection: inadequacy of laws or rules; SIPC: customer protection, proceedings and Broker-Dealer liquidations;

- Other (analyst complaints; market maker activities; employer/employee disputes; specify other).

Question 3: Indicate whether you were in the past, or are currently, an officer, director, employee, consultant, or contractor of the entity to which your complaint relates.

Question 4a: Indicate whether you have taken any prior action regarding your complaint, including whether you reported the violation to the entity, including the compliance office, whistleblower hotline or ombudsman; complained to the SEC, another regulator, a law enforcement agency, or any other agency or organization; initiated legal action, mediation or arbitration, or initiated any other action.

Question 4b: If you answered "yes" to question 4a, provide details, including the date on which you took the action(s) described, the name of the person or entity to whom you directed any report or complaint and contact information for the person or entity, if known, and the complete case name, case number, and forum of any legal action you have taken. Use additional sheets if necessary.

Question 5a: Choose from the following the option that you believe best describes the type of security or investment at issue, if applicable:

- 1031 exchanges
- 529 plans
- American Depositary Receipts
- Annuities (equity-indexed annuities, fixed annuities, variable annuities)
- Asset-backed securities
- Auction rate securities
- Banking products (including credit cards)
- Certificates of deposit (CDs)
- Closed-end funds
- Coins and precious metals (gold, silver, etc.)
- Collateralized mortgage obligations (CMOs)
- Commercial paper

- Commodities (currency transactions, futures, stock index options)
- Convertible securities
- Debt (corporate, lower-rated or "junk", municipal)
- Equities (exchange-traded, foreign, Over-the-Counter, unregistered, linked notes)
- Exchange Traded Funds
- Franchises or business ventures
- Hedge funds
- Insurance contracts (not annuities)
- Money-market funds
- Mortgage-backed securities (mortgages, reverse mortgages)
- Mutual funds
- Options (commodity options, index options)
- Partnerships
- Preferred shares
- Prime bank securities/high yield programs
- Promissory notes
- Real estate (real estate investment trusts (REITs))
- Retirement plans (401(k), IRAs)
- Rights and warrants
- Structured note products
- Subprime issues
- Treasury securities
- U.S. government agency securities
- Unit investment trusts (UIT)
- Viaticals and life settlements
- Wrap accounts
- Separately Managed Accounts (SMAs)
- Unknown

- Other (specify)

Question 5b: Provide the name of the issuer or security, if applicable.

Question 5c: Provide the ticker symbol or CUSIP number of the security, if applicable.

Question 6: State in detail all the facts pertinent to the alleged violation. Explain why you believe the facts described constitute a violation of the federal securities laws. Attach additional sheets if necessary.

Question 7: Describe all supporting materials in your possession and the availability and location of additional supporting materials not in your possession. Attach additional sheets if necessary.

Question 8: Describe how you obtained the information that supports your allegation. If any information was obtained from a public source, identify the source with as much particularity as possible. Attach additional sheets if necessary.

Question 9: Please provide any additional information you think may be relevant.

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

FORM WB-DEC

DECLARATION OF ORIGINAL INFORMATION SUBMITTED PURSUANT TO SECTION 21F OF THE SECURITIES EXCHANGE ACT OF 1934

A. SUBMITTER'S INFORMATION

1. Last Name	First		M.I.
2. Street Address			Apartment/ Unit #
City	State/ Province	ZIP Code	Country
3. Telephone	Alt. Phone	E-mail Address	

B. ATTORNEY INFORMATION (If Applicable - See Instructions)

1. Attorney's name			
2. Firm Name			
3. Street Address			
City	State/ Province	ZIP Code	Country
4. Telephone	Fax	E-mail Address	

C. TIP/COMPLAINT DETAILS

1. Manner in which information was submitted to SEC: SEC website ☐ Mail ☐ Fax ☐ Other ☐ ________

2a. Tip, Complaint or Referral (TCR) number:
(Required if you submitted your information through SEC website)

2b. Date TCR referenced in 2a submitted to SEC / /

2c. Individual or entity to which Tip, Complaint or Referral relates:

3a. Has the submitter or counsel had any communication(s) with the SEC concerning this matter? YES ☐ NO ☐

3b. If the answer to 3a is "Yes," name of SEC staff member with whom the submitter or counsel communicated

4a. Has the submitter or counsel provided the information to any other agency or organization? YES ☐ NO ☐

4b. If the answer to 4a is "Yes," please provide details. Use additional sheets if necessary

4c. Name and contact information for point of contact at agency or organization, if known

D. ELIGIBILITY REQUIREMENTS

1. Are you, or were you at the time you acquired the original information you submitted to us, a member, officer or employee of the Department of Justice, the Securities and Exchange Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision; the Public Company Accounting Oversight Board; any law enforcement organization; or any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board? YES ☐ NO ☐

2. Are you, or were you at the time you acquired the original information you submitted to us, a member, officer or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in Section 3(a)(52) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(52))? YES ☐ NO ☐

3. Did you obtain the information you are providing to us through the performance of an engagement required under the federal securities laws by an independent public accountant ? YES ☐ NO ☐

4. Did you provide the information identified in Section C above pursuant to a cooperation agreement with the SEC or another agency or organization? YES ☐ NO ☐

5. Are you a spouse, parent, child, or sibling of a member or employee of the Commission, or do you reside in the same household as a member or employee of the Commission? YES ☐ NO ☐

6. Did you acquire the information you are providing to us from any person described in questions D1 through D5? YES ☐ NO ☐

7. If you answered "yes" to any of questions 1 through 6 above, please provide details. Use additional sheets if necessary.

8a. Did you provide the information identified in Section C above before you (or anyone representing you) received any request, inquiry or demand from the SEC, Congress, or any other federal, state or local authority, or any self regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information your submission was relevant? YES ☐ NO ☐

8b. If you answered "no" to question 8a, please provide details. Use additional sheets if necessary.

9a. Are you currently a subject or target of a criminal investigation, or have you been convicted of a criminal violation, in connection with the information upon which your application for an award is based? YES ☐ NO ☐

9b. If you answered "Yes" to question 9a, please provide details. Use additional sheets if necessary.

E. DECLARATION

I declare under penalty of perjury under the laws of the United States that the information contained herein, and all information submitted to the SEC – either in the TCR referenced in Section C of this form or in the Form TCR accompanying this Form WB-DEC - is true, correct and complete to the best of my knowledge, information and belief. I fully understand that I may be subject to prosecution and ineligible for a whistleblower award if, in my submission of information, my other dealings with the SEC, or my dealings with another authority in connection with a related action, I knowingly and willfully make any false, fictitious, or fraudulent statements or representations, or use any false writing or document knowing that the writing or document contains any false, fictitious, or fraudulent statement or entry.

Signature	Date

F. COUNSEL CERTIFICATION

I certify that I have verified the identity of the whistleblower who completed Form WB-DEC in connection with the information referenced in Section C of this form by viewing the whistleblower's valid, unexpired government issued identification (e.g., driver's license, passport), that I have reviewed the whistleblower's Form WB-DEC for completeness and accuracy, and that I will retain an original, signed copy of the Form WB-DEC completed by the whistleblower in my records.

Signature	Date

Privacy Act Statement

This notice is given under the Privacy Act of 1974. The Privacy Act requires that the Securities and Exchange Commission (SEC) inform individuals of the following when asking for information. The information provided will enable the Commission to determine your eligibility for payment of an award pursuant to Section 21F of the Securities Exchange Act of 1934. This information may be disclosed to Federal, state, local, or foreign agencies responsible for investigating, prosecuting, enforcing, or implementing the federal securities laws, rules, or regulations consistent with the confidentiality requirements set forth in Section 21F(h)(2) of the Exchange Act and 21F-7 of this chapter. Furnishing the information is voluntary, but a decision not to do so may result in you not being eligible for award consideration.

Questions concerning this form may be directed to the SEC Whistleblower Office, 100 F Street, NE, Washington, D.C. 20549-XXXX, Tel. (800) XXX-XXXX, Fax (202) XXX-XXXX.

General Information

- Submitting information for the SEC's whistleblower award program is a two-step process. First, you must provide us with your information, which you may do in either of two ways. You may submit information electronically through the SEC's Electronic Data Collection System available on the SEC web site at [insert link]. Utilizing the SEC's online database is quick and easy and will enable you to print and retain a date and time-stamped confirmation of the information you provided to us. If you prefer, you may compete Form TCR ("Tip, Complaint, or Referral") manually, and mail or deliver it to us in hard copy following the instructions set forth on the form.

- **Submitting your information to us is the first step. If you want to be considered for a whistleblower award, you must also submit this Form WB-DEC and it must be manually signed under penalty of perjury.**

- ***If you submitted your information electronically through our web site, we must receive your completed Form WB-DEC within 30 days of your submission. If you did not submit your information electronically but instead are submitting your information on Form TCR,***

you must submit your declaration on Form WB-DEC at the same time that you submit your Form TCR. Follow the instructions set forth below for submitting this Form WB-DEC.

- If you follow these steps, and the information you submit leads to the successful enforcement of an SEC judicial or administrative action, or a related action, you will have an opportunity at a later date to submit a claim for an award. That is a separate process and is described in our whistleblower rules, which are available at [insert link for WBO website].

- You have the right to submit information anonymously. If you are doing so, please skip Part I of these instructions and proceed directly to Part II. Otherwise, please begin by following the instructions in Part I.

Part I: Instructions for filers who are disclosing their identity

- You are required to complete Sections A, C, D, and E of this form. If you are represented by an attorney in this matter, you must also complete Section B. Specific instructions for answering these questions can be found in Part IV below.

- If you previously submitted your complaint electronically through the SEC's web site, you may submit this Form WB-DEC to us in any of the following ways:
    - By mailing or delivering the signed form to the SEC Whistleblower Office, 100 F Street NE, Washington, D.C. 20549-XXXX; or
    - By faxing the signed form to (202) XXX-XXXX; or
    - By scanning and emailing the form in PDF format to [insert email address].

  Please note that we must receive your Form WB-DEC within thirty (30) days of when you submitted your information to us through our web site.

- If you did *not* previously submit your complaint electronically through the SEC's web site, but instead intend to send us a Form TCR, then you must submit your completed Form TCR and your declaration on this Form WB-DEC together. You may do so in one of two ways:

- By mailing or delivering the form TCR and the signed form WB-DEC to the SEC Whistleblower Office, 100 F Street NE, Washington, D.C. 20549-XXXX; or
- By faxing the form TCR and the signed form WB-DEC form to (202) XXX-XXXX.

Part II: Instructions for anonymous filers

- If you are submitting information anonymously, you *must* be represented by an attorney in this matter.
- If you previously submitted your complaint anonymously through the SEC's web site, make sure your attorney knows this.
- If you or your attorney did *not* previously submit your complaint electronically through the SEC's web site, but instead sent a Form TCR to us, then complete your Form TCR and give it to your attorney.
- You are also required to complete Sections B, C, D, and E of this form, and give the signed original to your attorney. Specific instructions for answering these questions can be found in Part IV below.
- In order for you to be eligible for a whistleblower award, your attorney must retain your signed original of Form WB-DEC in his or her records, and submit both your Form TCR (if you filled one out instead of submitting your complaint to us electronically) and an attorney declaration to us. You are encouraged to confirm that your attorney followed these steps.

Part III: Instructions for attorneys representing anonymous whistleblowers

- Obtain a completed and signed original of Form WB-DEC from your client. You must retain this signed original in your records because it may be required at a later date if your client files a claim for a whistleblower award.
- You must prepare your own Form WB-DEC, completing only Sections B, C and F. Specific instructions for answering these questions can be found in Part IV below.
- If your client previously submitted his or her complaint electronically through the SEC's web site, you may submit your attorney Form WB-DEC to us in any of the following ways:
    - By mailing or delivering the signed form to the SEC Whistleblower Office, 100 F Street NE, Washington, D.C. 20549-XXXX; or
    - By faxing the signed form to (202) XXX-XXXX; or

- By scanning and emailing the form in PDF format to [insert email address].

Please note that we must receive your Form WB-DEC within thirty (30) days of when your client submitted the information to us through our web site.

- If your client did *not* previously submit his or her complaint electronically through the SEC's web site, but instead intends to submit a Form TCR to us, then you must submit your client's complaint on Form TCR and your attorney declaration on this Form WB-DEC together. You may do so in one of two ways:
  - By mailing or delivering the Form TCR and the signed Form WB-DEC to the SEC Whistleblower Office, 100 F Street NE, Washington, D.C. 20549-XXXX; or
  - By faxing the Form TCR and the signed Form WB-DEC to (202) XXX-XXXX.

Part IV: Instructions for Completing Form WB-DEC:

Section A: Submitter's Information

Questions 1-3: Provide the following information about yourself:

- First and last name, and middle initial
- Complete address, including city, state and zip code
- Telephone number and, if available, an alternate number where you can be reached
- E-mail address

Section B: Information about Your Attorney. Complete this section only if you are represented by an attorney in this matter. You must be represented by an attorney, and this section must be completed, if you submitted your information anonymously.

Questions 1-4: Provide the following information about the attorney representing you in this matter:

- Attorney's name
- Firm name
- Complete address, including city, state and zip code
- Telephone number and fax number, and

- E-mail address

Section C: Tip/Complaint Details

Question 1: Indicate the manner in which the information was submitted to the SEC.

Question 2a: Include the TCR (Tip, Complaint or Referral) number, if available. **THE TCR NUMBER MUST BE INCLUDED ON FORM WB-DEC IN CASES WHERE THE ORIGINAL INFORMATION WAS SUBMITTED THROUGH THE SEC WEBSITE**

Question 2b: Provide the date on which the TCR referenced in 2a was submitted to the SEC.

Question 2c: Provide the name of the individual or entity to which your complaint relates.

Question 3a: Indicate whether the submitter or counsel have had any communication(s) with the SEC concerning this manner.

Question 3b: If you answered "yes" to question 3a, provide the name of the SEC staff member with whom the submitter or counsel communicated.

Question 4a: Indicate whether the submitted or counsel have provided the information being submitted to the SEC to any other agency or organization.

Question 4b: If you answered "yes" to question 4a, provide details, including the name of the agency or organization, the date on which you provided your information to the agency or organization and any other relevant details.

Question 4c: Provide a name and contact information for your point of contact at the other agency or organization, if known.

Section D: Eligibility Requirements

Question 1: State whether you are currently, or were at the time you acquired the original information that you submitted to the SEC a member, officer, or employee of the Department of Justice; the Securities and Exchange Commission; the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision; the Public Company Accounting

Oversight Board; any law enforcement organization; or any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board

Question 2: State whether you are, or were you at the time you acquired the original information you submitted to the SEC, a member, officer or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in Section 3(a)(52) of the Securities Exchange Act of 1934.

- Section 3(a)(52) of the Exchange Act (15 U.S.C. §78c(a)(52)) currently defines "foreign financial regulatory authority" as "any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above."

Question 3: Indicate whether you acquired the information you provided to the SEC through the performance of an engagement required under the securities laws by an independent public accountant.

Question 4: State whether you provided the information submitted to the SEC pursuant to a cooperation agreement with the SEC or with any other agency or organization.

Question 5: State whether you are a spouse, parent, child or sibling of a member or employee of the Commission, or whether you reside in the same household as a member or employee of the Commission.

Question 6: State whether you acquired the information you are providing to the SEC from any individual described in Question 1 through 5 of this Section.

Question 7: If you answered "yes" to questions 1 though 6, please provide details.

Question 8a: State whether you provided the information identified submitted to the SEC before you (or anyone representing you) received any request, inquiry or demand from the SEC, Congress, or any other federal, state or local authority, or any self regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information your submission was relevant.

Question 8b: If you answered "no" to questions 8a, please provide details. Use additional sheets if necessary.

Question 9a: State whether you are the subject or target of a criminal investigation or have been convicted of a criminal violation in connection with the information upon which your application for award is based.

Question 9b: If you answered "yes" to question 7a, please provide details, including the name of the agency or organization that conducted the investigation or initiated the action against you, the name and telephone number of your point of contact at the agency or organization, if available and the investigation/case name and number, if applicable. Use additional sheets, if necessary.

Section E: Declaration

To be completed and signed by person submitting the information

Section F: Counsel Certification

To be completed and signed by attorney for an anonymous person submitting information

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

FORM WB-APP

APPLICATION FOR AWARD FOR ORIGINAL INFORMATION SUBMITTED PURSUANT TO SECTION 21F OF THE SECURITIES EXCHANGE ACT OF 1934

A. APPLICANT'S INFORMATION (REQUIRED FOR ALL SUBMISSIONS)

1. Last Name	First	M.I.	Social Security No.
2. Street Address			Apartment/ Unit #
City	State/ Province	ZIP Code	Country
3. Telephone	Alt. Phone	E-mail Address	

B. ATTORNEY'S INFORMATION (IF APPLICABLE - SEE INSTRUCTIONS)

1. Attorney's name			
2. Firm Name			
3. Street Address			
City	State/ Province	ZIP Code	Country
4. Telephone	Fax	E-mail Address	

C. TIP/COMPLAINT DETAILS

1. Manner in which original information was submitted to SEC: SEC website ☐ Mail ☐ Fax ☐ Other ☐ ________

2a. Tip, Complaint or Referral number	2b. Date TCR referred to in 2a submitted to SEC / /
2c. Subject(s) of the Tip, Complaint or Referral:	

D. NOTICE OF COVERED ACTION

1. Date of Notice of Covered Action to which claim relates: / /	2. Notice Number:
3a. Case Name	3b. Case Number

E. CLAIMS PERTAINING TO RELATED ACTIONS

1. Name of agency or organization to which you provided your information	
2. Name and contact information for point of contact at agency or organization, if known.	
3a. Date you provided your information / /	3b. Date action filed by agency/organization / /
4a. Case Name	4b. Case number

F. ELIGIBILITY REQUIREMENTS

1. Are you, or were you at the time you acquired the original information you submitted to us, a member, officer or employee of the Department of Justice, the Securities and Exchange Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision; the Public Company Accounting Oversight Board; any law enforcement organization; or any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board? YES ☐ NO ☐

2. Are you, or were you at the time you acquired the original information you submitted to us, a member, officer or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in Section 3(a)(52) of the Securities Exchange Act of 1934 (15 U.S.C. §78c(a)(52))?	YES ☐	NO ☐
3. Did you obtain the information you are providing to us through the performance of an engagement required under the federal securities laws by an independent public accountant?	YES ☐	NO ☐
4. Did you provide the information identified in Section C above pursuant to a cooperation agreement with the SEC or another agency or organization?	YES ☐	NO ☐
5. Are you a spouse, parent, child, or sibling of a member or employee of the Commission, or do you reside in the same household as a member or employee of the Commission?	YES ☐	NO ☐
6. Did you acquire the information you are providing to us from any person described in questions F1 through F5?	YES ☐	NO ☐
7. If you answered "yes" to any of questions 1 through 6 above, please provide details. Use additional sheets if necessary.		
8a. Did you provide the information identified in Section C above before you (or anyone representing you) received any request, inquiry or demand from the SEC, Congress, or any other federal, state or local authority, or any self regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information your submission was relevant?	YES ☐	NO ☐
8b. If you answered "yes" to question 8a, please provide details. Use additional sheets if necessary.		
9a. Are you currently a subject or target of a criminal investigation, or have you been convicted of a criminal violation, in connection with the information upon which your application for an award is based?	YES ☐	NO ☐
9b. If you answered "Yes" to question 9a, please provide details. Use additional sheets if necessary.		

G. ENTITLEMENT TO AWARD

Explain the basis for your belief that you are entitled to an award in connection with your submission of information to us, or to another agency in a related action. Provide any additional information you think may be relevant in light of the criteria for determining the amount of an award set forth in Rule 21F-6 under the Securities Exchange Act of 1934. Include any supporting documents in your possession or control, and attach additional sheets, if necessary.

H. DECLARATION

I declare under penalty of perjury under the laws of the United States that the information contained herein is true, correct and complete to the best of my knowledge, information and belief. I fully understand that I may be subject to prosecution and ineligible for a whistleblower award if, in my submission of information, my other dealings with the SEC, or my dealings with another authority in connection with a related action, I knowingly and willfully make any false, fictitious, or fraudulent statements or representations, or use any false writing or document knowing that the writing or document contains any false, fictitious, or fraudulent statement or entry.

Signature	Date

Privacy Act Statement

This notice is given under the Privacy Act of 1974. The Privacy Act requires that the Securities and Exchange Commission (SEC) inform individuals of the following when asking for information. The information provided will enable the Commission to determine your eligibility for payment of an award pursuant to Section 21F of the Securities Exchange Act of 1934. This information may be disclosed to Federal, state, local, or foreign agencies responsible for investigating, prosecuting, enforcing, or implementing the federal securities laws, rules, or regulations consistent with the confidentiality requirements set forth in Section 21F(h)(2) of the Exchange Act and Rule 21F-7 thereunder. Furnishing the information is voluntary, but a decision not to do so may result in you not being eligible for award consideration.

Questions concerning this form may be directed to the SEC Whistleblower Office, 100 F Street, NE, Washington, D.C. 20549-XXXX, Tel. (800) XXX-XXXX, Fax (202) XXX-XXXX.

General

- This form should be used by persons making a claim for a whistleblower award in connection with information provided to the SEC or to another agency in a related action. In order to be deemed eligible for an award, you must meet all the requirements set forth in Section 21F of the Securities Exchange Act of 1934 and the rules thereunder.
- You must sign the Form WB-APP as the claimant. If you provided your information to the SEC anonymously, you must now disclose your identity on this form and your identity must be verified in a form and manner that is acceptable to the Whistleblower Office prior to the payment of any award.
    - If you are filing your claim in connection with information that you provided to the SEC, then your Form WB-APP, and any attachments thereto, **must be received by the SEC Whistleblower Office within sixty (60) days of the date of the Notice of Covered Action to which the claim relates.**

- If you are filing your claim in connection with information you provided to another agency in a related action, then your Form WB-APP, and any attachments there to, must be received by the SEC Whistleblower Office as follows:
  - If a final order imposing monetary sanctions has been entered in a related action at the time you submit your claim for an award in connection with a Commission action, **you must submit your claim for an award in that related action on the same Form WB-APP that you use for the Commission action.**
  - If a final order imposing monetary sanctions in a related action has not been entered at the time you submit your claim for an award in connection with a Commission action, **you must submit your claim on Form WB-APP within sixty (60) days of the issuance of a final order imposing sanctions in the related action.**

- You must submit your Form WB-APP to us in one of the following two ways:
  - By mailing or delivering the signed form to the SEC Whistleblower Office, 100 F Street NE, Washington, D.C. 20549-XXXX; or
  - By faxing the signed form to (202) XXX-XXXX.

Instructions for Completing Form WB-APP

Section A: Applicant's Information

Questions 1-3: Provide the following information about yourself:

- First and last name, and middle initial
- Complete address, including city, state and zip code
- Telephone number and, if available, an alternate number where you can be reached
- E-mail address

Section B: Attorney's Information. If you are represented by an attorney in this matter, provide the information requested. If you are not representing an attorney in this matter, leave this Section blank.

Questions 1-4: Provide the following information about the attorney representing you in this matter:

- Attorney's name
- Firm name
- Complete address, including city, state and zip code
- Telephone number and fax number, and
- E-mail address.

Section C: Tip/Complaint Details

Question 1: Indicate the manner in which your original information was submitted to the SEC.

Question 2a: Include the TCR (Tip, Complaint or Referral) number to which this claim relates.

Question 2b: Provide the date on which you submitted your information to the SEC.

Question 2c: Provide the name of the individual(s) or entity(s) to which your complaint related.

Section D: Notice of Covered Action

The process for making a claim for a whistleblower award begins with the publication of a "Notice of a Covered Action" on the Commission's website. This notice is published whenever a judicial or administrative action brought by the Commission results in the imposition of monetary sanctions exceeding $1,000,000. The Notice is published on the Commission's website subsequent to the entry of a final judgment or order in the action that by itself, or collectively with other judgments or orders previously entered in the action, exceeds the $1,000,000 threshold.

Question 1: Provide the date of the Notice of Covered Action to which this claim relates.

Question 2: Provide the notice number of the Notice of Covered Action.

Question 3a: Provide the case name referenced in Notice of Covered Action.

Question 3b: Provide the case number referenced in Notice of Covered Action.

Section E: Claims Pertaining to Related Actions

Question 1: Provide the name of the agency or organization to which you provided your information.

Question 2: Provide the name and contact information for your point of contact at the agency or organization, if known.

Question 3a: Provide the date on which that you provided your information to the agency or organization referenced in question E1.

Question 3b: Provide the date on which the agency or organization referenced in question E1 filed the related action that was based upon the information you provided.

Question 4a: Provide the case name of the related action.

Question 4b: Provide the case number of the related action.

Section F: Eligibility Requirements

Question 1: State whether you are currently, or were at the time you acquired the original information that you submitted to the SEC a member, officer, or employee of the Department of Justice; the Securities and Exchange Commission; the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision; the Public Company Accounting Oversight Board; any law enforcement organization; or any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board

Question 2: State whether you are, or were you at the time you acquired the original information you submitted to the SEC, a member, officer or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in Section 3(a)(52) of the Securities Exchange Act of 1934.

- Section 3(a)(52) of the Exchange Act (15 U.S.C. §78c(a)(52)) currently defines "foreign financial regulatory authority" as "any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above."

Question 3: Indicate whether you acquired the information you provided to the SEC through the performance of an engagement required under the securities laws by an independent public accountant.

Question 4: State whether you provided the information submitted to the SEC pursuant to a cooperation agreement with the SEC or with any other agency or organization.

Question 5: State whether you are a spouse, parent, child or sibling of a member or employee of the Commission, or whether you reside in the same household as a member or employee of the Commission.

Question 6: State whether you acquired the information you are providing to the SEC from any individual described in Question 1 through 5 of this Section.

Question 7: If you answered "yes" to questions 1 though 6, please provide details.

Question 8a: State whether you provided the information identified submitted to the SEC before you (or anyone representing you) received any request, inquiry or demand from the SEC, Congress, or any other federal, state or local authority, or any self regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information your submission was relevant.

Question 8b: If you answered "no" to questions 8a, please provide details. Use additional sheets if necessary.

Question 9a: State whether you are the subject or target of a criminal investigation or have been convicted of a criminal violation in connection with the information upon which your application for award is based.

Question 9b: If you answered "yes" to question 9a, please provide details, including the name of the agency or organization that conducted the investigation or initiated the action against you, the name and telephone number of your point of contact at the agency or organization, if available and the investigation/case name and number, if applicable. Use additional sheets, if necessary. If you previously provided this information on Form WB-DEC, you may leave this question blank, unless your response has changed since the time you submitted your Form WB-DEC.

Section G: Entitlement to Award

Use this section to explain the basis for your belief that you are entitled to an award in connection with your submission of information to us or to another agency in connection with a related action. Specifically address how you believe you voluntarily provided the Commission with original information that led to the successful enforcement of a judicial or administrative action filed by the Commission, or a related action. Refer to Rules 21F-3 and 21F-4 under the Exchange Act for further information concerning the relevant award criteria. You may attach additional sheets, if necessary.

Rule 21F-6 under the Exchange Act provides that in determining the amount of an award, the Commission will evaluate the following factors: (a) the significance of the information provided by a whistleblower to the success of the Commission action or related action; (b) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in the Commission action or related action; (c) the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws; and (d) whether the award otherwise enhances the Commission's ability to enforce the federal securities laws, protect investors, and encourage the submission of high quality information from whistleblowers. Address these factors in your response as well.

Additional information about the criteria the Commission may consider in determining the amount of an award is available on the Commission's website at [insert WBO web page address]

Section G: Declaration

This section must be signed by the claimant.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 3, 2010

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-63236; File No. S7-32-10]

RIN 3235- AK77

Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing for comment a new rule under the Securities Exchange Act of 1934 ("Exchange Act") that is intended to prevent fraud, manipulation, and deception in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance.

DATES: Comments should be received on or before [insert date 45 days after publication in the Federal Register].

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-32-10 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

9 of 52

Paper Comments:

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

All submissions should refer to File Number S7-32-10. 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 Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Josephine Tao, Assistant Director, Elizabeth Sandoe, Senior Special Counsel, or Joan Collopy, Special Counsel, 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.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on proposed Rule 9j-1 under the Exchange Act.

I. Introduction

The Commission is proposing Exchange Act Rule 9j-1, which is intended to prohibit fraud, manipulation, and deception in connection with the offer, purchase or sale of any security-based swap, as well as in connection with the exercise of any right or performance of any obligation under a security-based swap, including the avoidance of such exercise or performance. Section 761(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-

Frank Act")[1] adds new Section 3(a)(68) of the Exchange Act to define a "security-based swap" as any agreement, contract, or transaction that is a swap, as defined in Section 1(a) of the Commodity Exchange Act,[2] that is based on a narrow-based security index, or a single security or loan, or any interest therein or on the value thereof, or the occurrence or non-occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.[3]

Security-based swaps, as securities,[4] will be subject to the general antifraud and anti-manipulation provisions of the federal securities laws (e.g., Section 10(b) of the Exchange Act

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1 Pub. L. No. 111-203 (July 21, 2010).

2 7 U.S.C. 1a. Section 721(b) of the Dodd-Frank Act amends Section 1(a) of the Commodity Exchange Act to add paragraph (47) defining swap, subject to enumerated exceptions, as "any agreement, contract, or transaction: (i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind; (ii) that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence; (iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level . . . including any agreement, contract, or transaction commonly known as (I) an interest rate swap; (II) a rate floor; (III) a rate cap; (IV) a rate collar; (V) a cross-currency rate swap; (VI) a basis swap; (VII) a currency swap; (VIII) a foreign exchange swap; (IX) a total return swap; (X) an equity index swap; (XI) an equity swap; (XII) a debt index swap; (XIII) a debt swap; (XIV) a credit spread; (XV) a credit default swap; (XVI) a credit swap; . . . (iv) that is an agreement, contract, or transaction that is, or in the future becomes commonly known to the trade as a swap… or (vi) that is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of clauses (i) through (v)."

3 See Section 761(a)(6) of the Dodd-Frank Act. See also 15 U.S.C. 78c(a)(68).

4 See Section 761(a)(2) of the Dodd-Frank Act, which amends the definition of "security" in Section 3(a)(10) of the Exchange Act to include security-based swaps. See also Section 768(a)(1) of the Dodd-Frank Act, which amends the definition of "security" in Section 2(a)(1) of the Securities Act to include security-based swaps.

and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933 ("Securities Act"))[5] once the relevant provisions of the Dodd-Frank Act take effect.[6] Most security-based swaps are characterized by ongoing payments or deliveries between the parties throughout the life of the security-based swap pursuant to their rights and obligations. Because such payments or deliveries occur after the purchase of a security-based swap but before the sale or termination of the security-based swap,[7] we believe a rule making explicit the liability of persons that engage in misconduct to trigger, avoid, or affect the value of such ongoing payments or deliveries is a measured and reasonable means to prevent fraud, manipulation, and deception in connection with security-based swaps.

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5 Exchange Act Section 10(b) provides that "[i]t shall be unlawful for any person, directly or indirectly . . . (b) to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 78j.

Rule 10b-5 under the Exchange Act provides that "[i]t shall be unlawful for any person, directly or indirectly . . . (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 CFR 240.10b-5.

Securities Act Section 17(a) provides that "[i]t shall be unlawful for any person in the offer or sale of securities . . . directly or indirectly – (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. 77q(a).

6 See Section 774 of the Dodd-Frank Act. Security-based swap agreements, as defined in Section 206B of the Gramm-Leach-Bliley Act, 15 U.S.C. 78c note, are currently subject to the general antifraud and anti-manipulation provisions of the federal securities laws (e.g., Section 10(b) of the Exchange Act and Rule 10b-5 thereunder).

7 The Dodd-Frank Act amended the definitions of "purchase" or "sale" in the Securities Act and Exchange Act to include, in the context of security-based swaps, execution, termination, assignment, exchange, transfer, or extinguishment of rights. See Sections 761(a)(3) and (a)(4) of the Dodd-Frank Act (amending Sections 3(a)(13) and (a)(14) of the Exchange Act). See also Section 768(a)(3) of the Dodd-Frank Act (amending Section 2(a)(18) of the Securities Act). Therefore, misconduct in connection with these actions will also be prohibited under Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a).

Proposed Rule 9j-1 would prohibit the same misconduct as Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a), but would also explicitly reach misconduct that is in connection with the "exercise of any right or performance of any obligation under" a security-based swap. In other words, proposed Rule 9j-1 would apply to offers, purchases and sales of security-based swaps in the same way that the general antifraud provisions apply to all securities but would also explicitly apply to the cash flows, payments, deliveries, and other ongoing obligations and rights that are specific to security-based swaps.

II. Background

On July 21, 2010, the President signed into law the Dodd-Frank Act. Title VII of the Dodd-Frank Act, referred to as the Wall Street Transparency and Accountability Act of 2010, establishes a regulatory framework for the regulation of over-the-counter ("OTC") swaps market. Under this framework, in general, swaps are regulated primarily by the Commodity Futures Trading Commission ("CFTC"), and security-based swaps are regulated primarily by the Commission.

Section 763(g) of the Dodd-Frank Act expands the anti-manipulation provisions of Section 9 of the Exchange Act[8] and authorizes the Commission to adopt rules to prevent fraud, manipulation, and deception in connection with security-based swaps. Specifically, Section 763(g) adds new subparagraph (j) to Section 9 to make it unlawful for "any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security-based swap, in connection with which such person engages in any fraudulent, deceptive, or manipulative act or practice, makes any

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[8] See Exchange Act Section 9, 15 U.S.C. 78i.

fictitious quotation, or engages in any transaction, practice, or course of business which operates as a fraud or deceit upon any person."[9]

Because Exchange Act Section 9(j) applies to "any person,"[10] it would encompass issuers, broker-dealers, security-based swap dealers,[11] major security-based swap participants,[12] persons associated with a security-based swap dealer or major security-based swap participant, security-based swap counterparties, and any customers, clients or other persons that use or employ or effect transactions in security-based swaps, including security-based swaps to hedge or mitigate commercial risk or exposure.[13] Section 763(g) does not include any specific

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9 See Exchange Act Section 9(j), 15 U.S.C. 78i(j).

10 Exchange Act Section 3(a)(9) defines "person" as "a natural person, company, government or, political subdivision, agency, or instrumentality of a government." 15 U.S.C. 78c(a)(9).

11 Section 761 of the Dodd-Frank Act adds new definitions to Exchange Act Section 3(a). Subject to certain exceptions, Exchange Act Section 3(a)(71)(A) defines "security-based swap dealer" to mean any person who: (i) holds themself out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps. 15 U.S.C. 78c(a)(71)(A).

12 "Major security-based swap participant" is defined in Section 3(a)(67)(A) of the Exchange Act as any person: (i) who is not a security-based swap dealer; and (ii)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; (II) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or (III) that is a financial entity that (aa) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking regulator; and (bb) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission. 15 U.S.C. 78c(a)(67)(A).

The terms "security-based swap dealer," "major security-based swap participant," as well as "security-based swap," and other terms will be the subject of joint rulemaking by the Commission and the CFTC. The Commission has issued an advance notice of proposed rulemaking seeking comment on the definitions of key terms relating to the regulation of swaps and security-based swaps. See Securities Exchange Act Release No. 62717 (Aug. 13, 2010), 75 FR 51429 (Aug. 20, 2010).

13 In other words, in contrast to certain other provisions of Title VII of the Dodd-Frank Act, Section 763(g) does not make an exception for end-users.

exceptions. In addition, Exchange Act Section 9(j) directs the Commission to "by rules and regulations define, and prescribe means reasonably designed to prevent, such transactions, acts, practices, and courses of business as are fraudulent, deceptive, or manipulative, and such quotations as are fictitious."[14]

III. Proposed Rule 9j-1

As noted above, unlike many other securities, a key characteristic of most security-based swaps is the obligation for and rights to ongoing payments or deliveries between the parties throughout the life of the security-based swap pursuant to the rights and obligations under the security-based swap. For example, a total return swap ("TRS") that is a security-based swap may obligate one of the parties (i.e., the total return payer) to transfer the total economic performance (e.g., income from interest and fees, gains or losses from market movements, and credit losses) of a reference asset (e.g., a debt security) (the "reference underlying"),[15] in exchange for a specified or fixed or floating cash flow (including payments for any principal losses on the reference asset) from the other party (i.e., the total return receiver). This stream of payments, deliveries, or other ongoing obligations or rights between parties to a security-based swap can pose significant risk if, for example, the reference underlying of such security-based swap declines in value or the economic condition of the issuer changes (e.g., defaults or goes into bankruptcy).

The exercise of rights or performance of obligations under a security-based swap can present opportunities and incentives for fraudulent, deceptive, or manipulative conduct. Parties

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[14] See supra note 9.

[15] As used in this release, the term "reference underlying" of a security-based swap would include any reference asset underlying a security-based swap, including any security underlying a security-based swap, any deliverable obligation under the terms of a security-based swap, any reference obligation, or reference entity under a security-based swap. This could include, for example, securities, instruments of indebtedness, indices, interest rates, quantitative measures, or other financial or economic interests underlying a security-based swap.

to a security-based swap may engage in misconduct in connection with the security-based swap (including in the reference underlying of such security-based swap)[16] to trigger, avoid, or affect the value of such ongoing payments or deliveries. For instance, a party faced with significant risk exposure may attempt to engage in manipulative or deceptive conduct that increases or decreases the value of payments or cash flow under a security-based swap relative to the value of the reference underlying, including the price or value of a deliverable obligation under a security-based swap. However, because such payments (and the avoidance of such payments) occur after the purchase of a security-based swap but before the sale or termination of the security-based swap, we believe a rule making explicit the illegality of misconduct in connection with such payments is appropriate.

Proposed Rule 9j-1 therefore prohibits the same categories of misconduct as Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a)[17] in the context of security-based swaps, and explicitly reaches misconduct in connection with these ongoing payments or deliveries. In particular, proposed Rule 9j-1 would specify that it is unlawful for any person, directly or indirectly, in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance: (a) to employ any device, scheme, or artifice to defraud or manipulate; (b) to knowingly or recklessly make any untrue statement of a material fact, or to knowingly or recklessly omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; (c) to obtain money or property by means of any untrue statement of a material fact

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16 See id.

17 See supra note 5.

or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (d) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[18]

The language in paragraph (a) of the proposed rule, which is based on Rule 10b-5(a), differs from Rule 10b-5(a) in that it explicitly prohibits employing any device, scheme or artifice to defraud <u>or</u> <u>manipulate</u>. While the term 'manipulate' does not appear in the text of Rule 10b-5, Rule 10b-5 has been interpreted to reach manipulative activities. In light of that interpretation, we have added language to clarify that manipulation in connection with security-based swaps is unlawful. We do not anticipate or intend this clarification to represent a departure from the past interpretation or scope of Rule 10b-5(a). In addition, the language in paragraph (b) of the proposed rule, which is based on Rule 10b-5(b), differs from Rule 10b-5(b) in that it explicitly prohibits <u>knowingly</u> or <u>recklessly</u> making any untrue statement of a material fact, or <u>knowingly</u> or <u>recklessly</u> omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. This is intended to make clear, consistent with Rule 10b-5 case law, that paragraph (b), in contrast to paragraph (c), would require scienter. We do not anticipate or intend this clarification to represent a departure from the past interpretation or scope of Rule 10b-5(b).

The proposed rule would prohibit a person from engaging in fraudulent and deceptive schemes in order to increase or decrease the price or value of a security-based swap, or disseminating false or misleading statements that affect or otherwise manipulate the price or value of the reference underlying of a security-based swap for the purpose of benefiting such

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18 Proposed Rule 9j-1.

person's position in the security-based swap. The proposed rule would also prevent, for example, disseminating false financial information or data in connection with the sale of a security-based swap or insider trading in a security-based swap.[19]

In addition, the proposed rule would explicitly prohibit misconduct that is in connection with the "exercise of any right or performance of any obligation under" a security-based swap. This would include, for example, misconduct that affects the market value of the security-based swap for purposes of posting collateral or making payments or deliveries under such security-based swap. Thus, the proposed rule would, among other things, prohibit fraudulent conduct (e.g., knowingly or recklessly making a false or misleading statement) in connection with a security-based swap that affects the value of such cash flow, payments, or deliveries, such as by triggering the obligation of a counterparty to make a large payment or to post additional collateral. It would also prohibit a person from taking fraudulent or manipulative action with respect to the reference underlying of the security-based swap that triggers the exercise of a right or performance of an obligation or affects the payments to be made.

The proposed rule also would explicitly prohibit misconduct that avoids the exercise of rights or the performance of obligations under the security-based swap. Thus, it would prohibit a person from making false or misleading statements in order to avoid having to make a large payment, post additional collateral, or perform another obligation under the security-based swap. It would also prohibit a person from taking fraudulent or manipulative action with respect to the reference underlying of the security-based swap that avoids triggering the exercise of a right or performance of an obligation or affects the payments to be made.

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[19] See also supra note 5.

Paragraphs (a) and (b) of proposed Rule 9j-1 are modeled after Exchange Act Section 10(b) and Rule 10b-5,[20] and Securities Act Section 17(a)(1),[21] and therefore would require scienter. In contrast, paragraphs (c) and (d) of the proposed rule would not require scienter like Sections 17(a)(2) and (a)(3) of the Securities Act[22] and Section 206(2) of the Investment Advisers Act of 1940 ("Advisers Act").[23] These paragraphs are proposed to prevent conduct that operates as a fraud, manipulation, or deception.

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20 To state a claim under Exchange Act Section 10(b) and Rule 10b-5, the Commission must establish that the misstatements or omissions were made with scienter. See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate or defraud." Id. Recklessness will generally satisfy the scienter requirement. See, e.g., Greebel v. FTP Software, Inc., 194 F.3d 185, 198 (1st Cir. 1999); SEC v. Environmental, Inc., 155 F.3d 107, 111 (2d Cir. 1998).

21 Establishing violations of Securities Act Section 17(a)(1) requires a showing of scienter. See, e.g., Aaron v. SEC, 446 U.S. 680, 701-02 (1980). Scienter is the "mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). The Fifth Circuit Court of Appeals has held that scienter is established by a showing that the defendants acted intentionally or with severe recklessness. See Broad v. Rockwell International Corp., 642 F.2d 929 (5th Cir.) (en banc), cert. denied, 454 U.S. 965 (1981).

22 Actions pursuant to Securities Act Sections 17(a)(2) and 17(a)(3) do not require a showing of scienter. See, e.g., Aaron, 446 U.S. at 701-02. In Aaron, the Supreme Court sought to determine whether scienter was required in a Commission injunctive proceeding pursuant to the antifraud provisions of Exchange Act Section 10(b) and Securities Act Section 17(a). The Court examined the language of both sections and determined that scienter was required under Section 10(b) because the words "manipulative," "device," and "contrivance," which are used in the statute, evidenced a Congressional intent to proscribe only knowing or intentional misconduct. Similarly, the Court concluded that subsection (1) of Section 17(a) required proof of scienter because Congress used such words as "device," "scheme," and "artifice to defraud." Aaron, 446 U.S. at 696. In contrast, the Court concluded that the absence of such words under subsections (2) and (3) of Section 17(a) demonstrated that no scienter was required. Section 17(a)(2) prohibits any person from obtaining money or property "by means of any untrue statement of a material fact or omission to state a material fact," which the Court found to be "devoid of any suggestion whatsoever of a scienter requirement." Aaron, 446 U.S. at 696. Similarly, the Court found, in construing Section 17(a)(3), under which it is unlawful for any person "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit," that scienter was not required because it "quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible." Aaron, 446 U.S. at 697.

23 See, e.g., Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in "any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client." The Commission is not required to demonstrate that an adviser acted with scienter in order to prove a Section 206(2) violation. SEC v. Steadman, 967 F.2d 636, 643 (D.C. Cir. 1992) (citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92 (1963)).

While both paragraphs (b) and (c) of the proposed rule would prohibit material misstatements and omissions,[24] they would address different levels of culpability. Paragraph (b) would apply when there is evidence of scienter (e.g., when a party to a security-based swap knowingly or recklessly makes a false statement even though it may not receive any money or property as a result). In contrast, paragraph (c) would extend to conduct that is at least negligent (e.g., when a party to a security-based swap knows or reasonably should know that a statement was false or misleading and directly or indirectly obtains money or property from such statement).

Because the proposed rule would apply to conduct "in connection with . . . a security-based swap" it would apply to fraud, manipulation, or deception involving the reference underlying[25] of such security-based swap to the extent that such misconduct is in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance (e.g., manipulative activity in the reference underlying that affects the price of the security-based swap, including misconduct in the reference underlying of a security-based swap that triggers, avoids, or affects the value of ongoing payments or other delivery obligations under such security-based swap).[26] Depending on the facts and circumstances, misconduct involving a

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[24] Consistent with Exchange Act Section 10(b), such misstatements and omissions must be material to be actionable. See, e.g., Basic v. Levinson, 485 U.S. 224, 233 (1988). Statements and omissions are material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. See id. at 231-32; TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

[25] See supra note 15 (defining "reference underlying" of a security-based swap to include, for example, any reference asset, reference security, reference entity, or reference obligation underlying a security-based swap).

[26] See Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 12-13 (1971) (to satisfy the "in connection with" requirement, the fraud need only "touch" on the purchase or sale of a security). See also SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968) (en banc) (concluding that "Congress when it used the phrase "in connection with the purchase or sale of any security" intended only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities").

security that is also a reference underlying of any security-based swap may not necessarily be "in connection with" the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance, and therefore a violation of Rule 9j-1. The Commission, in determining whether to bring an enforcement action under Rule 9j-1 for misconduct involving such a security, would consider the facts and circumstances associated with the misconduct, including, among other things, the extent to which the effect of the misconduct on one or more security-based swaps is foreseeable to the party engaging in the misconduct or the purpose or the interest of that party.

Consistent with Section 9(j) of the Exchange Act, the proposed rule would apply to "any person."[27] In addition, the proposed rule would also apply to misconduct "directly or indirectly" engaged in by such person (i.e., whether the person engages in the misconduct alone or through others).[28]

The Commission preliminarily believes that Proposed Rule 9j-1 is reasonably designed to prevent fraud and manipulation in transactions in security-based swaps and inducements to purchase or sell security-based swaps. Because fraud and manipulation that affect the value of the payments or deliveries pursuant to a security-based swap are likely to distort the price and market for such security-based swaps, they can undermine investor confidence in the integrity of the market for security-based swaps, as well as the market for the reference underlying of such security-based swap. The proposed rule is intended to parallel the general antifraud provisions applicable to all securities, while also explicitly addressing the characteristics of cash flows, payments, deliveries, and other obligations and rights that are specific to security-based swaps.

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27 See text supra at notes 10-13.

28 The terms "directly and indirectly" are intended to describe the level of involvement necessary to establish liability under the proposed rule. See also id.

By targeting misconduct that is specific to the ways in which security-based swaps are structured and used, the proposed rule should help to prevent such fraudulent and manipulative conduct – without interfering with or otherwise unduly inhibiting legitimate market or business activity.

While the proposed rule is modeled on existing securities laws prohibiting fraud, manipulation, and deception in connection with security-based swaps, it is not intended to limit or extend liability in connection with non-swap securities to "rights or obligations" that do not involve purchases or sales. In other words, the scope of the proposed rule is not intended to affect the application or interpretation of the other antifraud provisions under the federal securities laws.

Finally, as noted above, the Dodd-Frank Act included security-based swaps in the definition of "security" under the Securities Act and the Exchange Act.[29] Thus, once the relevant provisions of the Dodd-Frank Act take effect,[30] persons effecting transactions in, or engaged in acts, practices, and courses of business involving security-based swaps will be subject to the Commission's rules and regulations that define and proscribe acts and practices involving securities that are deemed manipulative, deceptive, fraudulent, or otherwise unlawful for purposes of the general antifraud and anti-manipulation provisions of the federal securities laws, including Exchange Act Section 10(b), Rule 10b-5 (and the prohibitions against insider trading), and Securities Act Section 17(a).[31]

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[29] See supra note 4 (defining "security" under the Securities Act and Exchange Act to include "security-based swaps").

[30] See supra note 6.

[31] See, e.g., Exchange Act Rules 10b-1 through 10b-21; 17 CFR 240.10-1 through 240.10b-21.

IV. Request for Comment

The Commission seeks comment generally on all aspects of proposed Rule 9j-1. We encourage commenters to present data on our proposals and any suggested alternative approaches.

In addition, we seek specific comment on the following:

Does the reference in the proposed rule to "in connection with the offer, purchase or sale of a security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance" address the full scope of potentially fraudulent, manipulative, or deceptive conduct that pertains to security-based swaps? If not, how should the scope of these provisions be modified? Are there types of conduct not otherwise discussed above that should be addressed by the proposed rule? Commenters are invited to provide specific examples of such conduct.

Please discuss how and to what extent the proposed rule may affect issuers, broker-dealers, security-based swap dealers, major security-based swap participants, and other swap market participants. Are there other alternatives or additional, or different, approaches that the Commission should consider as means reasonably designed to prevent "such transactions, acts, practices, and courses of business as are fraudulent, deceptive, or manipulative"? In addition, are there specific practices that the Commission should explicitly restrict or permit as part of the proposed rule? Comments are invited regarding any prophylactic rules that would further enhance the integrity of the security-based swap markets.

Although much of the activity that would be prohibited by the proposed rule is already prohibited by the general antifraud and anti-manipulation provisions of the federal securities laws (e.g., Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section

17(a)), to what extent, if any, would the proposed rule affect the nature of the security-based swap market in general, including the extent or nature of information shared between market participants? If so, in what ways and to what degree?

Are there any legitimate market activities that the proposed rule could have the effect of discouraging? Commenters are invited to provide specific examples of any such activities and any such potential effect.

Are there any specific issues with respect to the application of the proposed rule to fraudulent, manipulative, or deceptive activity involving security-based swaps (including the reference underlying of such security-based swaps) that are or will be effected on or through security-based swap execution facilities or national securities exchanges, or over-the-counter? Please explain.

To what extent are transactions in security-based swaps used as a functional or economic substitute or equivalent transaction for transactions or practices that are otherwise prohibited by the antifraud and anti-manipulation provisions of the Exchange Act? Should the proposed rule impose any restrictions on such transactions? Commenters are invited to provide specific examples.

What, if any, costs or burdens would be imposed by the proposed rule? Would the proposed rule create any costs associated with changes to business operations or supervisory practices or systems? How much would the proposed rule affect compliance costs for issuers, broker-dealers, security-based swap dealers, major security-based swap participants, and other swap market participants (e.g., personnel or procedural changes)? We seek comment on the costs of compliance that may arise.

V. General Request for Comment

The Commission seeks comment generally on all aspects of proposed Rule 9j-1. Commenters are requested to provide empirical data or economic studies to support their views and arguments related to proposed rule. In addition to the questions above, commenters are welcome to offer their views on any other matter raised by the proposed rule. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and if accompanied by alternative suggestions to our proposal where appropriate.

VI. Paperwork Reduction Act

Proposed Rule 9j-1 does not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[32] 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.

VII. Consideration of Costs and Benefits

The Commission is considering the costs and benefits of proposed Rule 9j-1. The Commission is sensitive to these costs and benefits, and encourages commenters to discuss any additional costs or benefits beyond those discussed here, as well as any reductions in costs. In particular, the Commission requests comment on the potential costs for any modification market participants' business operations or supervisory practices or systems, as well as any potential benefits resulting from the proposed rule for issuers, investors, broker-dealers, security-based swap dealers, major security-based swap participants, persons associated with a security-based swap dealer or a major security-based swap participant, other security-based swap industry

[32] 44 U.S.C. 3501 et seq.

professionals, regulators, and other market participants. The Commission also seeks comments on the accuracy of any of the benefits identified and also welcomes comments on any of the costs identified here. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits.

A. Benefits

Proposed Rule 9j-1 would specify that it is unlawful for any person, directly or indirectly, in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security based swap, or the avoidance of such exercise or performance, to: (a) to employ any device, scheme, or artifice to defraud or manipulate; (b) to knowingly or recklessly make any untrue statement of a material fact, or to knowingly or recklessly omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; (c) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (d) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[33]

Thus, proposed Rule 9j-1 would prohibit the same misconduct as Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a)[34] but would also explicitly reach misconduct that is in connection with the "exercise of any right or performance of any obligation under" a security-based swap. In other words, proposed Rule 9j-1 would apply to offers, purchases and sales of security-based swaps in the same way that the general antifraud

[33] See Proposed Rule 9j-1.

[34] See supra note 5.

provisions apply to all securities but would also explicitly apply to the cash flows, payments, deliveries, and other ongoing obligations and rights that are specific to security-based swaps. This would include, for example, misconduct that affects the market value of the security-based swap for purposes of posting collateral or making payments or deliveries under a security-based swap. Thus, the proposed rule would, among other things, prohibit a person who is a party to a security-based swap from later engaging in fraudulent conduct (e.g., knowingly making a false or misleading statement) that affects the value of cash flow, payments, or deliveries, such as triggering the obligation of a counterparty to make a large payment or to post additional collateral.

By prohibiting fraud, manipulation, and deception in connection with the exercise of any rights or performance of any obligations under a security-based swap, including actions taken to avoid the triggering of such exercise or performance, the proposed rule would help to prevent such misconduct from distorting the price and market for such security-based swap, as well as for the reference underlying, and improperly interfering with the independent and proper functioning of the markets. We therefore believe that the proposed rule would benefit market participants and investors by promoting investor confidence in the integrity of the market for security-based swaps, as well as for the reference underlying[35] of such security-based swaps.

The proposed rule should prevent fraud, manipulation, and deception from causing prices of security-based swaps to deviate from their fundamental values. This would allow the Commission to guard against misconduct that improperly interferes with the independent and proper functioning of the markets and help to promote price efficiency, the integrity of the price discovery process, and fair dealing between market participants in connection with security-based swaps.

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[35] See supra note 15.

We solicit comment on any additional short-term and long-term benefits that could be realized with the proposed rule. Specifically, we solicit comment regarding benefits to the efficient operation of security-based swap markets, price efficiency, market integrity, and investor protection.

B. Costs

As an aid in evaluating costs and reductions in costs associated with proposed Rule 9j-1, the Commission requests the public's views and any supporting information.

By targeting misconduct that is specific to how security-based swaps are structured and used, the proposed rule is intended to be a measured and reasonable means to prevent fraudulent, deceptive, or manipulative acts or practices in connection with the exercise of any right or performance of any obligation under a security-based swap without interfering with or otherwise inhibiting legitimate market activity.

Because proposed Rule 9j-1 is intended to parallel the general antifraud provisions already applicable to all securities, while also explicitly addressing the characteristics of cash flows, payments, deliveries, and other obligations and rights that are specific to security-based swaps, we do not believe that the proposed rule would impose any significant costs on persons effecting transactions or otherwise trading in security-based swaps. As noted above, the Commission seeks comment on whether the proposed rule could discourage certain legitimate market activities because of concern that such activities might be viewed as a violation of the rule.

In addition, persons effecting transactions or otherwise trading in security-based swaps may incur costs associated with changes to business operations or supervisory practices or systems. However, we believe that, because most issuers, broker-dealers, security-based swap dealers, major security-based swap participants, and other swap market participants involved with security-based swaps are already subject to the general antifraud and anti-manipulation provisions, much of these practices and systems would already be in place. Thus, we believe that any costs associated with the proposed rule for such changes (e.g., business or procedural changes) would be minimal.

The Commission believes that the proposed rule would not compromise investor protection. We seek data, however, supporting any potential costs associated with the proposed rule. In addition, we request specific comment on any changes to business operations or supervisory practices or systems that might be necessary to implement the proposed rule.

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

Section 3(f) of the Exchange Act[36] requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act[37] 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 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.

Proposed Rule 9j-1 is intended to prevent fraud, manipulation, and deception in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance. Proposed Rule 9j-1 would prohibit the same misconduct as Exchange Act

[36] 15 U.S.C. 78c(f).

[37] 15 U.S.C. 78w(a)(2).

Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a)[38] but would also explicitly reach misconduct that is in connection with the "exercise of any right or performance of any obligation under" a security-based swap. In other words, proposed Rule 9j-1 would apply to offers, purchases and sales of security-based swaps in the same way that the general antifraud provisions apply to all securities but would also explicitly apply to the cash flows, payments, deliveries, and other ongoing obligations and rights that are specific to security-based swaps.

By targeting specific misconduct that is specific to how security-based swaps are structured and used, the proposed rule is intended to be a measured and reasonable means to prevent misconduct that is "in connection with the exercise of any right or performance of any obligation under" a security-based swap without interfering with or otherwise unduly inhibiting legitimate market activity. Also, because the proposed rule would prohibit the same misconduct as Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a),[39] except to explicitly reach misconduct that is "in connection with the exercise of any right or performance of any obligation under" a security-based swap, we believe that the proposed rule would not have an adverse effect on price efficiency. If the proposed rule mitigates fraudulent behavior, price efficiency should improve.

By prohibiting fraud, manipulation, and deception in connection with security-based swaps (including the exercise of any right or performance of any obligation under a security-based swap or the avoidance thereof), the proposed rule would help to prevent such conduct from distorting the market and artificially increasing or decreasing prices for security-based swaps.

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38 See supra note 5.

39 See id.

Thus, we believe the proposed rule would help to ensure price accuracy and fairness for the parties, which are elements of efficiency.

We also believe a rule highlighting the illegality of these activities would focus the attention of swap market participants on such activities and would reduce regulatory uncertainty for swap market participants and investors and would not impose significant costs on customers. We seek comment regarding whether proposed Rule 9j-1 may have any adverse effects on liquidity, market operations, or risks or costs to customers.

In addition, as discussed above, because the proposed rule would prohibit the same misconduct as Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a),[40] except to explicitly reach misconduct that is "in connection with the exercise of any right or performance of any obligation (or the avoidance of such exercise or performance) under" a security-based swap, we believe that the proposed rule would have minimal impact on the promotion of capital formation. Fraudulent and manipulative conduct in connection with security-based swaps can undermine the confidence of investors, not only in the market for the security-based swaps but also in the market for the reference underlying of such security-based swaps. For the same reasons, the proposed rule should promote capital formation by discouraging misconduct in connection with the performance of security-based swaps that could otherwise undermine investor confidence or the ability of investors to make investment decisions that are congruent to their investment objectives.

Thus, we believe that the proposed rule would promote capital formation by helping to eliminate abuses in connection with security-based swaps. We seek specific comment and

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[40] See id.

empirical data, if available, on the potential impact of the proposed rule on capital formation, including whether the proposed rule would promote or inhibit capital formation, and if so, how.

In addition, the prohibitions of the proposed rule would apply uniformly to all persons (e.g., issuers, broker-dealers, security-based swap dealers, major security-based swap participants, and all other swap market participants and investors) effecting transactions or otherwise trading in security-based swaps and, therefore, should not impose a burden on competition. Also, the proposed rule would prohibit the same misconduct as Exchange Act 10(b) and Rule 10b-5 thereunder, and Securities Act Section 17(a),[41] except to explicitly reach misconduct that is in connection with the exercise of any rights or performance of any obligations under a security-based swap and, therefore, the proposed rule should not impose a burden on competition. By applying uniformly to all persons and by discouraging swap market participants from engaging in unfair fraudulent, manipulative, and deceptive conduct in connection with security-based swaps, we preliminarily do not believe that the proposed rule will pose a burden on competition and would also promote competition.

We request comment on whether the proposed rule would promote efficiency, competition, and capital formation or have an impact or burden on competition. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[42] the Commission must advise the OMB as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it

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41 See id.

42 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).

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 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 proposed Rule 9j-1 on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

X. Regulatory Flexibility Certification

The Regulatory Flexibility Act ("RFA")[43] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)[44] of the Administrative Procedure Act,[45] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."[46] Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule or proposed rule amendment, which if adopted, would not have a significant economic impact on a substantial number of small entities.[47]

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43 5 U.S.C. 601 et seq.

44 5 U.S.C. 603(a).

45 5 U.S.C. 551 et seq.

46 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term small entity for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

47 See 5 U.S.C. 605(b).

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (i) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less,[48] or (ii) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[49] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[50] Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) for entities in credit intermediation and related activities, entities with $175 million or less in assets or, for non-depository credit intermediation and certain other activities, $7 million or less in annual receipts; (ii) for entities in financial investments and related activities, entities with $7 million or less in annual receipts; (iii) for insurance carriers and entities in related activities, entities with $7 million or less in annual receipts; and (iv) for funds, trusts, and other financial vehicles, entities with $7 million or less in annual receipts.[51]

Based on the Commission's existing information about the security-based swap market, the Commission preliminarily believes that the security-based swap market, while broad in

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[48] See 17 CFR 240.0-10(a).

[49] See 17 CFR 240.17a-5(d).

[50] See 17 CFR 240.0-10(c).

[51] See 13 CFR 121.201 (Jan. 1, 2010).

scope, is largely dominated by entities such as those that would be covered by the "security-based swap dealer" and "major security-based swap market participant" definitions.[52] The Commission preliminarily believes that entities that will qualify as security-based swap dealers and major security-based swap market participants, whether registered broker-dealers or not, exceed the thresholds defining "small entities" set out above. Moreover, while it is possible that other parties may engage in security-based swap transactions, the Commission preliminarily does not believe that any such entities would be "small entities" as defined in Exchange Act Rule 0-10.[53] Feedback from industry participants about the security-based swap markets indicates that only persons or entities with assets significantly in excess of $5 million (or with annual receipts significantly in excess of $7 million) participate in the security-based swap market. Even to the extent that a handful of transactions did have a counterparty that was defined as a "small entity" under the Commission Rule 0-10, we believe it is unlikely that proposed Rule 9j-1 would have a significant economic impact on such entity, as the rule prohibits fraudulent and manipulative acts, activities which are in most cases already prohibited. Finally, because the proposed rule applies to any person, the proposed rule applies equally to large and small entities and therefore would not have a disproportionate impact on small entities. Therefore, the Commission preliminarily does not believe that proposed Rule 9j-1 will have an impact on "small entities" in terms of the prohibitions included in the proposed rule.

For the foregoing reasons, the Commission certifies that proposed Rule 9j-1 would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission encourages written comments regarding this certification. The

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[52] See supra notes 11 and 12.

[53] See 17 CFR 240.0-10(a).

Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

XI. Statutory Authority

Pursuant to Exchange Act and, particularly, Sections 2, 3(b), 9(i), 9(j), 10, 15, 15F, and 23(a) thereof, 15 U.S.C. 78b, 78c(b), 78i(i), 78i(j), 78j, 78o, 78o-8, and 78w(a), the Commission is proposing a new antifraud rule, Rule 9j-1, to address fraud, manipulation, and deception in connection with security-based swaps.

List of Subjects

17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

Text of the Proposed Rule

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 is amended by adding an authority for §240.9j-1 to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78b, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78*l*, 78m, 78n, 78o, 78o-8, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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Section 240.9j-1 is also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

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2. Add §240.9j-1 to read as follows:

§240.9j-1. Prohibition against fraud, manipulation, and deception in connection with security-based swaps.

It shall be unlawful for any person, directly or indirectly, in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance,

(a) To employ any device, scheme, or artifice to defraud or manipulate;

(b) To knowingly or recklessly make any untrue statement of a material fact, or to knowingly or recklessly omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;

(c) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(d) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 3, 2010

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-29497; File No. 4-619]

President's Working Group Report on Money Market Fund Reform

AGENCY: Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is seeking comment on the options discussed in the report presenting the results of the President's Working Group on Financial Markets' study of possible money market fund reforms. Public comments on the options discussed in this report will help inform consideration of reform proposals addressing money market funds' susceptibility to runs.

DATES: Comments should be received on or before January 10, 2011.

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-619 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 Number 4-619. 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 website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing 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: Daniele Marchesani or Sarah ten Siethoff at (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION:

I. THE PRESIDENT'S WORKING GROUP REPORT

Following the recommendation in the U.S. Department of the Treasury's 2009 paper on *Financial Regulatory Reform: A New Foundation*, the President's Working Group on Financial Markets ("PWG") conducted a study of possible reforms that might mitigate money market funds' susceptibility to runs.[1] The results of this study are included in the report issued on October 21, 2010 and attached to this release as an Appendix (the "Report").[2]

The Report expresses support for the new rules regulating money market funds that the Commission approved last February.[3] These new rules seek to better protect money market fund investors in times of financial market turmoil and lessen the possibility that money market funds

1 The members of the PWG include the Secretary of the Treasury Department (as chairman of the PWG), the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the SEC, and the Chairman of the Commodity Futures Trading Commission.

2 The Report is also available at http://treas.gov/press/releases/docs/10.21%20PWG%20Report%20Final.pdf.

3 *Money Market Fund Reform*, Investment Company Act Release No. 29132 (Feb. 23, 2010) [75 FR 10060 (Mar. 4, 2010)] ("SEC Adopting Release").

will not be able to withstand stresses similar to those experienced in 2007 and 2008.[4] When we adopted these rules, we recognized that they were a first step to addressing regulatory concerns as the events of 2007 and 2008 raised the question of whether further, more fundamental changes to the regulatory structure governing money market funds may be warranted.[5]

The Report identifies the features that make money market funds susceptible to runs as well as the systemic implications of the run on prime money market funds that occurred in September 2008. The Report states that the Commission's new rules alone could not be expected to prevent a run of the type experienced in September 2008. Accordingly, the Report outlines possible reforms that could supplement the new rules we adopted and, individually or in combination, further reduce money market funds' susceptibility to runs and the related systemic risk. Some of the measures discussed in the Report could be implemented by the Commission under our existing statutory authority; others would require new legislation, coordination by multiple government agencies, or the creation of new private entities.[6]

II. REQUEST FOR COMMENT

The Commission requests comment on the Report. Comments received will better enable

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4 The new rules further limit the credit, liquidity, and interest rate risks money market funds may assume and require fund managers to stress test their portfolios against potential economic shocks. They also require money market funds to improve their disclosure to investors and the Commission and provide a means to wind down the operations of a fund that "breaks the buck" or suffers a run, in an orderly way that is fair to the fund's investors and reduces the risk of market losses that could spread to other funds. For a discussion of the market stresses experienced by money market funds in 2007 and 2008, see *Money Market Fund Reform*, Investment Company Act Release No. 28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)], at section II.D ("SEC Proposing Release").

5 *See* SEC Adopting Release, *supra* note 3, at section I. In proposing the new rules, we had requested comment on additional, more fundamental regulatory changes, including several of those discussed in the Report. *See* SEC Proposing Release, *supra* note 4, at section III. Following the adoption of the new rules, the Commission has continued to explore more significant changes in light of the comments received on that release and through our staff's work within the PWG.

6 In particular, the Report notes that reforms may be needed to avoid migration of institutional money market fund assets into unregulated or less regulated money market investment vehicles. Without new restrictions on such investment vehicles, money market reform may motivate some investors to shift assets into money market fund substitutes that may pose greater systemic risk than registered money market funds. *See* section 3.h of the Report.

the Commission and the newly-established Financial Stability Oversight Council (which will be taking over the work of the PWG in this area) to consider the options discussed in this Report to identify those most likely to materially reduce money market funds' susceptibility to runs and to pursue their implementation. As the Report states, we anticipate that following the comment period a series of meetings will be held in Washington, D.C. with various stakeholders, interested persons, experts, and regulators to discuss the options in the Report.

We request comments on the options described in the Report both individually and in combination. Commenters should address the effectiveness of the options in mitigating systemic risks associated with money market funds, as well as their potential impact on money market fund investors, fund managers, issuers of short-term debt and other stakeholders. We also are interested in comments on other issues commenters believe are relevant to further money market fund reform, including other approaches for lessening systemic risk not identified in the Report. We urge commenters to submit empirical data and other information in support of their comments.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 3, 2010

APPENDIX

Report of the President's Working Group on Financial Markets

Money Market Fund Reform Options

October 2010

Table of Contents

Executive Summary

Several key events during the financial crisis underscored the vulnerability of the financial system to systemic risk. One such event was the September 2008 run on money market funds (MMFs), which began after the failure of Lehman Brothers Holdings, Inc., caused significant capital losses at a large MMF. Amid broad concerns about the safety of MMFs and other financial institutions, investors rapidly redeemed MMF shares, and the cash needs of MMFs exacerbated strains in short-term funding markets. These strains, in turn, threatened the broader economy, as firms and institutions dependent upon those markets for short-term financing found credit increasingly difficult to obtain. Forceful government action was taken to stop the run, restore investor confidence, and prevent the development of an even more severe recession. Even so, short-term funding markets remained disrupted for some time.

The Treasury Department proposed in its *Financial Regulatory Reform: A New Foundation* (2009), that the President's Working Group on Financial Markets (PWG) prepare a report on fundamental changes needed to address systemic risk and to reduce the susceptibility of MMFs to runs. Treasury stated that the Securities and Exchange Commission's (SEC) rule amendments to strengthen the regulation of MMFs—which were in development at the time and which subsequently have been adopted—should enhance investor protection and mitigate the risk of runs. However, Treasury also noted that those rule changes could not, by themselves, be expected to prevent a run on MMFs of the scale experienced in September 2008. While suggesting a number of areas for review, Treasury added that the PWG should consider ways to mitigate possible adverse effects of further regulatory changes, such as the potential flight of assets from MMFs to less regulated or unregulated vehicles.

This report by the PWG responds to Treasury's call.[7] The PWG undertook a study of possible further reforms that, individually or in combination, might mitigate systemic risk by complementing the SEC's changes to MMF regulation. The PWG supports the SEC's recent actions and agrees with the SEC that more should be done to address MMFs' susceptibility to runs. This report details a number of options for further reform that the PWG requests be examined by the newly established Financial Stability Oversight Council (FSOC). These options range from measures that could be implemented by the SEC under current statutory authorities to broader changes that would require new legislation, coordination by multiple government agencies, and the creation of new private entities. For example, a new requirement that MMFs adopt floating net asset values (NAVs) or that large funds meet redemption requests in kind could be accomplished by SEC rule amendments. In contrast, the introduction of a private emergency liquidity facility, insurance for MMFs, conversion of MMFs to special purpose banks, or a two-tier system of MMFs that might combine some of the other measures likely would involve a coordinated effort by the SEC, bank regulators, and financial firms.

Importantly, this report also emphasizes that the efficacy of the options presented herein would be enhanced considerably by the imposition of new constraints on less regulated or unregulated MMF substitutes, such as offshore MMFs, enhanced cash funds, and other stable value vehicles. Without new restrictions on such investment vehicles,

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[7] The PWG (established by Executive Order 12631) is comprised of the Secretary of the Treasury (who serves as its Chairman), the Chairman of the Federal Reserve Board of Governors, the Chairman of the Securities and Exchange Commission, and the Chairman of the Commodity Futures Trading Commission.

which would require legislation, new rules that further constrain MMFs may motivate some investors to shift assets into MMF substitutes that may pose greater systemic risk than MMFs.

The PWG requests that the FSOC consider the options discussed in this report to identify those most likely to materially reduce MMFs' susceptibility to runs and to pursue their implementation. To assist the FSOC in any analysis, the SEC, as the regulator of MMFs, will solicit public comments, including the production of empirical data and other information in support of such comments. A notice and request for comment will be published in the near future. Following a comment period, a series of meetings will be held in Washington, D.C. with various stakeholders, interested persons, experts, and regulators.

MMFs are susceptible to runs

MMFs are mutual funds. They are investment vehicles that act as intermediaries between shareholders who desire liquid investments and borrowers who seek term funding. With nearly $3 trillion in assets under management, MMFs are important providers of credit to businesses, financial institutions, and governments. In addition, these funds are significant investors in some short-term funding markets.

Like other mutual funds, MMFs are regulated under the Investment Company Act of 1940 (ICA). In addition to ICA requirements for all mutual funds, MMFs must comply with SEC rule 2a-7, which permits these funds to maintain a stable net asset value (NAV) per share, typically $1. However, if the mark-to-market per-share value of a fund's assets falls more than one-half of 1 percent (to below $0.995), the fund must reprice its shares, an event colloquially known as "breaking the buck."

The events of September 2008 demonstrated that MMFs are susceptible to runs. In addition, those events proved that runs on MMFs not only harm fund shareholders, but may also cause severe dislocations in short-term funding markets that curtail short-term financing for companies and financial institutions and that ultimately result in a decline in economic activity. Thus, reducing the susceptibility of MMFs to runs and mitigating the effects of possible runs are important components of the overall policy goals of decreasing and containing systemic risks.

MMFs are vulnerable to runs because shareholders have an incentive to redeem their shares before others do when there is a perception that the fund might suffer a loss. Several features of MMFs, their sponsors, and their investors contribute to this incentive. For example, although a stable, rounded $1 NAV fosters an expectation of safety, MMFs are subject to credit, interest-rate, and liquidity risks. Thus, when a fund incurs even a small loss because of those risks, the stable, rounded NAV may subsidize shareholders who choose to redeem at the expense of the remaining shareholders. A larger loss that causes a fund's share price to drop below $1 per share (and thus break the buck) may prompt more substantial sudden, destabilizing redemptions. Moreover, although the expectations of safety fostered by the stable, rounded $1 NAV suggest parallels to an insured demand deposit account, MMFs have no formal capital buffers or insurance to prevent NAV declines; MMFs instead have relied historically on discretionary sponsor capital support to maintain stable NAVs. Accordingly, uncertainty about the availability of such support during crises may contribute to runs. Finally, because investors have come to view MMFs as extremely safe vehicles that meet all withdrawal requests on demand (and that are, in this sense, similar to banks), MMFs have attracted highly risk-averse investors who are particularly prone to flight when they perceive the possibility of a loss. These features likely mutually reinforce each other in times of crisis.

The SEC's new rules

In January 2010, the SEC adopted new rules for MMFs in order to make these funds more resilient and less likely to break the buck. The regulatory changes that mitigate systemic risks fall into three principal categories. First, the new rules enhance risk-limiting constraints on MMF portfolios by introducing new liquidity requirements, imposing additional credit-quality standards, and reducing the maximum allowable weighted average maturity of funds' portfolios. Funds also are required to stress test their ability to maintain a stable NAV. Second, the SEC's new rules permit a fund that is breaking the buck to suspend redemptions promptly and liquidate its portfolio in an orderly manner to limit contagion effects on other funds. Third, the new rules place more stringent constraints on repurchase agreements that are collateralized with private debt instruments rather than government securities.

The need for further measures

The SEC's new rules make MMFs more resilient and less risky and therefore reduce the likelihood of runs on MMFs, increase the size of runs that MMFs can withstand, and mitigate the systemic risks they pose. However, the SEC's new rules address only some of the features that make MMFs susceptible to runs, and more should be done to address systemic risk and the structural vulnerabilities of MMFs to runs. Indeed, the Chairman of the SEC characterized the new rules as "a first step" in strengthening MMFs, and Treasury's *Financial Regulatory Reform: A New Foundation* (2009) anticipated that measures taken by the SEC "should not, by themselves, be expected to prevent a run on MMFs of the scale experienced in September 2008."

Mitigating the risk of runs on MMFs is especially important because the events of September 2008 may have created an expectation that, in a future crisis, the government may provide support for MMFs at minimal cost in order to minimize harm to MMF investors, short-term funding markets, and the economy. Persistent expectations of unpriced government support distort incentives in the MMF industry and pricing in short-term funding markets, as well as heighten the systemic risk posed by MMFs. It is thus essential that MMFs be required to internalize fully the costs of liquidity or other risks associated with their operation.

In formulating reforms for MMFs, policymakers should aim primarily at mitigating systemic risk and containing the contagious effect that strains at individual MMFs can have on other MMFs and on the broad financial system. Importantly, preventing any individual MMF from ever breaking the buck is not a practical policy objective—though the new SEC rules for MMFs should help ensure that such events remain rare and thus constitute a limited means of containing systemic risk.

Policy options

The policy options discussed in this report may help further mitigate the susceptibility of MMFs to runs. Some of these options may be adopted by the SEC under its existing authorities. Others would require legislation and action by multiple government agencies and the MMF industry.

(a) *Floating net asset values.* A stable NAV has been a key element of the appeal of MMFs to investors, but a stable, rounded NAV also heightens funds' vulnerability to runs. Moving to a floating NAV would help remove the perception that

MMFs are risk-free and reduce investors' incentives to redeem shares from distressed funds. However, the elimination of the stable NAV for MMFs would be a dramatic change for a nearly $3 trillion asset-management sector that has been built around the stable share price. Such a change may have several unintended consequences, including: (i) reductions in MMFs' capacity to provide short-term credit due to lower investor demand; (ii) a shift of assets to less regulated or unregulated MMF substitutes such as offshore MMFs, enhanced cash funds, and other stable value vehicles; and (iii) unpredictable investor responses as MMF NAVs begin to fluctuate more frequently.

(b) *Private emergency liquidity facilities for MMFs.* The liquidity risk of MMFs contributes importantly to their vulnerability to runs, and an external liquidity backstop to augment the SEC's new liquidity requirements for MMFs would help mitigate this risk. Such a backstop could buttress MMFs' ability to withstand outflows, internalize much of the liquidity protection costs for the MMF industry, offer efficiency gains from risk pooling, and reduce contagion effects. A liquidity facility would preserve fund advisers' incentives for not taking excessive risks because it would not protect funds from capital losses. As such, a liquidity facility alone may not prevent broader runs on MMFs triggered by concerns about widespread credit losses. Importantly, significant capacity, structure, pricing, and operational hurdles would have to be overcome to ensure that such a facility would be effective during crises, that it would not unduly distort incentives, and that it would not favor certain types of MMF business models.

(c) *Mandatory redemptions in kind.* When investors make large redemptions from MMFs, they may impose liquidity costs on other shareholders in the fund by forcing MMFs to sell assets in an untimely manner. A requirement that MMFs distribute large

redemptions in kind, rather than in cash, would force these redeeming shareholders to bear their own liquidity costs and thus reduce the incentive to redeem. Depending on whether redeeming shareholders immediately sell the securities received, redemptions in kind may still generate market effects. Moreover, mandating redemptions in kind could present some operational and policy challenges. The SEC, for example, would have to make key judgments regarding when a fund must redeem in kind and how funds would fairly distribute portfolio securities.

(d) *Insurance for MMFs.* Treasury's Temporary Guarantee Program for Money Market Funds helped slow the run on MMFs in September 2008, and some form of insurance for MMF shareholders might be helpful in mitigating the risk of runs in MMFs. Unlike a private liquidity facility, insurance would limit credit losses to shareholders, so appropriate risk-based pricing would be critical in preventing insurance from distorting incentives, but such pricing might be difficult to achieve in practice. The appropriate scope of coverage also presents a challenge; unlimited coverage would likely cause large shifts of assets from the banking sector to MMFs, but limited insurance might do little to reduce institutional investors' incentives to run from distressed MMFs. The optimal form for insurance—whether it would be private, public, or a mix of the two—is also uncertain, particularly given the recent experience with private financial guarantees.

(e) *A two-tier system of MMFs with enhanced protection for stable NAV funds.* Reforms aimed at reducing MMFs' susceptibility to runs may be particularly effective if they permit investors to select the types of MMFs that best balance their appetite for risk and their preference for yield. Policymakers could allow two types of MMFs: stable NAV funds, which would be subject to enhanced protections such as, for

example, required participation in a private liquidity facility or enhanced regulatory requirements; and floating NAV funds, which would have to comply with certain, but not all, rule 2a-7 restrictions (and which would presumably offer higher yields). Because this two-tier system would permit stable NAV funds to continue to be available, it would reduce the likelihood of a substantial decline in demand for MMFs and large-scale shifts of assets toward unregulated vehicles. At the same time, the forms of protection encompassed by such a system would mitigate the risks associated with stable NAV funds. It would also avoid problems that might be encountered in transitioning the entire MMF industry to a floating NAV. Moreover, during a crisis, a two-tier system might prevent large shifts of assets out of MMFs—and a reduction in credit supplied by the funds—if investors simply shift assets from riskier floating NAV funds toward safer (because of the enhanced protections) stable NAV funds. However, implementation of such a two-tier system would present the same challenges as the introduction of any individual enhanced protections (such as mandated access to a private emergency liquidity facility) that would be required for stable NAV funds, and the effectiveness of a two-tier system would depend on investors' understanding the risks associated with each type of fund.

(f) *A two-tier system of MMFs with stable NAV MMFs reserved for retail investors.* Another approach to the two-tier system already described could distinguish funds by investor type: Stable NAV MMFs could be made available only to retail investors, who could choose between stable NAV and floating NAV funds, while institutional investors would be restricted to floating NAV funds. The run on MMFs in September 2008 was almost exclusively due to redemptions from prime MMFs by

institutional investors. Such investors typically have generated greater cash-flow volatility for MMFs than retail investors and have been much quicker to redeem MMF shares from stable NAV funds opportunistically. Hence, this approach would mitigate risks associated with a stable NAV by addressing the investor base of stable NAV funds rather than by mandating other types of enhanced protections for those funds. Such a system also would protect the interests of retail investors by reducing the likelihood that a run might begin in institutional MMFs (as it did in September 2008) and spread to retail funds, while preserving the original purpose of MMFs, which was to provide retail investors with cost-effective, diversified investments in money market instruments. This approach would require the SEC to define who would qualify as retail and institutional investors, and distinguishing those categories will present challenges. In addition, a prohibition on sales of stable NAV MMFs shares to institutional investors may have several of the same unintended consequences as a requirement that all MMFs adopt floating NAVs (see option *(a)* in this section).

(g) *Regulating stable NAV MMFs as special purpose banks.* Functional similarities between MMF shares and bank deposits, as well as the risk of runs on both, provide a rationale for requiring stable NAV MMFs to reorganize as special purpose banks (SPBs) subject to banking oversight and regulation. As banks, MMFs could have access to government insurance and lender-of-last-resort facilities. An advantage of such a reorganization could be that it uses a well-understood regulatory framework for the mitigation of systemic risk. But while the conceptual basis for this option is fairly straightforward, its implementation might take a broad range of forms and would probably require legislation together with interagency coordination. An important hurdle

for successful conversion of MMFs to SPBs may be the very large amounts of equity necessary to capitalize the new banks. In addition, to the extent that deposits in the new SPBs would be insured, the potential government liabilities through deposit insurance would be increased substantially, and the development of an appropriate pricing scheme for such insurance would present some of the same challenges as the pricing of deposit insurance. More broadly, the possible interactions between the new SPBs and the existing banking system would have to be studied carefully by policymakers.

(h) *Enhanced constraints on unregulated MMF substitutes*. New measures intended to mitigate MMF risks may also reduce the appeal of MMFs to many investors. While it is likely that some (particularly retail) investors may move their assets from MMFs to bank deposits if regulation of MMFs becomes too burdensome and meaningfully reduces MMF returns, others may be motivated to shift assets to unregulated funds with stable NAVs, such as offshore MMFs, enhanced cash funds, and other stable value vehicles. Such funds, which typically hold assets similar to those held by MMFs, are vulnerable to runs but are less transparent and less constrained than MMFs, so their growth would likely pose systemic risks. Hence, effective mitigation of this risk may require policy reforms targeting regulatory arbitrage. Reforms of this type generally would require legislation and action by the SEC and other agencies.

1. Introduction and Background

a. Money Market Funds

MMFs are mutual funds that offer individuals, businesses, and governments a convenient and cost-effective means of pooled investing in money market instruments. MMFs provide an economically important service by acting as intermediaries between shareholders who desire liquid investments, often for cash management, and borrowers who seek term funding.

With nearly $3 trillion in assets under management, MMFs are important providers of credit to businesses, financial institutions, and governments. Indeed, these funds play a dominant role in some short-term credit markets. For example, MMFs own almost 40 percent of outstanding commercial paper, roughly two-thirds of short-term state and local government debt, and significant portions of outstanding short-term Treasury and federal agency securities.

Like other mutual funds, MMFs are regulated under the Investment Company Act of 1940 (ICA). In addition to the requirements applicable to other funds under the ICA, MMFs must comply with rule 2a-7, which permits these funds to maintain a "stable" net asset value (NAV) per share, typically $1, through the use of the "amortized cost" method of valuation. Under this method, securities are valued at acquisition cost, with adjustments for amortization of premium or accretion of discount, instead of at fair market value. To prevent substantial deviations between the $1 share price and the mark-to-market per-share value of the fund's assets (its "shadow NAV"), a MMF must periodically compare the two. If there is a difference of more than one-half of 1 percent (or $0.005 per share), the fund must re-price its shares, an event colloquially known as "breaking the buck."

Historically, the stable NAV has played an important role in distinguishing MMFs from other mutual funds and in facilitating the use of MMFs as cash management vehicles. Rule 2a-7 also imposes credit-quality, maturity, and diversification requirements on MMF portfolios designed to ensure that the funds' investing remains consistent with the objective of maintaining a stable NAV. A MMF's $1 share price is not guaranteed through any form of deposit or other insurance, or otherwise—indeed, MMF prospectuses must state that shares can lose value. However, by permitting amortized cost valuation, rule 2a-7 affords MMFs price stability under normal market conditions.

MMFs pursue a range of investment objectives, with corresponding differences in portfolio composition. For example, tax-exempt MMFs purchase short-term municipal securities and offer tax-exempt income to fund shareholders, while Treasury-only MMFs hold only obligations of the U.S. Treasury. In contrast, prime MMFs invest largely in private debt instruments, such as commercial paper and certificates of deposit, and, commensurate with the greater risks in prime MMF portfolios, they generally pay higher yields than Treasury-only funds.

MMFs are marketed both to retail investors (that is, individuals), for whom MMFs are the only means of investing in many money market instruments, and to institutions, which are often attracted by the convenience and cost efficiency of MMFs, even though many institutional investors have the ability to invest directly in the instruments held by MMFs. Institutional MMFs, which currently account for about two-thirds of the assets under management in MMFs, have grown much faster, on net, in the past two decades than retail funds. The rapid growth of institutional funds has important implications for the MMF industry, because institutional funds tend to have more volatile flows and more yield-sensitive shareholders than retail funds.

MMFs compete with other stable-value, low-risk investments. Because MMFs generally maintain stable NAVs, offer redemptions on demand, and often provide services that compete with those offered to holders of insured deposits (such as transactions services), many retail customers likely consider MMF shares and bank deposits as near substitutes, even if the two classes of products are fundamentally different (most notably because MMF shares are not insured and because MMFs and banks are subject to very different regulatory regimes). Some institutional investors may also view bank deposits and MMFs as near substitutes, although usual limitations on deposit insurance coverage and interest payments on deposits likely reduce the attractiveness of bank deposits for most such investors.[8] Institutional investors also have access to less-regulated MMF substitutes (for example, offshore MMFs, enhanced cash funds, and other stable value vehicles) and may perceive them as near substitutes for MMFs, even if those vehicles are not subject to the protections afforded by rule 2a-7.

b. ***MMFs' Susceptibility to Runs***

In the twenty-seven years since the adoption of rule 2a-7, only two MMFs have broken the buck. In 1994, a small MMF suffered a capital loss because of exposures to interest rate derivatives, but the event passed without significant repercussions. In

[8] Under the Federal Deposit Insurance Corporation's (FDIC) Temporary Liquidity Guarantee Program, coverage limits on noninterest-bearing transaction deposits in FDIC-insured institutions were temporarily lifted beginning in October 2008 and coverage will extend through 2010. Effective December 31, 2010, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203, ("Dodd-Frank Act"), all noninterest-bearing transaction deposits will have unlimited coverage until January 1, 2013. In addition, section 627 of the Dodd-Frank Act repeals the prohibition on banks paying interest on corporate demand deposit accounts effective July 21, 2011.

contrast, as further discussed later, when the Reserve Primary Fund broke the buck in September 2008, it helped ignite a massive run on prime MMFs that contributed to severe dislocations in short-term credit markets and strains on the businesses and institutions that obtain funding in those markets.[9]

Although the run on MMFs in 2008 is itself unique in the history of the industry, the events of 2008 underscored the susceptibility of MMFs to runs. That susceptibility arises because, when shareholders perceive a risk that a fund will suffer losses, each shareholder has an incentive to redeem shares before other shareholders. Five features of MMFs, their sponsors, and their investors principally contribute to this incentive:

(i) Maturity transformation with limited liquidity resources. One important economic function of MMFs is their role as intermediaries between shareholders who want liquid investments and borrowers who desire term funding. As such, MMFs offer shares that are payable on demand, but they invest both in cash-like instruments and in short-term securities that are less liquid, including, for example, term commercial paper. Redemptions in excess of MMFs' cash-like liquidity may force funds to sell less liquid assets. When money markets are strained, funds may not be able to obtain full value (that is, amortized cost) for such assets in secondary markets and may incur losses as a consequence. Investors thus have an incentive to redeem shares *before* a fund has depleted its cash-like instruments (which serve as its liquidity buffer).

(ii) NAVs rounded to $1. Share prices of MMFs are rounded to the nearest cent, typically resulting in a $1 NAV per share. The rounding fosters an expectation that MMF share prices will not fluctuate, which exacerbates investors' incentive to run when there is

[9] Section 1(c) contains more detail on the MMF industry's experience during the recent financial crisis.

risk that prices *will* fluctuate. When a MMF that has experienced a small (less than one-half of 1 percent) capital loss redeems shares at the full $1 NAV, it concentrates the loss among the remaining shareholders. Thus, redemptions from such a fund further depress the market value of its assets per share outstanding (its shadow NAV), and redemptions of sufficient scale may cause the fund to break the buck. Early redeemers are therefore more likely to receive the usual $1 NAV than those who wait.

(iii) Portfolios exposed to credit and interest rate risks. MMFs invest in securities with credit and interest-rate risks. Although these risks are generally small given the short maturity of the securities and the high degree of portfolio diversification, even a small capital loss, in combination with other features of MMFs, can trigger a significant volume of redemptions. The events of September 2008—when losses on Lehman Brothers Holdings, Inc. (Lehman Brothers) debt instruments caused just one MMF to break the buck and triggered a broad run on MMFs—highlight the fact that credit losses at even a single fund may have serious implications for the whole industry and consequently for the entire financial system.[10]

(iv) Discretionary sponsor capital support. MMFs invest in assets that may lose value, but the funds have no formal capital buffers or insurance to maintain their $1 share prices in the event of a loss on a portfolio asset.

The MMF industry's record of maintaining a stable NAV reflects, in part, substantial discretionary intervention by MMF sponsors (that is, fund advisers, their affiliates, and their parent firms) to support funds that otherwise might have broken the

[10] Souring credits and rapid increases in interest rates have adversely affected MMFs on other occasions. For example, beginning in the summer of 2007, MMF exposures to structured investment vehicles and other asset-backed commercial paper caused capital losses at many MMFs, and many MMF sponsors voluntarily provided capital support that prevented some funds from breaking the buck.

buck.[11] Sponsors do not commit to support an MMF in advance, because an explicit commitment may require the sponsor to consolidate the fund on its balance sheet and—if the sponsor is subject to regulatory capital requirements—hold additional regulatory capital against the contingent exposure. Nor is there any requirement that sponsors support ailing MMFs; such a mandate would transform the nature of MMF shares by shifting risks from investors to sponsors and probably would require government supervision and monitoring of sponsors' resources and capital adequacy.[12] Instead, sponsor capital support remains expressly voluntary, and not all MMFs have a sponsor capable of fully supporting its MMFs. Nonetheless, a long history of such support probably has contributed substantially to the perceived safety of MMFs.

However, the possibility that sponsors may become unwilling or unable to provide expected support during a crisis is itself a source of systemic risk. Indeed, sponsor support is probably least reliable when systemic risks are most salient.[13] Moreover, MMFs without deep-pocketed sponsors remain vulnerable to runs that can affect the entire industry. The Reserve Primary Fund was not the only MMF that held Lehman Brothers debt at the time of the Lehman Brothers' bankruptcy in September 2008, but it broke the buck because the Reserve Primary Fund, unlike some of its competitors, had substantial holdings of Lehman Brothers debt and Reserve did not have

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[11] For example, more than 100 MMFs received sponsor capital support in 2007 and 2008 because of investments in securities that lost value and because of the run on MMFs in September and October 2008. See Securities and Exchange Commission (2009) "Money Market Reform: Proposed Rule," pp. 13-14, 17, and notes 38 and 54.

[12] Even discretionary support for MMFs may lead to concerns about the safety and soundness of MMF sponsors. Sponsors that foster expectations of such support may be granting a form of implicit recourse that is not reflected on sponsors' balance sheets or in their regulatory capital ratios, and such implicit recourse may contribute to broader systemic risk.

[13] Other forms of discretionary financial support, such as that provided by dealers for auction rate securities, did not fare well during the financial crisis.

the resources to support its fund. Investors also recognized the riskiness of sponsor support more broadly during the run on MMFs in 2008. For example, outflows from prime MMFs following the Lehman Brothers bankruptcy tended to be larger among MMFs with sponsors that were themselves under strain (as measured by credit default swap spreads for parent firms or affiliates), indicating that MMF investors quickly redeemed shares on concerns about sponsors' potential inabilities to bolster ailing funds.

(v) Investors' low risk tolerance and expectations. Investors have come to view MMF shares as extremely safe, in part because of the funds' stable NAVs and sponsors' record of supporting funds that might otherwise lose value. MMFs' history of maintaining stable value has attracted highly risk-averse investors who are prone to withdraw assets rapidly when losses appear possible.

MMFs, like other mutual funds, commit to redeem shares based on the fund's NAV at the time of redemption. MMFs are under no legal or regulatory requirement to redeem shares at $1; rule 2a-7 only requires that MMFs be managed to maintain a stable NAV. Yet sponsor-supported stable, rounded NAVs and the typical $1 MMF share price foster investors' impressions that MMFs are extremely safe investments. Indeed, the growth of retail MMFs in recent decades may have reflected some substitution from insured deposits at commercial banks, thrifts, and credit unions, particularly as MMFs have offered transactions services and other bank-like functions. Although MMF shares, unlike bank deposits, are not government insured and are not backed by capital to absorb losses, this distinction may have become even less clear to retail investors following the unprecedented government support of MMFs in 2008 and 2009. Furthermore, that recent support may have left even sophisticated institutional investors with the mistaken impression that MMF safety is enhanced because the government stands ready to support the industry again with the same tools employed at the height of the financial crisis.

The growth of institutional MMFs in recent years probably has heightened both the risk aversion of the typical MMF shareholder and the volatility of MMF cash flows. Many institutional investors cannot tolerate fluctuations in share prices for a variety of reasons. In addition, institutional investors are typically more sophisticated than retail investors in obtaining and analyzing information about MMF portfolios and risks, have larger amounts at stake, and hence are quicker to respond to events that may threaten the stable NAV. In fact, institutional MMFs have historically experienced much more volatile flows than retail funds. During the run on MMFs in September 2008, institutional funds accounted for more than 90 percent of the net redemptions from prime MMFs.

The interaction of these five features is critical. Taken alone, each of the features just listed probably would only modestly increase the vulnerability of MMFs to runs, but, in combination, the features tend to amplify and reinforce one another. For example, equity mutual funds perform maturity transformation and take on capital risks, but even after large capital losses, outflows from equity funds tend to be small relative to assets, most likely because equity funds are not marketed for their ability to maintain stable NAVs, do not attract the risk-averse investor base that characterizes MMFs, and offer the opportunity for capital appreciation. If MMFs with rounded NAVs had lacked sponsor support over the past few decades, many might have broken the buck and diminished the expectation of a stable $1 share price. In that case, investors who nonetheless elected to hold shares in such funds might have become more tolerant of risk and less inclined to run. If MMFs had attracted primarily a retail investor base rather than an institutional base, investors might be slower to respond to strains on a MMF. And even a highly risk-averse investor base would not necessarily make MMFs susceptible to runs—and to contagion arising from runs on other MMFs—if funds had a credible means to guarantee their $1 NAVs. Thus, policy responses that diminish the reinforcing interactions among the features discussed herein hold promise for muting overall risks posed by MMFs.

c. *MMFs in the Recent Financial Crisis*

The turmoil in financial markets in 2007 and 2008 caused severe strains both among MMFs and in the short-term debt markets in which MMFs invest. Beginning in mid-2007, dozens of funds faced losses from holdings of highly rated asset-backed commercial paper (ABCP) issued by structured investment vehicles (SIVs), some of which had exposures to the subprime mortgage market. Fear of such losses at one MMF caused that fund to experience a substantial run in August 2007, which was brought under control when the fund's sponsor purchased more than $5 billion of illiquid securities from the fund. Indeed, financial support from MMF sponsors in recent years probably prevented a number of funds from breaking the buck because of losses on SIV paper.

The crisis for MMFs worsened considerably in September 2008 with the bankruptcy of Lehman Brothers on September 15 and mounting concerns about other issuers of commercial paper, particularly financial firms. The Reserve Primary Fund, a $62 billion MMF, held $785 million in Lehman Brothers debt on the day of Lehman Brothers' bankruptcy and immediately began experiencing a run—shareholders requested redemptions of approximately $40 billion in just two days. In order to meet the redemptions, the Reserve Primary Fund depleted its cash reserves and began seeking to sell its portfolio securities, which further depressed their valuations. Unlike other MMFs that held distressed securities, the Reserve Primary Fund had no affiliate with sufficient resources to support its $1 NAV, and Reserve announced on September 16 that its Primary Fund would break the buck and re-price its shares at $0.97. On September 22, the SEC issued an order permitting the suspension of redemptions in certain Reserve MMFs to permit their orderly liquidation.

The run quickly spread to other prime MMFs, which held sizable amounts of financial sector debt that investors feared might decline rapidly in value. During the week of September 15, 2008, investors withdrew approximately $310 billion (15 percent of assets) from prime MMFs, with the heaviest redemptions coming from institutional funds. To meet these redemption requests, MMFs depleted their cash positions and sought to sell portfolio securities into already illiquid markets. These efforts caused further declines in the prices of short-term instruments and put pressure on per-share values of fund portfolios, threatening MMFs' stable NAVs. Nonetheless, only one MMF—the Reserve Primary Fund—broke the buck, because many MMF sponsors provided substantial financial support to prevent capital losses in their funds.

Fearing further redemptions, many MMF advisers limited new portfolio investments to cash, U.S. Treasury securities, and overnight instruments, and avoided term commercial paper, certificates of deposit, and other short-term credit instruments. During September 2008, MMFs reduced their holdings of commercial paper by about $170 billion (25 percent). As market participants hoarded cash and refused to lend to one another on more than an overnight basis, interest rates spiked and short-term credit markets froze. Commercial paper issuers were required to make significant draws on their backup lines of credit, placing additional pressure on the balance sheets of commercial banks.

On September 19, 2008, Treasury and the Board of Governors of the Federal Reserve System (Federal Reserve) announced two unprecedented market interventions to stabilize MMFs and to provide liquidity to short-term funding markets. Treasury's Temporary Guarantee Program for Money Market Funds temporarily provided guarantees for shareholders in MMFs that elected to participate in the program.[14] The Federal Reserve's Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) extended credit to U.S. banks and bank holding companies to finance their purchases of high-quality ABCP from MMFs.[15]

The announcements of these government programs substantially slowed the run on prime MMFs. Outflows from prime MMFs diminished to about $65 billion in the week after the announcements and, by mid-October, these MMFs began attracting net inflows. Moreover, in the weeks following the government interventions, markets for commercial paper and other short-term debt instruments stabilized considerably.[16]

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[14] MMFs that elected to participate in the program paid fees of 4 to 6 basis points at an annual rate for the guarantee. The Temporary Guarantee Program for Money Market Funds expired on September 18, 2009.

[15] The AMLF expired on February 1, 2010.

[16] Several other unprecedented government interventions that provided additional support for the MMF industry and for short-term funding markets were introduced after the run on MMFs had largely abated. For example, the Federal Reserve in October 2008 established the Commercial Paper Funding Facility (CPFF), which provided loans for purchases (through a special purpose vehicle) of term commercial paper from issuers. The CPFF, which expired on February 1, 2010, helped issuers repay investors—such as MMFs—who held maturing paper. Also in October 2008, the Federal Reserve announced the Money Market Investor Funding Facility (MMIFF), which was intended to bolster liquidity for MMFs by financing (through special purpose vehicles) purchases of securities from the funds. The MMIFF was never used and expired on October 30, 2009. In November 2008, Treasury agreed to become a buyer of last resort for certain securities held by the Reserve U.S. Government Fund (a MMF), in order to facilitate an orderly and timely liquidation of the fund. Under the agreement, Treasury would purchase certain securities issued by

2. The SEC's Changes to the Regulation of MMFs

The effects of the financial turmoil in 2007 and 2008 on MMFs—and, in particular, the run on these funds in September 2008 and its consequences—have highlighted the need for reforms to mitigate the systemic risks posed by MMFs. Appropriate reforms include changes to MMF regulations as well as broader policy actions. This section first examines rule changes that have been adopted by the SEC to improve the safety and resilience of MMFs and then discusses some limitations in these measures' mitigation of systemic risk and the need for further reforms.

Notwithstanding the need for reform, the significance of MMFs in the U.S. financial system suggests that changes must be considered carefully. Tighter restrictions on MMFs might, for example, lead to a reduction in the supply of short-term credit, a shift in assets to substitute investment vehicles that are subject to less regulation than MMFs, and significant impairment of an important cash-management tool for investors. Moreover, the economic importance of risk-taking by MMFs—as lenders in private debt markets and as investments that appeal to shareholders' preferences for risk and return—suggests that the appropriate objective for reform should not be to eliminate all risks posed by MMFs. Attempting to prevent any fund from *ever* breaking the buck would be an impractical goal that might lead, for example, to draconian and—from a broad economic perspective—counterproductive measures, such as outright prohibitions on purchases of private debt instruments and securities with maturities of more than one day. Instead, policymakers should balance the benefits of allowing individual MMFs to take some risks and facilitating private and public borrowers' access to term financing in

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government sponsored enterprises at amortized cost (not mark to market), and $3.6 billion of such purchases were completed in January 2009.

money markets with the broader objective of mitigating systemic risks—in particular, the risk that one fund's problems may cause serious harm to other MMFs, their shareholders, short-term funding markets, the financial system, and the economy.

a. SEC Regulatory Changes

In January 2010, the SEC adopted new rules regulating MMFs in order to make these funds more resilient to market disruptions and thus less likely to break the buck. The new rules also might help reduce the likelihood of runs on MMFs by facilitating the orderly liquidation of funds that have broken the buck. The SEC designed the new rules primarily to meet its statutory obligations under the ICA to protect investors and promote capital formation. Nonetheless, the rules should mitigate (although not eliminate) systemic risks by reducing the susceptibility of MMFs to runs, both by lessening the likelihood that an individual fund will break the buck and by containing the damage should one break the buck. The rule changes fall into three principal categories.

(i) Enhanced Risk-Limiting Constraints on Money Market Fund Portfolios. Each of the changes that follow further constrain risk-taking by MMFs.

Liquidity Risk. One of the most important SEC rule changes aimed at reducing systemic risk associated with MMFs is a requirement that each fund maintain a substantial liquidity cushion. Augmented liquidity should position MMFs to better withstand heavy redemptions without selling portfolio securities into potentially distressed markets at discounted prices. Forced "fire sales" to meet heavy redemptions may cause losses not only for the fund that must sell the securities, but also for other MMFs that hold the same or similar securities. Thus, a substantial liquidity cushion should help reduce the risk that strains on one MMF will be transmitted to other funds and to short-term credit markets.

Specifically, the SEC's new rules require that MMFs maintain minimum daily and weekly liquidity positions. Daily liquidity, which must be at least 10 percent of a MMF's assets, includes cash, U.S. Treasury obligations, and securities (including repurchase agreements) that mature or for which the fund has a contractual right to obtain cash within a day. Weekly liquidity, which must be at least 30 percent of each MMF's assets, includes cash, securities that mature or can be converted to cash within a week, U.S. Treasury obligations, and securities issued by federal government agencies and government-sponsored enterprises with remaining maturities of 60 days or less.[17] Furthermore, the new rules require MMF advisers to maintain larger liquidity buffers as necessary to meet reasonably foreseeable redemptions.

Credit Risk. The new rules reduce MMFs' maximum allowable holdings of "second-tier" securities, which carry more credit risk than first-tier securities, to no more than 3 percent of each fund's assets.[18] In addition, a MMF's exposure to a single second-tier issuer is now limited to one-half of 1 percent of the fund's assets, and funds can only purchase second-tier securities with maturities of 45 days or less. These new constraints reduce the likelihood that individual funds will be exposed to a credit event that could cause the funds to break the buck. Also, since second-tier securities often trade in thinner

[17] Tax-exempt money market funds are exempt from daily minimum liquidity requirements but not the weekly minimum liquidity requirements, because most tax-exempt fund portfolios consist of longer-term floating- and variable-rate securities with seven-day "put" options that effectively give the funds weekly liquidity. Tax-exempt funds are unlikely to have investment alternatives that would permit them to meet a daily liquidity requirement.

[18] Under SEC rule 2a-7, for short-term debt securities to qualify as second-tier securities, they generally must have received the second highest short-term debt rating from the credit rating agencies or be of comparable quality. Section 939A of the Dodd-Frank Act requires that government agencies remove references to credit ratings in their rules and replace them with other credit standards that the agency determines appropriate. As a result, the SEC will be reconsidering this rule and its provisions relating to second-tier securities to comply with this statutory mandate.

markets, these changes should improve the ability of individual MMFs to maintain a stable NAV during periods of market volatility.

Interest Rate Risk. By reducing the maximum allowable weighted average maturity (WAM) of fund portfolios from 90 days to 60 days, the new rules are intended to diminish funds' exposure to interest rate risk and increase the liquidity of fund portfolios. The SEC also introduced a new weighted average life (WAL) measure for MMFs—and set a ceiling for WAL at 120 days—in order to lower funds' exposure to interest-rate, credit, and liquidity risks associated with the floating-rate obligations that MMFs commonly hold.[19]

Stress Testing. Finally, the SEC's new rules require fund advisers to periodically stress test their funds' ability to maintain a stable NAV per share based on certain hypothetical events, including a change in short-term interest rates, an increase in shareholder redemptions, a downgrade or default of a portfolio security, and a change in interest rate spreads. Regular and methodical monitoring of these risks and their potential effects should help funds weather stress without incident.

(ii) Facilitating Orderly Fund Liquidations. The new SEC rules should reduce the systemic risk posed by MMFs by permitting a fund that is breaking the buck to promptly suspend redemptions and liquidate its portfolio in an orderly manner. This new rule should help prevent a capital loss at one fund from forcing a disorderly sale of portfolio securities that might disrupt short-term markets and diminish share values of other MMFs. Moreover, the ability of a fund to suspend redemptions should help prevent

[19] For purposes of computing WAM, a floating-rate security's "maturity" can be its next interest-rate reset date. In computing WAL, the life of a security is determined solely by its final maturity date. Hence, WAL should be more useful than WAM in reflecting the risks of widening spreads on longer-term floating-rate securities.

investors who redeem shares from benefiting at the expense of those who remain invested in a fund.

(iii) Repurchase Agreements. The SEC's new rules place more stringent constraints on repurchase agreements that are collateralized with private debt instruments rather than cash equivalents or government securities. MMFs are among the largest purchasers of repurchase agreements, which they use to invest cash, typically on an overnight basis. Because the collateral usually consists of long-term debt securities, a MMF cannot hold the securities underlying this collateral without violating SEC rules that limit MMF holdings to short-term obligations. Accordingly, if a significant counterparty fails to repurchase securities as stipulated in a repurchase agreement, its MMF counterparties can be expected to direct custodians to sell the collateral immediately, and sales of private debt instruments could be sizable and disruptive to financial markets. To address this risk, the SEC's new rule places additional constraints on MMFs' exposure to counterparties through repurchase agreement transactions that are collateralized by securities other than cash equivalents or government securities.

b. Need for Further Reform to Reduce Susceptibility to Runs

The new SEC rules make MMFs more resilient and less risky and therefore reduce the likelihood of runs on funds, increase the size of runs that they could withstand, and mitigate the systemic risks they pose. However, more can be done to address the structural vulnerabilities of MMFs to runs. Indeed, the Chairman of the SEC characterized its new rules as "a first step" in strengthening MMFs and noted that a number of additional possible reforms (many of which are presented in section 3 of this report) are under discussion. Likewise, Treasury's *Financial Regulatory Reform: A New*

Foundation (2009) anticipated that measures taken by the SEC "should not, by themselves, be expected to prevent a run on MMFs of the scale experienced in September 2008."

Of the five features that make MMFs vulnerable to runs (see section 1(b)), the two most directly addressed in the new SEC rules are liquidity risks associated with maturity transformation and MMF portfolios' exposures to credit and interest-rate risks. The SEC's new rules should substantially reduce these risks, but systemic risks arising from the other features of MMFs and their investors—the stable, rounded NAV, a system of discretionary sponsor support, and a highly risk-averse investor base—still remain, as do many of the amplifying interaction effects. Some mitigation of the destabilizing effects that one or a few MMFs can impose on the rest of the industry through contagion might be achievable through further modifications to rule 2a-7 and other SEC rules. Importantly, however, other reforms that could more substantially reduce the risk of contagion and that, as such, merit further consideration, would require action beyond what the SEC could achieve under its current authority.

Mitigating the risk of runs before another liquidity crisis materializes is especially important because the events of September 2008 may have induced expectations of government assistance at minimal cost in case of severe financial strains. Market participants know, and recent events have confirmed, that when runs on MMFs occur, the government will face substantial pressure to intervene in some manner to minimize the propagation of financial strains to short-term funding markets and to the real economy. Importantly, such interventions would be intended not only to reduce harm to MMF investors but also to prevent disruptions of markets for commercial paper and other short-term financing instruments, which are critical for the functioning of the economy. Therefore, if further measures to insulate the industry from systemic risk are not taken *before* the next liquidity crisis, market participants will likely expect that the government would provide emergency support at minimal cost for MMFs *during* the next crisis. Such market expectations of (hypothetical) future non-priced or subsidized government support would distort incentives for MMFs and prices in short-term funding markets and would potentially increase the systemic risk posed by MMFs. To forestall these perverse effects, it is thus imperative that MMFs be required to internalize fully the costs of liquidity or other risks associated with their operation.

MMF regulatory reform in light of the run on MMFs in September and October 2008. The run on MMFs in 2008 provides some important lessons for evaluating potential reforms for mitigating systemic risk. For example, the triggering events of the run and the magnitude of the outflows that followed underscore the difficulty of designing reforms that might prevent runs and the associated damage to the financial system.

Making each individual MMF robust enough to survive a crisis of the size of that experienced in 2008 may not be an appropriate policy objective because it would unduly limit risk taking. Indeed, although the SEC's tightening of restrictions on the liquidity, interest-rate, and credit risks borne by individual MMFs will be helpful in making MMFs more resilient to future strains, there are practical limits to the degree of systemic risk mitigation that can be achieved through further restrictions of this type. For example, an objective of preventing any MMF from breaking the buck probably would not be feasible for funds that invest in private debt markets. Changes that would prevent funds from breaking the buck due to a single Lehman Brothers-like exposure would have to be severe: Only limiting funds' exposures to each issuer to less than one-half of 1 percent of assets would prevent a precipitous drop in the value of any single issuer's debt from causing a MMF to break the buck.[20] But even such a limit on exposure to a single issuer would not address the risk that MMFs may accumulate exposures to distinct but highly correlated issuers, and that funds would remain vulnerable to events that cause the debt of multiple issuers to lose value.

Beyond diversification limits, new rules to protect MMFs from material credit losses would be difficult to craft unless regulators take the extreme step of eliminating funds' ability to hold *any* risky assets. But that approach would be clearly undesirable, as it would adversely affect many firms that obtain short-term financing through commercial paper and similar instruments. In addition, such an extreme approach would deny many retail investors any opportunity to obtain exposure to private money market instruments and most likely would motivate some institutional investors to shift assets from MMFs to less regulated vehicles.

Similarly, liquidity requirements sufficient to cover all redemption scenarios for MMFs probably would be impractical and inefficient. The SEC's new liquidity requirements help mitigate liquidity risks borne by the funds, and if MMFs had held enough liquid assets in September 2008 to meet the new liquidity requirements, each MMF would have had adequate daily liquidity to meet redemption requests on most individual days during the run. Even so, the cumulative effect of severe outflows on

[20] At the time of its bankruptcy, Lehman Brothers' short-term debt was still a first-tier security, so MMFs were able to hold up to 5 percent of their assets in Lehman Brothers' debt. The SEC's new rules do not affect this limit.

consecutive days would have exceeded many funds' liquidity buffers. Moreover, without external support in 2008—specifically, the introduction of the Treasury's Temporary Guarantee Program for Money Market Funds and the Federal Reserve's AMLF—outflows likely would have continued and been much larger, and they would have forced substantial sales of assets to meet redemptions. Such asset sales would have contributed to severe strains in short-term markets, depressed asset prices, caused capital losses for MMFs, and prompted further shareholder flight. Hence, MMFs' experience during the run in 2008 indicates that the new SEC liquidity requirements make individual MMFs more resilient to shocks but still leave them susceptible to runs of substantial scale.

Raising the liquidity requirements enough so that each MMF would hold adequate daily liquidity to withstand a large-scale run would be a severe constraint and would fail to take advantage of risk-pooling opportunities that might be exploited by external sources of liquidity. During the run in 2008, individual MMFs experienced large variations in the timing and magnitude of their redemptions. Liquidity requirements stringent enough to ensure that every individual MMF could have met redemptions without selling assets would have left most of the industry with far too much liquidity, even during the run, and would have created additional liquidity risks for issuers of short-term securities, since these issuers would have had to roll over paper more frequently. Some of the approaches discussed in section 3 are aimed at buttressing the SEC's new minimum liquidity requirements without simply increasing their magnitude.

Finally, the run on MMFs in 2008 demonstrated the systemic threat that such runs may represent. Without additional reforms to more fully mitigate the risk of a run spreading among MMFs, the actions to support the MMF industry that the U.S.

government took beginning in 2008 may create an expectation for similar government support during future financial crises, and the resulting moral hazard may make crises in the MMF industry more frequent than the historical record would suggest. Accordingly, despite the risk reduction that should be achieved by the initial set of new SEC rules, policymakers should explore the advantages and disadvantages of implementing further reforms before another crisis materializes.

3. Policy Options for Further Reducing the Risks of Runs on MMFs

This section discusses a range of options for further mitigation of the systemic risks posed by MMFs. The SEC requested comment on some of these options, such as requiring that MMFs maintain a floating NAV or requiring in kind redemptions in certain circumstances. In addition, the SEC received comments proposing a two-tier system of MMFs in which some funds maintain a stable NAV and others a floating NAV. Other options discussed in this section go beyond what the SEC could implement under existing authorities and would require legislation or coordinated action by multiple government agencies and the MMF industry. While the measures presented here, either individually or in combination, would help diminish systemic risk, new restrictions imposed solely on MMFs may reduce their appeal to some investors and might cause some—primarily institutional—investors to move assets to less regulated cash management substitutes. Many such funds, like MMFs, seek to maintain a stable NAV and have other features that make them vulnerable to runs, so such funds likely also would pose systemic risks. Therefore, effective mitigation of MMFs' susceptibility to runs may require policy reforms beyond those directed at registered MMFs to address risks posed by funds that compete with MMFs. Such reforms, which generally would require legislation, are discussed in section 3(h).

a. Floating Net Asset Values

Historically, the $1 stable NAV that MMFs maintain under rule 2a-7 has been a key element of their appeal to a broad range of investors, and the stable NAV has contributed to a dramatic expansion in MMFs' assets over the past two decades. At the same time, as noted in section 1(b), the stable, rounded NAV is one of the features that heighten the vulnerability of MMFs to runs. The significance of MMFs in financial markets and the central role of the stable, rounded NAV in making MMFs appealing to investors and, at the same time, vulnerable to runs, make careful discussion of the potential benefits and risks of moving MMFs away from a stable NAV essential to a discussion of MMF reform.

The stable, rounded NAVs of MMFs contribute to their vulnerability to runs for several reasons.

- First, the stable, rounded NAV, coupled with MMF sponsors' longstanding practice of supporting the stable NAV when funds have encountered difficulties, has fostered investors' expectations that MMF shares are risk-free cash equivalents. When the Reserve Primary Fund failed to maintain those expectations in September 2008, the sudden loss of investor confidence helped precipitate a generalized run on MMFs. By making gains and losses a regular occurrence, as they are in other mutual funds, a floating NAV could alter investor expectations and make clear that MMFs are not risk-free vehicles. Thus, investors might become more accustomed to and tolerant of NAV fluctuations and less prone to sudden, destabilizing reactions in the face of even modest losses. However, the substantial changes in investor expectations that could result from a floating NAV also might motivate investors to shift assets away from MMFs to banks or to unregulated cash-management vehicles, and the effects of potentially large movements of assets on the financial system should be considered carefully. These issues are discussed in more detail later.

- Second, a rounded NAV may accelerate runs by amplifying investors' incentives to redeem shares quickly if a fund is at risk of a capital loss. When a MMF experiences a loss of less than one-half of 1 percent and continues to redeem shares at a rounded NAV of $1, it offers redeeming shareholders an arbitrage opportunity by paying more for the shares than the shares are worth. Simultaneously, the fund drives down the expected future value of the shares because redemptions at $1 per share further erode the fund's market-based per-share value—and increase the likelihood that the fund will break the buck—as losses on portfolio assets are spread over a shrinking asset base. These dynamics are inherently unstable. Thus, even an investor who otherwise might not choose to redeem may do so in recognition of other shareholders' incentives to redeem and the effects of such redemptions on a fund's expected NAV. The growth of institutional investment in MMFs has exacerbated this instability because institutional investors are better positioned than retail investors to identify potential problems in a MMF's portfolio and rapidly withdraw significant amounts of assets from the fund.

  In contrast, a floating NAV eliminates *some* of the incentives to redeem when a MMF has experienced a loss. Because MMFs must redeem shares at NAVs set *after* redemption requests are received, losses incurred by a fund with a floating NAV are borne on a pro rata basis by all shareholders, whether they redeem or not.

Redemptions from such a fund do not concentrate already incurred losses over a smaller asset base and do not create clear arbitrage opportunities for investors. However, as discussed below, a floating NAV does not eliminate the incentive to redeem shares from a distressed MMF.

- Third, the SEC rules that permit funds to maintain a stable, rounded NAV also force an abrupt decrease in price once the difference between a fund's market-based shadow NAV and its $1 stable NAV exceeds one-half of 1 percent. So, although NAV fluctuations are rare in MMFs, when prices do decline, the change appears as a sudden drop. This discontinuity heightens investors' incentives to redeem shares before a loss is incurred, produces dire headlines, and probably raises the chance of a panic.

These considerations suggest that moving to a floating NAV would reduce the systemic risk posed by MMFs to some extent. Under a required floating NAV, MMFs would have to value their portfolio assets just like any other mutual fund. That is, MMFs would not be able to round their NAVs to $1 or use the accounting methods (for example, amortized cost for portfolio securities with a maturity of greater than 60 days) currently allowed under rule 2a-7.

To be sure, a floating NAV itself would not eliminate entirely MMFs' susceptibility to runs. Rational investors still would have an incentive to redeem as fast as possible the shares of any MMF that is at risk of depleting its liquidity buffer before that buffer is exhausted, because subsequent redemptions may force the fund to dispose of less-liquid assets and incur losses. However, investors would have less of an incentive to run from MMFs with floating NAVs than from those with stable, rounded NAVs.

Notwithstanding the advantages of a floating NAV, elimination of the stable NAV for MMFs would be a dramatic change for a nearly $3 trillion asset-management sector that has been built around the stable $1 share price. Indeed, a switch to floating NAVs for MMFs raises several concerns.

- First, such a change might reduce investor demand for MMFs and thus diminish their capacity to supply credit to businesses, financial institutions, state and local governments, and other borrowers who obtain financing in short-term debt markets. MMFs are the dominant providers of some types of credit, such as commercial paper and short-term municipal debt, so a significant contraction of MMFs might cause particular difficulties for borrowers who rely on these instruments for financing. If the contraction were abrupt, redemptions might cause severe disruptions for MMFs, the markets for the instruments the funds hold, and borrowers who tap those markets. While there is no direct evidence on the likely effect of a floating NAV on the demand for MMFs, the risk of a substantial shift of assets away from MMFs and into other vehicles should be weighed carefully. Assets under management in MMFs dwarf those of their nearest substitutes, such as, for example, ultra-short bond funds, most likely because ultra-short bond funds are not viewed as cash substitutes. To the extent that demand for stable NAV funds is boosted by investors who hold MMFs because they perceive them to be risk-free, a reduction in demand for these funds might be desirable.[21] However, some investors face functional obstacles to placing certain assets in floating NAV funds. For example, internal investment guidelines may prevent corporate cash managers from investing in floating NAV funds, some

[21] Even a contraction in the credit extended by MMFs might be an efficient outcome if such credit has been over-supplied because markets have not priced liquidity and systemic risks appropriately.

state laws allow municipalities to invest only in stable-value funds, and fiduciary obligations may prevent institutional investors from investing client money in floating NAV funds. In addition, some investors may not tolerate the loss of accounting convenience and tax efficiencies that would result from a shift to a floating NAV, although these problems might be mitigated somewhat through regulatory or legislative actions.[22]

- Second, a related concern is that elimination of MMFs' stable NAVs may cause investors to shift assets to stable NAV substitutes that are vulnerable to runs but subject to less regulation than MMFs. In particular, many institutional investors might move assets to less regulated or unregulated cash management vehicles, such as offshore MMFs, enhanced cash funds, and other stable value vehicles that hold portfolios similar to those of MMFs but are not subject to the ICA's restrictions on MMFs. These unregistered funds can take on more risks than MMFs, but such risks are not necessarily transparent to investors. Accordingly, unregistered funds may pose even greater systemic risks than MMFs, particularly if new restrictions on MMFs prompt substantial growth in unregistered funds. Thus, changes to MMF rules might displace or even increase systemic risks, rather than mitigate them, and make such risks more difficult to monitor and control. Reforms designed to reduce risks in less regulated or unregulated MMF substitutes are discussed in more detail in section 3(h).

[22] A stable NAV relieves shareholders of the administrative task of tracking the timing and price of purchase and sale transactions for tax and accounting purposes. For investors using MMFs for cash management, floating NAV funds (under current rules) would present more record-keeping requirements than stable NAV funds, although certain tax changes beginning in 2011 will require mutual funds, including MMFs, to report the tax basis (presumably using an average basis method) to shareholders and thereby help reduce any associated accounting burden from a floating NAV.

Elimination of MMFs' stable NAVs may also prompt some investors—particularly retail investors—to shift assets from MMFs to banks. Such asset shifts would have potential benefits and drawbacks, which are discussed in some detail in section 3(g).

- Third, MMFs' transition from stable to floating NAVs might itself be systemically risky. For example, if shareholders perceive a risk that a fund that is maintaining a $1 NAV under current rules has a market-based shadow NAV of less than $1, these investors may redeem shares preemptively to avoid potential losses when MMFs switch to floating NAVs. Shareholders who cannot tolerate floating NAVs probably also would redeem in advance. If large enough, redemptions could force some funds to sell assets and make concerns about losses self-fulfilling. Hence, successful implementation of a switch to floating NAVs would depend on careful design of the conversion process to guard against destabilizing transition dynamics.
- Fourth, risk management practices in a floating NAV MMF industry might deteriorate without the discipline required to maintain a $1 share price. MMFs comply with rule 2a-7 because doing so gives them the ability to use amortized-cost accounting to maintain a stable NAV. Without this reward, the incentive to follow 2a-7 restrictions is less clear. Moreover, the stable, rounded NAV creates a bright line for fund advisers: Losses in excess of ½ of 1 percent would be catastrophic because they would cause a fund to break the buck. With a floating NAV, funds would not have as clear a tipping point, so fund advisers might face reduced incentives for prudent risk management.
- The fifth and final concern is that a floating NAV that accomplishes its proponents' objectives of reducing systemic risks may be difficult to implement. Under normal

market conditions, even a floating NAV would likely move very little because of the nature of MMF assets. For example, although a requirement that MMFs move to a $10 NAV and round to the nearest cent would force funds to reprice shares for as little as a 5 basis point change in portfolio value, NAV fluctuations might still remain relatively rare. Enhanced precision for NAVs (for example, NAVs with five significant figures) could bring more regular, incremental fluctuations, but precise pricing of many money market securities is challenging given the absence of active secondary markets. In addition, if fund sponsors decided to provide support to offset any small deviations from the usual NAV, deviations from that NAV might remain rare.

Thus, a floating NAV may not substantially improve investors' understanding of the riskiness of MMFs or reduce the stigma and systemic risks associated with breaking the buck. Investors' perceptions that MMFs are virtually riskless may change slowly and unpredictably if NAV fluctuations remain small and rare. MMFs with floating NAVs, at least temporarily, might even be more prone to runs if investors who continue to see shares as essentially risk-free react to small or temporary changes in the value of their shares.

To summarize, requiring the entire MMF industry to move to a floating NAV would have some potential benefits, but those benefits would have to be weighed carefully against the risks that such a change would entail.

b. Private Emergency Liquidity Facilities for MMFs

As discussed in section 1(b), the liquidity risk of MMFs contributes importantly to MMFs' vulnerability to runs. The programs introduced at the height of the run on

MMFs in September 2008—Treasury's Temporary Guarantee Program for Money Market Funds and the liquidity backstop provided by the AMLF—were effective in stopping the run on MMFs.[23] More generally, policymakers have long recognized the utility of liquidity backstops for institutions engaged in maturity transformation: Banks, for example, have had access to the discount window since its inception, and backstop lending facilities also have been created more recently for other types of institutions. Thus, enhanced liquidity protection should be considered as part of any regulatory reform effort aimed at preventing runs on MMFs. At the same time, such enhanced liquidity protection does not have to be provided necessarily by the government: A private facility, adequately capitalized and financed by the MMF industry, could be set up to supply liquidity to funds that most need it at times of market stress. Depending on its structure, such a private facility itself might have access to broader liquidity backstops.

A private emergency liquidity facility could be beneficial on several levels. First, a private liquidity facility, in combination with the SEC's new liquidity requirements, might substantially buttress MMFs' ability to withstand outflows without selling assets in potentially illiquid markets.[24] Second, a private emergency facility might offer important efficiency gains from risk pooling. Even during the systemic liquidity crisis in 2008,

[23] Outflows from prime MMFs totaled about $200 billion in the two days prior to the Treasury and Federal Reserve announcements on Friday, September 19, 2008. However, in the two business days following the announcements (Monday and Tuesday, September 22 and 23), outflows were just $22 billion.

[24] For example, as noted in the text, even if MMFs in September 2008 had held liquid assets in the proportions that the SEC has recently mandated, the net redemptions experienced by the funds following the Lehman Brothers bankruptcy would have forced MMFs to sell considerable amounts of securities into illiquid markets in the absence of the substantial government interventions. But a liquidity facility with the capacity to provide an additional 10 percent overnight liquidity to each fund would double the effective overnight liquid resources available to MMFs. If MMFs in September 2008 had already been in compliance with the new liquidity requirements, a facility with this capacity would have considerably reduced funds' need to raise liquidity (for example, through asset sales) during the run. In addition, the very existence of the facility might have reduced redemption requests in the first place.

individual MMFs experienced large variations in the timing and magnitude of redemptions. An emergency facility could provide liquidity to the MMFs that need it; in contrast, liquidity requirements for individual MMFs would likely leave some funds with too much liquidity and others with too little. Third, a private liquidity facility might provide funds with flexibility in managing liquidity risks if, for example, regulators allowed MMFs some relief in liquidity requirements in return for the funds' purchase of greater access to the liquidity facility's capacity.

Importantly, a properly designed and well-managed private liquidity facility would internalize the cost of liquidity protection for the MMF industry and provide appropriate incentives for MMFs and their investors.[25] Such a facility would not help funds that take on excessive capital risks or face runs because of isolated credit losses (a well-designed private liquidity facility would not have helped the Reserve Primary Fund or its shareholders avoid losses in September 2008 due to holdings of Lehman Brothers debt). Moreover, a liquidity facility alone may not prevent runs on MMFs triggered by concerns about more widespread credit losses at MMFs. However, a liquidity facility could substantially reduce the damage that a run on a single distressed fund might cause to the rest of the industry.

While a private emergency liquidity facility would be appealing in several respects, setting up an effective facility would present a number of challenges. The structure and operations of a private liquidity facility would have to be considered carefully to ensure that it would be effective during crises and that it would not unduly

[25] A private liquidity facility could also result in retail fund investors bearing some of the costs of meeting the likely higher liquidity needs of institutional funds. Consideration should be given as to whether and how to prevent such an outcome.

distort incentives, while, at the same time, that it would be in compliance with all applicable regulations and that it would not favor certain market participants or business models. For example:

- On the one hand, if MMFs were required to participate in a private facility, regulators would assume some responsibility for ensuring that the facility was operated equitably and efficiently, that it managed risks prudently, and that it was able to provide liquidity effectively during a crisis. On the other hand, if participation were voluntary, some MMFs would likely choose not to participate to avoid sharing in the costs associated with the facility. Non-participating MMFs might present greater risks than their competitors but would free-ride on the stability the liquidity facility would provide. In a voluntary participation framework, one means of balancing risks between MMFs that do and do not participate in a liquidity facility would be to require nonparticipants to adhere to more stringent risk-limiting constraints or to require such funds to switch to a floating NAV. Such an approach (in which some MMFs have stable NAVs and others floating NAVs) is considered in section 3(e).
- Ensuring that the facility has adequate capacity to meet MMFs' liquidity needs during a crisis would be critical to the effectiveness of the facility in mitigating systemic risk. Inadequate capacity might, for example, create an incentive for MMF advisers to tap the facility before others do and thus make the facility itself vulnerable to runs. News of a depleted liquidity facility might amplify investor concerns and trigger or expand a run on MMFs. However, raising enough capital to build adequate liquidity capacity without undue leverage would be a challenge for the asset management

industry. Accordingly, meaningful mitigation of systemic risk may require that the facility itself have access to alternative sources of liquidity.

- A private facility may face conflicts of interest during a crisis when liquidity is in short supply. Responsibility to the facility's shareholders would mandate prudence in providing liquidity to MMFs. For example, facility managers would want to be selective in providing liquidity against term commercial paper out of concern about losses on such paper. However, excessive prudence would be at odds with the facility serving as an effective liquidity backstop. In addition, a private facility may face conflicts among different types of shareholders and participants who may have different interests, and a strong governance structure would be needed to address these conflicts as well as prevent the domination of the facility by the advisers of larger funds.
- Rules governing access to the facility would have to be crafted carefully to minimize the moral hazard problems among fund advisers, who could face diminished incentives to maintain liquidity in their MMFs. However, excessive constraints on access would limit the facility's effectiveness. An appropriate balancing of access rules might be difficult to achieve.

Notwithstanding these concerns, a private emergency liquidity facility could play an important role in supplementing the SEC's new liquidity requirements for MMFs. The potential advantages and disadvantages of such a facility, as well as its optimal structure and modes of operation, should be the subjects of further analysis and discussion.

c. Mandatory Redemptions in Kind

When investors make large redemptions from MMFs, they impose liquidity costs on other shareholders in the fund. For example, redemptions may force a fund to sell its most liquid assets to raise cash. Remaining shareholders are left with claims on a less liquid portfolio, so redemptions are particularly costly for other shareholders during a crisis, when liquidity is most valued.[26]

A requirement that MMFs distribute large redemptions by institutional investors in kind, rather than in cash, would force these redeeming shareholders to bear their own liquidity costs and reduce their incentive to redeem.[27] If liquidity pressures are causing money market instruments to trade at discounts, a MMF that distributes a large redemption in cash may have to sell securities at a discount to raise the cash. All shareholders in the fund would share in the loss on a pro rata basis. However, if the fund distributes securities to the investor in proportion to the claim on the fund represented by the redeemed shares, the liquidity risk would be borne most directly by the redeeming investor. If the fund elects to dispose of the securities in a dislocated market and incurs a loss, other shareholders are not directly affected.[28]

Requiring large redemptions to be made in kind would reduce, but not eliminate the systemic risk associated with large, widespread redemptions. Shareholders with

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[26] The problem is exacerbated by a rounded NAV, because a fund that has already incurred a capital loss but that continues to redeem each share at $1 also transfers capital losses from redeeming shareholders to those who remain in the fund.

[27] Such a requirement also would force redeeming shareholders to bear their share of any losses that a MMF has already incurred—even if the fund maintains a stable, rounded NAV and has not yet broken the buck—rather than concentrating those losses entirely in the MMF and thus on remaining MMF shareholders.

[28] If the investor sells securities at a loss, however, and the MMF also holds the same or similar securities, the fund may be forced to re-price the securities and lower its mark-to-market, shadow NAV. So, remaining investors in the fund may be affected indirectly by the redeeming investor, even if that investor receives redemptions in kind.

immediate liquidity needs who receive securities from MMFs would have to sell those assets, and the consequences for short-term markets of such sales would be similar to the effects if the money market fund itself had sold the securities. Smaller shareholders would still receive cash redemptions, and larger investors might structure their MMF investments and redemptions to remain under the in-kind threshold.

An in-kind redemption requirement would present some operational and policy challenges. Portfolio holdings of MMFs sometimes are not freely transferable or are only transferable in large blocks of shares, so delivery of an exact pro rata portion of each portfolio holding to a redeeming shareholder may be impracticable. Thus, a fund may have to deliver different securities to different investors but would need to do so in an equitable manner. Funds should not, for example, be able to distribute only their most liquid assets to redeeming shareholders, since doing so would undermine the purpose of an in-kind redemptions requirement. Thus, the SEC would have to make key judgments on the circumstances under which a fund must redeem in kind, as well as the criteria that funds would use for determining which portfolio securities must be distributed and how they would be valued.

d. Insurance for MMFs

As noted in section 1(b), the absence of formal capital buffers or insurance for MMFs, as well as their historical reliance on discretionary sponsor support in place of such mechanisms, further contributes to their vulnerability to runs. Treasury's Temporary Guarantee Program for Money Market Funds, announced on September 19, 2008, was a key component of the government intervention that slowed the run on MMFs. The program provided guarantees for shares in MMFs as of the announcement date. These guarantees were somewhat akin to deposit insurance, which for many decades has played a central role in mitigating the risk of runs on banks.[29] Therefore, some form of insurance for MMF shareholders might be helpful in mitigating systemic risks posed by MMFs, although insurance also may create new risks by distorting incentives of fund advisers and shareholders.

Like an external liquidity facility, insurance would reduce the risk of runs on MMFs, but the consequences of insurance and a liquidity facility would otherwise be different. A liquidity facility would do little or nothing to help a fund that had already experienced a capital loss, but such a facility might be very helpful in mitigating the destabilizing effects that one fund's capital loss might impose on the rest of the industry. Insurance, in contrast, would substantially reduce or eliminate any losses borne by the shareholders of the MMF that experienced the capital loss and damp their incentives to redeem shares in that fund. Although either option might reduce the incentives for asset managers and shareholders to minimize risks, a liquidity facility without an insurance scheme would leave intact shareholders' incentive to monitor funds for the credit and interest rate risks that may trigger a run. However, in a crisis that triggers concerns about widespread credit losses, liquidity protection without some form of insurance may still leave MMFs vulnerable to runs.

In addition to these general considerations, the design and implementation of an insurance program for MMFs would require resolution of a number of difficult issues.

[29] All publicly offered stable NAV MMFs were eligible to participate in the program. If a MMF elected to participate, the program guaranteed that each shareholder in that MMF would receive the stable share price (typically $1) for each share held in the fund, up to the number of shares held as of the close of business on September 19, 2008. In the event that a participating MMF broke the buck, the fund was required to suspend redemptions and commence liquidation, and the fund was eligible to collect payment from Treasury to enable payment of the stable share price to each covered investor. Treasury neither received any claims for payment nor incurred any losses under the program.

For example:

- Insurance could, in principle, be provided by the private sector, the government, or a combination of the two, but all three options have potential drawbacks. Private insurers have had considerable difficulties in fairly pricing and successfully guaranteeing rare but high-cost financial events, as demonstrated, for example, by the recent difficulties experienced by financial guarantors. That no private market for insurance has developed is some evidence that such insurance for MMFs may be a challenging business model, particularly if funds are not required to obtain insurance.[30] Making insurance for MMFs mandatory could attract private insurance providers, but the pricing and scope of coverage that these providers could offer would need to be the subject of careful consideration. In any case, insurers would need to maintain capital and carry reinsurance as necessary to cover losses during extraordinary events. Public insurance would necessitate new government oversight and administration functions and, particularly in the absence of private insurance, would require a mechanism for setting appropriate risk-based premiums (either pre- or post-event). A hybrid insurance scheme—for example, with MMFs or their sponsors retaining the first level of losses up to a threshold, private insurers or risk pools handling losses up to a certain higher threshold, and a government insurance

[30] The degree of insurance coverage provided by Treasury's Temporary Guarantee Program for Money Market Funds was unprecedented. Private insurance with considerably narrower coverage has been available to MMFs in the past: ICI Mutual Insurance Company, an industry association captive insurer, offered very limited insurance to MMFs from 1999 to 2003. This insurance covered losses on MMF portfolio assets due to defaults and insolvencies but not losses due to events such as a security downgrade or a rise in interest rates. Coverage was limited to $50 million per fund, with a deductible of the first 10 to 40 basis points of any loss. Premiums ranged from 1 to 3 basis points. ICI Mutual reportedly discontinued offering the insurance in 2003 because coverage restrictions and other factors limited demand to the point that the insurance was not providing enough risk pooling to remain viable. Of course, MMFs continue to have access to other market-based mechanisms for transferring risks, such as credit default swaps, although holdings of such derivative securities by MMFs are tightly regulated by rule 2a-7.

program serving as a backstop (perhaps with post-event recoupment)—might offer some advantages, but it would be subject to the risks of private insurance and the challenges of public insurance.

- On the one hand, mandatory participation in an insurance system likely would be necessary to instill investor confidence in the MMF industry, to ensure an adequate pooling of risk, to prevent riskier funds from opting out yet free-riding on the stability afforded by insured funds, and to create a sufficient premium base. On the other hand, an insurance requirement would create new government responsibilities, and the regulatory and economic implications of such a requirement would have to be evaluated carefully.

- Insurance increases moral hazard and would shift incentives for prudent risk management by MMFs from fund advisers, who are better positioned to monitor risks, to public or private insurers. In addition, insurance removes investors' incentives to monitor risk management by fund advisers. Broadly speaking, insurance fundamentally changes the nature of MMF shares, from pooled pass-through investments in risky assets to insured products with relatively low yields and limited or no risk.
- Appropriate pricing would be critical to the success of a MMF insurance program, as pricing would affect the financial position of the guarantor, the incentives of MMF advisers, and the relative attractiveness of different types of MMFs and their competitors (for example, bank deposits). Insurance pricing that is not responsive to

the riskiness of individual MMF portfolios, for example, would heighten moral hazard problems that undermine incentives for prudent MMF risk management. Underpriced insurance might cause disruptive outflows from bank deposits to MMFs and would be a subsidy for sponsors of and investors in MMFs. Still, insurance for MMFs might be easier to price fairly than deposit insurance for banks, as MMF portfolios are highly restricted, relatively homogeneous in comparison with bank portfolios, transparent, and priced on a daily basis.

- Limits on insurance coverage (perhaps similar to those for deposit insurance) would be needed to avoid giving MMFs an advantage over banks and to preserve incentives for large investors to monitor the risk management practices at MMFs. However, such limits would leave most institutional investors' shares only marginally covered by insurance and do little to reduce their incentive to run should MMF risks become salient.

e. A Two-Tier System of MMFs, with Enhanced Protections for Stable NAV MMFs

Reforms intended to reduce the systemic risks posed by MMFs might be particularly effective if they allow investors some flexibility in choosing the MMFs that best match their risk-return preferences. Policymakers might accommodate a range of preferences by allowing two types of MMFs to be regulated under rule 2a-7:

(i) Stable NAV MMFs. These funds would continue to maintain stable, rounded NAVs, but they would be subject to enhanced protections, which might include some combination of tighter regulation (such as higher liquidity standards) and required access to an external liquidity backstop. Other options to provide enhanced protection for stable NAV funds might include mandatory distribution of large redemptions in kind and insurance. (Policymakers may also consider limiting the risk arising from investors in stable NAV funds by restricting sales of such funds' shares to retail investors, as discussed in section 3(f).)

(ii) Floating NAV funds. Although these MMFs would still have to comply with many of the current restrictions of rule 2a-7, these restrictions might be somewhat less stringent than those for stable NAV funds. So, floating NAV funds could bear somewhat greater credit and liquidity risks than stable NAV funds, might not be required to obtain access to external sources of liquidity or insurance, and most likely would pay higher yields than their stable NAV counterparts. Regulatory relief—for example, allowing simplified tax treatment for small NAV changes in funds that adhere to rule 2a-7—might help preserve the attractiveness of such funds for many investors.

A two-tier system could mitigate the systemic risks that arise from a stable, rounded NAV, by requiring funds that maintain a stable NAV to have additional protections that directly address some of the features that contribute to their vulnerability to runs. At the same time, by preserving stable NAV funds, such a system would mitigate the risks of a wholesale shift to floating NAV funds. For example, a two-tier system would diminish the likelihood of a large-scale exodus from the MMF industry by investors who might find a floating NAV MMF unacceptable.

Floating NAV MMFs would face a lower risk of runs for the reasons outlined in section 3(a): Frequent changes in these funds' NAVs would help align investor perceptions and actual fund risks, and investors would have reduced incentives to redeem early in a crisis without a rounded NAV. In addition, investor sorting might ameliorate the risk of runs: Under such a two-tier system, investors who choose floating NAV funds presumably would be less risk-averse and more tolerant of NAV changes than the shareholders of stable NAV funds.

During a crisis, investors would likely shift at least some assets from riskier floating NAV MMFs to stable NAV MMFs, which would presumably be safer because of their enhanced protections. Such flows might be similar, in some respects, to the asset flows seen during the September 2008 crisis from prime MMFs to government MMFs, but a shift between tiers of prime funds could be less disruptive to short-term funding markets and the aggregate supply of credit to private firms than a flight from prime to government MMFs. Effective design of a two-tier system would have to incorporate measures to ensure that large-scale shifts of assets among MMFs in crises would not be disruptive.[31]

[31] If stable NAV MMFs carried mandatory insurance, some limitations on insurance coverage (for example,

For a two-tier system to be effective and materially mitigate the risk of runs, investors would have to fully understand the difference between the two types of funds and their associated risks. Investors who do not make this distinction might flee indiscriminately from floating NAV and stable NAV funds alike; in this case, a two-tier system would not be effective in mitigating the risk of runs.

The relative ease or difficulty of implementing a two-tier system would depend on the nature of the stable NAV and floating NAV MMFs that comprise it. For example, if the stable NAV funds simply were required to satisfy more stringent SEC rules governing portfolio safety, creation of a two-tier system would be fairly straightforward. A requirement that stable NAV funds obtain access to an emergency liquidity facility would likely make stable NAV funds less prone to runs and would reduce the likelihood that investors flee indiscriminately from both types of funds in the event of severe market strains. However, this approach also would face the challenges associated with the creation of an effective liquidity facility (discussed in more detail in section 3(b)).

f. A Two-Tier System of MMFs, with Stable NAV MMFs Reserved for Retail Investors

Another approach to the two-tier system described in section 3(e) could distinguish stable NAV and floating NAV funds by investor type. Stable NAV MMFs could be made available only to retail investors, while institutional investors would be restricted to floating NAV funds.

This approach would bring enhanced protections to stable NAV MMFs by

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stipulating that individual shares in such funds could be insured only after a given number of days) might reduce the magnitude of flows between different types of MMFs and reduce implicit subsidies for investors who purchase shares in stable NAV funds only during crises. However, such rules might diminish the value of insurance in preventing runs.

mitigating the risk arising from the behavior of their investors, because institutional investors have historically generated greater risks of runs for MMFs than retail investors. As noted previously, the run from MMFs in September 2008 was primarily a flight by institutional investors. More than 90 percent of the net outflows from prime MMFs in the week following the Lehman Brothers bankruptcy came from institutional funds, and institutional investors withdrew substantial sums from prime MMFs even before the Reserve Primary Fund broke the buck.

Moreover, evidence suggests that the additional risks posed by institutional investors during the run on MMFs in September 2008 were not unique to that episode. Relative to retail investors, institutional investors have greater resources to monitor MMF portfolios and risks and have larger amounts at stake, and are therefore quicker to redeem shares on concerns about MMF risks. Institutional MMFs typically have greater cash flow volatility than retail funds. Net flows to institutional MMFs have also exhibited patterns indicating that institutional investors regularly arbitrage small discrepancies between MMFs' shadow NAVs and their $1 share prices.[32] These observations suggest that many institutional investors are aware of such discrepancies—which are likely to widen during financial crises—and are able to exploit them.

A two-tier system based on investor type would protect the interests of retail investors by reducing the likelihood that a run might begin in institutional MMFs (as it did in September 2008) and spread to retail funds. Moreover, such a system would preserve the original purpose of MMFs, which was to provide retail investors with cost-effective access to diversified investments in money market instruments. Retail investors

[32] For example, after Federal Open Market Committee (FOMC) actions that lower the FOMC's target for the federal funds rate, MMF shadow NAVs rise and institutional MMFs often experience large net inflows.

have few alternative opportunities to obtain such exposures. In contrast, institutional investors, which can meet minimum investment thresholds for direct investments in money market instruments, would be able to continue doing so.

One advantage of this alternative is that it could be accomplished by SEC rulemaking under existing authorities without establishing additional market structures. A prohibition on institutional investors' use of stable NAV MMFs would have some practical hurdles, however. Successful enforcement of the rule would require the SEC to define who would qualify as retail and institutional investors. In practice, such distinctions may be difficult, although not impossible, to make. For example, retail investors who own MMF shares because of their participation in defined contribution plans (such as 401(k) plans) may be invested in institutional MMFs through omnibus accounts that are overseen by institutional investors (plan administrators). Simple rules that might be used to identify institutional investors, such as defining as institutional any investor whose account size exceeds a certain threshold, would be imperfect and could motivate the use of workarounds (such as brokered accounts) by institutional investors. The SEC, as part of its rulemaking, would need to take steps to prevent such workarounds.

Because many institutional investors may be particularly unwilling to switch to floating NAV MMFs, a prohibition on sales of stable NAV MMFs shares to such investors may have many of the same unintended consequences as a requirement that all MMFs adopt floating NAVs (see section 3(a)). In particular, prohibiting institutional investors from holding stable NAV funds might cause large shifts in assets to unregulated MMF substitutes. This concern is of particular importance given that institutional MMFs currently account for almost two-thirds of the assets under management in MMFs.

In addition, a two-tier system based on investor type would preclude some of the advantages of allowing institutional investors to choose between stable NAV MMFs and floating NAV MMFs (as the option described in section 3(e) would permit). For example, under the two-tier system described in section 3(e), investor sorting would provide some protection for the floating NAV funds, because institutional investors holding floating NAV MMFs likely would be less risk-averse than those who held stable NAV funds. With institutional investors prohibited from holding shares in stable NAV MMFs, such sorting among these investors would not occur. During a crisis, under the system described in section 3(e), institutional investors might be expected to shift assets from floating NAV MMFs to stable NAV funds, but a ban on institutional holdings of stable NAV MMF shares would prevent such shifts.

g. Regulating Stable NAV MMFs as Special Purpose Banks.

Functional similarities between MMF shares and deposits, as well as the risk of runs on both types of instruments, provide a rationale for introducing bank-like regulation for MMFs. For example, mandating that stable NAV MMFs be reorganized as SPBs might subject these MMFs to banking oversight and regulation, including requirements for reserves and capital buffers, and provide MMFs with access to a liquidity backstop and insurance coverage within a regulatory framework specifically designed for mitigation of systemic risk.[33] If each MMF were offered the option of implementing a floating NAV as an alternative to reorganizing as a bank, the reorganization requirement

[33] Such an approach to MMF reform was advocated by the Group of Thirty. See Group of Thirty, *Financial Reform: A Framework for Financial Stability*, released on January 15, 2009.

for stable NAV MMFs might be viewed as part of a two-tier system for MMFs.[34]

Although the conceptual basis for converting stable NAV MMFs to SPBs is seemingly straightforward, in practice this option spans a broad range of possible implementations, most of which would require legislative changes and complex interagency regulatory coordination. The advantages and disadvantages of this reform option depend on how exactly the conversion to SPBs would be implemented and how the new banks would be structured. A thorough discussion of the full range of possibilities—including their feasibility, probable effect on the MMF industry, broader implications for the banking system, and likely efficacy in mitigating systemic risk—would be quite complex and is beyond the scope of this report.

As an example of the issues that this option involves, one possible approach to its implementation would be to preserve stable NAV MMFs as standalone entities but to treat their shares as deposits for the purposes of banking law. These shares, unlike other deposits, might be claims specifically (and only) on MMF assets, which could continue to be subject to strict risk-limiting regulations such as those provided by rule 2a-7 or similar rules. The introduction of such hybrid investment vehicles would preserve investors' opportunity to benefit from mutualized investments in private money market instruments, but, being a novel combination of features of banks and mutual funds, such vehicles would also present complex regulatory and operational challenges. In contrast, other

[34] There may be a question as to whether floating NAV MMFs—if such funds are offered—should or should not be required to reorganize as SPBs. Other mutual funds with floating NAVs, such as ultra-short bond funds, presumably would not be affected by a mandate that MMFs reorganize as SPBs. The principal distinction between other (non-MMF) mutual funds and floating NAV MMFs would be that the latter are constrained by rule 2a-7 and thus have less risky portfolios, so the advantages and disadvantages of mandating these funds to reorganize as banks would have to be carefully evaluated. However, policymakers could consider prohibiting floating NAV MMFs from offering bank-like services that attract risk-averse investors, such as the ability to provide transactions services.

approaches to converting MMFs to SPBs, such as absorbing or transforming stable NAV MMFs into financial institutions that offer traditional deposits, might be simpler to accomplish in practice, but nonetheless subject to different sets of challenges. In particular, if the deposits offered by the new SPBs were only of the types currently offered by other banks, investors—and particularly retail investors, who have few alternative opportunities to obtain diversified exposures to money market instruments—would lose access to important investment options.[35] In addition, to the extent that banks have different preferences for portfolio assets than MMFs, a simple transformation of MMFs into depository institutions might lead to a decline in the availability of short-term financing for firms and state and local governments that currently rely on money markets to satisfy their funding needs. Considerable further study would thus be needed in pursuing this option..

Leaving aside the details of how exactly this option could be implemented, in general terms, a principal advantage of reorganizing MMFs as SPBs is that such a change would provide MMFs with a broad regulatory framework similar to existing regulatory systems that are designed for mitigation of systemic risk. Investments in MMFs and insured deposits—which already serve some similar functions, particularly for retail investors—could be regulated similarly. MMFs and their investors might benefit from access to government insurance and emergency liquidity facilities at a price similar to that currently paid by depository institutions. Importantly, such access would not require

[35] In contrast, institutional investors could continue to obtain such exposures either by investing directly in money market instruments or by holding shares in offshore MMFs, enhanced cash funds, and other stable value vehicles. Hence, absorption of MMFs by banks might have the unintended effect of reducing investment opportunities for retail investors, who generally did not participate in the run on MMFs in 2008, while leaving money market investment options for institutional investors largely intact.

any extraordinary government actions (such as the establishment in September 2008 of Treasury's Temporary Guarantee Program for Money Market Funds or the creation of the Federal Reserve's AMLF); instead, the terms of such access would be codified and well-understood in advance.

Moreover, by providing explicit capital buffers, access to a liquidity backstop, and deposit insurance, a conversion of stable NAV MMFs to SPBs might substantially reduce the uncertainties and systemic risks associated with MMF sponsors' current practice of discretionary capital support. Clear rules for how the buffers, backstop, and insurance would be used would improve the transparency of the allocation of risks among market participants.

However, the capital needed to reorganize MMFs as SPBs may be a significant hurdle to successful implementation of this option. Access to the Federal Reserve discount window and deposit insurance coverage most likely would require that the new SPBs hold reservable deposits and meet specific capitalization standards.[36] Given the scale of assets under management in the MMF industry, MMF sponsors (or banks) that wish to keep funds operating would have to raise substantial equity—probably at least tens of billions of dollars—to meet regulatory capital requirements.[37] Raising such sums would be a considerable challenge. The asset management business typically is not

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[36] Currently, MMFs are essentially 100 percent capital—their liabilities are the equity shares held by investors—so the meaning of "capital requirements" for such funds is not clear. However, if MMFs were reorganized as SPBs, their capital structure would become more complex. MMF shares would likely be converted to deposit liabilities, and MMFs would have to hold additional capital (equity) buffers to absorb first losses. Capital requirements would regulate the size of such buffers.

[37] The magnitude of the capital required might be reduced if floating NAV MMFs were not required to reorganize as SPBs and if a substantial number of funds elected to float their NAVs rather than reorganize as banks. In addition, the capital required might be reduced somewhat if regulators determined that the nature of the assets held by MMFs justifies capital requirements that are lower than those imposed on commercial banks and thrifts.

capital intensive, so many asset managers—and several of the largest sponsors of MMFs—are lightly capitalized and probably could not provide such amounts of capital. If asset managers or other firms were unwilling or unable to raise the capital needed to operate the new SPBs, a sharp reduction in assets in stable NAV MMFs might diminish their capacity to supply short-term credit, curtail the availability of an attractive investment option (particularly for retail investors), and motivate institutional investors to shift assets to unregulated vehicles.

An additional hurdle to converting MMFs to SPBs would be the substantial increase in explicit government guarantees that would result from the creation of new insured deposits. The potential liability to the government probably would far exceed any premiums that could be collected for some time.

Uncertainties about the reaction of institutional investors to MMFs reorganized as SPBs raise some important concerns about whether such reorganizations would provide a substantial degree of systemic-risk mitigation. Coverage limits on deposit insurance would leave many large investors unprotected in case of a significant capital loss. Thus, even with the protections afforded to banks, MMFs would still be vulnerable to runs by institutional investors, unless much higher deposit insurance limits were allowed for the newly created SPBs. Moreover, even in the absence of runs, institutional MMFs often experience volatile cash flows, and the potential effects of large and high-frequency flows into and out of the banking system (if MMFs become SPBs) would need to be analyzed carefully.

The reaction of institutional investors to the altered set of investment opportunities may also have unintended consequences. For example, SPBs that pay positive net yields to investors (depositors) would be very attractive for institutional investors who currently cannot receive interest on traditional bank deposits.[38] Thus, on the one hand, the new SPBs might prompt shifts of assets by institutional investors from the traditional banking system. On the other hand, a substantial mandatory capital buffer for MMFs would reduce their net yields and possibly motivate institutional investors to move assets from MMFs to unregulated alternatives (particularly if regulatory reform does not include new constraints on such vehicles). The effect of these competing incentives on institutional investors' cash management practices is uncertain, but it is at least plausible that a reorganization of MMFs as SPBs may lead to a net shift of assets to unregulated investment vehicles.

h. Enhanced Constraints on Unregulated MMF Substitutes

New rules intended to reduce the susceptibility of MMFs to runs generally also will reduce the appeal of the funds to many investors. For example, several of the reforms recently adopted by the SEC probably will reduce the net yields that the funds pay to shareholders, and a switch to floating NAVs would eliminate a feature that some MMF shareholders see as essential.

Reforms that reduce the appeal of MMFs may motivate some institutional investors to move assets to alternative cash management vehicles with stable NAVs, such as offshore MMFs, enhanced cash funds, and other stable value vehicles. These vehicles typically invest in the same types of short-term instruments that MMFs hold and share many of the features that make MMFs vulnerable to runs, so growth of unregulated MMF substitutes would likely increase systemic risks. However, such funds need not comply

[38] Section 627 of the Dodd-Frank Act repeals the prohibition on banks paying interest on corporate demand deposit accounts effective July 21, 2011.

with rule 2a-7 or other ICA protections and in general are subject to little or no regulatory oversight. In addition, the risks posed by MMF substitutes are difficult to monitor, since they provide far less market transparency than MMFs.

Thus, effective mitigation of systemic risks may require policy reforms targeted outside the MMF industry to address risks posed by funds that compete with MMFs and to combat regulatory arbitrage that might offset intended reductions in MMF risks. Such reforms most likely would require legislation and action by the SEC and other agencies. For example, consideration should be given to prohibiting unregistered investment vehicles from maintaining stable NAVs, perhaps by amending sections 3(c)(1) and 3(c)(7) of the ICA to specify that exemptions from the requirement to register as an investment company do not apply to funds that seek a stable NAV. Banking and state insurance regulators might consider additional restrictions to mitigate systemic risk for bank common and collective funds and other investment pools that seek a stable NAV but that are exempt from registration under sections 3(c)(3) and 3(c)(11) of the ICA.

Commissioner Casey and Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63243 / November 4, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3204 / November 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14107

In the Matter of **ROYAL DUTCH SHELL plc,** **and** **SHELL INTERNATIONAL EXPLORATION AND PRODUCTION INC.,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Royal Dutch Shell plc, (" Respondent Shell") and against Shell International Exploration and Production Inc. ("Respondent SIEP").

II.

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

III.

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

A. SUMMARY

This matter concerns violations of the anti-bribery provisions of the Foreign Corrupt Practices Act ("FCPA") by Respondent SIEP and the record keeping and internal controls provisions of the FCPA by Respondent Shell. From September 2002 through November 2005, SIEP, on behalf of Shell, authorized the reimbursement or continued use of services provided by a company acting as a customs broker that involved suspicious payments of approximately $3.5 million to officials of the Nigerian Customs Service in order to obtain preferential treatment during the customs process for the purpose of assisting Shell in obtaining or retaining business in Nigeria on Shell's Bonga Project. As a result of these payments, Shell profited in the amount of approximately $14 million. None of the improper payments was accurately reflected in Shell's books and records, nor was Shell's system of internal accounting controls adequate at the time to detect and prevent these suspicious payments.

B. RESPONDENTS

Royal Dutch Shell plc ("Shell"), an English-chartered company, headquartered in The Hague, Netherlands, focuses, through its subsidiaries, on oil, gas, and power production and exploration. Shell's American Depository Receipts are registered with the Commission pursuant to Section 12(b) of the Exchange Act, and trade on the New York Stock Exchange.[2]

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1 The findings herein are made pursuant to Respondents' Offers and are not binding on any other person or entity in this or any other proceeding.

2 The conduct at issue in the matter primarily occurred prior to a corporate restructuring which created Royal Dutch Shell plc. Royal Dutch Petroleum Company, a Dutch company, and The "Shell" Transport and Trading Company, an English company, are predecessors to Royal Dutch Shell plc. During the relevant period, the ordinary shares of Royal Dutch Petroleum Company and the American Depository Receipts of The "Shell" Transport and Trading Company were registered with the Commission and traded on the New York Stock Exchange. On October 28, 2004, the Royal Dutch Petroleum Company board and The "Shell" Transport and Trading Company board voted to propose to shareholders the unification of Royal Dutch Petroleum Company and The "Shell" Transport and Trading Company under a single parent company, Royal Dutch Shell plc. In July 2005, the transaction was completed in which Royal Dutch Shell

Shell International Exploration and Production Inc. ("SIEP"), a Delaware company with headquarters in Houston, Texas, is a wholly owned indirect subsidiary of Shell. SIEP acted as an agent of Shell for purposes of the Bonga Project. SIEP's financial results are components of the consolidated financial statements included in Shell's filings with the Commission.

C. OTHER RELEVANT ENTITY

Shell Nigerian Exploration and Production Company Ltd. ("SNEPCO"), located in Nigeria, is a wholly owned subsidiary of Shell Petroleum N.V., which, in turn, is a wholly owned direct subsidiary of Shell. SNEPCO performed work on the Bonga Project.

D. FACTS

I. The Bonga Project

Bonga, discovered by a Shell subsidiary in 1995, was the first deepwater offshore oil and gas project in Nigeria. Developmental drilling on the Bonga Project began in December 2000 and the project reached First Oil[3] in November 2005.

The Bonga field was developed by SNEPCO (55% interest), on Shell's behalf, and other oil companies pursuant to a Production Sharing Contract with the Nigerian National Petroleum Corporation ("NNPC"). Under the Production Sharing Contract, the oil companies were responsible for all upfront costs associated with reaching First Oil, but the costs were subsequently fully recoverable from the proceeds of oil production.

The Bonga Project, authorized and approved by Shell's board, was executed jointly across several Shell entities, including SIEP and SNEPCO. In particular, SIEP provided experienced project and technical personnel for the project who were responsible for such things as project controls, project accounting, document control, cost planning, cost controls, and handling claims against contractors. A SIEP employee located in Houston managed the contractual relationship with one of the Contractors on the project and was responsible for reviewing and approving invoices and underlying documentation submitted by the Contractor. Another SIEP employee was head of the Bonga Project Services Team with responsibility for reviewing and approving invoices and underlying documentation submitted by the Contractors before the invoices were passed on to SNEPCO's finance department for payment. In addition, on a monthly

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plc became the parent company of Royal Dutch Petroleum Company and The "Shell" Transport and Trading Company.

3 "First Oil" is the point at which the project's construction phase ceases, and the project commences production.

basis, the Bonga Project Manager reported on the progress of the Bonga Project through the corporate chain up to a member of Shell's board of directors.

Developing the Bonga field required the transportation of large amounts of equipment and parts into Nigeria. Pursuant to the Production Sharing Contract, ownership of this equipment passed to NNPC once imported into Nigeria. SNEPCO, on behalf of Shell, however, was responsible for arranging importation of the equipment and for paying customs duties on the items, which costs, pursuant to the contract, were recoverable later from the proceeds of oil production.

In developing Bonga, SNEPCO, on behalf of Shell, hired a number of contractors, unaffiliated with Shell, including Contractor A and Contractor B. In order to assist in the importation into Nigeria of equipment necessary for the Bonga Project, the Contractors, and in some instances SNEPCO directly, hired the services of an international freight forwarding and customs clearing company ("Courier Subcontractor") for transporting and customs clearance.[4]

One of the services Courier Subcontractor provided was an express door-to-door courier service ("Courier Service") that expedited the delivery of goods and equipment into Nigeria. The Nigerian customs clearance process was routinely delayed, often taking weeks or even months to clear equipment through customs. In addition, the Bonga Project was over-budget and behind schedule and a significant amount of equipment needed to be imported into Nigeria. These circumstances led to the repeated use of Courier Subcontractor's Courier Service.

Courier Subcontractor was able to expedite the importation of goods because of an "on the side" agreement between Courier Subcontractor and members of the Nigerian Customs Service ("NCS") in which Courier Subcontractor made corrupt payments to NCS officials to bypass the normal customs process. Goods shipped using Courier Subcontractor's Courier Service arrived in Nigeria "customs cleared," resulting in a significant savings of time and a reduction in the required customs duties and tariffs with a significantly higher freight fee. Typically, Courier Subcontractor billed the Contractors who paid the bill and, in turn, sought reimbursement, which required approval from SIEP. Certain of Courier Subcontractor's invoices charged a special fee (i.e. bribe). The special fee was initially invoiced as a "local processing fee" and later invoiced as "administration/transport charges." The use of Courier Subcontractor's Courier Service expedited shipments into Nigeria by about 20 to 39 days. Therefore, a shipment that would take 30 days to clear Nigerian customs using regular air freight could clear customs in as quickly as 10 days using the Courier Service.

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[4] In February 2007, one of the Bonga Project Contractors pleaded guilty to violations of the Foreign Corrupt Practices Act and agreed to pay $26 million in criminal fines in connection with the payments to Nigerian customs officials through Courier Subcontractor to obtain preferential treatment during the customs process. See United States v. Vetco Gray UK Limited, CR H07-04 (LNH) (S.D. Tex. 2007).

II. The Bonga Project Contractors

a. Bonga Project Contractor A

Under the contracts with the Bonga Project Contractors all costs were borne by the Contractors, subject to certain exceptions, such as, customs duties. SNEPCO, on behalf of Shell, was financially responsible for all customs duties and the Contractors were responsible for all shipping costs. For customs duties greater than $100,000, SNEPCO, on behalf of Shell, paid the Nigerian government directly. For customs duties less than $100,000, the Contractors paid and sought reimbursement. The payments at issue in this proceeding were each under $100,000, and were initially paid by the Contractors. In February 2004, Contractor A submitted a contract variation request for reimbursement of a $1.8 million accruement in "additional transportation and related charges" relating to the use of Courier Subcontractor's Courier Service and the payment of local processing fees.[5]

In analyzing whether to reimburse Contractor A for these courier costs, certain employees of SIEP responsible for approving the payment of invoices, were made aware of red flags relating to the service and that it likely involved illicit payments to customs officials. For example, SIEP repeatedly requested that Courier Subcontractor and Contractor A provide a receipt from NCS proving that the local processing fee had been deposited into a Nigerian Government account. However, neither company was able to supply such receipts. In addition, certain SIEP employees learned that Courier Subcontractor's Courier Service bypassed the normal customs duty payment process and that using the service "reduced [ ] liability for Nigerian Customs and Import Duty."

In July 2004, SIEP rejected Contractor A's contract variation request for the additional charges relating to the use of the Courier Service. At the same time, a "no proof, no pay" policy was implemented for the Bonga Project. Pursuant to the policy, SIEP, on behalf of Shell, would not approve reimbursement to Contractor A for any expenses relating to the Courier Service unless Contractor A could provide (1) Courier Subcontractor's receipts from NCS validating that customs duties were paid directly into an official NCS banking or financial institution and (2) NCS documentation confirming that associated payments satisfied the customs duties and that no further duties would be due. At the time, certain individuals at SIEP had concluded that it was unlikely that Contractor A would be able to provide such proof. However, certain SIEP employees continued to permit the Contractors to use Courier Subcontractor for customs clearance and Courier Subcontractor's Courier Service. In addition to continuing to encourage and support the use of Courier Subcontractor's courier service, certain individuals working on the Bonga Project also tried, without success, to modify the "no proof, no pay" policy in order to reimburse the courier expenses even without proof that payment had been made into a Nigerian government account.

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5 Contractor A made subsequent additional requests bringing its total reimbursement request to $2.1 million.

b. Bonga Project Contractor B

During the course of the Bonga Project, Contractor B sustained financial difficulties and accordingly, SIEP, on behalf of Shell, put in place a process to advance funds to Contractor B to pay Bonga Project expenses as they became due, including Contractor B's payment of shipping costs to Courier Subcontractor for the use of the Courier Service. Despite the red flags that came to SIEP employees' attention in examining whether to reimburse Contractor A for its courier expenses, SIEP approved advancing funds to Contractor B for the use of the Courier Service, even when Contractor B could not provide valid customs receipts as required by the "no proof, no pay" policy. Further, certain Bonga Project personnel agreed to a proposal by Courier Subcontractor to increase the tariff rate in Contractor B's and Courier Subcontractor's contract to hide the "local processing fees" which would no longer be broken out as a separate line item.

In total, approximately \$3.5 million in suspicious payments were made to Nigerian customs officials. Approximately \$1.8 million of these payments were for "local processing fees" and "administrative/transport charges" related to Courier Subcontractor's Courier Service. SIEP, on behalf of Shell, authorized reimbursement of approximately \$2.5 million of these payments.[6]

SIEP's Exchange Act Section 30A Violations

Section 30A of the Exchange Act makes it unlawful for an issuer that has a class of securities registered under Section 12 of the Exchange Act, or "for any officer, director, employee or agent of such issuer . . . acting on behalf of such issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to any person while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official . . . " for, among other things, influencing any act or decision of such foreign official in his official capacity in order to assist such issuer in obtaining or retaining business.

As detailed above, Respondent SIEP, an agent of Shell, authorized the reimbursement and continued use of Courier Subcontractor's services that involved unlawful payments to Nigerian customs officials in order to obtain preferential treatment during the customs process for the purpose of assisting Shell in obtaining or retaining business in Nigeria on Shell's Bonga Project. As a result, SIEP violated Section 30A of the Exchange Act. Shell benefitted through these payments by bypassing the normal customs process and importing equipment into Nigeria faster than Shell would have had the payments not been made. Ultimately, this accelerated Shell's ability to reach First Oil and

6 The activity relating to the additional \$1 million in suspicious payments was authorized by SIEP, but the reimbursement of those funds was ultimately not authorized.

provided Shell with the value of its oil production profits sooner than it would have had it not made the payments. By avoiding the payment of certain customs duties through these payments, Shell also benefited by having the use of those funds when Shell would have otherwise had to wait to be reimbursed from the proceeds of oil production. As a result of these payments, Shell profited in the amount of $14,153,536.

Exchange Act Section 13(b)(2)(A) and 13(b)(2)(B) Violations

Section 13(b)(2)(A) of the Exchange Act requires every issuer to make and keep books, records, and accounts, that in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

Respondent Shell violated Section 13(b)(2)(A) because Shell's books and records did not accurately reflect the nature of the improper payments. Instead, the improper payments were recorded as legitimate transaction costs such as "local processing fees" and "administration/transport charges" and thus were not fairly reflected or accurately recorded in its books, records, and accounts.

Section 13(b)(2)(B) of the Exchange Act requires every issuer to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) that 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. As evidenced by the details surrounding SIEP's authorization of reimbursement and continued use of Courier Subcontractor's services, Respondent Shell failed to devise and maintain an effective system of internal controls to prevent or detect illegal payments and as such, violated Section 13(b)(2)(B).

IV.

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

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

A. Respondent SIEP cease and desist from committing or causing any violations and any future violations of Section 30A of the Exchange Act and Respondent Shell cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act;

B. Respondents shall, within 30 days of the entry of this Order, jointly and severally, pay disgorgement of $14,153,536 and prejudgment interest thereon of $3,995,923 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to Rule 600 of the Commission's Rules of Practice. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Royal Dutch Shell plc and Shell International Exploration and Production 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 Laura B. Josephs, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63249 / November 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14109

In the Matter of Mid-American Waste Systems, Inc., Midwest Energy Companies, Inc., Mimbres Valley Farmers Association, Inc., MRL, Inc., MTX International, Inc., Multiple Dimensional Laser Technologies, Inc., and Muse Technologies, 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 Mid-American Waste Systems, Inc., Midwest Energy Companies, Inc., Mimbres Valley Farmers Association, Inc., MRL, Inc., MTX International, Inc., Multiple Dimensional Laser Technologies, Inc., and Muse Technologies, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Mid-American Waste Systems, Inc. (CIK No. 798671) is a dissolved Delaware corporation located in Canal Winchester, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mid-American 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 $295,562,000 for the prior nine months. On January 21, 1997, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was terminated on June 28, 2007.

2. Midwest Energy Companies, Inc. (CIK No. 350091) is a void Delaware corporation located in Tulsa, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Midwest Energy 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, 1995, which reported a net loss of $1,707,000 for the prior nine months.

3. Mimbres Valley Farmers Association, Inc. (CIK No. 781889) is a revoked New Mexico corporation located in Deming, New Mexico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mimbres is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2003, which reported a net loss of $394,822 for the prior six months. On May 5, 2004, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of New Mexico, and the case was terminated on September 10, 2008.

4. MRL, Inc. (CIK No. 66965) is a Missouri corporation located in St. Louis, Missouri with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MRL 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 31, 1996, which reported a net loss of $157,000 for the prior six months. On August 25, 1997, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of Missouri, and the case was terminated on June 23, 1999.

5. MTX International, Inc. (CIK No. 710197) is a delinquent Colorado corporation located in Englewood, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MTX International 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, 1997, which reported a net loss of $137,077 for the prior nine months. On August 20, 1999, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Maryland, and the case was terminated on January 8, 2001.

6. Multiple Dimension Laser Technologies, Inc. (CIK No. 1025841) is a dissolved Colorado corporation located in Sulphur Springs, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Multiple Dimension Laser 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 September 30, 1997, which reported a net loss of $183,953 for the prior nine months.

7. Muse Technologies, Inc. (CIK No. 1006368) is a void Delaware corporation located in Albuquerque, New Mexico with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Muse 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 September 30, 2001, which reported a net loss of $4,522,471 for the prior nine months. On November 13, 2002, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of New Mexico, and the case was pending as of April 12, 2010. As of October 29, 2010, the company's stock (symbol "MUZE") 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, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

III.

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

A. Whether the allegations contained in Section II 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

SECURITIES EXCHANGE ACT OF 1934
Release No. 63248 / November 4, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14108

In the Matter of	
Animatrix, Inc., Apex Resorts Corp. (n/k/a West Hawk Development Corp.), Apollo Capital Group, Inc., Artibles, Inc., Asche Transportation Services, Inc., Asia Supernet Corp., Assembly & Manufacturing Systems, Inc., and Azul Holdings, 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 Animatrix, Inc., Apex Resorts Corp. (n/k/a West Hawk Development Corp.), Apollo Capital Group, Inc., Artibles, Inc., Asche Transportation Services, Inc., Asia Supernet Corp., Assembly & Manufacturing Systems, Inc., and Azul Holdings, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Animatrix, Inc. (CIK No. 1162239) is a permanently revoked Nevada corporation located in Kent, Ohio with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Animatrix is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on November 21, 2001, which reported a net loss of $1,750 from April 7, 2001 to September 30, 2001.

2. Apex Resorts Corp. (n/k/a West Hawk Development Corp.) (CIK No. 919237) 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). Apex Resorts is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR registration statement on February 18, 1994, which reported a deficit of over $2 million (Canadian) for the nine months ended October 31, 1993. As of October 29, 2010, the company's stock (symbol "WHDCF") was traded on the over-the-counter markets

3. Apollo Capital Group (CIK No. 1289817) is a revoked Nevada corporation located in New Westminster, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Apollo Capital is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on May 11, 2004, which reported a net loss of $175,357 from the company's September 17, 1996 inception to October 31, 2003.

4. Artibles, Inc. (CIK No. 1126215) is a dissolved Michigan corporation located in Grand Rapids, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Artibles is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of $34,476 for the prior three months.

5. Asche Transportation Services, Inc. (CIK No. 927809) is a void Delaware corporation located in Shannon, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Asche is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1999, which reported a net loss of over $3.99 million for the prior nine months. On December 22, 2000, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of Illinois, which was terminated on January 26, 2010.

6. Asia Supernet Corp. (CIK No. 4165) is a dissolved Colorado corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Asia Supernet is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of $812,554 since the company's May 12, 1999 inception.

7. Assembly & Manufacturing Systems, Inc. (CIK No. 98583) is a Utah corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Assembly 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, 1997, which reported no net income or revenues for the prior twelve months.

8. Azul Holdings, Inc. (CIK No. 721080) is a void Delaware corporation located in Boulder, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Azul is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of over $1.16 million for the prior six months. As of October 29, 2010, the company's stock (symbol "AZUL") was traded on the over-the-counter markets

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 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

Commissioner Walter and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63265 / November 5, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3211 / November 5, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14114

In the Matter of **Leslie L. Jackson, 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 Leslie L. Jackson ("Respondent" or "Jackson") 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. Jackson, age 45, has been a certified public accountant licensed to practice in the State of Texas but did not renew her license in December 2008. She served as Dell Inc.'s ("Dell") Director of Financial Reporting from October 2001 to June 2003, Corporate Assistant Controller from June 2003 to January 2005, and Director of Global Finance Systems from January 2005 until she left Dell in 2008.

2. Dell was, at all relevant times, a Delaware corporation with its principal place of business in Round Rock, Texas. Dell is engaged in the business of providing electronic products, including mobility products, desktop PCs, software, peripherals, servers, networking equipment, and storage. Dell also offers services, including infrastructure technology, consulting and applications, and business process services. At all relevant times, Dell's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and was quoted on the NASDAQ National Market System.

3. On October 13, 2010, a final judgment was entered against Jackson, permanently enjoining her, by consent, from future violations of Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2 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 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v Dell Inc., et al., Civil Action Number 1:10-cv-01245-RJL, in the United States District Court for the District of Columbia.

4. The Commission's complaint alleged, among other things, that Dell engaged in improper accounting which resulted in the company filing materially false and misleading financial statements in its annual reports on Form 10-K for the fiscal years ended February 1, 2002, January 31, 2003, January 30, 2004, and January 28, 2005, and in the company's quarterly reports on Form 10-Q for the first three quarters of fiscal years 2002 through 2004 and for the first two quarters of 2005. The Complaint alleged that Jackson knowingly circumvented or failed to implement Dell's system of internal accounting controls

and falsified Dell's books, records, or accounts. The Complaint also alleged that Jackson aided and abetted improper accounting practices that materially misstated Dell's annual and quarterly financial statements. The Complaint alleged that Dell received substantial assistance in connection with the corporate contingencies from Jackson, and that Jackson knew or was reckless in not knowing that Dell improperly maintained excess reserves in the corporate contingencies for use in future periods. The Complaint also alleged that Jackson reviewed and approved the Forms 10-K and 10-Q that materially misstated Dell's financial results because of Dell's improper accounting for the corporate contingencies. The Complaint also alleged that Jackson made material misrepresentations to Dell's independent 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 Jackson's Offer.

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

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

B. After 3 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 Walter and
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63264 / November 5, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3210 / November 5, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14113

In the Matter of ROBERT W. DAVIS (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 Robert W. Davis ("Respondent" or "Davis") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the 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

[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.

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. Davis, age 51, is and has been a certified public accountant licensed to practice in the Commonwealth of Virginia. Davis joined Dell Inc. ("Dell") in 1996. In 2001, he was named Vice President of Corporate Planning and Reporting. In November 2002, Davis was named Vice President of Corporate Finance and Chief Accounting Officer, positions he retained until he left Dell in February 2005.

2. Dell is a Fortune 50 company in the business of providing electronic products, including mobility products, desktop PCs, peripherals, servers, networking equipment, and storage. Dell also offers services, including software, infrastructure technology, consulting and applications, and business process services. Dell was incorporated in Delaware in 1984 and is based in Round Rock, Texas. Since July 2006, Dell's common stock has been registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and is traded on the NASDAQ Global Select Market. During the prior relevant period, Dell's common stock was registered with the Commission under Section 12(g) of the Exchange Act and quoted on the Nasdaq National Market System.

3. On August 27, 2010, the Commission filed a complaint against Davis in the U.S. District Court for the District of Columbia captioned Securities and Exchange Commission v. Robert W. Davis (Civil Action No. 1:10-cv-01464). On October 13, 2010, the court entered an order permanently enjoining Davis, by consent, from future violations of Section 17(a)(2) and Section 17(a)(3) of the Securities Act of 1933 ("Securities Act"), Exchange Act Section 13(b)(5) and Rules 13b2-1 and 13b2-2 thereunder, and from aiding and abetting violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 12b-20, 13a-1, and 13a-13 thereunder. Davis was also ordered to pay $19,080 in disgorgement of ill-gotten gains, $9,078 in prejudgment interest, and a $175,000 civil money penalty.

4. The Commission's complaint alleges, among other things, that Dell fraudulently committed various accounting violations through the conduct of Davis and others. The Commission's complaint also alleges that Davis directed and engaged in improper accounting that resulted in Dell filing materially false and misleading financial statements in the company's annual reports on Form 10-K and in the company's quarterly reports on Form 10-Q from FY02 to FY05. The Complaint alleges that Davis directed Dell's improper use of reserves, including the Strat Fund and other "Corporate Contingencies," accrued relocation accruals, a Corporate restructuring reserve, and bonus and profit-sharing accruals. The Commission's complaint alleges further that Davis directed others to maintain and track excess reserves and to use excess reserves from prior periods to offset unforecasted expenses in order to meet financial targets. The

complaint also alleges that Davis was involved in Dell's improper accounting with respect to Dell's Europe, Middle East, and Africa segment restructuring reserve and Dell's failure to increase its reserves for Las Cimas liabilities.

IV.

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

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

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

B. After five 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

Commissioner Walter and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63263 / November 5, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3209 / November 5, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14112

In the Matter of RANDALL D. IMHOFF (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 Randall D. Imhoff ("Respondent" or "Imhoff") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the 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

[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.

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. Imhoff, age 48, is and has been a certified public accountant licensed to practice in the State of Texas. Imhoff joined Dell Inc. ("Dell") in February 2000 as Corporate Assistant Controller and was named Finance Director for U.S. Small and Medium Businesses in September 2003. He was named Finance Director for Global I/T in November 2005, a position he retained until he left Dell in April 2007.

2. Dell is a Fortune 50 company in the business of providing electronic products, including mobility products, desktop PCs, peripherals, servers, networking equipment, and storage. Dell also offers services, including software, infrastructure technology, consulting and applications, and business process services. Dell was incorporated in Delaware in 1984 and is based in Round Rock, Texas. Since July 2006, Dell's common stock has been registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and is traded on the NASDAQ Global Select Market. During the prior relevant period, Dell's common stock was registered with the Commission under Section 12(g) of the Exchange Act and quoted on the Nasdaq National Market System.

3. On August 27, 2010, the Commission filed a complaint against Imhoff in the United States District Court for the District of Columbia in SEC v. Imhoff (Civil Action No. 1:10-cv-01465). On October 13, 2010, the court entered an order permanently enjoining Imhoff, by consent, from future violations of Exchange Act Section 13(b)(5) and Rules 13b2-1 and 13b2-2 thereunder, and from aiding and abetting violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 12b-20, 13a-1, and 13a-13 thereunder. Imhoff was also ordered to pay $12,852 in disgorgement of ill-gotten gains, $6,197 in prejudgment interest, and a $25,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Imhoff engaged in improper accounting which resulted in Dell filing materially false and misleading financial statements in the company's annual reports on Forms 10-K and quarterly reports on Forms 10-Q from fiscal year 2002 to fiscal year 2004. The Complaint alleged that Imhoff rendered substantial assistance to Dell's improper use of general reserves, including the "Corporate Contingencies," a Corporate restructuring reserve, bonus and profit sharing accruals, certain reserves in Dell's Europe, Middle East and Africa segment, and relocation accruals. It further alleged that, with regard to the Corporate restructuring reserve established in fiscal year 2002, Imhoff tracked excess accruals, directed the re-designation of excess accruals to other liability accounts, and worked with others to utilize excess for unrelated operating expenses. With regard to the "Corporate Contingencies," the Complaint alleged that Imhoff instructed others at

Dell to maintain general reserves in "Corporate Contingencies" so they could be used for unrelated operating expenses in later periods. The complaint also alleged that Imhoff provided substantial assistance with respect to Dell's maintenance of bonus and profit sharing over-accruals from quarter to quarter and its periodic release of over-accruals from prior periods to offset current operating expenses. It also alleged that Imhoff provided substantial assistance with respect to Dell's failure to record a required reserve for the Las Cimas liability.

IV.

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

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

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

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

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

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

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

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

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

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Walter and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63262 / November 5, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3208 / November 5, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14111

In the Matter of Nicholas A. R. Dunning, ACA, 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 Nicholas A. R. Dunning ("Respondent" or "Dunning") 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 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. Dunning, age 47, is and has been a non-practicing Qualified Chartered Accountant in the United Kingdom. He served as Dell Inc.'s Vice President of Finance in the Europe, Middle East, and Africa segment ("EMEA") from 2001 to early 2004, Vice President of Marketing for EMEA's Home & Small Business ("HSB") business unit in 2004, and HSB's Vice President and General Manager from 2004 until leaving the company in February 2007.

2. Dell was, at all relevant times, a Delaware corporation with its principal place of business in Round Rock, Texas. Dell is engaged in the business of providing electronic products, including mobility products, desktop PCs, software, peripherals, servers, networking equipment, and storage. Dell also offers services, including infrastructure technology, consulting and applications, and business process services. At all relevant times, Dell's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and was quoted on the NASDAQ National Market System.

3. On October 13, 2010, a final judgment was entered against Dunning, permanently enjoining him, by consent, from future violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v Dell Inc., et al., Civil Action Number 1:10-cv-01245-RJL, in the United States District Court for the District of Columbia. Dunning was also ordered to pay $1 in disgorgement and a $50,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Dunning engaged in improper accounting which resulted in Dell filing materially false and misleading financial statements in the company's Annual Report on Form 10-K for the fiscal years ended January 31, 2003 and January 30, 2004, and in the company's quarterly reports on Form 10-Q for the third quarter of fiscal year 2003 and the first two quarters of fiscal year 2004. The Complaint alleged that Dunning circumvented Dell's system of internal accounting controls and falsified books, records, or accounts. The Complaint alleged further that Dunning aided and

abetted improper accounting practices that materially misstated Dell's consolidated, and the EMEA segment's, annual and quarterly operating income in departure from Generally Accepted Accounting Principles. These practices included, among other things, creating, maintaining, and releasing restructuring reserves, general reserves and other improper accruals, circumventing Dell's system of internal controls, and falsifying books, records, and accounts. Dunning consented to entry of the judgment without admitting or denying the allegations of the complaint.

IV.

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

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

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

B. After 3 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 status as an accountant is current and he has resolved all other disciplinary issues with the applicable board of accountancy. However, if resolution of any disciplinary action by a board of accountancy 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. 63261 / November 5, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14110

In the Matter of **VICTOR SELENOW,** **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 Victor Selenow ("Selenow" or "Respondent").

II.

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

III.

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

1. From March 2007 through December 2007, Selenow was a telemarketing sales agent for Winning Kids, Inc. ("Winning Kids"). During this period, Selenow solicited investors to purchase Winning Kids' securities and received transaction-based compensation in connection with sales of Winning Kids' securities. When he solicited investors to purchase Winning Kids' securities, Selenow was neither registered as a broker or dealer nor associated with a registered broker or dealer. Selenow, 48 years old, is a resident of Royal Palm Beach, Florida.

2. On October 15, 2010, a final judgment was entered by consent against Selenow, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Exchange Act, and Exchange Act Rule 10b-5, in the civil action entitled Securities and Exchange Commission v. Winning Kids, Inc., et al., Civil Action Number 9:10-CV-80186-KAM, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleges that Selenow fraudulently offered and sold the stock of Winning Kids in unregistered transactions without being associated with a broker or dealer registered with the Commission. The complaint further alleges Selenow's offers and sales of Winning Kids' securities were fraudulent because Selenow misrepresented to investors the status of Winning Kids' business operations, its profit projections and annual returns, and its sales agents' commissions.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Selenow 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

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. 63280 / November 9, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14029

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to enter this Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Damyon Mouzon ("Respondent").

II.

Following the institution of these proceedings on September 2, 2010, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of misrepresentations made by LACE Financial Corp. ("LACE") in its application to the Commission to become registered as a Nationally Recognized Statistical Rating Organization ("NRSRO") and in connection with its accompanying request for an exemption from a conflict of interest provision. Exchange Act Rule 17g-5(c)(1) prohibits an NRSRO from issuing or maintaining a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equaling or exceeding ten percent of the total net revenue of the NRSRO for the fiscal year (the "Ten Percent Rule"). In its application and request for an exemption from this rule, LACE materially misstated the amount of revenue it received from its largest customer during 2007.

LACE also violated certain other Commission rules governing NRSROs. LACE violated Section 15E(a)(1) of the Exchange Act and Exchange Act Rule 17g-1(a) by making the misstatements described above and by failing to disclose in its registration application that it performed an extra layer of review for the credit ratings of issuers whose securities made up the pools for asset-backed securities managed by LACE's largest customer. LACE violated Section 17(a) of the Exchange Act and Exchange Act Rule 17g-2(a)(6) by failing to document the process of this extra layer of review in its written policies and procedures. LACE also violated Section 17(a) of the Exchange Act and Exchange Act Rule 17g-2(b)(7) by failing to maintain all emails relating to its credit ratings. Mouzon, as President of LACE beginning in April 2007 and the person responsible for the day-to-day operations of the company until his departure in January 2009, was a cause of LACE's violations.

Respondent

1. From April 2007 until January 2009, Mouzon was the President of LACE, a credit rating agency that has been registered with the Commission as an NRSRO since February 2008. As the President, Mouzon was responsible for managing the operations of LACE, including overseeing LACE's staff of analysts and the ratings process, maintaining client relationships, and managing sales and marketing. In his capacity as President of LACE, he communicated frequently with the Commission staff regarding LACE's application to register with the Commission as an NRSRO. Mouzon was notified in October 2008 that he would be terminated by LACE, and his final day at LACE was January 16, 2009.

Related Entity

2. LACE is a credit rating agency located in Frederick, Maryland. During 2008, LACE had total revenues of $918,714 and net income of $98,837. LACE was formed in 1984, and derives most of its revenue from subscription fees. On February 11, 2008, the Commission granted LACE's application to register as an NRSRO for all five classes of credit ratings described

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

in clauses (i) through (v) of Section 3(a)(62)(B) of the Exchange Act. On the same day, the Commission also granted LACE's request for an exemption from the Ten Percent Rule until January 1, 2009. The Commission's order required that LACE disclose that the firm received more than ten percent of its net revenue in fiscal year 2007 from a client that paid it to rate asset-backed securities. Since its founding, LACE has specialized in issuing credit ratings for financial institutions. At the time that LACE became registered as an NRSRO, LACE provided quarterly credit ratings on approximately 7,900 commercial and savings banks, 1,000 bank holding companies, 850 savings and loans, 1,500 to 8,700 credit unions (depending on the quarter), 250 foreign banks, and 95 title insurance companies.

The Credit Rating Agency Reform Act and Commission Rules Governing NRSROs

3. The Credit Rating Agency Reform Act of 2006 ("Rating Agency Act"),[2] enacted on September 29, 2006, defined the term "nationally recognized statistical rating organization" and provided authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies. The final Commission implementing rule (Exchange Act Rule 17g-1) and form (Form NRSRO) prescribing the process for a credit rating agency to apply for registration became effective on June 18, 2007. Exchange Act Rule 17g-1 requires a credit rating agency applying for registration as an NRSRO to use Form NRSRO to furnish the Commission with the initial application. The Rule requires a firm, after becoming registered as an NRSRO, to update its registration application if any of the information becomes materially inaccurate and to provide an annual certification on Form NRSRO. Exchange Act Rules 17g-2 through 17g-6 became effective on June 26, 2007. Among other things, these rules (a) require an NRSRO to make and retain certain records (Rule 17g-2); and (b) prohibit NRSROs from having certain conflicts of interest and require NRSROs to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage certain other conflicts of interest related to the issuance of credit ratings by the NRSRO (Rule 17g-5).

4. At the time of LACE's application, to register with the Commission as an NRSRO, a credit rating agency must have been in business as a credit rating agency for at least three consecutive years immediately preceding the date of its application, and it must have issued credit ratings with respect to one or more of the following categories of obligors: (a) financial institutions, (b) insurance companies, (c) corporate issuers, (d) issuers of asset-backed securities, and (e) issuers of government securities, municipal securities, or securities issued by a foreign government. The credit rating agency also was required to submit an application that contained certain information including, among other things, the procedures and methodologies that the applicant uses to determine credit ratings, policies and procedures to prevent the misuse of material, nonpublic information, any conflict of interest relating to the issuance of credit ratings, whether it has a code of ethics in effect, and certain financial information.

5. The Commission's rules were designed to further the goals of the Rating Agency Act to "improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."[3] To meet these

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[2] Pub. L. No. 109-291 (2006).

[3] Preamble to the Rating Agency Act.

goals, it is critical that firms provide accurate information to the Commission and the public in their Form NRSROs and financial reports, that they do not have prohibited conflicts, and that they establish, maintain, and enforce policies and procedures to address conflicts of interest. Compliance with the recordkeeping requirements is critical to the Commission's NRSRO examination and oversight programs.

Facts

A. LACE's Misstatements in its NRSRO Application

6. The Commission received a completed application from LACE to register as an NRSRO on October 31, 2007.

7. In a letter dated October 30, 2007, LACE requested that the Commission issue an order exempting LACE from the Ten Percent Rule.

8. LACE requested an exemption from the Ten Percent Rule because, for the fiscal year ending December 31, 2007, LACE maintained credit ratings on asset-backed securities solicited by LACE's largest client ("Firm A"), which had provided LACE with more than ten percent of LACE's total revenue during fiscal year 2007. Firm A, among other things, manages Collateralized Debt Obligation ("CDO") investment vehicles constructed from pools of assets comprised largely of trust-preferred securities issued by banks and thrifts, and hired LACE to prepare initial and semi-annual reports regarding the issuing entities that Firm A distributed to investors in these CDOs.

9. LACE prepared the investor reports for Firm A twice a year for each of Firm A's five (and beginning in 2007, six) CDO pools. The reports included, among other things, a report on the financial condition of the particular CDO pool, summaries of all issuers whose LACE ratings had been upgraded or downgraded from the previous quarter, a description of any issuers that had undergone a merger or acquisition in the past quarter, and a banking industry analysis. The reports also included charts showing selected financial ratios and other financial data.

10. The reports also contained LACE's credit rating for each issuer whose securities were in the CDO pools, as well as a rating of the overall credit worthiness of each CDO pool, based on the par weighted average of LACE's ratings on each issuer of securities in the pool. LACE did not rate the various tranches of securities issued by the CDOs.

11. Mouzon was involved in the editing and production of these reports. He supervised the analysts who created the initial drafts, edited their drafts, and oversaw the production process.

12. In its October 30, 2007 letter requesting an exemption from the Ten Percent Rule, LACE stated that its estimated annual revenues from Firm A for 2007 would be $119,000 when calculated on a cash basis and $179,000 when calculated on an accrual basis. The letter further stated that the account represented 18.6 percent of LACE's revenues and that LACE expected this percentage to decrease by the end of 2007 and further decrease in 2008.

13. Subsequently, in an attempt to keep its 2007 revenue from Firm A as close as possible to ten percent of its total revenues for the year, LACE postponed until January 2008 billing Firm A for reports completed during December 2007. The deferred billings totaled $115,450, which LACE recognized as 2008 revenue. However, because the reports had been

completed in December 2007, under generally accepted accounting principles ("GAAP"), LACE should have recorded the $115,450 as 2007 revenue.[4]

14. In a letter dated January 10, 2008 to the staff of the Commission's Division of Trading and Markets, LACE stated that its 2007 revenues from Firm A were $119,393, which accounted for 14.2 percent of LACE's 2007 revenue. The letter, signed by Mouzon and copied to LACE's majority owner, stated that although the numbers provided in the letter were unaudited, LACE did not anticipate that there would be any material changes. The amount of revenue attributed to Firm A in the letter was the amount that LACE actually had been paid by Firm A during 2007, but did not include the $115,450 that LACE had deferred billing for until January 2008. The letter signed by Mouzon did not describe the basis for the stated revenue amount or disclose that, inconsistent with GAAP, LACE had deferred its recognition of revenue from Firm A into 2008. The total value of work performed for Firm A by LACE during 2007 was in fact $233,268.28, comprising approximately 28 percent of LACE's revenues for the year when properly calculated on an accrual basis as required by GAAP.[5]

15. On February 11, 2008, the Commission granted LACE's application to be registered as an NRSRO in all five classes of credit ratings. On the same day, the Commission issued an order exempting LACE from the Ten Percent Rule until January 1, 2009, provided that LACE disclosed in its Form NRSRO that it received more than ten percent of its net revenue from a client that paid it to rate asset-backed securities. In granting the exemption, the Commission recognized the "unique circumstances of a small credit rating agency while balancing this against the goal of Rule 17g-5(c)(1) - to prohibit a conflict that has the potential to influence a credit rating agency's impartiality." The Commission's order also specifically noted that LACE had "stated that it expects the percentage of total revenue provided by the client will decrease."

16. On February 27, 2008, LACE's auditor sent an email to Mouzon stating, "I did notice that there was a billing to [Firm A] early in January 2008 . . . that appeared to be for services provided in December 2007. We'll have to talk about this when I come out, as I need to make sure that revenues are recorded in the correct accounting period." In response, Mouzon represented to the auditor that the work in question for Firm A had not been completed until January 2008, thus making them 2008 revenues, even though he knew or should have known that the work in question had been completed during December 2007.

17. Mouzon directed the auditor to entries on the Firm A invoices indicating that "rework" had been performed, and told the auditor that this work had carried over into 2008, when in fact LACE had completed its work on the Firm A reports before the end of 2007. The "rework" noted in the invoices referred to Firm A adding additional issuers to the CDO pools during November 2007. Mouzon knew or should have known that this work had been completed in 2007, because he was heavily involved in editing the reports for Firm A and overseeing their completion. Furthermore, Mouzon sent and received emails indicating that the reports were to be amended and delivered in November or December of 2007.

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4 GAAP provides that revenue should generally be recognized when it is earned, as opposed to when it is billed or received. See SEC Staff Accounting Bulletin No. 104, Revenue Recognition (December 17, 2003) (Corrected Copy).

5 There is a discrepancy of $1,574.72 between the revenue LACE reported from Firm A in the January 10, 2008 letter ($119,393) and the amounts reflected on the invoices sent by LACE to Firm A and paid during 2007 ($117,819.28).

18. LACE thus continued to improperly record as 2008 revenue the $115,450 for which it had deferred billing to Firm A. Because LACE did not properly record the revenues that it earned from Firm A, LACE's audited financial statements for 2007, which were provided to the Commission and purportedly prepared in accordance with GAAP, were inaccurate.

19. As president of LACE, Mouzon, together with LACE's founder and majority owner, was responsible for ensuring the accuracy of the information provided to the Commission in connection with LACE's NRSRO application and its request for an exemption from the Ten Percent Rule.

20. Mouzon knew or should have known that LACE was required to recognize all of the revenue it earned from Firm A for work completed during 2007 as 2007 revenue, and that as a result, the financial information that LACE provided to the Commission in connection with its NRSRO application and its request for an exemption from the Ten Percent Rule was inaccurate. Furthermore, despite LACE's frequent communications with the Division of Trading and Markets staff regarding LACE's NRSRO application and exemption request, Mouzon failed to ensure that the Commission was informed about LACE's deferral of revenue from Firm A at the time the application and exemption request were pending. In January 2009, three months after he had been notified that he would be terminated and shortly before his departure from LACE, Mouzon contacted the Commission staff and informed them of LACE's deferral of revenue from Firm A.

B. LACE's Undisclosed, Additional Internal Review for Credit Ratings on Certain Entities

21. During 2007 and 2008, LACE's process for rating banks, thrifts, and credit unions began with the retrieval of publicly-available financial data on the rated institutions. After the data was loaded into LACE's computer system, LACE's proprietary computer ratings model was applied to the data.

22. Using ratings guidelines established by LACE, analysts then reviewed the ratings generated by the computer model. Initially, the ratings were reviewed by a junior analyst, who marked any computer-generated ratings that he or she thought should be changed. Those changes were then reviewed by a senior analyst, and the two analysts discussed any discrepancies. If the analysts could not reach agreement, they consulted a third analyst or a supervisor, including Mouzon or LACE's majority owner.

23. After the ratings were finalized, they were entered into the LACE computer system and issued on the LACE Monitoring System, which allowed subscribers to view LACE's credit ratings online.

24. LACE, however, performed an extra review of its credit ratings for the banks whose securities were part of the CDO pools managed by Firm A. After completing its normal ratings procedures, but before the ratings were entered into LACE's system and published online, the ratings for these banks were reviewed a third time. During 2007 and 2008, Mouzon was primarily responsible for performing this extra review.

25. Mouzon made a significant number of changes to the ratings produced by the firm's normal ratings procedures when performing this extra layer of review on the issuers whose securities were in the CDO pools managed by Firm A. In December 2007, March 2008, and June 2008, for example, there were over 50 changes in each quarter, out of a total of approximately 220 institutions whose securities were in Firm A's CDO pools. Approximately 85 percent of these

changes were upgrades from the ratings that had resulted from LACE's normal quarterly credit ratings process. These revised ratings were then published online and incorporated into the investor reports that LACE prepared regarding Firm A's CDO pools.

26. LACE was required to disclose in its NRSRO application the procedures and methodologies that it used to determine credit ratings. LACE failed to disclose its practice of conducting an extra review for the issuers whose securities were in the CDO pools managed by Firm A. Furthermore, LACE had no written policies and procedures in place governing this extra layer of review. Mouzon knew or should have known that LACE was required to disclose this extra review, and have written policies and procedures in place that described and governed the extra review, yet he failed to ensure that LACE did so.

C. LACE's Failure to Retain Emails

27. During 2008 to mid-2009, after LACE became registered as an NRSRO, LACE had no systems in place to ensure that email messages relating to initiating, determining, maintaining, changing, or withdrawing a credit rating were retained, and, as a result, LACE failed to retain all relevant email messages for that period. As LACE's President from April 2007 to January 2009, Mouzon knew or should have known that, as an NRSRO, LACE was required to retain such email messages. Mouzon failed to ensure that the required emails were retained.

D. Violations

28. Pursuant to Section 15E(a)(1) of the Exchange Act, a credit rating agency that elects to be treated as an NRSRO:

> shall furnish to the Commission an application for registration . . . containing . . . the procedures and methodologies that the applicant uses in determining credit ratings . . . and . . . any other information and documents concerning the applicant . . . as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

29. Rule 17g-1(a) requires a credit rating agency applying for registration as an NRSRO to furnish the Commission with an initial application on Form NRSRO that follows the Form's instructions. By willfully making misstatements[6] concerning the amount of revenue it received from Firm A in its NRSRO application and its request for an exemption from the Ten Percent Rule, LACE violated Section 15E(a)(1) of the Exchange Act and Rule 17g-1(a). Additionally, the instructions to Exhibit 2 of Form NRSRO require that an applicant or NRSRO provide "a general description of the procedures and methodologies used by the Applicant/NRSRO to determine credit ratings . . . within the classes of credit ratings for which the Applicant/NRSRO is seeking registration . . . . The description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the Applicant/NRSRO in determining credit ratings . . ." LACE violated Section 15E(a)(1) and Rule 17g-1(a) and the instructions to Exhibit 2 of Form NRSRO by failing to disclose in its application that it performed an extra layer of review when determining credit ratings for banks whose securities were part of Firm A's CDO

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[6] 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))

pools, after those entities already had been rated through LACE's standard ratings process, which LACE had described in its initial application.

30. The Rating Agency Act amended Section 17(a)(1) of the Exchange Act to add NRSROs to the list of entities required to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. The Commission implemented Rule 17g-2 under this authority. Rule 17g-2(a)(6) requires an NRSRO to make and retain a current and complete record documenting the established procedures and methodologies it uses to determine credit ratings. LACE violated Section 17(a) of the Exchange Act and Rule 17g-2(a)(6) by failing to maintain records regarding the policies and procedures that governed the extra layer of review performed on the credit ratings issued on the banks whose securities were part of Firm A's CDO pools.

31. Rule 17g-2(b)(7) requires an NRSRO to retain internal and external communications, including electronic communications, received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining, changing, or withdrawing a credit rating. LACE violated Section 17(a) of the Exchange Act and Rule 17g-2(b)(7) because it did not retain all emails sent or received by the firm and its employees relating to initiating, determining, maintaining, changing, or withdrawing credit ratings.

32. As a result of the conduct described above, LACE willfully violated Sections 15E(a)(1) and 17(a) of the Exchange Act and Rules 17g-1(a), 17g-2(a)(6), and 17g-2(b)(7) thereunder.

33. Mouzon, as the President of LACE and a person responsible for LACE's policies and procedures, the disclosures in LACE's NRSRO application, and the statements made to the Commission staff in connection with LACE's request for an exemption from the Ten Percent Rule, was a cause of LACE's violations.

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that Respondent Mouzon cease and desist from committing or causing any violations and any future violations of Sections 15E(a)(1) and 17(a) of the Exchange Act and Rules 17g-1 and 17g-2 thereunder.

By the Commission.

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 63290 / November 9, 2010

Administrative Proceeding
File No. 3-11940

In the Matter of **HUNTINGTON BANCSHARES, INC., THOMAS E. HOAGLIN, MICHAEL J. MCMENNAMIN, and JOHN VAN FLEET, CPA** **Respondents.**	**ORDER DIRECTING DISBURSEMENT OF FAIR FUND**

On December 29, 2005, the Commission issued a Notice of Proposed Plan of Distribution of Disgorgement Fund and Opportunity for Comment by Non-Parties (Exchange Act Release No. 53035) in connection with this proceeding pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103. No comments were received and on March 16, 2006, the Commission approved the Plan of Distribution (Exchange Act Release No. 53495).

The Plan of Distribution required that within 90 days of its approval by the Commission, the appointed Plan Administrator shall seek to amend the Plan of Distribution to specify the procedures to be used to administer the distribution. The Plan Administrator subsequently filed a Modified Distribution Plan (the "Modified Plan") and on August 15, 2006, the Commission issued a Notice of Modified Plan of Distribution of Disgorgement Fund (Exchange Act Release No. 54322). No comments were received and on October 2, 2006, the Commission approved the Modified Plan (Exchange Act Release No. 54554).

The Distribution Plan provides that a Fair Fund consisting of $8,634,485.29 in disgorgement, pre-judgment interest, and civil penalties paid by Huntington Bancshares, Inc., Thomas E. Hoaglin, Michael J. McMennamin, and John Van Fleet, plus any accrued interest, and less any fees and other expenses of administering the Plan of Distribution, be distributed to current and former injured shareholders of Huntington Bancshares, Inc. according to the methodology set forth in the Plan of Distribution and Modified Plan. The Plan of Distribution provides that the Commission will arrange for the distribution of the Fair Fund when a Payment

File listing the identification information required to make the distribution has been received and accepted. The Payment File has been received and accepted.

Accordingly, IT IS HEREBY ORDERED that the Plan Administrator, in coordination with the Commission's Office of Financial Management, shall distribute $35,716.47 of the Fair Fund to investors in accordance with the terms of the Plan of Distribution and Modified Plan.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3104 / November 10, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14120

In the Matter of ROBERT J. SUCARATO, Respondent.	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Robert J. Sucarato ("Sucarato" 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 Sections III.2 and III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. From at least February 2005 through July 9, 2007, Sucarato held himself out to be the President of New York Financial Company ("NYFC"), an unregistered investment adviser that purportedly managed two hedge funds. As President of NYFC, Sucarato raised money from investors, provided investment advice to clients and prospective clients, and made investment decisions for the hedge funds. Sucarato is 40 years old, and his last known residence was in New Brunswick, New Jersey.

2. On November 23, 2009, a final judgment was entered against Sucarato, permanently enjoining him from violating Sections 4b(a)(1)(A)-(C), 4b(a)(2)(A)-(C), 4c(b), 4m(1) and 4o(1) of the Commodity Exchange Act, and Commission Regulations 4.20(a)(1) and (b), 4.21 and 33.10(a)-(c), and ordering him to pay restitution of $800,000 and a civil penalty of $1,200,000, in the civil action entitled Commodity Futures Trading Commission v. Robert J. Sucarato d/b/a New York Financial Company, Civil Action No. 08-cv-1932, in the United States District Court for the District of New Jersey.

3. On October 28, 2010, a final judgment was entered against Sucarato, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act"), and ordering him to pay disgorgement of $1,205,684, together with prejudgment interest of $140,451, for a total of $1,346,135, in the civil action entitled Securities and Exchange Commission v. Robert J. Sucarato d/b/a New York Financial Company, Civil Action No. 09-cv-4953, in the United States District Court for the District of New Jersey.

4. The Commission's complaint alleged, among other things, that Sucarato raised at least $1,728,954 from several investors by offering investments in two hedge funds purportedly managed by Sucarato and NYFC. The complaint alleged that Sucarato made numerous false and misleading representations about the funds and NYFC, and that Sucarato either misappropriated the investors' funds for his own personal use or lost the funds by making risky investments in commodity options and securities. The complaint further alleged that, despite having never invested the funds or losing the funds that were invested, Sucarato provided false quarterly account statements to clients in which he showed extremely successful hedge funds and claimed huge returns on the investors' individual investments.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Sucarato be, and hereby is barred from association with any investment adviser.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63306 / November 10, 2010

CORRECTED

Admin. Proc. File No. 3-12944

In the Matter of

STEVEN ALTMAN, ESQ.

c/o Jeffrey C. Hoffman, Esq.
Hoffman & Pollok LLP
260 Madison Avenue
22nd Floor
New York, NY 10016

OPINION OF THE COMMISSION

RULE 102(e) PROCEEDING

EXCHANGE ACT SECTION 4C PROCEEDING

Grounds for Remedial Action

Unethical or Improper Professional Conduct

Attorney engaged in unethical and improper professional conduct while representing prospective witness in Commission administrative proceeding, in violation of state bar disciplinary rules. *Held*, it is in the public interest to permanently deny him the right to appear or practice before the Commission.

APPEARANCES:

Jeffrey C. Hoffman, of Hoffman & Pollok LLP, for Steven Altman.

Melinda Hardy, Donna S. McCaffrey, and *Christopher M. Bruckmann*, for the Office of the General Counsel.

Appeal filed: February 2, 2009
Last briefs filed: January 19, 2010

I.

Steven Altman, Esq., an attorney licensed to practice law in New York, appeals from an administrative law judge's decision.[1] The law judge found that between January 28, 2004 and March 10, 2004 (the "relevant period"), Altman engaged in unethical and improper professional conduct while representing a prospective witness for the Division of Enforcement ("Division") in a Commission administrative proceeding. Specifically, the law judge found that Altman offered to have his client evade the Division's service of a subpoena and/or testify falsely in exchange for a financial package from two respondents in the proceeding. The law judge further found that Altman did so with scienter. As a result of his conduct, Altman violated Disciplinary Rules ("DR") 1-102(A)(4), 102(A)(5), and 102(A)(7) of the New York State Bar Association Lawyer's Code of Professional Responsibility.[2] The law judge suspended Altman from appearing or practicing before the Commission for nine months pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice[3] and Section 4C of the Securities Exchange Act of 1934.[4]

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1 *Steven Altman, Esq.*, Initial Decision Rel. No. 367 (Jan. 14, 2009), 94 SEC Docket 13430.

2 DR 1-102(A)(4) prohibits "conduct involving dishonesty, fraud, deceit, or misrepresentation." DR 1-102(A)(5) prohibits "conduct that is prejudicial to the administration of justice." DR 1-102(A)(7) prohibits "conduct that adversely reflects on the lawyer's fitness as a lawyer." After the events at issue, New York replaced its existing disciplinary rules with new professional conduct rules that follow the format of the American Bar Association ("ABA") Model Rules of Professional Conduct. Although the New York Rules of Professional Conduct did not become effective until April 1, 2009, new Rules 8.4(c),(d), and (h) are identical in substance to former DR 1-102(A)(4), (5), and (7), respectively. The conclusions reached in this proceeding would be the same, whether resolved under the Code of Professional Responsibility or the ABA Model Rules of Professional Conduct.

3 17 C.F.R. § 201.102(e)(1)(ii) (providing, in pertinent part, that "[t]he Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter -- to be lacking in character or integrity or to have engaged in unethical or improper professional conduct").

4 15 U.S.C. § 78d-3(a)(2) (providing, in pertinent part, that "[t]he 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 by the Commission, after notice and opportunity for hearing in the matter -- to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct") (codifying Rule of Practice 102(e)).

The Office of the General Counsel ("OGC") appeals the nine-month suspension imposed on Altman. It seeks an order permanently denying him the privilege of appearing or practicing before the Commission. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. We conclude that Altman's conduct is fundamentally inconsistent with the effective administration of justice and warrants a permanent denial of the privilege of appearing or practicing before the Commission.

A. Altman.

Altman has been a member of the New York bar since 1987 and practices law in New York City with his solely-owned firm, Altman & Company, P.C.[5] Altman describes himself as a general commercial litigator who is regularly involved in state and federal court litigation and National Association of Securities Dealers, Inc. ("NASD," now known as FINRA) arbitrations. Altman has represented parties in proceedings before the Commission,[6] but considers such matters to constitute a "small" percentage of his legal practice.

B. Altman's Representation of Rosen.

Altman has known Bonnie Rosen since he was in high school and she worked at a local insurance agency.[7] From November 1999 to October 2003, Rosen worked as an administrative assistant with a salary of $60,000 at Nextgen Inc. ("Nextgen"), a company that was owned by Jay Adoni and shared office space with Harrison Securities, Inc. ("Harrison"), a broker-dealer. Nextgen paid Rosen's salary, but she spent half of her time working for Harrison and its chief executive officer, Frederick C. Blumer, who was Adoni's close business associate.

Sometime in 2003, Rosen called Altman and told him that she had been forced out of her job at Nextgen. Rosen asked Altman for his help in obtaining severance pay from Nextgen and removing her name from two car leases she co-signed for Blumer, who used the cars and paid the leases. Altman testified that he agreed to assist Rosen as a "favor." Altman twice contacted

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5 Altman is not a member of the bar of any other state.

6 *See, e.g., Sky Capital LLC,* Securities Exchange Act Rel. No. 55828 (May 30, 2007), 90 SEC Docket 2201; *Dominic A. Alvarez*, Exchange Act Rel. No. 53231 (Feb. 6, 2006), 87 SEC Docket 985; *Javed Anver Latef,* 56 S.E.C. 290 (2003), *petition denied*, 94 Fed. Appx. 969 (3d Cir. 2004) (Table).

7 Rosen declined to testify during OGC's investigation of Altman and asserted her Fifth Amendment privilege against self-incrimination. Rosen was not called as a witness at the May 2008 hearing in this Rule 102(e) proceeding.

Adoni and requested that he pay Rosen severance and remove her name from the car leases.[8] On both occasions, Adoni refused the requests.

C. The Harrison Proceeding.

In 2003, the Division instituted administrative and cease-and-desist proceedings against Harrison, Blumer, and Nebrissa Song, alleging violations of the Exchange Act's books and records, net capital, and financial reporting provisions (hereinafter the "Harrison Proceeding"). Respondents raised as a defense to the books and records charge that they were unable to maintain the firm's general ledger for certain periods because a computer virus corrupted their files. A hearing in the Harrison Proceeding was held on January 20 through January 26, 2004 and March 8 through 10, 2004.

On January 26, 2004, Division staff learned from NASD staff that Rosen had called NASD and claimed to have information adverse to Harrison's and Blumer's computer virus defense. Division staff hoped, but were not sure, that Rosen would be able to testify that there was no computer virus that compromised Harrison's files. Division staff also thought that Rosen might be able to testify about Blumer's accounting practices. Division staff concluded that Rosen might be a good rebuttal witness.

Division staff called Rosen on January 28, 2004 and told her that they learned she might have useful information for the Harrison Proceeding. They asked Rosen if she would be willing to meet or speak with them. Rosen expressed some anxiety about testifying. She mentioned to Division staff that she co-signed two car leases for Blumer, and she was concerned that if Blumer was ordered to pay a civil penalty in the Harrison Proceeding, it might increase the likelihood that he would default on the leases and she would have to pay the remaining balance on the leases. Division staff testified that the car leases were not relevant to their case and were not a subject of interest to them, except insofar as the leases might prevent Rosen from testifying in the Harrison Proceeding. Rosen identified Altman as her attorney and referred Division staff to him.

D. Division Staff Communicate with Altman about Interviewing Rosen.

On or about January 28, 2004, Division staff spoke with Altman, who identified himself as Rosen's legal representative. During the conversation, Division staff described the nature of the Harrison Proceeding, indicated that it was ongoing, and expressed their interest in possibly using Rosen's testimony as part of their case. Division staff asked Altman if they could interview Rosen. Division staff testified that Altman was "noncommital" about whether Rosen would

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8 Altman testified that he did not open a file for Rosen or enter into a retainer agreement with her. Altman testified that Rosen was not an active, paying client, and that he did not bill her or get paid by her. Altman testified that he could not recall specifically telling Rosen that he would not bill her for his services, but that he never intended to do so.

agree to an interview and said that he would get back to them. Altman asked Division staff who was representing Harrison and Blumer, and they gave him Irving Einhorn's name.[9]

Over the next six weeks, Division staff contacted Altman multiple times in an effort to determine if Rosen would cooperate with them by agreeing to be interviewed and appearing for testimony in the Harrison Proceeding. Division staff testified that they wanted to know what Rosen knew and what she would say if called to testify as a witness. According to Division staff, Altman did not promptly return messages they left him, and when he answered their calls, he was "noncommittal" about Rosen's cooperation and whether he would allow them to interview her. At the May 2008 hearing in this proceeding, the law judge asked Altman if there was a reason why he did not return the Division's calls. Altman responded that the matter was not a "high priority" for him and that he paid it "very little" attention.

E. Altman Calls Einhorn Seeking a Financial Package for Rosen in Exchange for her Not Cooperating or Not Remembering Relevant Facts.

While Altman was "trad[ing] phone calls" with Division staff, he initiated a series of at least six telephone conversations with Einhorn that occurred between January 28 and February 10, 2004. Einhorn tape recorded five of these conversations without Altman's knowledge. During the conversations, Altman requested that Harrison and Blumer give Rosen a financial package consisting of severance pay and a release from her obligations under the car leases. In return, Altman suggested that Rosen would evade the Division's service of a subpoena, and/or if served, testify falsely that she could not recall facts damaging to Harrison's and Blumer's computer virus defense.

1. The first (untaped) telephone conversation.

Altman first called Einhorn on or about January 28, 2004. In this conversation, Altman told Einhorn that he represented Rosen and that the Division was interested in possibly using her as a witness in the Harrison Proceeding. Altman also told Einhorn that Rosen had left Nextgen under unfavorable circumstances with little or no severance pay; she had worked for Harrison and Blumer; and she was hostile towards them. Altman gave Einhorn an abbreviated version of his discussions with Adoni and said he thought this would be an opportune time to reinvigorate Rosen's requests for severance pay and removal of her name from the car leases. In his hearing testimony and briefs on appeal, Altman admitted that the Division's interest in Rosen as a witness gave him some leverage to renew her requests.

Einhorn testified that he was "stunned" by Altman's call. According to Einhorn, Altman "suggested that if a favorable . . . severance/compensation package could be arranged for Ms. Rosen, she would be more favorably disposed towards [his] client[s] if she was called as a

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[9] Einhorn has practiced law since 1972 and maintains a solo practice in California.

witness. . . and whether she would even appear as a witness."[10] Einhorn interpreted Altman's call as "an extortion attempt, seeking money from [his] client[s] in exchange for favorable behavior and testimony from a witness." Einhorn understood that if paid the money, Rosen would be inclined to testify favorably, or not at all, against his clients, and if not paid the money, she would do damage to his clients at the hearing. Einhorn told Altman that he did not know what Altman was talking about and would have to talk to Blumer before he could respond.

Einhorn testified that he decided to tape record their subsequent conversations because he believed Altman was engaging in an "extortion attempt" and wanted to protect himself and his clients in the event Rosen testified in the Harrison Proceeding "without being paid off." Einhorn did not tell Altman that he was taping their conversations, and Altman was unaware that he was being taped.

2. The second (first taped) telephone conversation.

The second conversation, which was the first taped conversation, occurred on or about February 2, 2004, when Einhorn returned Altman's call after speaking to Blumer. Einhorn told Altman that Blumer said Rosen did not work for him and had nothing to do with his computer. The following discussion ensued:

MR. ALTMAN: I am not going to pull punches with you. They [Division staff] are aware[,] if asked, [Rosen] will testify that there was no virus in the computer,[11] and I suspect once they start peeling it away, some other very, very unhelpful stuff with respect to the books and records of the firm --

(Untranscribable)

MR. ALTMAN: As I understand it, [b]ased on her personal knowledge, . . . it was a small suite of executive offices that they all sat in.

MR. EINHORN: Uh-huh.

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[10] The law judge found that Einhorn gave credible testimony. A law judge's credibility findings are entitled to considerable weight because they are based on hearing the witnesses' testimony and observing their demeanor. *Anthony Tricarico*, 51 S.E.C. 457, 460 (1993). These credibility findings can be overcome only where the record contains substantial evidence for doing so. *Id.* We find no such evidence here. We therefore reject Altman's various arguments that the law judge erred in crediting Einhorn's testimony.

[11] Einhorn acknowledged that it would be "very detrimental" and "harmful" to his clients if Rosen were to testify that there was no computer virus because such testimony "directly related" to his clients' defense to the books and records charge.

MR. ALTMAN: And that this was not just a professional relationship, it was personal, not, not in any --

MR. EINHORN: Not a sexual or intimate way.

MR. ALTMAN: Not an intimate way, but a personal basis. And, listen, when you have a $60,000 a year secretary co-signing for cars of a president of a firm, it . . . raises eyebrows initially.[12] Frankly, probably all this would have gone away if at least something would have happened,[13] but, you know, if that's Fred's [Blumer] view, that is -- you know, it shouldn't have gone forward.

MR. EINHORN: No, no, no, I am here, Steven, trying to figure out what's happening here. So, she hasn't given that testimony?

MR. ALTMAN: That's correct. She is not a registered rep[resentative] so she is not at risk of losing her license if she doesn't appear any place.

MR. EINHORN: Well, suppose she gets a subpoena to appear at the hearing?

MR. ALTMAN: Well, you know[,] if she gets served, then, you know, she is going to be [like] any other human being. I, of course, can't advise her to evade the

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12 Altman testified that his statement, "[W]hen you have a $60,000 a year secretary co-signing for cars of a president of a firm, it . . . raises eyebrows initially," meant that Blumer would look "foolish" on the witness stand in the Harrison Proceeding if Rosen testified that Blumer "threw her out on the street" without removing her name as co-signer on the car leases. Einhorn admitted that such testimony would make Blumer look "a little foolish" and be "a little awkward to explain," but Einhorn did not view it as detrimental to his clients' defense because the testimony was not probative of any issue in the proceeding. Einhorn stated, "Certainly[,] the [law] judge couldn't find that my clients violated the net capital and books and records provision[s] of the federal securities laws because the secretary . . . for Mr. Blumer carried two car leases for cars that he was using."

13 Einhorn testified that he interpreted Altman's statement, "Frankly, probably all this would have gone away if at least something would have happened," to mean that Rosen was "tossed out [of her job at Nextgen] without anything," and that her hostility towards Harrison and Blumer "would have gone away" if she had received a "satisfactory severance package."

[subpoena] process, but . . . [m]emory fades and the like.[14] And you know[,] I don't know.

MR. EINHORN: So, what you are saying is[,] if they reach some agreement, she would be more favorably inclined?

MR. ALTMAN: That would be my guess as to what her recollection would be, you know.[15] I don't have the personal knowledge, and I haven't done a full debriefing of her. I know Fred, I met him, as he may have told you.

MR. EINHORN: Yeah, no, [Fred] told me he likes you.

MR. ALTMAN: I like him. He is a nice guy. This is all silly. I hate to see this happen. Really, it would be terrible.

MR. EINHORN: Okay.

MR. ALTMAN: If somebody just does the right thing,[16] and --

MR. EINHORN: But you think they learned about this from others and were pointed to her. They have other people lined up that are --

MR. ALTMAN: No, no. I don't think that is the case.

MR. EINHORN: You don't think they have other people coming to testify?

MR. ALTMAN: No, no, not with respect to what I talked to you about.

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[14] When asked about Altman's statements, "[I]f [Rosen] gets served, then . . . she is going to be [like] any other human being," and "I . . . can't advise her to evade the [subpoena] process, but . . . [m]emory fades and the like," Einhorn testified that he understood that Rosen "would be very difficult for [Division staff] to find and serve, or . . . if they found . . . and served her, like everybody else, she would have to come . . . to the hearing, but she could have amnesia, she could be 'I don't remember,' 'I don't recall' and 'I don't know.'"

[15] Einhorn testified that he understood Altman's statement, "That would be my guess as to what her recollection would be," to mean that if Einhorn's clients gave Rosen a financial package, she "would be more favorably disposed towards [them] and . . . would be difficult to serve [by subpoena], or if served, would not give . . . testimony adverse to" their interests.

[16] Einhorn testified that he interpreted Altman's statement, "If somebody just does the right thing," to mean that his clients should "do right" by Rosen and give her a financial package.

MR. EINHORN: Okay.

MR. ALTMAN: I think if you cut it off with her, then it is closed.[17] That will be[,] you know[,] killing themselves.

3. The third (second taped) telephone conversation.

The third conversation, which was the second taped conversation, occurred on or about February 7, 2004. Altman initiated the conversation to give Einhorn a "heads up" that Division staff had been calling him and that he, Altman, told the staff that he was not "focusing" on the matter:

MR. ALTMAN: Hi, I just wanted to give you the heads up. Primoff [a Division staff attorney] called me again today.

MR. EINHORN: Yeah?

MR. ALTMAN: Just wants to know what the story was. I said I was not focusing on the matter, I appreciated him following up with me.

MR. EINHORN: Okay. So he is going to call you back and ask you --

MR. ALTMAN: I said, "You are welcome to call me if I don't call you." He said, "Oh, we'll certainly bug you." I said, "I am sure you will. You are welcome to."

MR. EINHORN: Well, I am going to call my client.

MR. ALTMAN: I expect [Primoff] wants to push me sometime before the end of the week.

MR. EINHORN: I am sure. We have got a hearing coming up. My client, Fred Blumer, is going to take the witness stand around March the 8th, so you know . . . [Primoff's] going to want your client for purposes of rebuttal, or impeachment or whatever. Anyway, I don't know what Fred is going to do, but I'll talk to him and let you know.

MR. ALTMAN: Okay, just thought I'd give you the heads up.

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17 Einhorn testified that he understood Altman's statement, "[I]f you cut it off with her, then it is closed," to mean, "[d]one deal; nobody else is going to step forward on behalf of the SEC to say that Mr. Blumer's records weren't damaged by a virus that corrupted the files on his computer."

4. The fourth (third taped) telephone conversation.

The fourth conversation, which was the third taped conversation, occurred on or about February 9, 2004. Einhorn called Altman to inform him that Blumer would not give Rosen a severance package:

MR. EINHORN: Anyway, I spoke to Fred [Blumer], and he has no control over, you know, anything that you are suggesting. He feels that this is an extortion attempt, trying to, you know, buy [Rosen] a severance agreement. If he gets Jay [Adoni] to do this, her testimony will be more favorable to him. And he just -- he doesn't want to get involved in something like that. So she will do what she wants to do and testify however she wants to testify, and that will have to be it.

MR. ALTMAN: Okay. That's probably unfortunate for you,[18] but --

MR. EINHORN: You know, look --

MR. ALTMAN: -- I am certainly not going to facilitate any untruthful testimony.[19] And,

MR. EINHORN: Well --

MR. ALTMAN: To the extent I am involved in the testimony, the testimony will be as limited as possible, but --

* * *

MR. ALTMAN: My understanding is [Rosen] is going to directly say that there was no -- I don't have my notes in front of me, but, bug in his computer that precipitated any loss of records. The truth is there were no records. She had access to all of them, that was part of the grist of the work of what she did, even though she was technically an employee of Nextgen and not Harrison.

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[18] Einhorn testified that he understood Altman's statement, "That's probably unfortunate for you," to mean that "this could all go away if [Rosen] got the right [financial] package[,] meaning that either she wouldn't be served, or if served, her testimony would not hurt [his] client."

[19] When asked his reaction to Altman's statement, "I am certainly not going to facilitate any untruthful testimony," Einhorn testified, " I don't know what he's talking about when he says something like that. I think it's just self-serving."

MR. EINHORN: If Nextgen settled with her, she wouldn't remember that?

MR. ALTMAN: You know, I don't even know -- you know, she was not a registered person, and you know, I don't even know what her address is. The SEC can find her or not find her.

MR. EINHORN: Well, you know, it is up to them. You know, what you are saying, she doesn't have a subpoena, she doesn't have to cooperate, but she will go in there and burn them unless they agree to pay her some severance and make her happy financially. And,

MR. ALTMAN: No. I think they should have done that anyway. I am reinvigorating the offers I made to Jay [Adoni], you know, a year ago.

MR. EINHORN: Well --

MR. ALTMAN: Well, I thought [Adoni] made a misjudgment in doing that, . . . and I think he is probably making a misjudgment now. It is kind of -- you know, think about her testimony. Here is a $60,000 a year secretary who's required to be -- The president [Blumer] is such a bad manager of his own financial affairs that it was required for him to get two car leases, that she co-sign it [sic] and despite repeated demands that she be relieved from that co-obligation, the president denied [Rosen's demands]. It is[,] you know[,] it's just terrible, terrible.

MR. EINHORN: I can tell you why. The guy is separated from his wife, and he has had problems, but that is neither here nor there. Just I don't know why [Rosen] agreed to do it, but you know she agreed to do it, and I am sorry she is not happy with her bargain and things didn't work out for her. But we're not gonna, he doesn't want to buy her silence. Okay?

MR. ALTMAN: That's not what this is about anyway.

MR. EINHORN: What the hell is this about?

MR. ALTMAN: You pays your money, you take your chances.[20] They should have settled with [Rosen] a long time ago. This was another opportunity to do that,

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[20] Einhorn testified that he understood Altman's statement, "You pays your money, you take your chances," to mean that Blumer and Adoni were "faced with a potential disaster on their hands"; Rosen "was going to bury them" at the hearing for not doing the "right thing" and agreeing to a financial package; and his clients would "suffer the consequences."

you didn't do that. There are consequences to that, some of which are controllable, some are not.

MR. EINHORN: Okay. Well. All right. You know, I just feel I am not -- Fred has decided he is not going to buy her silence.

MR. ALTMAN: Fred has nothing to do with this decision.[21] Come on, Irv.

MR. EINHORN: You got the wrong guy here. You got the wrong guy here. I deal with Fred Blumer and no one else.

MR. ALTMAN: I am sure you do. I am sure you do. But, you know, [Blumer] runs an hour's worth of that business by himself. That is just the reality of it. It has been the economic reality of it. And he doesn't have the financial wherewithal to get her off the co-signing of the lease[s], but his bank, as you described him [Adoni], does, and he [Adoni] should do that, and he is not doing that.

This reaction doesn't surprise me because Jay [Adoni] doesn't seem to be the kind of guy that you back into a corner and I regret that he is perceiving it this way. What [Adoni] really should do is take care of this gal who worked for . . . many years, and these things all just disappear and everyone goes on with their lives.[22] And, you know, it's the stupid things in my experience that end up affecting people in much more significant ways than they should.

MR. EINHORN: Okay. Steve, I can only pass the message along to you. That is all I am doing.[23]

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21 Einhorn testified that he understood that Altman believed that Adoni was "the real power behind the scenes," and that Blumer only needed to get Adoni "to come up with the [financial] package[] and everything would be taken care of."

22 Einhorn testified that he understood Altman's statement, "What [Adoni] really should do is take care of this gal . . . and these things all just disappear," to mean that his clients should "[g]ive [Rosen] the money, [and] it [her adverse testimony] will go away and disappear one way or the other; either . . . ducking service of process, or if served and asked whether there was a [computer] virus, you know, or any kind of bug, you know, I don't remember, I can't recall, I don't know anything about that."

23 When Einhorn was asked what he thought Rosen would do if she did not get a financial package, he stated, "I believe[d] that [Rosen] would seek revenge . . . in order to stick it

(continued...)

MR. ALTMAN: I hear you. I hear you. It's a colossal, colossal mistake, Irv.[24] Personally, because I like Fred personally. It's regrettable, really regrettable. Just so, so stupid.

5. The fifth and sixth (fourth and fifth taped) telephone conversations.

The fifth telephone conversation, which was the fourth taped conversation, occurred on February 10, 2004, when Einhorn called Altman in response to a message Altman had left asking Einhorn to call him.[25] Altman told Einhorn that he was on another telephone call and would call him back.

The sixth telephone conversation, which was the fifth taped conversation, occurred the same day when Altman called Einhorn back. Altman told Einhorn that Rosen was "going in" for an interview with the Division unless there was a "way to figure out some last clear chance to get out of it":

MR. ALTMAN: I just wanted to give you a heads up. The SEC has been badgering me. And,

MR. EINHORN: But they don't have a subpoena, and they don't have anything.

MR. ALTMAN: She is going to go in next week.

MR. EINHORN: Okay.

MR. ALTMAN: That is her call. I have to tell you, this is not -- I don't represent cooperators. Not just typically. I am trying to think back. I don't think I ever have, I just don't do it. I am always on the other side. I represent you know the bad guys or the good guys.

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23 (...continued)
to Mr. Adoni and my client for what she believed was the shabby treatment she received at their hands. She would get on the witness stand and do everything she could to inflict damage on my client."

24 Einhorn testified that he understood Altman's statement, "It's a colossal, colossal mistake," to mean that Blumer and Adoni were being "stupid" because, "for a little bit of money[,] they could make this problem disappear." By refusing to give Rosen a financial package, they would "bring disaster upon themselves" at the Harrison Proceeding hearing.

25 Einhorn testified that he believed Altman was calling him to "[t]ake another run at getting [Rosen] some money out of this."

MR. EINHORN: Or the defendants. You are defense counsel.

MR. ALTMAN: I typically am. I am. I am plaintiff in some cases, but I am definitely a defense counsel.

MR. EINHORN: Umm-hmm.

MR. ALTMAN: So, you know, it is just foreign to me, and it is not -- I don't want to say uncomfortable, but particularly having met Fred [Blumer], it is regrettable, and I just wanted to sort of -- I understand Jay [Adoni]'s -- I think I have a feeling for his personality and psyche, and I certainly understand that his natural first reaction to this is, look, it is a stick-up, what are you doing? I don't get stuck up by anybody, f*** you, so that's why we are not paying. As just as a general business practice, and personality wise and just trying to see -- since I know how bad a result that is for everybody --

MR. EINHORN: Umm-hmm.

MR. ALTMAN: If there's not some other way to figure out some last clear chance to get out of it,[26] because, you know, there is no --

MR. EINHORN: What is it gonna take? What is the bottom line? What is it going to take? What kind of package is this? I am a communicator here. What is the package that she wants to, you know, not cooperate or whatever?

MR. ALTMAN: Get her off those leases and, you know, a year's salary, and you can even pay it out over a year. As long as we've got . . . .

MR. EINHORN: What will we get if they do that, she won't cooperate or she won't remember?

MR. ALTMAN: Uh, [p]robably both.

MR. EINHORN: Ok. All right. Let me pass it on to the client one more time, and --

* * *

MR. EINHORN: All right. Well, I will make a call to Fred [Blumer] tomorrow.

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[26] Einhorn testified that he understood Altman to mean that Rosen was "going in and giving an unfavorable interview with the SEC, which would . . . result in her taking the witness stand . . . when the hearing recommences and giving adverse testimony to [his] clients."

MR. ALTMAN: I appreciate it.

MR. EINHORN: And tell him what you said and that [Rosen] is going in next week unless something else happens.

MR. ALTMAN: Help me, help me not do this.. I don't want to do this.

Altman did not hear from Einhorn again, and they had no further conversations after February 10, 2004. Einhorn testified, and Altman does not dispute, that their conversations did not result in any agreement between Einhorn's clients and Rosen.

F. The Division Subpoenas Rosen to Testify in the Harrison Proceeding.

Unaware of Altman's conversations with Einhorn and unsure whether Rosen would cooperate with them, on or about March 2, 2004, Division staff served Rosen with a subpoena compelling her to appear and testify as a witness in the Harrison Proceeding. On March 3, 2004, after confirming that Rosen had been served, Division staff notified Altman and again asked to interview Rosen before she appeared and testified at the hearing.[27] According to Division staff, Altman was still "noncommital."

Division staff eventually spoke to Rosen in a telephone interview on March 8, 2004, the day that the hearing in the Harrison Proceeding resumed. Altman participated in the telephone interview as Rosen's attorney. During the telephone interview, Division staff asked Rosen about Harrison's and Blumer's computer virus defense. Rosen told Division staff that a Harrison information technology manager admitted to her that a letter he signed in support of Harrison's and Blumer's computer virus defense was false. Division staff also asked Rosen about Blumer's accounting practices. Division staff spoke to Rosen once again in person on the morning of March 10, 2004, the day she testified.[28] Altman was present at this in-person interview as well.

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[27] Division staff testified that they deliberately waited until Rosen had been served with a subpoena before notifying Altman because Altman had not yet made Rosen available for an interview and they did not want him to be able to contact Rosen and interfere with service of process. According to Division staff, Altman expressed some surprise that subpoena service by Federal Express was valid in Commission administrative proceedings. In his hearing testimony, Altman acknowledged that he did not offer to accept service of a subpoena on Rosen's behalf.

[28] Division staff testified that the information they received from Rosen during the telephone and in-person interviews was "less comprehensive than what we [the staff] thought we would be getting, based on what the NASD told us." According to Division staff, Rosen "didn't either know or didn't remember some of the things that we thought she would know from what the NASD told us."

G. Einhorn Uses Altman's Taped Statements to Impeach Rosen on Cross-Examination.

On March 10, 2004, the Division called Rosen to testify as a rebuttal witness in the Harrison Proceeding hearing. Altman attended the hearing as Rosen's counsel, but was not allowed to participate in the proceeding. Before Rosen began testifying, Einhorn requested an off-the-record conference. The law judge, Division staff, and Song's counsel were in attendance, but not Altman. At the conference, Einhorn disclosed for the first time that Altman had called him repeatedly to obtain a financial package for Rosen, and that he, Einhorn, had tape recorded several of the telephone calls. Einhorn stated that he believed Altman had engaged in extortion or blackmail during those calls because Altman demanded a severance payment from Harrison and Blumer to prevent Rosen's testimony from being damaging to them at the hearing. Einhorn told Division staff that if they called Rosen to testify as a witness, he would play the tapes at the hearing and refer the matter to the FBI, but that if they did not call Rosen, he would not pursue the matter further. At the Division's request, Einhorn played the tapes of the calls. Division staff were "very disturbed" by the substance of Altman's conversations. Nevertheless, they concluded that the conversations did not indicate Rosen would be untruthful and elected to proceed with her testimony.

On direct examination, Rosen testified that a Harrison information technology manager admitted to her that a letter he signed in support of Harrison's and Blumer's computer virus defense was false.[29] Division staff did not raise the subject of the car leases during her direct testimony because they did not believe that the leases were relevant to the proceeding. On cross-examination, Einhorn asked Rosen about the leases because he wanted to show her "bias and hostility" towards his clients. Einhorn then played the tapes of Altman's conversations on the record.[30]

H. Altman's Explanations of his Taped Statements.

Altman testified that he first learned of the existence of the tapes during Einhorn's cross-examination of Rosen. Listening to the tapes, Altman could not believe that Einhorn asked him, "What will we [Harrison and Blumer] get if they do that [*i.e.*, give Rosen a severance payment and remove her name from the car leases], she won't cooperate or she won't remember?," and that he replied, "Uh, [p]robably both." Altman had "no memory" of saying those words and could not

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[29] Division staff testified that Rosen's direct testimony was "less fulsome compared to what [they] had been led to expect" from NASD staff.

[30] The tapes were admitted into evidence in the Harrison Proceeding as Respondents' Exhibits 48, 49, and 50. The tapes were admitted into evidence in this Rule 102(e) proceeding as OGC Exhibit 13. Altman challenged the admissibility of the tapes before the law judge, but it appears that he has abandoned this issue on appeal.

believe they "fell out of [his] mouth." Altman did not know why he said, "[p]robably both," and admitted that "[t]hose words should have never been said."

But Altman denied that he intended to have Rosen evade service of a subpoena and/or give false testimony in exchange for a financial package from Harrison and Blumer. Altman testified that the sole objective of his telephone conversations with Einhorn was to "appeal" to Einhorn as a "fellow defense counsel" and "convince him to get [Rosen] off the [car] leases and get her some money" so she "wouldn't be a pissed-off ex-secretary," or angry witness, at the hearing. Altman testified, "I was just trying to negotiate [with Einhorn] and say[,] got to be some way, just not make Fred [Blumer] look bad [on the witness stand], that's all I really had to work with. Her testimony is going to be her truthful testimony. She's not going to evade [subpoena] service. But if you paid her, she'll not be pissed-off." In Altman's view, Blumer's conduct in having Rosen co-sign the car leases and keeping Rosen on the leases after her employment ended made Blumer "look bad" and was his "best ammunition" against Blumer.[31]

Altman testified that he was "shocked," "stammering," and "blubbering" during the fourth (third taped) conversation when he realized Einhorn was interpreting his remarks as proposing "some kind of exchange" of financial benefits for substantive testimony. Altman testified that he told Einhorn, "No," and "That's not what this is about," but admitted that he did not seek to clear up Einhorn's purported confusion by saying, "[H]ey, what's going on, what are you talking about?," "[E]xcuse me, but where are you coming from?," "[N]o, stop it, I don't do that," or similar words. Altman explained, "In my mind, if I said no -- if I had done what I would do in another context, which is raise my voice, scream, yell, curse and slam the phone down, I couldn't do that with Mr. Einhorn in those conversations because if I did, I understood there was no chance that we could get what I was trying to negotiate for, if I told him."

The law judge found that Altman's testimony was not "candid and credible" and rejected his explanations of his taped statements. In her view, none of Altman's explanations or defenses could change the plain meaning of his words, which supported a finding that Altman knowingly and intentionally engaged in unethical and improper professional conduct.[32] As noted previously,

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[31] The record shows that Altman had no reason to believe that Division staff were interested in the car leases as impeachment material. As discussed, Division staff knew about the leases from their initial contact with Rosen, but they did not believe that the leases were relevant to the Harrison Proceeding. Similarly, Einhorn thought that the leases were irrelevant to any of the charges against his clients. *See supra* note 12.

[32] For example, to bolster his claim that the car leases were relevant impeachment evidence, Altman contended that the car leases were the focus of his conversations with Einhorn. Altman pointed to his statement in the second (first taped) conversation that Rosen would "testify that there was no virus in the computer, and [...]some other very, very unhelpful stuff with respect to the books and records of the firm." Altman asserted that the "very unhelpful stuff with

(continued...)

a law judge's credibility findings are entitled to considerable weight absent substantial evidence to the contrary.[33] Altman has not shown, nor do we find, substantial evidence contradicting the law judge's adverse credibility findings, which were based, among other things, on hearing Altman's testimony and observing his demeanor.[34]

I. Subsequent Events.

After the hearing in the Harrison Proceeding, Einhorn withdrew as counsel for Harrison and Blumer and disclosed the tapes to law enforcement authorities.[35] In addition, Division staff reported the substance of Altman's tape recorded conversations to the Commission for "possible attorney misconduct."[36] In September 2004, the law judge in the Harrison Proceeding issued an initial decision finding that Harrison and Blumer had violated the federal securities laws,[37] but that Rosen had been "thoroughly impeached" on cross-examination and was not a reliable witness.[38]

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32 (...continued)
respect to the books and records of the firm" referred to the car leases. Altman's argument adds words to the transcript of his taped conversations that do not exist.

33 *See supra* note 10.

34 We reject Altman's claim that the law judge "displayed a pronounced prejudice against" him. We find no evidence of prejudice or other improper conduct. In all events, our *de novo* review of the record cures whatever prejudice, if any, that may have existed. *See, e.g., Robert Bruce Orkin*, 51 S.E.C. 336, 344 (1993) (stating that "our *de novo* review of this matter cures whatever bias or disregard of precedent or evidence, if any, that may have existed below"), *petition denied,* 31 F.3d 1056 (11th Cir. 1994).

35 The record does not indicate that any criminal action has been taken against Altman.

36 *See* 17 C.F.R. § 203.7(e) (authorizing officer conducting formal investigative proceeding to report to Commission "any instances where any witness or counsel has been guilty of dilatory, obstructionist or contumacious conduct during the course of an investigation or any other instance of violation of these rules"). The Commission referred the matter to OGC for investigation, *see* 17 C.F.R. § 200.21(a) (providing that the General Counsel is responsible for conducting preliminary investigations into potential violations of Rule 102(e) by attorneys), resulting in the initiation of this Rule 102(e) proceeding against Altman.

37 *See Harrison Secs.*, Initial Decision Rel. No. 256 (Sept. 21, 2004), 83 SEC Docket 2986, *declared final*, Exchange Act Rel. No. 50614 (Oct. 29, 2004), 84 SEC Docket 117.

38 *Harrison Secs.*, 83 SEC Docket at 2996.

III.

Rule 102(e) is the primary tool available to the Commission to protect the integrity of its administrative processes.[39] It enables the Commission to initiate administrative disciplinary proceedings against professionals who lack integrity or competence, who engage in unethical or improper professional conduct, or who are found to have violated the federal securities laws or rules and regulations thereunder.[40] In interpreting the phrase "unethical or improper professional conduct," the Commission has stated that it will hold attorneys who practice before it to the standards to which they are already subject, including state bar rules.[41] Although Rule 102(e) and Exchange Act 4C do not specify the mental state necessary to discipline an attorney for "unethical or improper professional conduct,"[42] the record establishes that Altman engaged in such conduct with scienter.[43]

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39 *Implementation of Standards of Professional Conduct for Attorneys*, Exchange Act Rel. No. 46868 (Nov. 21, 2002) (proposed rules), 78 SEC Docket 3240, 3241; *see, e.g., Marrie v. SEC*, 374 F.3d 1196, 1200 (D.C. Cir. 2004) (stating that Rule 102(e) "is directed at protecting the integrity of the Commission's processes, as well as the confidence of the investing public in the integrity of the financial reporting process"); *Touche Ross & Co. v. SEC*, 609 F.2d 570, 582 (2d Cir. 1979) (stating that Rule 102(e)'s predecessor, Rule 2(e), "represents an attempt by the Commission to protect the integrity of its own processes"; holding that Rule 2(e)'s provisions were "reasonably related" to the purposes of the federal securities laws and therefore valid).

40 *See* 17 C.F.R. § 201.102(e)(1)(i)-(iii).

41 *See William R. Carter*, 47 S.E.C. 471, 508 (1981) (stating, in context of Rule 2(e) proceeding, that "we perceive no unfairness whatsoever in holding those professionals who practice before us to generally recognized norms of professional conduct, whether or not such norms had previously been explicitly adopted or endorsed by the Commission. To do so upsets no justifiable expectations, since the professional is already subject to those norms.") (footnote omitted); *see also Implementation of Standards of Professional Conduct for Attorneys*, 78 SEC Docket at 3241 n.13 (stating that Rule 102(e) "enables the Commission to discipline professionals who have engaged in improper professional conduct by failing to satisfy the rules, regulations or standards to which they are already subject, including state bar ethical rules governing attorney conduct . . . .").

42 *Cf.* 17 C.F.R. § 201.102(e)(1)(iv) (expressly setting forth mental state standards for accountants who engage in "improper professional conduct" under Rule 102(e)(1)(ii)).

43 Because we conclude that Altman's conduct demonstrated scienter, we do not decide whether some other culpability standard would also suffice. Although the Commission

(continued...)

A. Altman Engaged in Unethical and Improper Professional Conduct.

The record shows that during the relevant period, Altman initiated and engaged in a series of telephone conversations with Einhorn in an attempt to obtain a financial package for Rosen, a prospective Division witness in the Harrison Proceeding. The plain meaning of Altman's words, recorded on tape, establishes that he was proposing a *quid pro quo*: if Harrison and Blumer gave Rosen severance pay (a year's salary or about $60,000) and removed her name as co-signer on the car leases, she would not cooperate with the Division (by avoiding service of a subpoena or not complying with the subpoena) and/or falsely testify that she could not remember relevant facts detrimental to Harrison's and Blumer's computer virus defense.

In the first (untaped) conversation, Altman informed Einhorn that Rosen was hostile towards Harrison and Blumer and had information damaging to them. Altman suggested that if Harrison and Blumer could arrange a severance or compensation package for Rosen, she would be more favorably disposed towards them if called as a witness, or she might not appear as a witness at all. Altman's call "stunned" Einhorn, who interpreted it as an "extortion attempt," seeking money for a witness in return for her favorable behavior and/or testimony.

In the second (first taped) conversation, Altman informed Einhorn that Rosen would testify there was no virus in Blumer's computer. Einhorn knew that this testimony would be "very detrimental" and "harmful" to his clients. Einhorn asked Altman, "So, she hasn't given that testimony?" Altman replied, "That's correct," and indicated that Rosen would not lose her livelihood if she did not cooperate with the Division. Einhorn next asked, "Well, suppose she gets a subpoena to appear at the hearing?" Altman stated that he could not advise Rosen to evade subpoena service, but suggested that, if served, Rosen's memory of the relevant facts might "fade." Einhorn then asked, "So, what you are saying is[,] if they reach some agreement, she would be more favorably inclined?" Altman responded, "That would be my guess as to what her recollection would be," meaning that Rosen's recollection would be more favorable towards Harrison and Blumer if she received a severance payment. Altman further informed Einhorn that he did not think the Division had other witnesses lined up to testify that there was no computer virus. "I think if you cut if off with her[,]" Altman relayed to Einhorn, "then it is closed." Altman thus conveyed to Einhorn, and Einhorn understood, that if Rosen received a financial package from Harrison and Blumer, she would not cooperate with Division staff and/or would testify falsely that she did not remember facts damaging to their computer virus defense.

In the fourth (third taped) conversation, Einhorn informed Altman that Blumer thought Altman was engaging in an "extortion attempt"; Blumer would not agree to pay Rosen; and Rosen would have to "testify however she want[ed] to testify." Altman did not dispute the

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[43] (...continued)
has cautioned against bringing Rule 102(e) attorney disciplinary proceedings based on negligent legal advice, it did so in *dicta* and the question was not squarely presented in the case. *See Scott G. Monson*, Exchange Act Rel. No. 28323 (June 30, 2008), 93 SEC Docket 7517, 7522-25.

characterization of his proposal as an "extortion attempt." Instead, Altman replied, "That's probably unfortunate for you."[44] Einhorn construed Altman's response to mean that Rosen's damaging testimony would "go away" if she received a financial package.

After Altman reiterated that Rosen would testify there was no computer virus, Einhorn asked, "If Nextgen settled with her, she wouldn't remember that?" Altman replied that Rosen was not "a registered person," he did not know her address, and the Division could "find her or not find her." Einhorn stated that Blumer did not want to "buy her silence," to which Altman responded, "That's not what this is about anyway." Einhorn then asked, "What the hell is this about?" Altman answered, "You pays your money, you take your chances. They should have settled with her a long time ago. This was another opportunity to do that, you didn't do that. There are consequences to that, some of which are controllable, some are not." When Einhorn repeated that Blumer would not "buy [Rosen's] silence," Altman insisted that Blumer had "nothing to do with this decision," Adoni controlled the finances, and Adoni should "take care" of Rosen and "these things" would "disappear." Altman thus conveyed to Einhorn, and Einhorn understood, that if Rosen received a financial package, her damaging testimony would "disappear" because she would avoid service of a subpoena and/or falsely claim not to remember relevant facts if served. Einhorn further understood that if Harrison and Blumer did not give Rosen a financial package, they would be taking their "chances" and suffer the "consequences" at the hearing.

In the sixth (fifth taped) and final conversation, Altman stated that he understood Adoni's "natural first reaction" was to construe his proposal as a "stick-up" and refuse to pay Rosen, but that such a position would lead to a "bad" result. Einhorn tried to pin Altman down as to what exactly he was offering from Rosen in return for a financial package from Harrison and Blumer: evading service of a subpoena or falsely testifying that she did not remember relevant facts. Altman answered, "Uh, [p]robably both." Altman's answer left no uncertainty as to the terms of his proposed *quid pro quo*.

B. Altman Violated New York Ethics Rules.

Altman agreed that, at all relevant times, he understood his ethical obligations and was able to tell the difference between right and wrong and understand the nature and consequences of his actions. Despite what he understood, Altman violated fundamental ethics rules to which

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[44] On appeal, Altman argues that this statement "was not a clumsy attempt to deny extortion while committing it[,] but rather another (clumsy) attempt at lawful hectoring to obtain things to which Ms. Rosen was arguably entitled while truthfully denying unlawful intent." We find no support in the record for this position and note further that legal argument is not evidence.

he was subject as a member of the New York bar.[45] Altman's actions in repeatedly seeking financial benefits for his client, a prospective Division witness in a Commission administrative proceeding, in exchange for her evasion of subpoena service and/or provision of false testimony, constituted conduct involving "dishonesty, fraud, deceit, or misrepresentation," in violation of DR 1-102(A)(4). Altman acted knowingly and with an intent to deceive or mislead Division staff and the law judge.[46] Altman's objective was to interfere with the truthful disclosure of facts pertaining to Harrison's and Blumer's computer virus defense, and thereby impair the integrity of the Harrison Proceeding.

Altman knew before he first contacted Einhorn that the Harrison Proceeding was ongoing; that the Division wanted to interview Rosen as a prospective witness; that Division staff believed Rosen had information which could rebut Harrison's and Blumer's computer virus defense; and that Einhorn was counsel for Harrison and Blumer. Altman also knew that Rosen would testify there was no computer virus that compromised Harrison's files. Altman further believed that Rosen had other information about the firm's files that would be "very, very unhelpful" to Harrison and Blumer. In his hearing testimony and briefs on appeal, Altman acknowledged that he thought this was an opportune time to renew Rosen's requests for financial benefits from Harrison and Blumer because the pending Harrison Proceeding and the Division's interest in Rosen as a witness gave him some leverage.

At the same time, Altman knew that Division staff had only second- or third-hand information from NASD and himself about Rosen's potential testimony. Altman did not want Division staff to interview Rosen and learn exactly what she knew until he found out if Harrison and Blumer would pay her. As a result, Altman put off the Division staff's multiple requests to interview Rosen by not returning their calls or falsely stating that he was not "focusing" on the matter when he called them back.

With Division staff's efforts to interview Rosen effectively forestalled, Altman repeatedly contacted Einhorn and proposed that, in exchange for a financial package, Rosen would avoid

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45 *See generally In re Snyder*, 470 U.S. 634, 645-46 n.7 (1985) (referring to the duty in DR 1-102(A)(5) as "almost universally recognized"); *Carter*, 47 S.E.C. at 508 n.65 (describing prohibition embodied in DR 1-102(A)(4) to be of a "fundamental" nature).

46 New York courts have held that scienter is a necessary element of a DR 1-102(A)(4) violation, *see, e.g., Matter of Altomerianos*, 160 A.D.2d 96, 559 N.Y.S.2d 712 (1st Dept. 1990) (stating that "venal intent," which is a necessary element of a DR 1-102(A)(4) violation, does not include conduct "which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another") (quoting definition of fraud in "Definitions" section of Code of Professional Responsibility), but not a DR 1-102(A)(7) violation, *see In re Latimore*, 252 A.D.2d 217, 683 N.Y.S.2d 526 (1st Dept. 1999), *appeal and reargument denied*, 260 A.D.2d 170, 693 N.Y.S.2d 434 (1st Dept. 1999).

service of a subpoena and/or testify falsely if served in the Harrison Proceeding. Altman sought to induce Einhorn's clients to accept this quid pro quo by telling Einhorn that Rosen was hostile towards Harrison and Blumer and would give testimony damaging to them at the hearing unless they did the "right thing" and paid her. While Altman testified that he said, "No," and "That's not what this is about," in response to Einhorn's statements that Blumer would not "buy" Rosen's silence, he admitted that he never said, "[H]ey, what's going on, what are you talking about?," or "[E]xcuse me, but where are you coming from?" In light of Altman's hearing testimony that he was "shocked" that Einhorn interpreted his remarks as proposing a *quid pro quo*, Altman's refusal to confront Einhorn and say, "[N]o, stop it, I don't do that," or other words of similar import, is persuasive evidence that he acted knowingly and intended for Rosen to avoid subpoena service and/or testify falsely in exchange for financial benefits from Harrison and Blumer.

In the sixth (fifth taped) and last conversation, Altman made the terms of his proposed *quid pro quo* clear. In response to Einhorn's question, "What will we [Harrison and Blumer] get if they do that [*i.e.*, give Rosen severance pay and remove her name from the car leases], she [Rosen] won't cooperate or she won't remember?," Altman stated that they "[p]robably" would get "both" an attempt to avoid service of a subpoena and false testimony if served. In his hearing testimony, Altman did not offer an explanation for why he stated, "[p]robably both," and our *de novo* review of the record reveals none, other than that he intended to extract money and other benefits for Rosen in exchange for her favorable behavior and/or testimony. Given the tenor and substance of Altman's conversations with Einhorn, Altman must have known or believed that if his proposal were consummated, Rosen would have testified falsely in the Harrison Proceeding and undermined the Division's case against Harrison and Blumer.

Altman continued to stall Division staff's efforts to interview Rosen for approximately a month after the last conversation while he waited to hear from Einhorn, to no avail. Altman eventually agreed to make Rosen available for an interview and have her appear for testimony in the Harrison Proceeding, but not until the eve of the resumed hearing, after Rosen had already been subpoenaed, and it was apparent that his attempts to strike a bargain with Harrison and Blumer had failed. Altman's actions in preventing Division staff from obtaining relevant information from Rosen until the eleventh hour before she was required to appear and testify in the Harrison Proceeding is further evidence that he acted knowingly and with a high degree of scienter.

In addition to violating DR 1-102(A)(4), Altman violated DR 1-102(A)(5), prohibiting conduct by an attorney that is prejudicial to the administration of justice. Altman's conduct was prejudicial to the administration of justice in the Harrison Proceeding because it disrupted the orderly and efficient progress of the Harrison Proceeding hearing, led to the impeachment of Rosen and the law judge's rejection of her testimony, and, as Altman himself acknowledged in his briefs on appeal, caused Commission staff to "waste their resources."

Furthermore, Altman violated DR 1-102(A)(7), prohibiting conduct by an attorney that reflects adversely on his fitness to practice law. Altman's conduct reflected adversely on his fitness to practice law because he sought to trade Rosen's favorable behavior and/or testimony for financial benefits.[47]

C. Altman's Primary Contentions on Appeal.

1. This Rule 102(e) proceeding against him should be dismissed.

Altman argues that this proceeding should be dismissed for a variety of reasons. His first reason is that he was not charged with violating the federal securities laws. A federal securities law violation, however, is not a prerequisite to the initiation of a disciplinary proceeding under Rule 102(e) and Exchange Act Section 4C. Those provisions set forth three independent bases on which the Commission may discipline a person licensed to practice as an attorney: first, when the attorney lacks the "requisite qualifications to represent others"; second, when the attorney lacks "character or integrity" or engages in "unethical or improper professional conduct"; or third, when the attorney willfully violates, or willful aids and abets a violation of, the federal securities laws.[48]

Altman's argument is based on the language from Rule 102(e)(1)(iii) that requires a violation of the federal securities laws or rules or regulations thereunder. The language of Rule 102(e)(1)(iii) does not carry over to Rule 102(e)(1)(ii). The use of the disjunctive "or" indicates that there are alternative bases for bringing Rule 102(e) and Exchange Act Section 4C disciplinary proceedings, and such proceedings are not limited to those attorneys who violate the federal securities laws.

Second, Altman argues that his alleged misconduct did not occur while he was "appearing or practicing" before the Commission. We reject Altman's narrow interpretation of Rule 102's language and find that his argument lacks merit. "[P]racticing before the Commission," as

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[47] New York courts have found violations of DR 1-102(A)(4), (5), and (7) on similar facts and ordered that the attorney be disbarred. *See, e.g, In re Geoghan*, 253 A.D.2d 205, 686 N.Y.S.2d 839 (2d Dept. 1999) (attorney who offered to have his client testify falsely in criminal proceeding in exchange for personal injury settlement violated DR 1-102(A)(4), (5), and (7) and was disbarred); *see also, e.g., In re Gen*, 29 A.D. 3d 230, 813 N.Y.S.2d 78 (1st Dept. 2006) (attorney who offered that his burglary victim client would provide favorable victim's statement, waive civil liability, and refuse to cooperate with district attorney in exchange for $100,000 payment from burglary defendant's family engaged in conduct prejudicial to the administration of justice that reflected adversely on his fitness to practice law and was disbarred).

[48] 15 U.S.C. § 78d-3(a)(1)-(3); 17 C.F.R.§ 201.102 (e)(1)(i)-(iii).

defined in Rule 102(f), is not a requisite for the applicability of Rule 102(e).[49] The Commission has previously held that

> the text of Rule 102(e)(1) contains no requirement that a person must be appearing or practicing before the Commission at the time of the conduct on which the Commission's findings are based. Rule 102(e)(1) provides that a person may be denied the privilege of appearing or practicing before the Commission once the Commission makes one of three findings: (i) that the person does not possess the requisite qualifications to represent others; (ii) that the person lacks character or integrity or has engaged in unethical or improper professional conduct; or (iii) that the person has willfully violated or willfully aided and abetted the violation of any provision of the federal securities laws or rules and regulations thereunder. Denying the person the privilege of appearing or practicing before the Commission is the authorized remedy once the Commission makes one of the findings specified in Rule 102(e)(1)(i)-(iii); appearing or practicing before the Commission at the time of the misconduct is not the precondition to imposing that remedy.[50]

Even though a finding that Altman was "appearing or practicing" before the Commission while engaging in unethical or improper professional conduct is not required in order for Rule 102(e) to apply to Altman, we conclude that Altman was "appearing or practicing" before the Commission during the relevant period. Altman represented Rosen in relation to the Division's attempts to talk with her as a prospective witness in the Harrison Proceeding, and he spoke to, and exchanged voice mails with, Division staff between January 28 and March 10, 2004, to that end. Altman was Rosen's attorney when Division staff interviewed her by telephone on March 8, 2004 and in-person on the morning of her testimony in the Harrison Proceeding on March 10, 2004. Rosen testified in the Harrison Proceeding that "[e]verything went through [her] attorney," Altman. Thus, at all relevant times, Altman was representing a witness before the Commission, and that conduct constitutes "appearing or practicing" before the Commission. Altman's attempts to distinguish his contacts with Division staff from his contacts with Einhorn do not alter this conclusion because all of those contacts occurred during the course of his representation of Rosen before the Commission. Indeed, it was the specter of his client's testimony in a Commission administrative proceeding that Altman admitted gave him leverage to renew Rosen's requests for financial benefits from Harrison and Blumer.

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49 Rule 102(f) states that "practicing before the Commission *shall include, but shall not be limited to*: (1) Transacting any business with the Commission; and (2) The preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other professional or expert, filed with the Commission in any registration statement, notification, application, report or other document with the consent of such attorney, accountant, engineer or other professional or expert." 17 C.F.R. § 201.102(f) (emphasis added).

50 *Robert W. Armstrong, III*, 58 S.E.C. 542, 574 (2005).

Our conclusion also comports with an important remedial purpose of Rule 102(e), which is for the Commission to "protect the integrity of its own processes."[51] Rule 102(e) "provides the Commission with the means to ensure that those professionals, on whom the Commission relies heavily in the performance of its statutory duties, perform their tasks diligently and with a reasonable degree of competence."[52] The integrity of the Commission's processes is threatened when an unethical attorney offers to have his client, who is a prospective witness in a Commission administrative proceeding, avoid service of a subpoena or testify falsely in exchange for financial benefits. Disciplining an attorney under Rule 102(e) for such conduct furthers the Rule's remedial purpose of protecting the integrity of the Commission's processes.[53]

Third, Altman argues that this proceeding should be dismissed because the Commission "has long stated that it did not bring original proceedings against attorney advocates and was not well-equipped to do so, implying that it would not do so." Altman relies on two statements, decades-old, neither of which supports dismissal of this proceeding. The first statement, a 1982 speech by Edward F. Greene, the Commission's then-General Counsel, concerned attorney disciplinary proceedings brought under Rule 2(e), the predecessor to Rule 102(e).[54] The views expressed by Greene -- regardless of their content -- cannot be attributed to the Commission.[55] Under the Commission's regulations, staff opinions "do not constitute an official expression of the

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51 *See supra* n.39 and authorities cited therein.

52 *Touche Ross & Co.*, 609 F.2d at 582.

53 *See Armstrong*, 58 S.E.C. at 572 (stating that "disciplining accountants pursuant to Rule 102(e) for effecting a fraudulent scheme by computing the figures and providing the information incorporated into Commission filings furthers the Rule's remedial purpose of protecting the integrity of the Commission's processes").

54 *See* http://www.sec.gov/news/speech/1982/011382greene.pdf. In the speech, Greene did not state that the Commission lacked authority to bring attorney disciplinary proceedings. Rather, Greene expressed his "initial tentative view " that, "as a general matter," the Commission should bring such proceedings only when an attorney's alleged misconduct is "(I) a violation of established state law ethical or professional misconduct rules, and (ii) has a direct impact on the Commission's internal processes." *Id.* This case involves allegations that Altman's misconduct violated New York's attorney disciplinary rules and directly impacted a Commission administrative proceeding. As a result, it falls within the scope of what Greene considered to be an appropriate basis for an attorney disciplinary proceeding.

55 Greene emphasized this point in his speech when he stated, "These, of course, are my personal views and not those of the Commission or the staff." *Id.*

[Commission's] views."[56] In addition, courts have held that evidence reflecting staff opinions is not relevant in ascertaining the Commission's intent in any given instance.[57]

The second statement, a 1988 Commission release, addressed arguments about the Commission's purported lack of expertise to conduct public Rule 2(e) proceedings. As relevant here, the release stated, "With respect to attorneys, the Commission generally has not sought to develop or apply independent standards of professional conduct."[58] The release also stated that "the Commission, as a matter of policy, generally refrains from using its administrative forum to conduct *de novo* determinations of the professional obligations of attorneys."[59] The release did not state that the Commission would not, or could not, conduct a *de novo* determination of an attorney's professional obligations in a Rule 2(e) proceeding. It said the Commission generally did not do so, which the case law shows to be true.

Fourth, Altman argues that, while he "understood that he was bound by New York's disciplinary rules, he could not reasonably have expected that the Commission would seek to enforce those rules in the first instance." Rule 102(e) and its predecessor provisions have been in existence since 1935, giving Altman and other attorneys more than adequate notice of the possibility that the Commission might bring disciplinary proceedings against them based on "unethical or improper professional conduct." That the Commission generally has refrained from initiating this type of proceeding does not deprive it of its authority to do so.[60] The Sarbanes-

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56 *See* 17 C.F.R. § 202.1(d) (stating that, "[w]hile opinions expressed by members of the staff do not constitute an official expression of the Commission's views, they represent the views of persons who are continuously working with the provisions of the statute involved").

57 *See, e.g., SEC v. Nat'l Student Mktg. Corp.*, 68 F.R.D. 157, 160 (D.D.C. 1975) (stating that "[t]he SEC consists of five appointed Commissioners who are assisted by staff members. While Commissioners may in fact respect the staff's recommendations, they are not bound by them nor do such recommendations necessarily reflect the position of the agency itself on any given topic. Similarly, the views of an individual Commissioner will not invariably reflect the position of the agency as a whole"), *aff'd*, 538 F.2d 404 (D.C. Cir. 1976) (per curiam), *cert. denied*, 429 U.S. 1073 (1977).

58 *Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission*, Exchange Act Rel. No. 25893 (July 7, 1988), 41 SEC Docket 448, 452.

59 *Id.*

60 *See United States v. Morton Salt Co.*, 338 U.S. 632, 647-48 (1950) (holding that powers granted to FTC had not been "lost by being allowed to lie dormant"); *Cooley v. FERC*, 843 F.2d 1464, 1470 (D.C. Cir.) (stating that "even a prolonged failure to assert an agency power does not destroy it"), *cert. denied*, 488 U.S. 933 (1988).

Oxley Act of 2002 further confirms our application of Rule 102(e) in these circumstances by codifying it substantially verbatim in Exchange Act Section 4C.[61]

Finally, Altman argues that this proceeding should be dismissed because it is not "reasonable that the Commission may apply different standards of professional conduct to attorneys who are located in different jurisdictions with different rules." Beyond this bare assertion, Altman provides no legal or factual support for his argument. In any event, we believe that Altman's conduct was of the type which "'all responsible attorneys would recognize as improper for a member of the profession.'"[62]

2. Altman did not intend to exchange Rosen's substantive testimony for financial benefits.

Altman argues that he did not intend to exchange Rosen's substantive testimony for financial benefits because he never spoke to Rosen about the substance of his conversations with Einhorn. This argument fails on its face because Altman was purporting to act on Rosen's behalf. Moreover, Altman offers no evidence to buttress this argument, aside from his own discredited testimony in this proceeding and Rosen's unreliable testimony in the Harrison Proceeding. Furthermore, even if Altman had kept the substance of the conversations to himself, such conduct does not establish a lack of intent to consummate the transaction. We have found that Altman's taped statements indicate that he must have known or believed Rosen would uphold her end of the agreement, and he would live up to the promises he made to Einhorn, if Rosen was paid. Indeed, no other plausible explanation exists for Altman's communications with Einhorn.

Altman also argues that he did not intend to exchange Rosen's substantive testimony for financial benefits because he had no further conversations with Einhorn after February 10, 2004; those conversations did not result in any agreement; and he and Rosen cooperated with Division staff. These facts demonstrate only that Altman failed to convince Harrison and Blumer to agree to his proposal. They do not establish that he lacked the intent to follow through with it.

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[61] *See Armstrong,* 58 S.E.C. at 571 n.61 (stating that "Congress embraced our application of Rule 102(e) by codifying the rule substantially verbatim in Section 4C of the Exchange Act as a result of the Sarbanes-Oxley Act of 2002"; stating further that "when Congress revisits a statute giving rise to a longstanding administrative interpretation without pertinent change, the 'congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress'") (quoting *CFTC v. Schor*, 478 U.S. 833, 846 (1986)).

[62] *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 666 (1985) (Brennan, J., concurring in part and dissenting in part) (quoting *In re Ruffalo*, 390 U.S. 544, 550 (1968) (White, J., concurring)).

Altman attempts to further this argument by asserting that Division staff already knew the information she had, making her testimony "unchangeable." The Division had only second-hand, or perhaps third-hand, hearsay information about Rosen's testimony. Such information was not perpetuated sworn testimony and was subject to change, modification, or expansion upon further reflection.[63]

3. The law judge's findings regarding Altman's alcohol abuse were erroneous.

Altman, who admits he suffers from alcohol abuse, argues that the law judge erred in finding that he was not impaired by alcohol in any of his telephone conversations with Einhorn and that his alcohol abuse did not affect his conduct. According to Altman, the evidence shows that he drank most evenings during the relevant period; he had been drinking before at least the last conversation with Einhorn; and years earlier he told his therapist that he had been drinking before that last conversation.

The record shows that alcohol abuse did not cause Altman's conduct or prevent him from forming the intent necessary to engage in the alleged violations. Altman testified that, despite his drinking, he was able to work and was "functioning" at all relevant times. Altman testified that when he was drinking heavily, he had a higher tolerance for alcohol and no loss of functioning at his job that would be noticeable to others. Altman reported he had no blackouts, memory lapses, seizures, or other withdrawal symptoms related to alcohol.

Significantly, Altman testified that he did not claim that he was intoxicated during any of his telephone conversations with Einhorn, nor did he claim that his taped statements were made as a result of alcohol consumption or because he was intoxicated. This testimony was supported by the testimony of OGC's expert witness, who concluded that Altman was not intoxicated or impaired during his conversations with Einhorn. Neither of Altman's two experts contradicted that conclusion. The only evidence that Altman relies on to show that his alcohol abuse contributed, in some unspecified way, to his conduct comes from his own self-serving testimony. As discussed, the law judge rejected that testimony because she found that Altman was not a believable witness.

Altman disputes the law judge's finding that he "changed his position" on the subject of his alcohol abuse because he did not raise it as a defense until his post-hearing brief before the law judge. But Altman does not dispute that he made no claim in his investigative testimony, Wells submission, answer to OGC's order instituting this Rule 102(e) proceeding, or hearing testimony

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63 *Cf. IBM Corp. v. Edelstein*, 526 F.2d 37, 41 (2d Cir. 1975) (per curiam) (stating that "[i]t is the common experience of counsel at the trial bar that a potential witness, upon reflection, will often change, modify or expand upon his original statement and that a second or third interview will be productive of greater accuracy. Little wonder then that a witness being interviewed . . . would not wish to have his initial thoughts taken down by a court reporter as if it were sworn testimony").

that he was intoxicated during any of his conversations with Einhorn, or that any of his statements to Einhorn were caused by his alcohol consumption.

Altman also argues that he "operated at a distinct disadvantage" in his conversations with Einhorn because, among other things, he was "careless," "distracted," and "sometimes had impaired mental faculties." Altman offers no evidence that his carelessness, inattentiveness, or "impaired mental faculties" caused his misconduct. Indeed, he admitted in his post-hearing brief that he did not suffer from any mental condition that caused him to commit the alleged violations, prevented him from forming the intent necessary to do so, or mitigated his responsibility for his own conduct.

4. The law judge improperly relied on OGC's expert's testimony.

Altman argues that the law judge erred in admitting OGC's expert's testimony, except for the expert's diagnosis of alcohol abuse, because such testimony was "irrelevant, often highly prejudicial, and much of it invaded the exclusive provinces of the judge and attorneys." Rule of Practice 320 provides that law judges "may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial or unduly repetitious."[64] Law judges have broad discretion in deciding whether to admit evidence, including expert testimony.[65] Having reviewed the report of OGC's expert, we conclude that the law judge did not abuse her broad discretion in admitting portions of it.

Altman also argues that the law judge erred in relying on the excluded or sealed portions of OGC's expert's testimony. We find no support in the record for this argument and, in fact, find the opposite to be true. In her initial decision, the law judge expressly stated, "I have not relied on [OGC's] expert['s] opinions, which are unrefuted and which I find to be accurate, because, except for [OGC's expert's] public finding that Altman was not intoxicated during the phone conversations, they do not impact Altman's conduct that is the basis for this proceeding."[66]

IV.

The remedial sanctions available to the Commission in Rule 102(e) and Exchange Act Section 4C attorney disciplinary proceedings include a censure, temporary suspension, and permanent disqualification from practice before the Commission.[67] OGC requests that we permanently deny Altman the privilege of appearing or practicing before us, to protect the

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64 17 C.F.R. § 201.320.

65 *See, e.g., Pagel, Inc.*, 48 S.E.C. 223, 230 (1985).

66 *Altman*, 94 SEC Docket at 13464 n.42.

67 17 C.F.R. § 201.102(e)(1); 15 U.S.C. § 78d-3(a).

integrity of our processes and deter similar misconduct.[68] In determining the appropriate remedial sanction, we are guided by the public interest factors in *Steadman v. SEC*:[69] the egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood of future violations.[70] We also consider deterrence as a factor.[71] Our inquiry into the appropriate remedial sanction "is a flexible one, and no one factor is dispositive."[72]

Altman's conduct was egregious, recurrent, and reflected a high degree of scienter.[73] By suggesting that Rosen, a potential Division witness in the Harrison Proceeding, would evade the

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[68] Our authority to increase the sanction imposed by the law judge is set forth in Rule of Practice 411(c), which provides that "[t]he Commission may affirm, reverse, modify, set aside, or remand for further proceedings, in whole or in part, an initial decision by a hearing officer and may make any findings or conclusions that in its judgment are proper and on the basis of the record." 17 C.F.R. § 201.411(a).

[69] 603 F.2d 1126 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981); *see Herbert M. Campbell, II, Esq.*, Initial Decision Rel. No. 266 (Oct. 27, 2004), 83 SEC Docket 4000, 4009 (ALJ decision) (applying *Steadman* factors in proceeding under Rule of Practice 102(e)), *declared final*, Exchange Act Rel. No. 50906 (Dec. 22, 2004), 84 SEC Docket 1943.

[70] *See Steadman*, 603 F.2d at 1140.

[71] *See, e.g., McCarthy v. SEC,* 406 F.3d 179, 190 (2d Cir. 2005) (noting that deterrent value is a relevant factor in deciding sanctions); *Ahmed Mohamed Soliman,* 52 S.E.C. 227, 231 n.12 (1995) (stating that selection of an appropriate sanction involves a consideration of several elements, including deterrence); *Lester Kuznetz,* 48 S.E.C. 551, 555 (1986) (noting that the sanction of a bar serves the purpose of general deterrence).

[72] *David Henry Disraeli*, Exchange Act Rel. No. 57027 (Dec. 21, 2007), 92 SEC Docket 852, 875, *petition denied,* 334 Fed. Appx. 334 (D.C. Cir. 2009). Contrary to Altman's argument, we are not required to choose the "least onerous" of sanctions available. *See, e.g, Paz Securities, Inc. v. SEC*, 566 F.3d 1172, 1176 (D.C. Cir. 2009) (stating that the SEC was not required to choose "the least onerous" of sanctions provided sanctions imposed were "remedial and not excessive or oppressive"); *see also, e.g., Kornman v. SEC*, 592 F.3d 173, 188 (D.C. Cir. 2010) (rejecting argument that the SEC must show why action less severe than permanent bar would not protect investors).

[73] Altman argues that the law judge "unreasonably discount[ed]" the "stresses" he was suffering at the time of his misconduct, namely, his difficulties in dealing with his ex-wife and his desire to spend time with his children who lived with her. The record fails to support Altman's argument that stress caused his misconduct.

Division's service of a subpoena and/or falsely claim at the hearing not to remember certain facts damaging to Harrison and Blumer in exchange for a financial package, Altman knowingly and intentionally offered to subvert a Commission administrative proceeding for his client's gain, and violated his fundamental ethical obligations as a New York bar member. Altman's conduct was recurrent because it took place in a series of telephone conversations with Einhorn over a two-week period and in communications with Division staff between January 28 and March 10, 2004.

Altman has not made any meaningful assurances against future violations, nor has he recognized the wrongfulness of his conduct. Although Altman apparently admits that it is inappropriate for an attorney to agree to have a witness testify falsely in exchange for payment, and although Altman acknowledges that it was wrong to make his "[p]robably both" statement in the last taped conversation with Einhorn,[74] he denies that he ever actually sought to exchange false testimony for payment, despite his having been captured on tape doing so. Altman's unwillingness or inability to acknowledge that he committed intentional ethical violations, even when confronted with such compelling evidence, demonstrates that he can provide no assurance that he will refrain from future violations.

Furthermore, Altman's occupation as a commercial litigator makes future violations likely.[75] A significant failure to perform properly the professional's role has implications extending beyond the particular transaction involved, for wrongdoing by a lawyer . . . raises the spectre of a replication of that conduct with other clients."[76]

Altman argues that OGC must make a "strong showing" that future violations are likely because a substantial suspension from Commission practice can carry with it severe collateral consequences, "likely" including his suspension from the practice of law in New York for an equivalent amount of time and further damage to his reputation and legal practice. Altman points to no case law which supports his position. We see no basis for applying such a heightened standard here.

Altman argues that his "main concern in these proceedings is not his ability to practice before the Commission -- something he has done rarely and will most likely never do again -- but rather

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[74] On appeal, Altman trivializes this statement by characterizing it as "simply a thoughtless answer to a very loaded question" that "had no more real meaning to him than does a parent's 'maybe' to an insistent child."

[75] *See Campbell*, 83 SEC Docket at 4009-10 (permanently denying attorney, who was enjoined from violating the federal securities laws, the privilege of appearing or practicing before the Commission, because, among other reasons, he could continue practicing commercial law); *Chris G. Gunderson*, Exchange Act Rel. No.61234 (Dec. 23, 2009), 97 SEC Docket 24040, 24050 & n.43 (same) (citing *Campbell*).

[76] *Carter*, 47 S.E.C. at 477.

the catastrophic collateral consequences of a lengthy suspension or permanent ban and particularly the effect it will have on New York disciplinary authorities." We are mindful of potential collateral consequences that may result from our decision in this case. We also heed the appellate court's admonition in *Kivitz v. SEC*[77] that an attorney's license to practice "cannot lightly or capriciously be taken from him."[78] Nevertheless, we have recognized that "[a]n incompetent or unethical practitioner has the ability to inflict substantial damage to the Commission's processes, and thus the investing public, and to the level of trust and confidence in our capital markets."[79] We have warned that "where such individuals engage in professional misconduct which impairs the integrity of the Commission's processes, the Commission has an obligation to respond through the application of" Rule 102(e).[80]

Based on our consideration of the public interest factors and the factual circumstances presented,[81] we conclude that permanently denying Altman the privilege of appearing or practicing before us serves the public interest and is remedial because it will protect the integrity of our prosecutorial and adjudicatory processes, and thereby the investing public, from future harm by Altman.[82] Altman's professional misconduct undermined the effectiveness of the

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77 475 F.2d 956 (D.C. Cir.1973).

78 *Id.* at 962.

79 *Keating, Muething, & Klekamp,* 47 S.E.C. 95, 120 (1979) (concurring opinion).

80 *Id.*

81 Altman argues that several factors mitigate his conduct (*e.g.*, he suffers from alcohol abuse, has obtained treatment, and is now in recovery; he stopped communicating with Einhorn a month before the Harrison Proceeding hearing resumed; he never told Rosen about the substance of his conversations with Einhorn; he had a clean disciplinary record before the events at issue; he has practiced law without incident in the years following the institution of this Rule 102(e) proceeding; he did not profit financially from his conduct; his conduct did not cause "material harm" because the Division won its case in the Harrison Proceeding; and OGC began its investigation in 2004 but waited until 2008 to charge him). None of these factors mitigates his egregious misconduct. *See, e.g., Kornman,* 592 F.3d at 187-88 (rejecting as mitigating factors the lack of a disciplinary history, personal regret about the misconduct and vow not to engage in such misconduct again, and the absence of harm to Commission or public); *Janet Gurley Katz*, Exchange Act Rel. No. 61449 (Feb. 1, 2010), 97 SEC Docket 25074, 25109-10 & n.66 (collecting cases) (rejecting lack of profit as mitigating factor); *Armstrong*, 58 S.E.C. at 579 (rejecting delay in instituting proceeding as mitigating factor in absence of prejudice).

82 Altman suggests that, in lieu of a suspension or disqualification, the Commission "condition Mr. Altman's practice on his continued participation in recovery programs, including

(continued...)

Commission's enforcement of the federal securities laws in the Harrison Proceeding. Because Altman's actions are fundamentally repugnant to the integrity of the Commission's administrative processes, he must not be permitted to be in a position to engage in professional misconduct in a Commission proceeding again. Other attorneys, who might be encouraged by a more lenient sanction to act in a similar fashion, must also be deterred.

An appropriate order will issue.[83]

By the Commission (Chairman SCHAPIRO and Commissioners CASEY, WALTER, AGUILAR and PAREDES).

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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82 (...continued)
the New York City Bar Association Lawyer Assistance Program, for a period of years, or on other conditions that the Commission could monitor by means of periodic reports from medical professionals or others." Altman points to no authority for our imposing such a requirement, and we are aware of none.

83 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63306 / November 10, 2010

Admin. Proc. File No. 3-12944

In the Matter of

STEVEN ALTMAN, ESQ.

c/o Jeffrey C. Hoffman, Esq.
Hoffman & Pollok LLP
260 Madison Avenue
22nd Floor
New York, NY 10016

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Steven Altman be, and he hereby is, permanently denied the privilege of appearing or practicing before the Commission.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

November 10, 2010

In the Matter of **Edentify, Inc.,** **Embryo Development Corp.,** **Enclaves Group, Inc.,** **Energytec, Inc.,** **Enesco Group, Inc.,** **Entertainment Is Us, Inc.,** **Entrada Networks, Inc.,** **Entropin, Inc.,** **Epic Financial Corp.,** **Epicus Communications Group, Inc.,** **Epixtar Corp.,** **Equisure, Inc.,** **Equus Gaming Co., and** **Evans, Inc. (n/k/a Fur Company A),** **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 Edentify, Inc. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Embryo Development Corp. because it has not filed any periodic reports since the period ended July 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Enclaves Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Energytec, Inc. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Enesco Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Entertainment Is Us, Inc. because it has not filed any periodic reports since the period ended June 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Entrada Networks, Inc. because it has not filed any periodic reports since the period ended April 30, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Entropin, Inc. because it has not filed any periodic reports since the period ended September 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Epic Financial Corp. because it has not filed any periodic reports since the period ended July 31, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Epicus Communications Group, Inc. because it has not filed any periodic reports since the period ended November 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Epixtar Corp. because it has not filed any periodic reports since the period ended June 30, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Equisure, 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 Equus Gaming Co. because it has not filed any periodic reports since the fiscal year ended 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 Evans, Inc. (n/k/a Fur Company A) because it has not filed any periodic reports since the period ended November 28, 1998.

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 November 10, 2010, through 11:59 p.m. EST on November 23, 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. 63297 / November 10, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14119

In the Matter of **Enclaves Group, Inc.,** **Energytec, Inc.,** **Entrada Networks, Inc.,** **Epic Financial Corp.,** **Equisure, Inc., and** **Equus Gaming Co.,** **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 Enclaves Group, Inc., Energytec, Inc., Entrada Networks, Inc., Epic Financial Corp., Equisure, Inc., and Equus Gaming Co.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Enclaves Group, Inc. (CIK No. 1045260) is a void Delaware corporation located in Carrollton, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Enclaves Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2006, which reported a net loss of over $1 million for the prior nine months. As of November 3, 2010, the company's stock (symbol "ECGR") 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).

2. Energytec, Inc. (CIK No. 1202963) is a Nevada corporation located in Plano, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Energytec 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, 2007, which reported a loss of over $5.9 million for the prior nine months. On May 13, 2009, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Texas, which was still pending as of September 29, 2010. As of November 3, 2010, the company's stock (symbol "EYTCQ") 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. Entrada Networks, Inc. (CIK No. 1000695) is a void Delaware corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Entrada Networks 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 30, 2005, which reported a net loss of $824,000 for the prior three months. On July 20, 2006, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of California, which was still pending as of September 29, 2010. As of November 3, 2010, the company's stock (symbol " ESAN") was quoted on the Pink Sheets, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Epic Financial Corp. (CIK No. 1144892) is a revoked Nevada corporation located in Fresno, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Epic Financial is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 2005, which reported a net loss of $119,825 for the prior nine months. As of November 3, 2010, the company's stock (symbol "EPFL") 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. Equisure, Inc. (CIK No. 917246) is an inactive Minnesota corporation located in Herts, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Equisure 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. Equisure is also in violation of an October 6, 1999 permanent injunction entered by the District Court for the District of Columbia that enjoined it from future violations of Section 13(a) and Exchange Act Rules 13a-1 and 13a-13 thereunder. As of November 3, 2010, the company's stock (symbol "EQEU") was quoted on the Pink Sheets, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Equus Gaming Company L.P. (CIK No. 928423) is a cancelled Virginia corporation located in Canovanas, Puerto Rico with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Equus Gaming 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, 2002, which reported a net loss of

over $16 million for the prior year. As of November 3, 2010, the company's stock (symbol "EQUUS") 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

7. 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.

8. 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.

9. 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

SECURITIES EXCHANGE ACT OF 1934
Release No. 63296 / November 10, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14118

In the Matter of Edentify, Inc., Embryo Development Corp., Enesco Group, Inc., Entertainment Is Us, Inc., Entropin, Inc., Epicus Communications Group, Inc., Epixtar Corp., and Evans, Inc. (n/k/a Fur Company A), 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 Edentify, Inc., Embryo Development Corp., Enesco Group, Inc., Entertainment Is Us, Inc., Entropin, Inc., Epicus Communications Group, Inc., Epixtar Corp., and Evans, Inc. (n/k/a Fur Company A).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Edentify, Inc. (CIK No. 1091938) is a Nevada corporation located in Bethlehem, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Edentify 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, 2007, which reported a net loss of over $1.96 million

for the prior three months. As of November 3, 2010, the company's stock (symbol "EDFY") was quoted on the Pink Sheets operated by Pink OTC Markets, Inc. ("Pink Sheets"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Embryo Development Corp. (CIK No. 945439) 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). Embryo Development is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 2006, which reported a net loss of $82,000 for the prior three months. As of November 3, 2010, the company's stock (symbol "EMBR") 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. Enesco Group, Inc. (CIK No. 93542) is a dissolved Illinois corporation located in Itasca, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Enesco 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 September 30, 2006, which reported a net loss of $40,958 for the prior nine months. On January 12, 2007, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court of the Northern District of Illinois, which was converted to a Chapter 7 proceeding on July 28, 2008. The case was still pending as of September 29, 2010. As of November 3, 2010, the company's stock (symbol "ENCZQ") 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. Entertainment Is Us, Inc. (CIK No. 1144254) is a void Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Entertainment Is Us 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, 2006, which reported a net loss of $147,389 for the prior nine months. As of November 3, 2010, the company's stock (symbol "EIUS") was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Entropin, Inc. (CIK No. 837600) is a void Delaware corporation located in Bradenton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Entropin 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, 2006, which reported a net loss of $729,874 for the prior three months. As of November 3, 2010, the company's stock (symbol "ETOP") 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).

6. Epicus Communications Group, Inc. (CIK No. 800401) is a Florida corporation located in Lake Mary, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Epicus Communications 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 November 30, 2007, which reported a net loss of over $10.3 million for the prior six months. On October 25, 2004, 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 30, 2005. As of November 3, 2010, the company's stock (symbol "EPCG") was quoted on the Pink Sheets, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Epixtar Corp. (CIK No. 1099730) is an active Florida corporation located in Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Epixtar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended June 30, 2005, which reported a net loss of over $12.4 million for the prior six months. On October 6, 2005, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Florida, which was still pending as of September 29, 2010. As of November 3, 2010, the company's stock (symbol "EPXR") 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).

8. Evans, Inc. (n/k/a Fur Company A) (CIK No. 33780) is a void Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Evans 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 November 28, 1998, which reported a net loss of over $6 million. On September 24, 1999, a Chapter 7 bankruptcy petition was filed against Evans in the U.S. Bankruptcy Court for the Southern District of New York. On October 12, 1999, the case was converted to a Chapter 11 proceeding, which was still pending as of September 29, 2010. As of November 3, 2010, the company's stock (symbol "EVAN") was quoted on the Pink Sheets, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

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

Chairman Schapiro and Commissioner Walter not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63312 / November 12, 2010

Admin. Proc. File No. 3-13750

In the Matter of the Application of

JOHN B. BUSACCA, III
2500 Treymore Drive
Orlando, FL 32825

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDING

Failure to Supervise

Failure to Comply with Membership and Registration Requirements

Conduct Inconsistent with Just and Equitable Principles of Trade

Former president of member firm of registered securities association failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws, regulations, and association rules and failed to comply with membership and registration requirements. *Held*, association's findings of violations and sanctions imposed *sustained.*

APPEARANCES:

John B. Busacca, pro se.

Marc Menchel, *Alan Lawhead*, *Carla Carloni*, and *Andrew J. Love*, for Financial Industry Regulatory Authority, Inc.

Appeal filed: January 15, 2010
Last brief received: April 1, 2010

I.

John B. Busacca, III, former president and registered principal of North American Clearing, Inc. ("North American" or the "Firm"), formerly a FINRA member firm,[1] appeals from FINRA disciplinary action. FINRA found that Busacca violated NASD Conduct Rules 3010 and 2110 by failing to exercise reasonable supervision over North American's back-office operations from March 2004, when he became Firm president, through early 2005. FINRA further found that Busacca violated NASD Membership and Registration Rule 1022(a) and Rule 2110 by permitting the Firm to employ an unregistered chief compliance officer.[2] FINRA suspended Busacca for six months from serving as a principal, fined him a total of $30,000, and assessed $2,078.60 in costs. We base our findings on an independent review of the record.

II.

This case primarily involves Busacca's discharge of his supervisory responsibilities as North American's president following the Firm's adoption, in February 2004, of a new computer software system to maintain its back-office operations. It is undisputed that the Firm's software conversion caused widespread operational breakdowns throughout 2004 and early 2005, resulting in an influx of customer complaints. Its is also undisputed that a March 2005 FINRA examination further identified, during this time period, numerous instances of noncompliance with various customer protection, recordkeeping, reporting, and credit extension requirements.

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[1] On July 26, 2007, the Commission approved a proposed rule change NASD filed to amend its Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. Because this disciplinary action was instituted after consolidation, references to FINRA herein include references to NASD.

[2] Following the consolidation of NASD and NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008). Because the conduct at issue took place before the consolidated rules took effect, NASD conduct rules apply.

NASD Conduct Rule 3010 requires members to "establish and maintain" a supervisory system "that is reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD Rules." NASD Membership and Registration Rule 1022(a) requires members to register their chief compliance officers after they have passed the appropriate qualification examination. NASD Conduct Rule 2110 requires members to "observe high standards of commercial honor and just and equitable principles of trade."

Although Busacca did not become president until shortly after the software conversion, he was involved in the selection of the software, knew, at the time he became president, of the resulting operational problems and customer complaints, and understood his duties as president included supervision of the Firm's operations. Busacca's testimony, however, showed that, during the period at issue, he admittedly focused his efforts on marketing the Firm's services to new clients rather than on the Firm's operational deficiencies. Evidence further indicated that Busacca's selling efforts, in fact, compounded operational problems by adding more client accounts to an already overwhelmed system.

* * * *

North American was a Florida-based clearing broker[3] that, in addition to clearing and executing trades, conducted back-office functions on behalf of introducing broker-dealers.[4] Until late 2003, the Firm, then known as Advantage Trading Group, Inc. ("Advantage"), was a wholly owned subsidiary of Empire Financial Holding Company ("Empire"). In May 2003, a dispute arose between Empire's co-owners, Richard Goble and Kevin Gagne, that resulted in Empire's removal of Goble as an officer and employee of Empire and its affiliates. While Goble retained his ownership interest, he sued to dissolve Empire.[5] In November 2003, Goble and Gagne settled their dispute by, among other things, spinning off Advantage to form an independent clearing firm (later renamed North American).[6] Goble became the Firm's sole owner and initially served as its president.

A. Busacca's Role at the Firm

Busacca entered the securities industry in 1992 and has served in various compliance and operations capacities for several FINRA member firms. He joined North American's predecessor

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[3] "The services provided by clearing firms often include maintaining books and records; receipt, custody and delivery of customer securities and funds; extending credit to finance customer transactions in margin accounts; and in many cases, executing transactions on exchanges or on over-the-counter markets." *Richard Harriton*, Exchange Act Rel. No. 42707 (Apr. 20, 2000), 72 SEC Docket 626, 631 (settled order).

[4] "An introducing or correspondent broker deals directly with the public and originates customer accounts." *Del Mar Fin. Serv., Inc.*, 56 S.E.C. 1332, 1336 n.5 (2003) (citing *Katz v. Fin. Clearing & Serv. Corp.*, 794 F. Supp. 88, 90 (S.D.N.Y. 1992)).

[5] Pursuant to Commission Rule of Practice 323, 17 C.F.R. § 201.323, we take official notice of Empire's filings with the Commission, which are publicly available on the Commission's Web site. Empire is now known as Jesup & Lamont, Inc.

[6] The Firm changed its name on July 8, 2004. Unless indicated otherwise, noted references to North American and the Firm include references to Advantage.

firm in January 2003 as a salesperson, selling clearing services to introducing broker-dealers, and remained with the Firm after the spin-off as its primary salesperson. Busacca described the Firm's transition from its previous ownership as "very acrimonious."[7] According to Busacca, Empire left the Firm with insufficient operating capital and transferred its nearly 20,000 customer accounts with the Firm to another clearing broker.[8]

Busacca's role at the Firm expanded after the spin-off. Although he formally remained a salesperson during the first few months, Busacca had increasing involvement in the Firm's clearing operations beginning at the "end of [20]03," according to the Firm's Sandra Farr, who held the title "operations manager." Farr testified, for example, that, "if a correspondent [broker-dealer] would call up and say that they had a problem with something, that I would deny a transaction or something . . . [t]hey would talk to [Busacca], and if . . . he deemed it should be cleared to go, we would actually send it." Busacca explained that because of his operations experience, if operations staff asked him "for decisions . . . [he]'d give them all [his] expert advice."

Moreover, although the Firm did not formally designate Busacca as its president until March 2004, evidence indicated that he had agreed to assume that role as soon as the Firm's agreement with Empire received regulatory approval. As Goble testified, "it was agreed when I would take over 100%" ownership of North American "that [Busacca] would become president." While Busacca became increasingly involved in supervisory activities, his role as the Firm's primary or only salesperson nonetheless remained paramount, particularly in light of the Firm's early financial struggles following its spin-off. Busacca described himself as the Firm's "breadwinner [with] every client that was brought in [being] mine."

B. Computer Software Problems

North American used a back-office computer software program to assist in its preparation of required books and records and compliance with regulatory requirements. In December 2003, primarily as a cost-cutting measure, Goble decided against renewing the Firm's licensing agreement with its existing back-office software provider, ADP/SIS. While the ADP/SIS software was the most commonly used system in the brokerage industry and had worked well for the Firm when it was part of Empire, it cost the Firm approximately $50,000 per month to maintain.

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7 As recounted in Busacca's answer, Empire "was still in the building. Doors were locked, power was turned off and lines were cut on almost a daily basis. The Sheriff[']s department made no less than half a dozen visits to the building over the next several months."

8 Busacca stated that Empire, pursuant to the settlement agreement with Goble, "was supposed to leave [North American] with net capital of 1 million dollars to operate with; instead . . . they left approximately [$]300,000 in net capital."

According to Busacca, Goble claimed at the time that "[t]here was no way [the Firm] could survive" if it continued to use ADP/SIS. Goble directed that, unless North American found an alternative (*i.e.*, less costly) system by the end of its contract with ADP/SIS on January 28, 2004, the Firm would "go manual" -- that is, the Firm would manually input its trading data by "put[ting] them [in]to an Excel spreadsheet." Busacca stated that Goble's proposal upset Firm personnel, some of whom "walked out the door and said we can't do it, we can't go manual and we're not going to do it."[9]

Busacca worked with Goble to find a new software provider, but Goble rejected the first several providers that Busacca suggested as "too expensive." Eventually, Busacca found Brokerage Computer Systems, Inc. ("BCS"), a small software company that promised a complete back-office and financial software system for one-tenth the cost of ADP/SIS. Busacca acknowledged that, although he only conducted "some" due diligence into BCS, he knew it would appeal to Goble because it was "pretty cheap." Despite finding the BCS software to be "untested [and] relatively unknown" and "wasn't the best system," he nonetheless referred it to Goble because it "beat going manual." On January 29, 2004 -- *i.e.*, one day after its ADP/SIS contract expired -- the Firm reached a licensing agreement with BCS to use their software.[10]

On February 9, 2004, the Firm converted its back-office operations program completely over to the BCS software system. While the conversion represented a major change in operations, the Firm did little in preparation. For instance, the Firm conducted no advance testing of the new software to determine its compatibility with the Firm's other systems. Nor, as was common for a back-office software conversion, did the Firm arrange for at least the temporary operation of a parallel system, such as the continuation of the existing ADP/SIS system to be run as a backup, during the software transition. The Firm also failed to notify FINRA of its software conversion, so FINRA could monitor the situation.[11] Busacca admitted before FINRA's Hearing Panel that the conversion was "hastily" done and that it "probably should have been tested."

Almost immediately following the conversion, North American began experiencing a wide range of systemic breakdowns in its operations, caused primarily by the system's inability to receive and process information from other internal and external software programs. The system's problems required Firm operations personnel -- who were accustomed to an automated

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9 FINRA's Hearing Panel declined to credit Goble's testimony -- contradicted by Busacca -- that the switch to BCS was not motivated entirely by cost but also by his dissatisfaction with certain operating features of ADP/SIS.

10 Although Goble executed the agreement on behalf of the Firm as then-president, Busacca testified that "[he] and Gob[le] made the decision to switch" to the BCS system.

11 NASD Conduct Rule 1017(a)(5), while not charged here, requires firms to notify FINRA of "a material change in business operations."

system under the ADP/SIS system -- to input manually large amounts of data to make up for the malfunctioning system, which led to further processing errors. The BCS system, for example, proved incompatible with the Firm's trading software program, "Xavier," with the result that Firm personnel were required to enter manually into Xavier "in excess of 1000 trades per day." As a result of the system's problems, North American and its correspondent brokers received an influx of customer complaints about missing and inaccurate information in customer accounts, as discussed more fully below.

C. Busacca is Officially Designated Firm President

On March 17, 2004, the Firm filed an amendment to its Form BD, officially designating Busacca as its president, replacing Goble.[12] Although Busucca did not officially become president until this time, because he was closely involved in the acquisition of the BCS software, he knew about the resulting operational problems. Busacca admitted that, when he became president, the Firm was "a mess," and "complaints were flying off the shelf." On the day he was designated president, Busacca wrote to a complaining customer that errors reflected in her account were a result of the software conversion, not fraud as the customer had feared:

> [Y]our concern about your account is due to our software conversion, not from any of your Broker's actions . . . . We had hoped for a smoother [software] transition but unfortunately there were many technical glitches that our computer programmers did not anticipate . . . . I apologize for the confusion and we will do all we can to correct the entry in your account.

The record, including Busacca's testimony, demonstrates that Busacca's duties as president included supervision over the Firm's operations.[13] Busacca testified that he did not personally delegate his supervisory responsibility over operations to anyone else until late 2005 or early 2006, when the Firm hired a chief operating officer. While Farr served directly under Busacca as the Firm's "operations manager," she was unable to supervise the Firm's operations

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[12] Busacca served as Firm president until June 2007, when he became a director. He left the Firm voluntarily in August 2007.

[13] The record included the Firm's 2003 written supervisory procedures ("WSP") that were in effect when Busacca became president. The WSP stated that a listing of "assignment of responsibilities" for each principal was attached, but the listing was not part of the record. Although generally a brokerage firm's Financial and Operational Principal ("FINOP") oversees operations, ample testimony, including Busacca's, confirmed that he had supervisory responsibility for North American's operations.

under NASD rules because she was unlicensed.[14] Farr testified, without dispute, that Busacca began overseeing "day-to-day operations" by February or March 2004.

Busacca testified that, when he became president, he agreed to "stop being Mr. Salesman . . . and clean up the mess" in operations. However, during his first year as president, he did not concentrate on the Firm's operational deficiencies. Busacca admitted that, after his promotion to president, his "primary function at North America[n] was sales" of the Firm's clearing services to introducing brokers and that such sales activities consumed much of his time. In addition, while Busacca had extensive operations and compliance experience, his compensation arrangement with the Firm was based primarily on his results as a salesperson, including a $2,500 bonus for each new contract he acquired.[15]

Busacca also admitted that his sales efforts caused him to be away from the Firm's offices for extended periods, limiting his oversight of operations. Busacca testified that, only when he "wasn't . . . on the road," selling the Firm's services, "would [he] come back to the office" and "tackle the problems" faced by the Firm's operations department. Busacca also testified that he performed occasional spot "checks" on operations personnel, requiring employees to review and sign the Firm's written procedures. He testified additionally that he held weekly meetings to discuss operations matters, but Farr testified that these meetings did not take place until 2005. Busacca did not dispute her testimony.

D. Operational Problems Persist

After Busacca became president, the Firm continued to receive numerous operational complaints from introducing firms (on behalf of their customers) and from customers directly. Customers complained variously that they were denied access to their accounts, their accounts reflected inaccurate trade information, and the Firm had failed to timely deliver funds.[16] For several months following conversion, the Firm also failed to provide account statements to

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14 *See* NASD Rule 1022(b) (requiring a person with "overall supervision of and responsibility for the individuals who are involved in the administration and maintenance of the member's back office operations" to register as a "Limited Principal–Financial and Operations").

15 Busacca earned a monthly salary equal to the greater of $4,000 or fifteen percent of the Firm's net income. In addition, according to Goble, if the Firm was sold during Busacca's tenure, Busacca by contract would receive "fifteen percent of whatever growth occurred during the time he was there."

16 For example, the day after its software conversion, a correspondent broker notified the Firm of at least six accounts reflecting erroneous securities positions on the Xavier trading system.

numerous customers, preventing the customers from reconciling charges they saw in their bank statements and causing them to worry that possible misconduct was occurring in their accounts.[17]

Introducing firms and their customers became increasingly dissatisfied with the Firm's delays in addressing problems they identified and the manner in which the Firm was communicating information regarding its operational breakdowns. For example:

- On March 25, 2004, an introducing firm e-mailed Busacca directly, stating "our office has made numerous attempts to resolve this issue which came about based on your firm[']s trade error. You continue to take the same position that you have with all of your other mistakes which is to blame someone else for them."

- In a letter to North American on April 15, 2004, a second introducing firm complaining about a trading error in a customer account stated that it "cannot operate under the circumstances that [North American] has created. While [we] understand that problems will arise[,] . . . operational problems experienced over the past weeks are unacceptable."[18]

- On May 5, 2004, a third introducing firm e-mailed Busacca attempting to locate its client's funds: "Can someone please find this, it's now been missing for almost 2 months and [the] client is getting very, very upset. I really don't want her to write a complaint. Please, please someone find it and put it into her account."

- On July 13, 2004, an "unsatisfied customer" wrote directly to North American's customer service: "Hello! Anybody home? Are you still there? . . . You are ignoring all my communications regarding my request. It looks like you care not about your customers. . . . [P]lease, PLEASE send the total amount of $852.71 to the address below immediately . . . . I need it very badly."

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[17] For example, a concerned customer wrote to the Firm after it eventually provided an explanation of the missing account statements: "I had no way of knowing what the disputed charge referred to, as I did not receive a statement during the period January – July 2004 and did not have access to the web account, and had no way of knowing what transactions were taking place on my account."

[18] This letter, while addressed to the compliance department, referenced previous discussions with Busacca. A follow-up letter from the introducing firm noted: "At this point [the customer] is extremely irritated at the 'incompetence' of [North American] in fixing his [trading error] but we have been able to keep him from making any formal complaint at this time."

Compounding the operational dysfunction caused by the software conversion were deficiencies in the quantity and quality of the Firm's operations personnel administering back-office functions. Two experienced computer programmers resigned just prior to the software conversion. The Firm had only ten employees in March 2004 to administer 5,000 accounts.

According to Busacca, he convinced Goble, who made the ultimate hiring decisions, to hire additional personnel, including several information technology specialists to address computer problems and others to input data manually.[19] Nonetheless, Goble's business decisions appeared to interfere with Busacca's efforts to address personnel deficiencies. Busacca stated that the operations department was in "constant turmoil" and that "it was hard to keep employees." Busacca testified that often, while he was away from the office, Goble would replace experienced personnel that Busacca had brought in with young, inexperienced, and inexpensive personnel "right out of [college] or high school." Other experienced Firm personnel, according to Busacca, resigned due to personality conflicts with Goble. Busacca stated that such personnel issues caused "a lot of blow-ups" between him and Goble, and that they "didn't have the best relationship."[20]

On-the-record testimony from the Firm's then-chief compliance officer, Daniel McAuliffe, confirmed the Firm's operational dysfunction during these months.[21] McAuliffe testified that he informed Busacca and Goble that he was receiving numerous customer complaints, "so they were aware of it," but McAuliffe stated that they expressed "no unusual concern" about the problems. In McAuliffe's view, the Firm's operational problems were a result of a combination of the limitations of the software system and unqualified personnel staffed to the back-office. McAuliffe, moreover, acknowledged that the Firm took "longer than [he] wanted" in addressing the problems that arose, noting it "sometimes took weeks. And [on] one occasion [it took] months to resolve."

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19 For example, Busacca explained that "a lot of the systems . . . were manual. So we had to hire a person [and] all [he] did all day long was dividends, or one person all [he] did was mutual fund dividends, and [he would] have to capture them from the fund family and manually enter them into the computer system."

20 Busacca acknowledged, in response to questioning at the hearing, that he considered leaving the Firm, but a three-year non-compete clause in his Executive Employment Agreement prevented him from quitting.

21 As chief compliance officer, McAuliffe had no direct operational responsibility. Although McAuliffe died before the hearing in this case, FINRA staff sought to introduce portions of his on-the-record testimony and, in response, Busacca, without objection, moved for inclusion of the full transcript of the testimony, which became part of the record.

E. FINRA's Investigation

By June 2004, several customers had filed formal complaints with FINRA regarding possible misconduct with respect to their accounts, prompting FINRA to open an investigation into "various operations allegations." On August 26, 2004, FINRA staff requested information from the Firm concerning thirty-one customer complaints dating from January 16, 2004, through July 16, 2004.[22] In response, Busacca provided signed statements for each customer account in question, generally attributing the account errors to the software conversion and manual data entry mistakes committed by operations personnel.

In February 2005, FINRA requested additional information from the Firm. Busacca again provided the Firm's response to this inquiry. By this time, the Firm's customer base had substantially expanded due to Busacca's aggressive sales efforts of Firm clearing services, acquiring by the end of 2004 the accounts of two large introducing firms.[23] Although the record indicated that Firm personnel had also expanded to about forty-five employees by 2005, operational breakdowns continued.[24] According to Farr, operations personnel tried to make up for deficiencies in the software "on a manual basis for a little while. But as our business grew, it wasn't able to handle our business. And the lack of automation is what really took a lot of our time, and . . . left room for a lot of error."

In March 2005, FINRA staff conducted an on-site examination of North American's operations indicating that the Firm's problems extended beyond those identified earlier. The staff detected widespread compliance deficiencies throughout 2004 and early 2005. The examination found the following deficiencies, which occurred during Busacca's first year as Firm president and which he does not dispute:

1. Inaccurate Box Count

Under Exchange Act Rule 17a-13(b), a broker-dealer must conduct a quarterly "box count" of all securities held by it, compare the results against the firm's records, and record any

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[22] FINRA addressed its initial inquiry to McAuliffe, as chief compliance officer.

[23] For example, by Busacca's account, in late 2004 the Firm received 8,000 customer accounts from a single introducing firm, more than doubling the accounts the Firm had when Busacca became president.

[24] For example, an introducing firm noted in a December 2004 letter to FINRA: "[T]his is just one example of clients having difficulty . . . access[ing] their funds and securities."

unresolved differences.[25] During the March 2005 examination, FINRA staff found nineteen discrepancies between the Firm's box count on February 28, 2005, and the staff's count of the Firm's securities.[26] A FINRA examiner testified that, in his experience, erroneous box-counts were unusual and ascribed the Firm's errors to a lack of automation in its operations system, which in turn required Firm personnel to input data manually resulting in the errors.

2. Inaccurate Customer Securities Records

Exchange Act Rule 17a-3(a)(5) requires broker-dealers "to make and keep current a securities record or ledger" of its customers' securities positions.[27] During its March 2005 examination, the staff found seventeen inaccuracies (of twenty-five accounts sampled) in the Firm's records pertaining to customer mutual fund positions dated March 9, 2005. FINRA staff ascribed the errors to the Firm's manual entry of records, noting, in contrast, that automated systems generally "interact directly with mutual fund companies" to update securities positions.

3. Failure to Follow FINRA Transfer Procedures

NASD Rule 11870(b) requires member firms that have received broker-to-broker transfer instruction forms ("TIFs") to, within three business days following receipt of the TIF, either validate the transfer instructions or take exception to them.[28] FINRA staff found that, from November 2004 through January 2005, the Firm failed to comply with Rule 11870(b)'s transfer procedures more than twenty percent of the time. Farr testified that the BCS system could not interface with the Automated Customer Account Transfer Service ("ACATS"), requiring operations personnel "to manually input all the transfers on to [the Firm's] system," a time-

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[25] 17 C.F.R. § 240.17a-13(b); *see also Quarterly Securities Counts by Certain Exchange Members, Brokers and Dealers*, Exchange Act. Rel. No. 9376 (Oct. 29, 1971) (establishing Exchange Act Rule 17a-13 as "a minimum standard of control over securities for all subject members, brokers, and dealers").

[26] "Implicit in the recordkeeping rules is the precondition that information contained in these records be accurate." *Ko Sec., Inc.*, 56 S.E.C. 1126, 1133 (2003) (citation omitted), *petition denied sub nom., Yoshikawa v. SEC*, 122 F. App'x. 364 (9th Cir. 2005).

[27] 17 C.F.R. § 240.17a-3(a)(5); *see also* NASD Rule 3110(a) (requiring FINRA members to comply with Commission recordkeeping rules).

[28] FINRA has since amended Rule 11870 reducing the deadline from three days to one. *Order Granting Approval of a Proposed Rule Change Relating to NASD Rule 11870*, Exchange Act Rel. No. 56677 (Oct. 19, 2007), 91 SEC Docket 2814.

consuming task.[29] Busacca acknowledged the Firm's transfer failures in a February 2005 letter to FINRA, explaining the Firm had "an inordinate amount of ACATS requests" during this time "due to a conversion and several correspondents leaving simultaneously."

4. Failure to Initiate Timely Buy-In Procedures

Exchange Act Rule 15c3-3(d)(2) and corresponding NASD Rule 11870(f) require broker-dealers to initiate, within a specified time period, buy-in procedures or to take other "steps to obtain physical possession or control of securities" that a firm fails to receive in connection with an account transfer.[30] FINRA staff found that, from June 2004 to January 2005, the Firm failed on six occasions to initiate timely buy-in procedures or otherwise obtain control or possession of securities in connection with account transfers. Three of the six failures involved ACATS.

5. Failure to Comply with Cash and Margin Requirements

Section 220.8(b) of Regulation T requires broker-dealers to "cancel or otherwise liquidate a transaction or any part of a transaction for which the customer has not made full cash payment within the required time."[31] Under certain circumstances, when securities are transferred out of a cash account without the customer having paid for them, Section 220.8(c) requires firms to freeze the account for ninety days.[32] FINRA staff reviewed 511 trades in North American customer accounts from January 1, 2004, through February 28, 2005, finding at least fifty-four occasions in which the Firm failed to cancel or liquidate purchases in accordance with Regulation T. FINRA staff further found that the Firm allowed eleven customers to trade in frozen accounts.

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[29] ACATS "is a system administered by the National Securities Clearing Corporation that automates and standardizes procedures for the transfer of assets in a customer account from one firm to another." NASD Notice to Members 04-58 (Aug. 2004).

[30] 17 C.F.R. § 240.15c3-3(d)(2); NASD Rule 11870(f).

[31] 12 C.F.R. § 220.8(b); *see generally Howard Brett Berger*, Exchange Act Release No. 58950 (Nov. 14, 2008), 94 SEC Docket 11615, 11626 ("Exchange Act Section 7 incorporates rules (specifically, Regulation T) of the Board of Governors of the Federal Reserve governing margin requirements and prescribes lending limits for the initial extension of credit on securities for the purpose of preventing the excessive use of credit for the purchase or carrying of securities." (internal punctuation and citation omitted)), *petition denied*, 347 F. App'x 692 (2d Cir. 2009).

[32] 12 C.F.R. § 220.8(c).

NASD Rule 2520(c), as a supplement to Regulation T, requires member firms to ensure that customers maintain minimum levels of margin (also known as "maintenance margin") in their margin accounts with the firms.[33] FINRA staff found ten instances, between October 2004 and January 2005, when the Firm failed to liquidate timely accounts that had dropped below FINRA's specified maintenance margin requirements.[34] FINRA staff testified that the Firm's cash and margin failures were again due to a lack of automation in the Firm's operations systems. FINRA staff further blamed a lack of "trained personnel to conduct the daily review of this area." McAuliffe's on-the record testimony concurred with this view, noting that the margin department, which reported directly to Busacca, was run by an individual who had no margin experience.

6. Failure to Report Surveillance Data

NASD Conduct Rule 3150 requires member firms to report certain market information to FINRA, including data required under FINRA's Integrated National Surveillance and Information Technology Enhancements ("INSITE") program.[35] FINRA found that for the three-month period following the Firm's software conversion (February 2004 to May 2004) North American did not report any INSITE data to FINRA. Busacca admitted during his testimony that the BCS system for several months had "a different [Market Participant] ID than the [Firm's] actual [Market Participant] ID," resulting in the Firm's failure to report required data to FINRA.

F. Employment of an Unregistered Chief Compliance Officer

The Firm employed McAuliffe as its chief compliance officer from July 2004 to February 2005, despite his being unregistered as a principal during this time. McAuliffe had previously served as a registered principal and chief compliance officer with other FINRA member firms, but his last registration terminated in March 2001. Because more than two years had elapsed since his last registration, FINRA's registration provisions required McAuliffe to requalify as a principal or obtain a waiver from FINRA before serving as the Firm's chief

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33 *See also* NASD Rule 2520(a)(7) (defining "margin" as "the amount of equity to be maintained on a security position held or carried in an account").

34 *See* NASD Rule 2520(f)(6) (requiring "margin . . . be obtained promptly as possible and in any event within fifteen business days from the date such deficiency occurred").

35 NASD Notice to Members 01-84 (Dec. 2001) (explaining that the data collected by the INSITE program helps FINRA "detect emerging risk patterns at member firms").

compliance officer.[36] McAuliffe did neither but was listed on the Firm's Form BD as the chief compliance officer.

According to the Central Registration Depository ("CRD"), Busacca executed the Firm's Amended Form BD on July 8, 2004, that listed McAuliffe as the Firm's chief compliance officer. Although the Firm's supervisory manual at the time identified "[t]he President" as having "ultimate responsibility for the assessment of a candidate's qualifications," Busacca acknowledged that he conducted no inquiry into whether McAuliffe was properly qualified to serve as the Firm's chief compliance officer, trusting McAuliffe had reinstated his licenses with FINRA.

In his on-the-record testimony, McAuliffe explained that, because he had passed numerous NASD licensing examinations before, he assumed that he would be granted a waiver of the examination requirement.[37] McAuliffe testified that, when FINRA notified him that it had denied his waiver request several months after he began serving as chief compliance officer, he told Busacca, who was "disappoint[ed]." According to McAuliffe, he also told Busacca and Goble that without a proper license he could not remain the Firm's chief compliance officer and "asked them if they wanted me to make changes [on CRD]," to which they responded: "No. Just leave it. And we'll get it fixed as soon as possible." McAuliffe continued serving as chief compliance officer until resigning in February 2005.[38]

G. FINRA's Proceeding

On August 13, 2007, FINRA's Department of Enforcement filed a disciplinary action against North American and Busacca, charging the Firm with various primary violations of the net capital, customer protection, recordkeeping and reporting, and credit extension requirements. FINRA additionally charged the Firm and Busacca with failing to reasonably supervise the Firm's

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[36] *See* NASD Rule 1021(c) (requiring persons "whose most recent registrations as a principal has been terminated for a period of two or more years . . . to pass" an appropriate qualification examination); NASD Rule 1022(a) (requiring chief compliance officers to register with FINRA after passing the appropriate qualification examination).

[37] McAuliffe testified that Busacca recruited him, finding his résumé on an employment Web site and referring him to Goble, who ultimately hired him.

[38] McAuliffe stated that he left the Firm because of a disagreement with Busacca and Goble over a February 2005 written response McAuliffe prepared to a FINRA inquiry. According to McAuliffe, Busacca had edited the response to replace a reference to Goble as supervisor of the Firm's bond traders with a name of a Firm official who was not a principal and not involved with bond trading. McAuliffe testified that he told them: "I can't sign this. It's . . . false. It's not correct."

back-office operations and permitting McAuliffe to serve as chief compliance officer without a proper registration. North American settled FINRA's charges prior to hearing.[39]

FINRA's Hearing Panel found that Busacca, as Firm president, "failed to exercise reasonable supervision" over "North American's operations systems and personnel" in violation of NASD Rules 3010 and 2110, and that he violated NASD Rules 1022(a) and 2110 by allowing the Firm to employ an unregistered chief compliance officer. The Hearing Panel suspended Busacca in all principal capacities for six months, fined him $25,000 for failing to supervise and $5,000 for employing an unregistered chief compliance officer, and assessed costs.

The National Adjudicatory Council ("NAC") affirmed. The NAC found that "Busacca did not act promptly and with the 'utmost vigilance' to resolve North American's widespread operational problems." The NAC rejected Busacca's principal argument that the "Hearing Panel held him liable for the [Firm's] software conversion itself, which occurred more than one month before" Busacca was officially designated Firm president. The NAC stated that the Firm's operational "problems persisted until well after Bussaca was listed as the Firm's president on its Form BD, and [that] Busacca failed to diligently address the problems beginning in March 2004."

III.

Busacca does not deny that numerous operational breakdowns took place at North American following its software conversion, nor that the Firm employed an unregistered chief compliance officer. Rather, he asserts that he had no responsibility for these matters. Based on our *de novo* review of the record, we find that a preponderance of evidence supports FINRA's findings of violations.

A. Busacca's Supervisory Failure

NASD Rule 3010 requires members to "establish and maintain" a supervisory system "that is reasonably designed to achieve compliance with applicable securities laws and

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39 During the pendency of FINRA's action, a trustee was appointed in separate federal court proceeding to liquidate the Firm pursuant to the Securities Investor Protection Act of 1970. *See Sec. Investor Protection Corp. v. North Am. Clearing, Inc.*, Adv. No. 6:08-ap-00145-KSJ (M.D. Fla. filed July 28, 2008). Before the commencement of FINRA's hearing, the Firm, represented by the SIPC trustee, consented to findings that it violated various net capital, customer protection, recordkeeping, reporting, and credit extension requirements and failed to provide reasonable supervision over its operations. As part of the settlement, the Firm was expelled from FINRA membership.

regulations and with applicable NASD Rules."[40] We further have held that "red flags and suggestions of irregularities demand inquiry as well as adequate follow-up and review. When indications of impropriety reach the attention of those in authority, they must act decisively to detect and prevent violations of the securities laws."[41]

The Firm lacked an adequate supervisory system to prevent the widespread operational failures that took place from February 2004 through early 2005 following its conversion to an untested back-office software program. Due to systemic breakdowns resulting from the conversion, the Firm was unable to carry out rudimentary clearing firm functions, such as executing customer trades, maintaining accurate customer records and handling back-office matters, as evidenced by an influx of complaints. The Firm -- fully automated under its previous software system -- became heavily reliant on inexperienced operations personnel to input manually large amounts of data into the Firm's systems because of the software's limitations. The resulting patchwork system of semi-automation and manual data-entry proved inadequate in meeting customer needs and regulatory requirements. FINRA's March 2005 examination further revealed the extent of the Firm's operational failings -- showing pervasive non-compliance with regulatory requirements.

We have frequently emphasized that "the president of a brokerage firm is responsible for the firm's compliance with all applicable requirements unless and until he or she reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his or her duties."[42] Busacca admittedly assumed overall responsibility for the Firm's operations upon becoming North American's president in March 2004 and did not delegate this responsibility to another registered principal until late 2005, well after the events at issue.

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40 *Ronald Pellegrino*, Exchange Act Rel. No. 59125 (Dec. 19, 2008), 94 SEC Docket 12628, 12641 (internal punctuation omitted); *see also Robert E. Strong*, Exchange Act Rel. No. 57426 (Mar. 4, 2008), 92 SEC Docket 2875, 2887 (finding firm official's "unreasonable inaction effectively nullified the supervisory system . . . that he himself had designed and was responsible for enforcing").

41 *Edwin Kantor*, 51 S.E.C. 440, 447 (1993); *cf. Consol. Inv. Servs., Inc.*, 52 S.E.C. 582, 588 (stating under the Exchange Act that "any indication of irregularity brought to a supervisor's attention must be treated with the utmost vigilance"). We have also stated that "[t]he standard of reasonable supervision is determined based on the particular circumstances of each case." *John A. Chepak*, 54 S.E.C. 502, 513 n.27 (2000).

42 *Richard F. Kresge*, Exchange Act Rel. No. 55988 (June 29, 2007), 90 SEC Docket 3072, 3084 (citing *Rita H. Malm*, 52 S.E.C. 64, 69 (1994)); *see also Donald T. Sheldon*, 51 S.E.C. 59, 79 (1992), *aff'd*, 45 F.3d 1515, 1517 (11th Cir. 1995).

Busacca's supervision of North American's operations was deficient. Having worked with Goble in selecting a new software system, Busacca knew from the beginning of his presidency of the software's limitations and the systemwide breakdowns that followed. He acknowledged that, when he became president, the Firm was a "mess," "complaints were flying off the shelf," and back-office personnel were ill-equipped to handle the increased workload created by the new system. Despite the presence of numerous red flags, Busacca failed to direct his prompt and full attention to remedying the Firm's operational breakdowns that arose and to preventing the occurrence of future problems.[43] Instead, he admits that he acted as the Firm's sole "breadwinner," focusing on generating more clearing business. This focus caused Busacca to "travel extensively" and to address operational problems only when he returned to the office. Under Busacca's supervision, the Firm's operational breakdowns persisted throughout 2004 and early 2005. Moreover, Busacca's ability to secure new business as salesman exacerbated, rather than alleviated, existing problems by adding more accounts to an already overwhelmed system.[44]

On appeal, Busacca urges us to "vacate or at the very least modify" FINRA's decision because, he claims, he should not be held "responsible for the software problems caused by [the computer software] conversion" that occurred prior to his designation as Firm president. Busacca, however, misstates the nature of FINRA's supervisory charges here, which concern his failure once he became president to address operational problems caused by the adoption of the software. Although Busacca repeatedly blames the "faulty software" for the Firm's problems, we have previously held that, "if a broker-dealer or its agent develops a computer-communications system to facilitate regulatory compliance, failure of that system does not excuse the broker-dealer from its obligation to comply with each of its regulatory responsibilities."[45]

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43 *Cf. George J. Kolar*, 55 S.E.C. 1009, 1016 (2002) (stating under the Exchange Act that "[d]ecisive action is necessary whenever supervisors are made aware of suspicious circumstances, particularly those that have an obvious potential for violations"); *Quest Capital Strategies, Inc.*, 55 S.E.C. 362, 371 (2002) ("[S]upervisors must act decisively to detect and prevent violations of the securities laws when an indication of irregularity is brought to their attention.").

44 *See Pellegrino*, 94 SEC Docket at 12643 (finding securities principal's "sales efforts exacerbated, rather than alleviated, the risk of" additional noncompliance). As noted above, the Firm's customer base increased substantially by 2005.

45 *Lowell H. Listrom*, 50 S.E.C. 883, 887 n.7 (1992) (noting further that "[w]e expect that a broker-dealer will appropriately design, test, and maintain those systems so that such systems will assist it in fulfilling its regulatory responsibilities"), *aff'd*, 975 F.2d 866 (8th Cir. 1992) (Table); *see also Use of Electronic Media*, 65 Fed. Reg. 25,843-01 (May 4, 2000) (noting that, "[a]s broker-dealers increasingly rely on electronic facilities . . . , they must have the facilities to handle the expected user volume").

Moreover, evidence that he helped acquire the software and acted in a managerial capacity before serving as president remains relevant. His previous involvement underscores the unreasonableness of his supervision. He understood the severity of the operational problems when he became president, yet he failed to act promptly.[46]

Busacca contends that, after becoming president, he acted reasonably, doing everything he could to "clean up the problems." For example, although not cited directly in his brief, Busacca's hearing testimony identified corrective measures he took to address the Firm's operational problems. These measures included the holding of weekly meetings with staff to discuss compliance and operations issues, periodically "check[ing]" on operations staff and requiring them to review the Firm's procedures, and increasing operations and information technology staff to address deficiencies in the software system.[47]

Busacca's testimony and other evidence contradict his claims of reasonable supervision. He admitted that he addressed operational problems only between sales trips, rather than giving them the priority they needed. Customer complaints, as well as McAuliffe's sworn testimony, further demonstrated that the Firm, under Busacca's supervision, often failed to resolve operational issues for weeks or, in some instances, months after they were identified. McAulliffe also observed that Busacca had "no unusual concern" when McAuliffe brought customer complaints to his attention. Farr's unrebutted testimony clarified that operational meetings did not occur until 2005, well after FINRA had opened its investigation. Reasonable supervision, however, required Busacca as the Firm principal responsible for supervising operations to address known deficiencies promptly -- on his own initiative -- not only after regulatory action had commenced.[48] Busacca's awareness of numerous red flags, including customer complaints, should have caused him to address the Firm's problems much earlier.

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[46] *Sec. Planners Assoc., Inc.*, 44 S.E.C. 738, 742 (1971) (finding firm president -- who was "generally aware" of firm's problems before accepting promotion to president -- failed to "exercise reasonable supervision to prevent" firm's back-office violations that continued to occur after he became president); *see also Pellegrino*, 94 SEC Docket at 12649 (recognizing that the firm "had a deficient supervisory system before [respondent] joined the firm, but reasonable supervision required that [he] correct the deficiencies promptly").

[47] Busacca identified additional steps he took to address the Firm's failings including the hiring of personnel to audit the Firm's systems, hiring a chief operations officer, and forcing Farr to qualify as a principal, but these steps occurred after the period at issue.

[48] *Pellegrino*, 94 SEC Docket at 12649 (applicant's "failure to take such steps until after NASD's investigation began demonstrates unreasonable supervision"); *Kresge*, 90 SEC Docket at 3087 (finding deficient supervision where supervisor's actions occurred only "after NASD had begun its investigation").

Busacca's purported corrective measures, in addition to being untimely, were not reasonably designed to address the extensive operational dysfunction that arose.[49] For example, Busacca's "spot checks" of operations staff were cursory, at best -- describing them in his testimony as occasionally requiring staff to review Firm policies and procedures -- and "did not remedy the obvious potential" for continued operational problems.[50] Moreover, we have long held that "the presence of procedures alone is not enough" because "[w]ithout sufficient implementation, guidelines and strictures do not assure compliance."[51]

Busacca's efforts to address personnel issues also were ineffectual. Despite a larger staff, the Firm's operational problems continued to occur due, in large part, to processing errors committed by personnel that Busacca admitted were inexperienced and often overwhelmed. We have often stressed the "obvious need to keep [a] new office with . . . untried personnel under close surveillance."[52] Busacca's awareness of the Firm's personnel deficiencies, in addition to the computer malfunctions, demanded his utmost attention and follow up.[53]

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49 *See, e.g.*, *Pellegrino*, 94 SEC Docket at 12648 (stating the relevant inquiry is "whether [applicant's] supervision 'was reasonably designed to prevent the violations at issue, not weigh [his] supervisory performance in other areas against his deficiencies in the area under review'" (quoting *Quest*, 55 S.E.C. at 374)); *cf. Albert Vincent O'Neal*, 51 S.E.C. 1128, 1135 (1994) (stating that "the test" under the Exchange Act "is whether [the] supervision was reasonably designed to prevent the violations at issue").

50 *Pellegrino*, 94 SEC Docket at 12648; *see also Blinder, Robinson & Co.*, 47 S.E.C. 812, 814 (1982) (finding applicants' "cursory examination" to be "clearly inadequate" because a failure of supervision "connotes 'a failure to learn of improprieties when diligent application of supervisory procedures would have uncovered them'") (quoting *Jerome F. Tegeler*, 45 S.E.C. 512, 515 n.8 (1974), and *Anthony J. Amato*, 45 S.E.C. 282, 286 (1973)).

51 *Kresge*, 90 SEC Docket at 3089 n.37 (quoting *Rita H. Malm*, 52 S.E.C. 64, 69 & n.17 (1994)); *see also George J. Kolar*, 55 S.E.C. 1009, 1020 (2002) (rejecting supervisor's claim that he enacted reasonable supervisory procedures because the "routine surveillance measures cited by [respondent] were clearly inapplicable to the situation that he confronted"); *Thomson & McKinnon*, 43 S.E.C. 785, 788 (1968) ("Although it was registrant's stated policy . . . it failed to establish an adequate system of internal control to insure compliance with such policy.").

52 *LaJolla Capital Corp.*, 54 S.E.C. 275, 282 & n.18 (1999) (internal punctuation omitted) (collecting cases).

53 *See, e.g., Reynolds & Co.*, 39 S.E.C. 902, 917 (1960) ("The duty of supervision cannot be avoided by pointing to the difficulties involved where facilities are expanding or by placing the blame upon inexperienced personnel or by citing the pressures inherent in competition for new business. These factors only increase the necessity for vigorous effort.").

Busacca's testimony suggested that Goble may have interfered with Busacca's effective supervision by making personnel decisions while Busacca was away on sales trips. Under the circumstances, however, given the Firm's ongoing operational failings and that it was ultimately his responsibility to oversee operations, Busacca should have ensured that the Firm dedicated sufficient resources and attention to resolving the Firm's operational problems. If Goble continued to undermine his efforts, Busacca was "required to insist on [Goble's] cooperation and compliance with applicable requirements or to resign."[54] There is no indication that Busacca made any such demands of Goble until 2007, long after the events at issue occurred.[55]

In light of the foregoing, we sustain FINRA's findings that Busacca, as North American's president, failed to supervise reasonably the Firm's operations in violation of NASD Conduct Rules 3010 and 2110.[56]

B. Unregistered Chief Compliance Officer

NASD Membership and Registration Rule 1022(a) requires each person designated as a chief compliance officer on Schedule A of a member firm's Form BD to be registered as a general securities principal. McAuliffe served as the Firm's chief compliance officer for eight months, from July 2004 to February 2005, without a proper registration in effect. Because more than two years had elapsed since his last registration terminated, McAuliffe was required to re-qualify with FINRA by passing the appropriate qualification examination or obtaining a waiver of the requirements -- neither of which occurred.[57] As reflected in the Firm's supervisory manual,

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[54] *George Lockwood Freeland*, 51 S.E.C. 389, 392 (1993); *see also James J. Pasztor*, 54 S.E.C. 398, 409 n.28 (1999) (supervisor not relieved of responsibility because he had to report to firm president who repeatedly overruled his decisions); *Steven P. Sanders*, 53 S.E.C. 889, 904 (1998) ("even where supervisory responsibility is shared between firm executives, each can be held liable for supervisory failure") (collecting cases).

[55] We do not find, as Busacca contends, that the existence of a three-year non-compete clause in Busacca's employment contract was a valid reason for failing to confront Goble earlier. *Cf. Pellegrino*, 94 SEC Docket at 12655 n.67 (holding, in context of sanction determination, that applicant's concern that he would be unable to find employment if he resigned did not mitigate his supervisory failures).

[56] A violation of any NASD rule or regulation also constitutes a violation of Conduct Rule 2110. *Siegel v. SEC*, 592 F.3d 147, 153 (D.C. Cir. 2010).

[57] *See* NASD Rules 1021(c) and 1070(d).

Busacca was responsible for ensuring that McAuliffe was properly registered, but he failed to do so.[58]

Busacca asserts he was "duped into trusting" McAuliffe, "an experienced industry veteran," to properly register himself. He asserts further that, in any event, "FINRA [*i.e.*, the NAC] acknowledges that [McAuliffe] did a good job but" that McAuliffe simply "did not have his licenses up with the firm." Busacca, however, cannot shift blame to others for his failure as president to determine McAuliffe's registration status.[59] Moreover, Busacca's attempt to downplay McAuliffe's lack of registration as simply an oversight, on McAuliffe's part, is inconsistent with the record. Busacca conducted no inquiry into McAuliffe's registration status before identifying McAuliffe as chief compliance officer on the Firm's Form BD. Even when informed by McAuliffe that he had failed to requalify for registration (and for that reason could not continue to serve in that capacity), Busacca was indifferent, according to McAuliffe, allowing him to continue in office.

We accordingly sustain FINRA's finding that Busacca violated NASD Membership and Registration Rule 1022(a) and 2110 by permitting McAuliffe to act as chief compliance officer without being so registered.

IV.

A. Allegations of FINRA Staff Misconduct

Busacca claims that FINRA's action is a form of retaliation "due to his voice of dissent" in opposing the "merger of NASD and NYSE regulation" and "for daring to take on [an] abusive staff at NASD and FINRA." According to Busacca, he is being "unfairly punished due to his stance as a Small Firm Leader." Busacca asserts he has "endured constant harassment," alleging that, during a previous proceeding against North American, FINRA staff "threatened [him] in the presence of" Firm personnel, "that if he didn't 'watch it,' he would find himself named to this complaint as well."

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[58] *See Kresge*, 90 SEC Docket at 3093 (holding firm president liable for violating FINRA registration rules by permitting unregistered person to act in a principal capacity); *Dennis Todd Lloyd Gordon*, Exchange Act Rel. No. 57655 (Apr. 11, 2008), 93 SEC Docket 5089, 5114 (holding firm's chief executive officer and president liable for violating FINRA registration rules by permitting unregistered individual to function in a principal capacity).

[59] *See, e.g., Justine Susan Fischer*, 53 S.E.C. 734, 741 n.4 (1998) (holding that "[a] broker has responsibility for his or her own actions and cannot blame others for [his or] her own failings") (citing *Dan A. Druz*, 52 S.E.C. 130, 135 n.18 (1995)). Although Busacca indicated he did not have access to CRD, relying instead on others for information, he appeared as signatory on numerous Firm filings, including several identifying McAuliffe as chief compliance officer.

To establish a claim for selective prosecution, Busacca must demonstrate that "he was unfairly singled out and that his prosecution was motivated by improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right."[60] Busacca has not made such a showing.

In any event, we find no evidence that FINRA unfairly targeted Busacca or was biased against him.[61] The record shows that FINRA's investigation was amply warranted. It was begun after numerous introducing firms and customers filed complaints about the Firm's operations with FINRA. Such complaints -- together with the back-office violations later found by FINRA examining staff -- formed the basis for FINRA's August 2007 complaint against Busacca and North American. In contrast, Busacca presented no evidence during the proceeding below, called no witnesses (including those he claimed had observed FINRA staff misconduct), and declined to cross-examine the several FINRA staff members who gave testimony in FINRA Enforcement's case-in-chief, about their motives in prosecuting him.[62] We, therefore, reject Busacca's claims of selective prosecution.[63]

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[60] *Raghavan Sathianathan*, Exchange Act Rel. No. 54722 (Nov. 8, 2006), 89 SEC Docket 774, 788-89 (citing *United States v. Huff*, 959 F.2d 731, 735 (8th Cir. 1992)), *petition denied*, 304 F. App'x. 883 (D.C. Cir. 2008); *see also Fog Cutter Capital Group Inc. v. SEC*, 474 F.3d 822, 826 (D.C. Cir. 2007).

[61] *See Stephen Russell Boadt*, 51 S.E.C. 683, 685 (1993) (rejecting contention that "the instant sanction is the result of a vendetta against [applicant] by the Regional Counsel" because "even if we were to find that Regional Counsel were biased, that would not suggest that the fairness of the hearing itself was compromised").

[62] As part of his brief to us, Busacca attached seven previously unadmitted documents purportedly supporting his claims of FINRA staff misconduct. The submitted documents include Busacca's affidavit in a separate civil suit, e-mails he sent to FINRA staff and to the U.S. Department of Justice, and various other materials. Commission Rule of Practice 452, 17 C.F.R. § 201.452, permits the admission of additional evidence where the evidence is material and where there exist reasonable grounds for failing to produce the evidence earlier. Rule 452's requirements have not been met. Busacca gave no explanation for his failure to adduce these materials earlier and failed to respond when FINRA challenged his requested submission. In addition, these documents do not appear to be material in that they neither support his claim of staff misconduct nor otherwise address the allegations in this case.

[63] Busacca asserts further, without citation to any specific authority, that he "should be protected under the Whistle Blower Act." We have repeatedly held, however, that whistle-blower statutes "'do not purport to provide a defense in a disciplinary action or to estop [FINRA] from taking disciplinary action consistent with its rules.'" *Scott Epstein*, Exchange Act Rel. No.

(continued...)

B. Busacca's Production Request

Busacca also argues that the hearing officer's denial of his request to compel the production of documents from North American prevented him from properly defending himself. NASD Rule 9252(b) provides that a request for FINRA to compel the production of documents from a member firm "shall be granted only upon a showing that: the information sought is relevant, material, and non-cumulative," and "the requesting party has previously attempted in good faith to obtain the desired Documents . . . but has been unsuccessful in such efforts." In ruling on such a request, the hearing officer also "shall consider whether the request is unreasonable, oppressive, excessive in scope, or unduly burdensome."

On April 29, 2008, Busacca submitted his request nine months after commencement of FINRA's action, seeking the Firm's production of (1) "all communications and minutes" from meetings beginning in December 2003; (2) all Forms BD and amendments filed by the Firm from January 2001 to April 2008; and (3) "all Written Supervisory Procedures" used by the Firm from January 2001 to May 2007. The hearing officer denied Busacca's motion, holding that Busacca's request "seeks broad categories of documents, fails to state why they are material and does not describe his prior efforts to obtain them" from the Firm -- which was still a party to FINRA's action.[64] Busacca did not challenge this ruling.

Three months later (after the Firm went into SIPC liquidation), Busacca again raised his need for the documents during a prehearing conference. The hearing officer reiterated his earlier position that Busacca had not satisfied Rule 9252(b)'s requirements, and explained to Busacca that, "if there are things that you need[,] you can still request them . . . [but] you have to ask for them. If [the SIPC trustee presiding over the Firm's liquidation] refuses to provide them *then* you would have a basis" for compelling production (emphasis supplied). Busacca, however, did not notify the hearing officer of having any trouble obtaining the documents from the SIPC trustee until October 27, 2008, less than two weeks before the hearing (and nearly six months after his initial request). On November 3, 2008, the hearing officer denied Busacca's second request to compel document production, ruling that "FINRA lacks jurisdiction over the [SIPC] trustee . . . [to] compel production of the documents" and, in any event, "Busacca has still failed to demonstrate that the documents he is seeking . . . are relevant and material to his defense."[65] The NAC affirmed the hearing officer's denial, stating that Busacca failed to show he made any

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63 (...continued)
59328 (Jan 30, 2009), 95 SEC Docket 13833, 13856 n.42 (quoting *Sathianathan*, 89 SEC Docket at 788), *appeal filed*, No. 09-1550 (3d Cir. Feb. 24, 2009).

64 *See supra* note 39 (discussing Firm's subsequent placement in SIPC receivership).

65 The record indicated that Busacca had access to all discoverable documents in possession of FINRA staff, as required by NASD Rule 9251.

attempts to obtain the documents from the Firm. In any event, the NAC gave Busacca the benefit of the doubt regarding his efforts to address operational issues by "credit[ing] Busacca's unrebutted testimony that he took the [corrective] actions that he described."[66]

Under the circumstances, we find no error in FINRA's handling of Busacca's request to compel document production. The hearing officer gave Busacca ample opportunity to properly obtain the materials he desired from the Firm before it was placed under SIPC trusteeship (and ceased to be a FINRA member) when the hearing officer became unable to compel their production.[67] Busacca, however, delayed action and repeatedly failed (when he did act) to comply with the requirements of Rule 9252(b) by, for example, in the first instance, not seeking the materials directly from the Firm and, then, failing to obtain them from the Firm, documenting that failure, and explaining to the hearing officer his need for the materials.

The materiality of these documents, which covered an eight-year period, is not apparent, particularly since the violative conduct is limited to 2004 and early 2005. Moreover, the record contains other competent evidence -- including Busacca's own testimony -- that described the measures Busacca took to address the Firm's problems.[68] In addition, the record contains, as FINRA exhibits, the relevant written supervisory procedures that Busacca sought in his request, and we have reviewed all relevant Forms BD and their amendments, which are available on CRD. We have considered this evidence as part of our *de novo* review of the proceeding,[69] and accordingly reject Busacca's claims of unfairness during FINRA's proceedings.[70]

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[66] For instance, the NAC accepted Busacca's claims that he held weekly meetings with operations management, as clarified by Farr's unrebutted testimony that they occurred in 2005. *See supra* text following note 15.

[67] FINRA "lacks subpoena power" and has limited authority to compel production of materials from member firms pursuant to NASD Rules 8210 and 9252. *PAZ, Sec., Inc.*, Exchange Act Rel. No. 57656 (Apr. 11, 2008) 93 SEC Docket 5122, 5127, *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009).

[68] *Cf. Andrew P. Gonchar*, Exchange Act Rel. No. 60506 (Aug. 14, 2009), 96 SEC Docket 19852, 19871-72 & n.49 (holding that "applicant's inability to subpoena witnesses is not grounds for overturning a disciplinary action unless the applicant can show prejudice") (citing *Crimmins v. Am. Stock Exch., Inc.*, 368 F. Supp. 270, 277 (S.D.N.Y. 1973), *appeal filed*, No. 09-4215 (2d. Cir. Oct. 8, 2009)).

[69] *See Robert Bruce Orkin*, 51 S.E.C. 336, 344 (1993) ("Furthermore, our *de novo* review of this matter cures whatever bias or disregard of precedent or evidence, if any, that may have existed below."), *aff'd*, 31 F.3d 1056 (11th Cir. 1994).

[70] We also reject Busacca's argument that these proceedings violate the Double Jeopardy Clause of the U.S. Constitution because, as he claims, FINRA issued a 2006 letter of

(continued...)

V.

Busacca challenges the sanctions FINRA imposed as excessive. In particular, he argues that the $30,000 in fines that FINRA assessed is "insan[e] given the nature of the claim being technical violations" and, he claims, "no injury nor customers [being] involved." He further contends that the sanction is excessive in light of his "clean[,] reputable and ethical career for over 18 years."[71] According to Busacca, "his punishment reflects a vendetta by FINRA of his telling the truth" about the regulatory consolidation of NASD and NYSE Regulation.

Exchange Act Section 19(e)(2) directs us to reduce or set aside FINRA sanctions if we find, having "due regard for the public interest and the protection of investors," that the sanctions are "excessive or oppressive" or impose an unnecessary or inappropriate burden on competition.[72] As discussed below, we find no merit to Busacca's arguments challenging the sanctions and find they are neither excessive nor oppressive and are appropriately remedial.

We disagree with Busacca's characterization that the violations involved merely "technical" requirements and that customers were uninvolved. We further reject his efforts to blame these proceedings on policy differences Busacca purportedly had with members of FINRA management. The record shows that Busacca presided over a firm that was, for a significant period, effectively unable to carry out fundamental duties of a clearing firm. The operational deficiencies identified had clear implications for the safety of customer accounts and North American's proper functioning in the self-regulatory system.[73] As found above, the Firm's

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70 (...continued)
caution against the Firm for "fail[ing] to timely validate or take exception to transfer instructions." The U.S. Supreme Court has held that the Double Jeopardy Clause only applies to "the imposition of multiple criminal punishments for the same offense," which Busacca does not claim occurred here. *Hudson v. United States*, 522 U.S. 93, 99 (1997) (collecting cases); *see also Jones v. S.E.C.*, 115 F.3d 1173, 1183 (4th Cir. 1997), *cert. denied*, 523 U.S. 1072 (1998) (agreeing with the argument that "the double jeopardy clause is not applicable [to FINRA] because [it] is a private party and not a governmental agent").

71 Busacca also challenges the authority of FINRA to impose the sanction because, according to Busacca, "the merger of NASD and NYSE was done so under misrepresentation and fraud." Busacca, however, provides no support, nor do we see a basis, for his claim. *See, e.g., Standard Inv. Chartered, Inc. v. NASD*, No. 07 Civ. 2014 (JSR), 2010 WL 749844, at *2 (S.D.N.Y. Mar. 1, 2010) (dismissing private action challenging FINRA consolidation).

72 15 U.S.C. § 78s(e)(2). Busacca does not claim, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

73 We have previously stated that, "[i]n most respects, introducing brokers are dependent on clearing firms to clear and to execute customer trades, to handle customer funds
(continued...)

operational breakdowns resulted in an inability to meet the basic needs of introducing firms' customers by failing, for example, to provide account statements and trade confirmations to customers for several months. The Firm also regularly failed to comply with customer protection safeguards, such as failing to keep accurate securities records, follow transfer procedures, institute buy-in procedures for securities it did not receive, and adhere to cash and margin requirements.

We are troubled by the fact that Busacca was confronted with numerous complaints and other indications of serious problems with the Firm's operations yet, for much of 2004, gave limited emphasis to addressing such problems -- choosing to focus instead on increasing the Firm's business. Busacca may have enhanced North American's profitability (as well as his own remuneration) but at the cost of adding to the stress on an already overwhelmed operations system. We are also troubled by Busacca's inclination to blame others for the Firm's problems, including the Firm's software, Goble, other Firm personnel, and FINRA staff, when he had overall responsibility for supervising the Firm's operations. "'Assuring proper supervision is a critical component of broker-dealer operations,'"[74] and Busacca's failure to promptly address known red flags "'reveal[s] a fundamental misunderstanding of his supervisory duties.'"[75]

While we, like FINRA, consider certain facts in mitigation -- such as his cooperation with FINRA staff in investigating and resolving problems at the Firm and that McAuliffe, the unregistered compliance officer, had previously been registered and was not shown to have contributed to the Firm's compliance problems -- we do not believe they justify a reduction of the sanctions, which are fully consistent with FINRA's Sanction Guidelines.[76] Those guidelines recommend, for a supervisory violation, a fine between $5,000 and $50,000 and, in egregious cases, a suspension of up to two years or a bar in any or all capacities. Among the factors identified in supporting significant sanctions for a supervisory failure are "[w]hether respondent

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[73] (...continued)
and securities, and to handle many back-office functions, including issuing [trade] confirmations . . . and customer account statements." *See Definitions of "Small Business" or "Small Organization" under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Exchange Act of 1934, and the Securities Act of 1933*, Exchange Act Rel. No. 40122 (June 24, 1998), 67 SEC Docket 1113, 1118 n.65.

[74] *Pellegrino*, 94 SEC Docket at 12641 (quoting *Richard F. Kresge*, 90 SEC Docket at 3083).

[75] *Id.* at 12654 (quoting *Stephen J. Horning*, Exchange Act Rel. No 56886 (Dec. 3, 2007), 92 SEC Docket 207, 226, *aff'd*, 570 F.3d 337 (D.C. Cir. 2009)).

[76] We are "not bound by the Guidelines [but] use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2)." *CMG Inst'l Trading, Inc.*, Exchange Act Rel. No. 59325 (Jan. 30, 2009), 95 SEC Docket 13802, 13814 n.38.

ignored 'red flag' warnings that should have resulted in additional supervisory scrutiny" and the "[n]ature, extent, size and character of the underlying misconduct." The multitude of red flags identified above, combined with the protracted duration and scope of the Firm's operational problems, support FINRA's imposition of a $25,000 fine against Busacca and six-month suspension from serving in a principal capacity.[77]

With respect to Busacca's registration violation, the Sanction Guidelines recommend a fine of $2,500 to $50,000 and suspension of up to six months, and in egregious cases, a suspension up to two years. We note that the FINRA's $5,000 fine against Busacca for violating FINRA registration requirements is at the lower end of the sanction range. Although Goble made the ultimate decision to hire McAuliffe, it was Busacca's express responsibility to confirm that he was adequately qualified and Busacca acknowledged not making the proper inquiries. In addition, we do not view, as Busacca suggests, McAuliffe's lack of registration as a technical rules violation. FINRA's "registration requirement provides an important safeguard in protecting public investors, and strict adherence to that requirement is essential because it serves a significant purpose in policing of the securities markets and in the protection of the public interest."[78] Busacca's failure to confirm McAuliffe's registration status and to remove McAuliffe as chief compliance officer after McAuliffe informed him that FINRA had not granted him a waiver undermined FINRA's ability to ensure that a member firm's chief compliance officer had the requisite qualifications to serve in that position.[79]

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[77] Contrary to Busacca's assertions, his "[l]ack of a disciplinary history is not a mitigating factor." *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006); *see also Philippe N. Keyes*, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 801 (stating that the absence of disciplinary history is not mitigating because member firms and their associated persons "should not be rewarded for acting in accordance with [their] duties").

[78] *Hans N. Beerbaum*, Exchange Act Rel. No. 55731 (May 9, 2007), 90 SEC Docket 1863, 1869 n.17 (internal punctuation omitted) (quoting *Michael F. Flannigan*, 56 S.E.C. 8, 17 (2003)); *see also Requirement of Broker-Dealers to Comply with SRO Qualification Standards*, Exchange Act Rel. No. 32261 (May 4, 1993), 54 SEC Docket 39, 40 (stating, in adopting Exchange Act Rule 15b7-1, that "[self-regulatory organization] qualification of associated persons of broker-dealers is of substantial importance in promoting compliance with the substantive requirements of the federal securities laws").

[79] *See Self-Regulatory Organizations; Order Approving Proposed Rule Change*, Exchange Act Rel. No. 44451 (June 19, 2001), 75 SEC Docket 723, 724 (recognizing that FINRA registration requirement helps ensure that chief compliance officers, who "play a critical role" in operations, have "attained the requisite knowledge of applicable securities laws and regulations").

Under the circumstances, we believe the sanctions imposed are amply warranted. The sanctions will additionally serve to encourage Busacca, as well as other supervisors, to respond vigorously to known operational problems and to ensure that firm officials are properly registered with regulatory authorities.[80]

An appropriate order will issue. [81]

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

Elizabeth M. Murphy
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

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80 Although "'general deterrence is not, by itself, sufficient justification for expulsion or suspension[,] . . . it may be considered as part of the overall remedial inquiry.'" *PAZ Sec., Inc.*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (quoting *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005)).

81 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63312 / November 12, 2010

Admin. Proc. File No. 3-13750

In the Matter of the Application of

JOHN B. BUSACCA, III
2500 Treymore Drive
Orlando, FL 32825

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

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

ORDERED that the disciplinary action taken by FINRA against John B. Busacca, III, be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3108 / November 16, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14124

In the Matter of **THRASHER CAPITAL MANAGEMENT, LLC AND JAMES PERKINS,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Thrasher Capital Management, LLC ("Thrasher") and James Perkins ("Perkins," collectively with Thrasher, "Respondents").

II.

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

III.

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

Summary

James Perkins was at all times relevant herein the Chief Executive Officer and managing member of Thrasher, an investment adviser registered with the Commission. These proceedings arise out of (i) Respondents' failure to make available to the Commission's staff books and records that Thrasher was required to make available under Section 204 of the Advisers Act, and (ii) Respondents' untrue statements of material facts in Thrasher's Form ADV.

Respondents ignored repeated requests for books and records from the Commission's Examination staff in violation of Section 204 of the Advisers Act. In fact, Respondents failed to produce for inspection any files whatsoever until the Commission's Enforcement staff issued a subpoena for such records. Thrasher's Form ADV, filed on July 24, 2007, contained untrue statements of material facts concerning Thrasher's client base and the ownership of the Adviser in violation of Section 207 of the Advisers Act.

Respondents

1. **Thrasher Capital Management, LLC ("Thrasher," or "Adviser")** is an investment adviser headquartered in New York, New York. Thrasher registered with the Commission effective March 23, 2007 and served as the investment adviser for the GendeX Fund ("GendeX"), a series of the Coventry Group, a registered investment company that registered with the Commission effective September 24, 2007 and was liquidated on approximately September 19, 2008.

2. **James Perkins**, a resident of New York, New York, is the founder and Chief Executive Officer of Thrasher. He was a registered "Series 6" representative from approximately September 2007 through October 2008. Perkins has no prior disciplinary actions.

Facts

3. On approximately May 14, 2009, the Commission's Examination staff visited Thrasher's New York offices and requested that the Adviser timely make available certain books and records pursuant to Section 204 of the Advisers Act.

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

4. James Perkins, on Thrasher's behalf, initially promised to provide the Examination staff with the books and records it requested, but over the course of several weeks following May 14, 2009, he failed to produce any books and records and failed even to respond to the Examination staff's repeated attempts to contact him. In fact, Perkins failed to produce any books and records to the Commission until the Commission's Enforcement staff issued a subpoena to Thrasher on October 26, 2009, and even that production came weeks after the November 10, 2009 due date identified on the Commission's subpoena.

5. Thrasher falsely represented in its Form ADV, filed on July 24, 2007, that more than 40% of its clients were high net worth individuals (as distinguished from investment companies). At that time, Thrasher did not advise any high net worth individuals.

6. Thrasher also falsely represented the Adviser's ownership structure in its July 24, 2007 Form ADV. That filing failed to identify an individual who held a significant ownership stake in Thrasher as of July 24, 2007.

7. At all times relevant herein, Perkins, as Chief Executive Officer, was responsible for the accuracy of the information in Thrasher's Form ADV. Thrasher's Form ADV was signed by the Adviser's general counsel, who relied upon Perkins for factual information set forth in the Form ADV.

8. As a result of the conduct described above, Thrasher willfully violated Section 204(a) of the Advisers Act, which requires investment advisers that use the mails or interstate commerce to maintain and make available to the Commission certain books and records as prescribed by the Commission, and Section 207 of the Advisers Act, which prohibits any "person" (defined to include advisers such as Thrasher) to "make any untrue statement of a material fact in any registration application or report filed with the Commission under section 203 or 204, or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

9. As a result of the conduct described above, Perkins willfully aided and abetted and caused Thrasher's violations of Sections 204(a) and 207 of the Advisers Act.

Civil Penalties

10. Perkins has submitted a sworn Statement of Financial Condition dated April 23, 2010 and other evidence and has asserted his inability to pay a civil penalty.

IV.

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

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

A. Respondents Thrasher and Perkins cease and desist from committing or causing any violations and any future violations of Sections 204(a) and 207 of the Advisers Act.

B. Respondent Thrasher's registration as an investment adviser shall be revoked.

C. Respondent Perkins be, and hereby is, suspended from association with any investment adviser for a period of nine months, effective on the second Monday following the entry of this Order.

D. Based upon Respondent Perkins' sworn representations in his Statement of Financial Condition dated April 23, 2010 and other documents submitted to the Commission, the Commission is not imposing a monetary penalty against Perkins.

E. The Division of Enforcement may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent Perkins provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent Perkins was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent Perkins may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

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. 63328 / November 17, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14128

In the Matter of **WALTER W. KNITTER,** **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 Walter W. Knitter ("Knitter" or "Respondent").

II.

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

III.

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

1. Walter W. Knitter was a promoter with Integrity Financial AZ LLC ("IFAZ"), a limited liability corporation registered in the State of Arizona. Knitter engaged in an unregistered offering of securities, acted as an unregistered broker, earned commissions on IFAZ investments, and engaged in a variety of conduct that operated as a fraud and deceit on investors. Knitter, 52 years old, is a resident of Wheaton, Illinois.

2. On October 29, 2010, a final judgment was entered by consent against Knitter, permanently enjoining him from future violations of Sections 5 and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Exchange Act and Exchange Act Rule 10b-5, in the civil action entitled United States Securities and Exchange Commission v. Integrity Financial AZ, LLC, et al., Civil Action Number 1:10-CV-00782, in the United States District Court for the Northern District of Ohio.

3. The Commission's complaint alleged, that in connection with the sale of promissory notes purportedly secured by real estate in Tonopah, Arizona, Respondent falsely told investors that they would receive 10% guaranteed interest on their investments, that principal would be returned to investors by a date certain within two years of the investment, that the investments were insured by the Federal Deposit Insurance Corporation and by homeowner's insurance, and that 100% of investors' money would be used to build homes. The complaint also alleged that Respondent engaged in an unregistered offering of securities, acted as an unregistered broker and engaged in a variety of conduct that operated as a fraud and deceit on investors.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act that Respondent 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

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. 63327 / November 17, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14127

In the Matter of **VIPC Communications, Inc., and Vizario, 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 VIPC Communications, Inc. and Vizario, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. VIPC Communications, Inc. (CIK No. 1066059) is a void Delaware corporation located in Geneva, Switzerland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). VIPC 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 $14,160 for the prior nine months. As of November 4, 2010, the company's stock (symbol "VPCM") was traded on the over-the-counter markets.

2. Vizario, Inc. (CIK No. 1097452) is a Nevada corporation located in Guangzhou, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Vizario 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 $131,848 for the prior twelve months. As of November 4, 2010, the company's stock (symbol "VZRO") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

3. 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.

4. 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.

5. 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

SECURITIES EXCHANGE ACT OF 1934
Release No. 63326 / November 17, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14126

In the Matter of Tabatha V, Inc., Tagalder Global Investment, Inc., and Technical Environment Solutions, 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 Tabatha V, Inc., Tagalder Global Investment, Inc., and Technical Environment Solutions, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Tabatha V, Inc. (CIK No. 1111814) is a delinquent Colorado corporation located in Shenzhen, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Tabatha V 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, 2006, which reported a net loss of $79,095 since the company's March 17, 2000 inception.

2. Tagalder Global Investment, Inc. (CIK No. 1307690) is a void Delaware corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Tagalder is delinquent in its

periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended June 30, 2007, which reported a net loss of $24,139 since the company's September 14, 2004 inception.

3. Technical Environment Solutions, Inc. (CIK No. 1055148) is a delinquent Colorado corporation located in Munich, Germany with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Technical Environment is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended September 30, 2000, which reported a net loss of $668,514 for the prior nine months.

B. DELINQUENT PERIODIC FILINGS

4. 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.

5. 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.

6. 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

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63323 / November 17, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3109 / November 17, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14125

In the Matter of **THE BUCKINGHAM RESEARCH GROUP, INC., BUCKINGHAM CAPITAL MANAGEMENT, INC., and LLOYD R. KARP,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e), 203(f) and 203(k) 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 Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against The Buckingham Research Group, Inc. ("BRG"), pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Buckingham Capital Management, Inc. ("BCM"), and pursuant to Sections 15(b) and 21C of the Exchange Act and Sections 203(f) and 203(k) of the Advisers Act against Lloyd R. Karp ("Karp") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. From at least September 2005, BRG, a registered broker-dealer and institutional equity research firm, and its subsidiary, BCM, a registered investment adviser, failed to establish, maintain and enforce policies and procedures reasonably designed, taking into account the nature of their respective and interconnected businesses, to prevent the misuse of material, nonpublic information. For 2005, BCM also failed to conduct an annual review of the adequacy of its compliance policies and procedures and the effectiveness of their implementation, as required by the Advisers Act.

2. BRG and BCM's policies and procedures were deficient in a number of ways. BRG had a written procedure to address the misuse of material, nonpublic information, but did not follow its written procedure in practice. Important compliance policies and procedures were not contained in BCM's written policies and procedures. Further, in some instances, BCM's written policies and procedures were so unclear that employees did not understand their responsibilities. In other instances, the practices BCM employed varied materially from its written policies and procedures. These failures led to inadequate implementation and enforcement of the firms' written compliance policies and procedures.

3. BCM also failed to create and maintain records evidencing important supervisory authorizations and compliance reviews. In October 2006, the SEC examination staff began conducting an examination of BCM. In the course of preparing for the examination and collecting records to produce to the SEC staff, BCM discovered that certain compliance-related records were incomplete and that others were missing from its files. BCM personnel altered its records by creating compliance documents, and produced those records to the SEC examination staff without disclosing that those records included "replacements" for incomplete or missing records. This conduct prevented the examination staff from discovering BCM's failure to follow its compliance procedures and violated BCM's statutory obligation to make its records available for examination.

4. Karp was the chief compliance officer of both BRG and BCM during the relevant period and was directly responsible for establishing and administering the firms' compliance programs, including policies and procedures reasonably designed to prevent misuse of material, nonpublic information. Karp failed to discharge those responsibilities adequately, which resulted in the violations by BRG and BCM.

Respondents

5. BRG is a Delaware corporation with its principal place of business in New York City. Since 1982, it has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act. BRG's primary business is providing equity research to hedge funds, broker-dealers, and other institutional customers, and the firm is known for its research in retail, apparel and footwear. BRG obtains the majority of its revenue from executing trades for its research customers.

6. BCM is a Delaware corporation with its principal place of business in New York City. Since December 1985, it has been registered with the Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act. BCM is a wholly-owned subsidiary of BRG. BCM provides discretionary investment advisory services to investors that include high net worth individuals and various entities. BCM offers its clients equity portfolio management through two groups of funds, one that invests in the retail, apparel and footwear sector and one that invests in a diversified portfolio.

7. Lloyd Karp, age 52, was the chief compliance officer of both BRG and BCM from December 2002 to May 2010. He has also been the chief operations officer of BRG since 2004, and is the corporate secretary, treasurer and a senior vice-president of the firm. Karp has a small direct ownership interest in BRG. Karp has Series 7, Series 8 and Series 63 licenses, and has been an associated person and registered principal of BRG since December 2002.

Facts

A. Compliance Failures

8. BRG and BCM have adjoining office space, separated only by a partial glass barrier, and they share certain facilities. In addition to their parent-subsidiary relationship, BRG and BCM share a chief executive officer and, until May 2010, Karp was the chief compliance officer of both firms. BRG analysts cover, and BCM invests in, securities in a wide range of industry sectors, including the retail, apparel, and footwear sector ("RAF"). Two of the senior portfolio managers of BCM's RAF strategy are former BRG analysts. BCM is a significant brokerage customer of BRG; its trading accounts for approximately 25% of BRG's commission revenue. Taking into consideration the nature of the firms' business and relationship, BCM and BRG did not establish, maintain and enforce written policies and procedures reasonably designed to prevent misuse of material, nonpublic information.

9. In January 2005, to address the information flow risk between BRG and BCM, BRG instituted a Material Research Information ("MRI") review procedure to detect and prevent potential misuse by BCM of BRG material research information, such as the initiation of research coverage or changes in price targets. BRG's written policy required research analysts to complete a certification form whenever there was an MRI event, attesting that they had maintained confidentiality of the material research information. The policy specifically identified two reasons for the certification: to document compliance with the firm's confidentiality policy and to remind the analyst of his/her responsibility to restrict disclosure of material research information. However, in practice, BRG did not follow its written policy.

Instead, BRG required an analyst to complete a certification only if a compliance assistant determined that BCM had traded in the stock in the same direction as the research and requested the analyst certification. Nor did BRG uniformly adhere to this practice—in some instances, analyst certifications were lacking or incomplete, and some were dated long after the MRI event occurred. In February 2007, BRG changed its written policy to conform to its practice.

10. Before February 2007, BCM's written policies did not address the potential misuse of BRG material research information. In practice, if a BRG analyst was required to complete a certification, the BCM portfolio manager who directed the trade was asked afterward to provide a written explanation of the basis for his investment decision. This practice was not consistently followed. Further, prior to 2007, the compliance staff did not request back-up information to determine whether the portfolio manager's explanation was reasonable. In early 2007, BCM incorporated the BRG practice into its written policies and procedures.

11. Two of BCM's senior portfolio managers are former executives of companies in the retail, apparel, and footwear sector. They have long-standing, collegial relationships with industry insiders. In addition, some of these industry insiders are BCM investors. Until May 2009, BCM's written "Insider Trading Prohibitions" policy required that persons with access to material, nonpublic information report "all business, financial or personal relationships that *may* result in access to material, non-public information." (emphasis added) However, BCM never followed its written policy. Instead, the firm required employees to report only relationships that actually *did* result in access to material, nonpublic information. BCM did not compile a list of its investors who are RAF insiders to use for compliance review of its trading.

12. Rule 206(4)-7(a) requires an investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder. Karp created a compliance review log form in 2005 to ensure that important compliance reviews, including best execution and observing client guidelines and restrictions, had been conducted and thereby prevent violations of the anti-fraud provisions of the Advisers Act. However, as late as June 2009, BCM had no written procedure that adequately set forth the use of the compliance review log, and, therefore, BCM's personnel had no uniform understanding of its use.

13. Rule 206(4)-7(b) requires an investment adviser to review, at least annually, the adequacy of its policies and procedures and the effectiveness of their implementation. BCM failed to conduct an annual compliance review for 2005.

14. In late 2003 and early 2004, the SEC examination staff identified deficiencies in BCM's monitoring of employees' personal trading, and documented those findings in a deficiency letter to the firm. The staff specifically stated that BCM's written policies and procedures should be updated to reflect its current policies and procedures.

15. In a written response to the staff, prepared by Karp, BCM represented that it would cure the deficiencies identified by the examination staff by adding certain documentation and review requirements. The remedial steps included: requiring all employees to use a pre-approval form to document pre-approval of their trades; requiring Karp to conduct quarterly reviews of all employee trading to determine that the pre-approval and documentation

requirements had been met; and requiring Karp to initial and date a compliance log to confirm that quarterly reviews had been performed.

16. BCM and Karp failed to implement these remedial steps fully. The updates to BCM's written policies and procedures did not clearly or completely reflect these new procedures, including use and maintenance of the pre-approval forms and completion of the compliance log. Karp did not conduct the promised quarterly review of all employee trading to assure that pre-approval and documentation requirements had been met.

17. For the entire period of the conduct described above, Karp was the chief compliance officer at both firms and was responsible for establishing and administering their compliance policies and procedures. Karp was aware of the compliance weaknesses and failures and either failed to act or failed to correct them.

B. BCM's Failures to Produce

18. When BCM began preparing for the 2006 examination by the Commission staff, BCM discovered that it was missing pre-approval forms for more than 100 employee trades in 2005. However, instead of producing the incomplete employee trading records to the exam staff, BCM altered the records produced by creating and adding forms, and produced the existing records along with the added forms to the Commission examination staff without disclosing what had been done.

19. During the 2006 exam, BCM also discovered that its compliance review logs for 2005 and 2006 were incomplete. Karp had not initialed and dated the compliance logs and had not checked them regularly. Instead of producing the incomplete compliance logs, BCM staff altered the firm's records by replacing the incomplete logs with newly-created ones that the staff had various BCM personnel initial, creating the appearance that all the reviews had been completed timely, that various compliance reviews were being logged properly, and that Karp was following through on his promise to use the log to track his quarterly employee trading review. BCM produced those replacement logs to the Commission examination staff without disclosing what had been done.

20. Karp was on medical leave at the time the 2006 examination commenced and did not have primary responsibility for BCM's response to the Commission staff's examination requests.

Legal Discussion

21. Section 15(f) of the Exchange Act requires brokers and dealers to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer. "Person associated with a broker or dealer" is defined in Section 3(a)(18) of the Exchange Act to include "any person directly or indirectly…controlled by, or under common control with" the broker or dealer. Accordingly, BCM is an associated person of BRG.

22. Section 204A of the Advisers Act requires investment advisers to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser's business, to prevent the misuse of material, nonpublic information by such investment adviser or any person associated with such investment adviser. "Person associated with an investment adviser" is defined in Section 202(a)(17) of the Advisers Act to include "any person directly or indirectly...controlling" the investment adviser. Accordingly, BRG is an associated person of BCM.

23. Taking into consideration the relationship between BRG and BCM, BRG's research and BCM's investment in the RAF sector, their overlapping senior management and their physical proximity, the firms' policies and procedures were not reasonably designed to prevent the misuse of material, nonpublic information. Despite the need for enhanced controls to prevent the misuse of material, nonpublic information presented by the firms' relationship, BCM and BRG failed to establish adequate written policies and procedures to address those risks. BRG had a written policy to address the misuse of material, nonpublic information, its MRI review, but did not follow that written policy in practice. Important compliance procedures, such as the MRI review, were not contained in BCM's written policies and procedures until 2007. Further, in some instances, such as documenting employee trading pre-approval, BCM's written procedures were so unclear that employees did not understand their responsibilities. In other instances, such as identifying relationships that may result in access to material, nonpublic information, the practices BCM employed varied materially from its written procedures. These failures led to inadequate implementation and enforcement of the firms' written procedures. Accordingly, BRG willfully violated Section 15(f) of the Exchange Act, and BCM willfully violated Section 204A of the Advisers Act. As the chief compliance officer who was responsible for establishing and administering all compliance policies, including policies and procedures to prevent misuse of material, nonpublic information, Karp willfully aided and abetted and caused the firms' violations.

24. Section 206(4) of the Advisers act prohibits advisers from engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. Rule 206(4)-7 thereunder requires advisers to adopt and implement written policies and procedures reasonably designed to prevent violation of the Act and the rules. BCM willfully violated Section 206(4) and Rule 206(4)-7 by failing to adopt and implement adequate written procedures with respect to use of the compliance log, which was designed, among other things, to monitor compliance reviews to prevent violation of the anti-fraud provisions of the Advisers Act. As the chief compliance officer who was responsible for establishing and administering all compliance policies, Karp willfully aided and abetted and caused BCM's violations.

25. Rule 206(4)-7(b) under Section 206(4) of the Advisers Act requires that an investment adviser review, at least annually, the adequacy of its policies and procedures and the effectiveness of their implementation. BCM willfully violated Advisers Act Section 206(4) and Rule 206(4)-7(b) thereunder by failing to conduct an annual compliance review for 2005. As the chief compliance officer who was responsible for establishing and administering all compliance policies, Karp willfully aided and abetted and caused BCM's violations.

26. Section 204(a) of the Advisers Act provides that all records of an investment adviser are subject to examination by the Commission. The Commission's examination

authority is fundamental to its ability to protect investors by monitoring investment advisers' compliance with the federal securities laws. Regulated firms cannot undermine this crucial component of Commission oversight by producing altered records or by supplementing existing records with replacements for missing documents, even if not required records, without disclosure of the additions and alterations to the Commission examination staff. BCM was obligated under Section 204(a) to produce its records for the Commission examination staff as those records existed at the time of the exam staff's request. BCM willfully violated Section 204(a) by failing to produce to the examination staff its incomplete compliance logs and by creating records and producing them to the exam staff without disclosing what had been done.

Respondents' Remedial Efforts

27. In determining to accept the Offers, the Commission considered remedial acts undertaken by Respondents and cooperation afforded the Commission staff.

Undertakings

28. Respondents BRG and BCM have undertaken to:

A. Retain, at Respondents' expense and within 30 (thirty) days of the issuance of this Order, a qualified independent consultant (the "Consultant") not unacceptable to the staff of the Division of Enforcement (the "Staff") to conduct a comprehensive review of Respondents' policies, practices, and procedures to ensure compliance with the federal securities laws, including: (1) the prevention of the misuse of material, nonpublic information as required, for BRG, by Section 15(f) of the Exchange Act and, for BCM, by Section 204A of the Advisers Act, taking into account and consideration the nature of Respondents' businesses and the relationship between the two Respondents; and (2) BCM's policies and procedures required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, and to prepare the written reports, referenced below, reviewing the adequacy of each Respondent's policies, practices, and procedures and making recommendations regarding how Respondents should modify or supplement their respective policies, practices, and procedures, taking into account and consideration the nature of their businesses and the relationship between them, to prevent the misuse of material, nonpublic information in compliance with Section 15(f) of the Exchange Act and Sections 204A and 206(4) of the Advisers Act. Respondents shall provide a copy of the engagement letter detailing the Consultant's responsibilities to Kara N. Brockmeyer, Assistant Director, Division of Enforcement, U.S. Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5720;

B. Cooperate fully with the Consultant, including providing the Consultant with access to their respective files, books, records, and personnel as reasonably requested for the above-mentioned review, and obtaining the cooperation of their respective employees or other persons under their control;

C. Require the Consultant to report to the Staff on his/her/its activities as the Staff shall request;

D. Permit the Consultant to engage such assistance, clerical, legal or expert, as necessary and at a reasonable cost, to carry out his/her/its activities, and the cost, if any, of such assistance shall be borne exclusively by Respondents;

E. Within ninety (90) days of the issuance of this Order, unless otherwise extended by the Staff for good cause, Respondents shall require the Consultant to complete the review described in subparagraph A above and prepare a written Preliminary Report that: (i) evaluates the adequacy under Section 15(f) of the Exchange Act and Sections 204A and 206(4) of the Advisers Act of each Respondent's policies, practices, and procedures, taking into account and consideration the nature of their businesses and the relationship between them, to prevent the misuse of material, nonpublic information; and (ii) makes any recommendations about modifications thereto or additional or supplemental procedures deemed necessary to remedy any deficiencies described in the Preliminary Report. Respondents shall require the Consultant to provide the Preliminary Report simultaneously to both the Staff (at the address set forth above) and Respondents;

F. Within one hundred and twenty (120) days of Respondents' receipt of the Preliminary Report, Respondents shall adopt and implement all recommendations set forth in the Preliminary Report; provided, however, that as to any recommendation that Respondents consider to be, in whole or in part, unduly burdensome or impractical, Respondents may submit in writing to the Consultant and the Staff (at the address set forth above), within thirty (30) days of receiving the Preliminary Report, an alternative policy, practice, or procedure designed to achieve the same objective or purpose. Respondents shall then attempt in good faith to reach an agreement with the Consultant relating to each recommendation that Respondents consider to be unduly burdensome or impractical and request that the Consultant reasonably evaluate any alternative policy, practice, or procedure proposed by Respondents. Within fourteen (14) days after the conclusion of the discussion and evaluation by Respondents and the Consultant, Respondents shall require that the Consultant inform Respondents and the Staff (at the address set forth above) of his/her/its final determination concerning any recommendation that Respondents consider to be unduly burdensome or impractical. Respondents shall abide by the determinations of the Consultant and, within sixty (60) days after final agreement between Respondents and the Consultant or final determination by the Consultant, whichever occurs first, Respondents shall adopt and implement all of the recommendations that the Consultant deems appropriate;

G. Within fourteen (14) days of Respondents' adoption of all of the recommendations that the Consultant deems appropriate, Respondents shall certify in writing to the Consultant and the Staff (at the address set forth above) that Respondents have adopted and implemented all of the Consultant's recommendations and that Respondents have established policies, practices, and procedures as required by Section 15(f) of the Exchange Act and Sections 204A and 206(4) of the Advisers Act that are consistent with the findings of this Order;

H. Within one hundred and eighty (180) days from the date of the certifications described in subparagraph G above, Respondents shall require the Consultant to have completed a review of Respondents' revised policies and procedures and practices and submit a written Final Report to Respondents and the Staff. The Final Report shall describe the review made of Respondents' revised policies, practices, and procedures and describe how Respondents are implementing, enforcing, and auditing the enforcement and implementation of those policies, practices, and procedures. The Final Report shall include an opinion of the Consultant as to whether the revised policies, practices, and procedures and their implementation and enforcement by Respondents and Respondents' auditing of the implementation and enforcement of those policies, practices, and procedures are reasonably adequate under Section 15(f) of the Exchange Act and Sections 204A and 206(4) of the Advisers Act;

I. Respondents may apply to the Staff for an extension of the deadlines described above before their expiration and, upon a showing of good cause by Respondents, the Staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate;

J. To ensure the independence of the Consultant, Respondents shall not have the authority to terminate the Consultant without prior written approval of the Staff and shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates;

K. Respondents shall require the Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she/it is affiliated or of which he/she/it is a member, and any person engaged to assist the Consultant in performance of his/her/its duties under this Order shall not, without prior written consent of the Staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement; and

L. Respondents agree to certify in writing to the Staff (at the address set forth above), as of the calendar year ended December 31, 2011, that Respondents have established and continue to maintain policies, practices, and procedures as required by Section 15(f) of the Exchange Act and Sections 204A and 206(4) of the Advisers Act that are consistent with the findings of this Order.

IV.

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

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

A. Respondent BRG cease and desist from committing or causing any violations and any future violations of Sections 15(f) of the Exchange Act.

B. Respondent BCM cease and desist from committing or causing any violations and any future violations of Sections 204(a), 204A and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

C. Respondent Karp cease and desist from causing any violations and any future violations of Section 15(f) of the Exchange Act and Sections 204A and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

D. Respondents BRG, BCM, and Karp are censured.

E. Respondent BRG shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of $50,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be : (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) 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 BRG's name 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 Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F. Street, N.E., Washington, D.C. 20549-5720.

F. Respondent BCM shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of $75,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be : (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) 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 BCM's name 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 Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F. Street, N.E., Washington, D.C. 20549-5720.

G. Respondent Karp shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of $35,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be : (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) 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 Karp's name 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 Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F. Street, N.E., Washington, D.C. 20549-5720.

H. Respondents BRG and BCM shall comply with the undertakings enumerated in Section 28 above.

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 ACT OF 1933
Release No. 9157 / November 19, 2010

SECURITIES EXCHANGE ACT OF 1934
Release No. 63345 / November 19, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14129

In the Matter of Conal C. Doyle Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Conal C. Doyle ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of

1933, and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order as to Conal C. Doyle.

III.

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

Summary

This proceeding involves the conduct of Conal C. Doyle in a scheme to offer for sale a fictitious unregistered program of securities transactions involving a purported high yield investment opportunity known as a "Project Funding Platform." The program purportedly required participants to invest a minimum of $2 million and Doyle claimed that the program would yield returns of 100 percent or greater within a year with no risk to the investor. Doyle, who was not registered with the Commission in any capacity at the time of the offers, made numerous misrepresentations to potential investors in connection with the offers of the Project Funding Platform. Doyle attempted to sell the program through the use of documents and oral statements containing representations that Doyle knew, or was reckless in not knowing, were false.

Respondent

Doyle, a resident of Cambridge, Massachusetts, is a 66 year old self-employed real estate broker. From August 1983 through October 1989, and from December 1994 to July 1995, Doyle was also a registered representative associated with broker-dealers registered with the Commission.

[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.

Background

1. From at least March 2008, Doyle repeatedly offered to sell participation in a fictitious investment program known as the "Project Funding Platform."

2. Doyle used the telephone, internet and in person meetings to offer to sell the program.

3. Doyle told potential participants that he was a "moderator" for the program and that if the potential investors invested $2 million into an escrowed bank account, they would receive $11.4 million in net profits within 40 weeks. Doyle claimed that the funds would remain in the escrow account at all times and would never "move." As a "moderator" Doyle stated that he could not directly invest in the program, but would receive $15,000 per week on each investment of $2 million.

4. Doyle stated that the investment opportunity and the promised returns were possible because of a "secret" banking system that was derived from an arrangement between the Federal Reserve, the World Bank and other international sources of funds. Doyle noted to the potential investors that major international non-profit groups obtained funding from this "secret" banking system.

5. Doyle also provided potential investors with "Project Funding Platform" documents, which further described the program. For example, according to a document called the "Project Funding Platform Summary," a "Master Commitment Holder," would invest in confidential $100 million notes by pooling the funds gathered together by the "platform moderators" to generate a return for the investors.

6. The documents describing the specifics of the program were fraudulent on their face and Doyle as a former investment professional had no basis for believing that the representations in the documents or the ones he was making orally to potential investors were accurate. In fact, Doyle was offering a program premised on transactions and a fictitious "secret" banking system that he knew or was reckless in not knowing did not exist.

7. As a result of the conduct described above, Doyle willfully violated Sections 17(a)(1) and 17(a)(3) of the Securities Act, which prohibit fraudulent conduct in the offer and sale of securities.

8. Furthermore, since the offers of the securities described above were not registered with the Commission, nor were they exempt from registration, as a result of the conduct described above, Doyle willfully violated Section 5(c) of the Securities Act.

9. Doyle also willfully violated Section 15(a) of the Exchange Act by attempting to induce the purchase of securities in interstate commerce, without being registered with the Commission as a broker or dealer.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Doyle shall cease and desist from committing or causing any violations and any future violations of Sections 5(c), 17(a)(1), and 17(a)(3) of the Securities Act, and Section 15(a) of the Exchange Act.

B. Respondent Doyle be, and hereby is barred from association with any broker or dealer.

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

D. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $25,000.00 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) 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 Conal C. Doyle 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 John Dugan, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, Boston, Massachusetts 02110.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA-3111; File No. S7-37-10]

RIN 3235-AK81

Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (the "Commission") is proposing rules that would implement new exemptions from the registration requirements of the Investment Advisers Act of 1940 for advisers to certain privately offered investment funds that were enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). As required by Title IV of the Dodd-Frank Act – the Private Fund Investment Advisers Registration Act of 2010, the new rules would define "venture capital fund" and provide for an exemption for advisers with less than $150 million in private fund assets under management in the United States. The new rules would also clarify the meaning of certain terms included in a new exemption for foreign private advisers.

DATES: Comments should be received on or before [insert date 45 days after publication in Federal Register].

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-37-10 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 Number S7-37-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing 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: Tram N. Nguyen, Daniele Marchesani, or David A. Vaughan, at (202) 551-6787 or <IArules@sec.gov>, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on proposed rules 203(l)-1, 203(m)-1 and 202(a)(30)-1 (17 CFR 275.203(l)-1, 275.203(m)-1 and

275.202(a)(30)-1) under the Investment Advisers Act of 1940 (15 U.S.C. 80b) ("Advisers Act").[1]

TABLE OF CONTENTS

I. BACKGROUND

On July 21, 2010, President Obama signed into law the Dodd-Frank Act,[2] which amends

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1 Unless otherwise noted, all references to rules under the Advisers Act will be to Title 17, Part 275 of the Code of Federal Regulations (17 CFR 275).

2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat.

various provisions of the Advisers Act and requires or authorizes the Commission to adopt several new rules and revise existing rules.[3] Unless otherwise provided for in the Dodd-Frank Act, the amendments become effective on July 21, 2011.[4]

The amendments include the repeal of section 203(b)(3) of the Advisers Act, which exempts any investment adviser from registration if the investment adviser (i) has had fewer than 15 clients in the preceding 12 months, (ii) does not hold itself out to the public as an investment adviser and (iii) does not act as an investment adviser to a registered investment company or a company that has elected to be a business development company (the "private adviser exemption").[5] Advisers specifically exempt under section 203(b) are not subject to reporting or recordkeeping provisions under the Advisers Act, and are not subject to examination by our staff.[6]

The primary purpose of Congress in repealing section 203(b)(3) was to require advisers to "private funds" to register under the Advisers Act.[7] Private funds include hedge funds, private equity funds and other types of pooled investment vehicles that are excluded from the definition of "investment company" under the Investment Company Act of 1940[8] ("Investment Company

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1376 (2010).

3 In this Release, when we refer to the "Advisers Act," we refer to the Advisers Act as in effect on July 21, 2011.

4 Section 419 of the Dodd-Frank Act.

5 15 U.S.C. 80b-3(b)(3) as in effect before July 21, 2011.

6 See section 204(a) of the Advisers Act. See also infra note 30.

7 See S. REP. NO. 111-176, at 71-3 (2010) ("S. REP. NO. 111-176"); H. REP. NO. 111-517, at 866 (2010) ("H. REP. NO. 111-517"). H. REP. NO. 111-517 contains the conference report accompanying the version of H.R. 4173 that was debated in conference, infra note 39.

8 15 U.S.C. 80a.

Act") by reason of sections 3(c)(1) or 3(c)(7) of such Act.[9] Section 3(c)(1) is available to a fund that does not publicly offer the securities it issues[10] and has 100 or fewer beneficial owners of its outstanding securities.[11] A fund relying on section 3(c)(7) cannot publicly offer the securities it issues[12] and generally must limit the owners of its outstanding securities to "qualified purchasers."[13]

Each of these types of private funds advised by an adviser typically qualifies as a single client for purposes of the private adviser exemption.[14] As a result, investment advisers could form up to 14 private funds, regardless of the total number of investors investing in the funds,

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9 Section 202(a)(29) of the Advisers Act defines the term "private fund" as "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act."

10 Interests in a private fund may be offered pursuant to an exemption from registration under the Securities Act of 1933 (15 U.S.C. 77a) ("Securities Act"). Notwithstanding these exemptions, the persons who market interests in a private fund may be subject to the registration requirements of section 15(a) under the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78o(a)). The Exchange Act generally defines a "broker" as any person engaged in the business of effecting transactions in securities for the account of others. Section 3(a)(4)(A) of the Exchange Act (15 U.S.C. 78c(a)(4)(A)). See also Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 44291 (May 11, 2001) [66 FR 27759 (May 18, 2001)], at n.124 ("Solicitation is one of the most relevant factors in determining whether a person is effecting transactions.''); Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 3043 (July 1, 2010) [75 FR 41018 (July 14, 2010)], n.326 ("Pay to Play Release").

11 See section 3(c)(1) of the Investment Company Act (providing an exclusion from the definition of "investment company" for any "issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities.").

12 See supra note 10.

13 See section 3(c)(7) of the Investment Company Act (providing an exclusion from the definition of "investment company" for any "issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of such securities."). The term "qualified purchaser" is defined in section 2(a)(51) of the Investment Company Act.

14 See rule 203(b)(3)-1(a)(2).

without the need to register with us.[15] This has permitted the growth of unregistered investment advisers with large amounts of assets under management and significant numbers of investors but without the Commission oversight that registration under the Advisers Act provides.[16] Concern about this lack of Commission oversight led us to adopt a rule in 2004 extending registration to hedge fund advisers,[17] which was vacated by a federal court in 2006.[18] In Title IV of the Dodd-Frank Act ("Title IV"), Congress has now generally extended Advisers Act registration to advisers to hedge funds and many other private funds by eliminating the current private adviser exemption.[19]

In addition to removing the broad exemption provided by section 203(b)(3), Congress created three exemptions from registration under the Advisers Act.[20] These new exemptions apply to: (i) advisers solely to venture capital funds, without regard to the number of such funds

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15 See STAFF REPORT TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS, at 21 (2003), http://www.sec.gov/news/studies/hedgefunds0903.pdf (discussing section 203(b)(3) of the Advisers Act as in effect before July 21, 2011).

16 See generally id. (noting that the private adviser exemption contributed to growth in the number and size of, and investor participation in, hedge funds).

17 See Registration Under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333 (Dec. 2, 2004) [69 FR 72054 (Dec. 10, 2004)] ("Hedge Fund Adviser Registration Release").

18 Goldstein v. Securities and Exchange Commission, 451 F.3d 873 (D.C. Cir. 2006) ("Goldstein").

19 Section 403 of the Dodd-Frank Act amends existing section 203(b)(3) of the Advisers Act by repealing the current private adviser exemption and inserting the foreign private adviser exemption. See infra Section II.C. Unlike our 2004 rule, which sought to apply only to advisers of "hedge funds," the Dodd-Frank Act requires that, unless another exemption applies, all advisers previously eligible for the private adviser exemption register with us regardless of the type of private funds or other clients the adviser has.

20 Title IV also created exemptions and exclusions in addition to the three discussed at length in this Release. See, e.g., sections 403 and 409 of the Dodd-Frank Act (exempting advisers to licensed small business investment companies from registration under the Advisers Act and excluding family offices from the definition of "investment adviser" under the Advisers Act). We proposed a rule defining "family office" in a prior release (Family Offices, Investment Advisers Act Release No. 3098 (Oct. 12, 2010) [75 FR 63753 (Oct. 18, 2010)]).

advised by the adviser or the size of such funds;[21] (ii) advisers solely to private funds with less than $150 million in assets under management in the United States, without regard to the number or type of private funds advised;[22] and (iii) non-U.S. advisers with less than $25 million in aggregate assets under management from U.S. clients and private fund investors and fewer than 15 such clients and investors.[23]

II. DISCUSSION

Today we are proposing three rules that would implement these exemptions.[24] In a separate companion release (the "Implementing Release"),[25] we are proposing rules to implement other amendments made to the Advisers Act by the Dodd-Frank Act, some of which also concern certain advisers that qualify for the exemptions discussed in this Release.[26]

New section 203(l) of the Advisers Act provides that an investment adviser that solely

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21 See section 407 of the Dodd-Frank Act (exempting advisers solely to "venture capital funds," as defined by the Commission).

22 See section 408 of the Dodd-Frank Act (directing the Commission to exempt private fund advisers with less than $150 million in aggregate assets under management in the United States).

23 See section 402 of the Dodd-Frank Act (defining "foreign private adviser" as "any investment adviser who—(A) has no place of business in the United States; (B) has, in total, fewer than 15 clients and investors in the United States in private funds advised by the investment adviser; (C) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25,000,000, or such higher amount as the Commission may, by rule, deem appropriate in accordance with the purposes of this title; and (D) neither—(i) holds itself out generally to the public in the United States as an investment adviser; nor (ii) acts as—(I) an investment adviser to any investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a]; or a company that has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940 (15 U.S.C. 80a-53), and has not withdrawn its election.").

24 The Commission provided the public with an opportunity to present its views on various rulemaking and other initiatives that the Dodd-Frank Act required the Commission to undertake. Public views relating to our rulemaking in connection with the exemptions for certain advisers addressed in this Release are available at http://www.sec.gov/comments/df-title-iv/exemptions/exemptions.shtml.

25 Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3110 (Nov. 19, 2010).

26 See infra note 30 and accompanying and following text.

advises venture capital funds is exempt from registration under the Advisers Act and directs the Commission to define "venture capital fund" within one year of enactment.[27] We are proposing new rule 203(l)-1 to provide such a definition, which we discuss below in Section II.A of this Release.

New section 203(m) of the Advisers Act directs the Commission to provide an exemption from registration to any investment adviser that solely advises private funds if the adviser has assets under management in the United States of less than $150 million.[28] We are proposing such an exemption in a new rule 203(m)-1, which we discuss below in Section II.B of this Release. Proposed rule 203(m)-1 includes provisions for determining the amount of an adviser's private fund assets for purposes of the exemption and when those assets are deemed managed in the United States.

The new exemptions under sections 203(l) and 203(m) provide that the Commission shall require advisers relying on them to provide the Commission with reports and keep records as the Commission determines necessary or appropriate in the public interest or for the protection of investors.[29] These new exemptions do not limit our statutory authority to examine the books and records of advisers relying upon these exemptions.[30] For purposes of this Release we will refer to these advisers as "exempt reporting advisers." In the Implementing Release, we are proposing

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27 See supra note 21.

28 See supra note 22.

29 See supra notes 21 and 22.

30 Under section 204(a) of the Advisers Act, the Commission has the authority to require an investment adviser to maintain records and provide reports, as well as the authority to examine such adviser's records, unless the adviser is "specifically exempted" from the requirement to register pursuant to section 203(b) of the Advisers Act. Investment advisers that are exempt from registration in reliance on section 203(l) or 203(m) of the Advisers Act are not "specifically exempted" from the requirement to register pursuant to section 203(b), and thus the Commission has authority under section 204(a) of the Advisers Act to require those advisers to maintain records and provide reports and has authority to examine such advisers' records.

reporting requirements for exempt reporting advisers.[31]

The third exemption, set forth in amended section 203(b)(3) of the Advisers Act, provides an exemption from registration for certain foreign private advisers. New section 202(a)(30) of the Advisers Act defines "foreign private adviser" as an investment adviser that has no place of business in the United States, has fewer than 15 clients in the United States and investors in the United States in private funds advised by the adviser,[32] and less than $25 million in aggregate assets under management from such clients and investors.[33] As discussed in Section II.C of this Release, in order to clarify the application of this new exemption, we are proposing a new rule 202(a)(30)-1, which would define a number of terms included in the statutory definition of foreign private adviser.[34]

These exemptions are not mandatory. Thus, an adviser that qualifies for any of the exemptions could choose to register (or remain registered) with the Commission, subject to section 203A of the Advisers Act, which generally prohibits from registering with the

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31 See Implementing Release, supra note 25, at section II.B.

32 Subparagraph (B) of section 202(a)(30) refers to number of "clients and investors in the United States in private funds;" while subparagraph (C) refers to the assets of "clients in the United States and investors in the United States in private funds" (emphasis added). We interpret these provisions consistently so that only clients in the United States and investors in the United States should be included for purposes of determining eligibility for the exemption under subparagraph (B).

33 The exemption is not available to an adviser that "acts as (I) an investment adviser to any investment company registered under the [Investment Company Act]; or (II) a company that has elected to be a business development company pursuant to section 54 of [that Act] and has not withdrawn its election." Section 202(a)(30)(D)(ii). We interpret subparagraph (II) to prevent an adviser that advises a business development company from relying on the exemption.

34 Proposed rule 202(a)(30)-1 would define the following terms: (i) "client;" (ii) "investor;" (iii) "in the United States;" (iv) "place of business;" and (v) "assets under management." See discussion infra in section II.C of this Release. We are proposing rule 202(a)(30)-1 pursuant to section 211(a) of the Advisers Act, which Congress amended to explicitly provide us with the authority to define technical, trade, and other terms used in the Advisers Act. See section 406 of the Dodd-Frank Act.

Commission most advisers that do not have at least $100 million in assets under management.[35] An adviser choosing to avail itself of the exemptions under sections 203(l), 203(m) or 203(b)(3), however, may be subject to registration by one or more state securities authorities.[36]

A. Definition of Venture Capital Fund

We are proposing a definition of "venture capital fund" for purposes of the new exemption for investment advisers that advise solely venture capital funds.[37] Proposed rule 203(l)-1 would define the term venture capital fund consistently with what we believe Congress understood venture capital funds to be, and in light of other provisions of the federal securities laws that seek to achieve similar objectives.[38]

We understand that Congress sought to distinguish advisers to "venture capital funds" from the larger category of advisers to "private equity funds" for which Congress considered, but ultimately did not provide, an exemption.[39] As a general matter, venture capital funds are long-

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35. Section 203A(a)(1) of the Advisers Act generally prohibits an investment adviser regulated by the state in which it maintains its principal office and place of business from registering with the Commission unless it has at least $25 million of assets under management, and preempts certain state laws regulating advisers that are registered with the Commission. Section 410 of the Dodd-Frank Act amended section 203A(a) to also prohibit generally from registering with the Commission an investment adviser that has assets under management between $25 million and $100 million if the adviser is required to be registered with, and if registered, would be subject to examination by, the state security authority where it maintains its principal office and place of business. See section 203A(a)(2) of the Advisers Act. In each of subparagraphs (1) and (2) of section 203A(a), additional conditions also may apply. See Implementing Release, supra note 25, at section II.A.

36. See section 203A(b)(1) of the Advisers Act (exempting from state regulatory requirements only advisers registered with the Commission). See also infra note 265 (discussing the application of section 222 of the Advisers Act).

37. See proposed rule 203(l)-1.

38. See infra notes 94, 123, 125 (discussing the history of and regulatory framework applicable to business development companies under federal securities laws).

39. While the Senate voted to exempt private equity fund advisers in addition to venture capital fund advisers, the final Dodd-Frank Act only exempts venture capital fund advisers. Compare Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. § 408 (2010) (as passed by the Senate) with Dodd-Frank Wall Street Reform and Consumer Protection Act of

term investors in early-stage or small companies that are privately held, as distinguished from other types of private equity funds, which may invest in businesses at various stages of development including mature, publicly held companies.[40] Testimony received by Congress characterized venture capital funds as typically contributing substantial capital to early-stage companies[41] and generally not leveraged,[42] and thus not contributing to systemic risk, a factor

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2009, H.R. 4173, 111th Cong. (2009) (as passed by the House) ("H.R. 4173") and Dodd-Frank Act.

40 See Testimony of Trevor Loy, Flywheel Ventures, before the Senate Banking Subcommittee on Securities, Insurance and Investment Hearing, July 15, 2009 ("Loy Testimony"), at 3; Testimony of James Chanos, Chairman, Coalition of Private Investment Companies, July 15, 2009, at 4 ("Chanos Testimony") ("Private investment companies play significant, diverse roles in the financial markets and in the economy as a whole. For example, venture capital funds are an important source of funding for start-up companies or turnaround ventures. Other private equity funds provide growth capital to established small-sized companies, while still others pursue 'buyout' strategies by investing in underperforming companies and providing them with capital and/or expertise to improve results."); Testimony of Mark Tresnowksi, General Counsel, Madison Dearborn Partners, LLC, on behalf of the Private Equity Council, before the Senate Banking Subcommittee on Securities, Insurance and Investment, July 15, 2009, at 2 ("Tresnowski Testimony") (stating that private equity firms invest in broad categories of companies, including "struggling and underperforming businesses" and " promising or strong companies"). See also Preqin, Private Equity and Alternative Asset Glossary, http://www.preqin.com/itemGlossary.aspx?pnl=UtoZ (defining venture capital as "a type of private equity investment that provides capital to new or growing businesses. Venture funds invest in start-up firms and small businesses with perceived, long-term growth potential.").

41 Loy Testimony, supra note 40, at 3; Testimony of Terry McGuire, General Partner, Polaris Venture Partners, and Chairman, National Venture Capital Association, before the U.S. House of Representatives Committee on Financial Services, October 6, 2009, at 3 ("McGuire Testimony") ("Our job is to find the most promising, innovative ideas, entrepreneurs, and companies that have the potential to grow exponentially with the application of our expertise and venture capital investment. Often these companies are formed from ideas and entrepreneurs that come out of university and government laboratories – or even someone's garage."). See also National Venture Capital Association Yearbook 2010, at 7-8 (noting that venture capital is a "long-term investment" and the "payoff [to the venture capital firm] comes after the company is acquired or goes public") ("NVCA Yearbook 2010"); Private Equity Growth Capital Council, Private Equity: Frequently Asked Questions, http://www.privateequitycouncil.org/just-the-facts/private-equity-frequently-asked-questions/ (noting that venture capital funds focus on "start-up and young companies with little or no track record," whereas buyout and growth funds focus on more mature businesses).

42 Loy Testimony, supra note 40, at 3. See also McGuire Testimony, supra note 41, at 3-4 ("most limited partnership agreements [of venture capital funds] . . . prohibit [the venture capital fund] from any type of long term borrowing . . . . Leverage is not part of the equation because start-ups

that appears significant to Congress' determination to exempt these advisers.[43] In drafting the proposed rule, we have sought to incorporate this Congressional understanding of the nature of investments of a venture capital fund, and these principles guided our consideration of the proposed venture capital fund definition.

This is not the first time that Congress has included special provisions to the federal securities laws for these types of private funds and the advisers that advise them. In 1980, in an effort to promote capital raising by small businesses,[44] Congress provided exemptions from various requirements in the Investment Company Act and Advisers Act for "business development companies" (or "BDCs").[45] Congress adopted the term BDC to avoid "semantical disagreements" over what constituted a venture capital or small business company,[46] but acknowledged that the purpose of the BDC provisions was to support "venture capital" activity in capital formation for small businesses.[47] The BDC provisions and venture capital exemption reflect many similar policy considerations, and thus in drafting the definition of "venture capital

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do not typically have the ability to sustain debt interest payments and often do not have collateral that lenders desire. In fact most of our companies are not profitable and require our equity to fund their losses through their initial growth period.").

43 See S. REP. NO. 111-176, supra note 7, at 74-5 (noting that venture capital funds "do not present the same risks as the large private funds whose advisers are required to register with the SEC under this title [IV]. Their activities are not interconnected with the global financial system, and they generally rely on equity funding, so that losses that may occur do not ripple throughout world markets but are borne by fund investors alone. Terry McGuire, Chairman of the National Venture Capital Association, wrote in congressional testimony that 'venture capital did not contribute to the implosion that occurred in the financial system in the last year, nor does it pose a future systemic risk to our world financial markets or retail investors.'"). See also Loy Testimony, supra note 40, at 7 (noting the factors by which the venture capital industry is exposed to "entrepreneurial and technological risk not systemic financial risk").

44 See H. REP. NO. 96-1341, at 21-22 (1980) ("1980 House Report").

45 See infra note 123 for a discussion of these definitions.

46 See 1980 House Report, supra note 44, at 22.

47 See id., at 21.

fund," we have looked, in part, to language Congress previously used to describe these types of funds.

As described in more detail below, we propose to define a venture capital fund as a private fund that: (i) invests in equity securities of private companies in order to provide operating and business expansion capital (i.e., "qualifying portfolio companies," which are discussed below) and at least 80 percent of each company's securities owned by the fund were acquired directly from the qualifying portfolio company; (ii) directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, the qualifying portfolio company; (iii) does not borrow or otherwise incur leverage (other than limited short-term borrowing); (iv) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (v) represents itself as a venture capital fund to investors; and (vi) is not registered under the Investment Company Act and has not elected to be treated as a BDC.[48] We also propose to grandfather an existing fund as a venture capital fund if it satisfies certain criteria under the grandfathering provision.[49] An adviser would be eligible to rely on the exemption under section 203(l) of the Advisers Act (the "venture capital exemption") only if it solely advised venture capital funds that met all of the elements of the proposed definition or if it were grandfathered.

1. Qualifying Portfolio Companies

We propose to define a venture capital fund for the purposes of the exemption as a fund that invests in equity securities issued by "qualifying portfolio companies," which we define generally as any company that: (i) is not publicly traded; (ii) does not incur leverage in

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48 Proposed rule 203(l)-1(a).

49 Proposed rule 203(l)-1(b).

connection with the investment by the private fund; (iii) uses the capital provided by the fund for operating or business expansion purposes rather than to buy out other investors; and (iv) is not itself a fund (i.e., is an operating company).[50] In addition to equity securities, the venture capital fund may also hold cash (and cash equivalents) and U.S. Treasuries with a remaining maturity of 60 days or less.[51] We understand each of the criteria to be characteristic of issuers of portfolio securities held by venture capital funds.[52] Moreover, collectively, these criteria would operate to exclude most other private equity funds and hedge funds from the definition. We describe each element of a qualifying portfolio company below.

a. Private Companies

We propose to define a venture capital fund as a fund that invests in equity securities of qualifying portfolio companies and cash and cash equivalents and U.S. Treasuries with a remaining maturity of 60 days or less.[53] At the time of each investment by the venture capital fund, the portfolio company could not be publicly traded nor could it control, be controlled by, or be under common control with, a publicly traded company.[54] Under the proposed definition, a

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50 Proposed rule 203(l)-1(c)(4).

51 Proposed rule 203(l)-1(a)(2).

52 See infra sections II.A.1.a – II.A.1.e of this Release.

53 Proposed rule 203(l)-1(a)(2).

54 Proposed rule 203(l)-1(c)(4)(i); proposed rule 203(l)-1(c)(3) (defining a "publicly traded" company as one that is subject to the reporting requirements under section 13 or 15(d) of the Exchange Act, or has a security listed or traded on any exchange or organized market operating in a foreign jurisdiction). This definition is similar to rule 2a51-1 under the Investment Company Act (defining "public company," for purposes of the qualified purchaser standard, as "a company that files reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934") and rule 12g3-2 under the Exchange Act (conditioning a foreign private issuer's exemption from registering securities under section 12(g) of the Exchange Act if, among other conditions, the "issuer is not required to file or furnish reports" pursuant to section 13(a) or section 15(d) of the Exchange Act). Under the proposed rule, securities of a publicly traded company, as defined, would include securities of non-U.S. companies that are listed on a non-U.S. market or non-U.S. exchange. Some securities that are "pink sheets" (i.e., generally over-the-counter securities that

venture capital fund could continue to hold securities of a portfolio company that subsequently becomes public.

Venture capital funds provide operating capital to companies in the early stages of their development with the goal of eventually either selling the company or taking it public.[55] Unlike other types of private funds, venture capital funds do not trade in the public markets, but may sell portfolio company securities into the public markets once the portfolio company has matured.[56] As of year-end 2009, U.S. venture capital funds managed approximately $179.4 billion in assets.[57] In comparison, as of year-end 2009, the U.S. publicly traded equity market had a

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are quoted on an electronic quotation system operated by Pink OTC Markets) are not subject to the reporting requirements under sections 13 and 15(d) of the Exchange Act and would not be publicly traded for purposes of the proposed rule.

55 See Chanos Testimony, supra note 40, at 4 ("[V]enture capital funds are an important source of funding for start-up companies or turnaround ventures."); NVCA Yearbook 2010, supra note 41, at 7-8 (noting that venture capital is a "long-term investment" and the "payoff [to the venture capital firm] comes after the company is acquired or goes public."); GEORGE W. FENN, NELLIE LIANG AND STEPHEN PROWSE, THE ECONOMICS OF THE PRIVATE EQUITY MARKET, December 1995, 22, n.61 and accompanying text ("FENN et al.") ("Private sales" are not normally the most important type of exit strategy as compared to IPOs, yet of the 635 successful portfolio company exits by venture capitalists between 1991-1993 "merger and acquisition transactions accounted for 191 deals and IPOs for 444 deals." Furthermore, between 1983 and 1994, of the 2,200 venture capital fund exits, 1,104 (approximately 50%) were attributed to mergers and acquisitions of venture-backed firms.). See also JACK S. LEVIN, STRUCTURING VENTURE CAPITAL, PRIVATE EQUITY AND ENTREPRENEURIAL TRANSACTIONS, 2000 ("LEVIN") at 1-2 to 1-7 (describing the various types of venture capital and private equity investment business but stating that "the phrase 'venture capital' is sometimes used narrowly to refer only to financing the start-up of a new business"); ANNA T. PINEDO & JAMES R. TANENBAUM, EXEMPT AND HYBRID SECURITIES OFFERINGS (2009), Vol. 1 at 12-2 ("PINEDO") (discussing the role initial public offerings play in providing venture capital investors with liquidity).

56 See Loy Testimony, supra note 40, at 5 ("We do not trade in the public markets."). See also McGuire Testimony, supra note 41, at 11 ("[V]enture capital funds do not typically trade in the public markets and generally limit advisory activities to the purchase and sale of securities of private operating companies in private transactions"); LEVIN, supra note 55, at 1-4 ("A third distinguishing feature of venture capital/private equity investing is that the securities purchased are generally privately held as opposed to publicly traded . . . a venture capital/private equity investment is normally made in a privately-held company, and in the relatively infrequent cases where the investment is into a publicly-held company, the [venture capital fund] generally holds non-public securities.") (emphasis in original).

57 NVCA Yearbook 2010, supra note 41, at 9.

market value of approximately $13.7 trillion,[58] whereas global hedge funds had approximately $1.4 trillion in assets under management.[59] As a consequence, the aggregate amount invested in venture capital funds is considerably smaller, and Congressional testimony asserted that these funds may be less connected with the public markets and may involve less potential for systemic risk.[60] This appears to be a key consideration by Congress that led to the enactment of the venture capital exemption.[61]

We request comment on our proposed approach. We considered more narrow definitions, such as defining a qualifying portfolio company as a "start-up company" or "small company."[62] There appears to be little consensus, however, as to what a start-up company is. A company may be considered a "start-up" business depending on when it was formed as a legal entity,[63] whether it employs workers or paid employment taxes,[64] or whether it has generated

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58 Bloomberg Terminal Database, WCAUUS <Index> (Bloomberg United States Exchange Market Capitalization).

59 See Saijel Kishan, Hedge Funds Hold Investors "Hostage" After Decade's Best Year, BLOOMBERG BUSINESSWEEK, Jan. 20, 2010, available at http://www.businessweek.com/news/2010-01-20/hedge-funds-hold-investors-hostage-after-decade-s-best-year.html.

60 See supra note 43; McGuire Testimony, supra note 41, at 6 (noting that the "venture capital industry's activities are not interwoven with U.S. financial markets."). See also GROUP OF THIRTY, FINANCIAL REFORM: A FRAMEWORK FOR FINANCIAL STABILITY, January 15, 2009, at 9 (discussing the need for registration of managers of "private pools of capital that employ substantial borrowed funds" yet recognizing the need to exempt venture capital from registration).

61 See supra note 43.

62 See S. REP. NO. 111-176, supra note 7, at 74 (describing venture capital funds as a subset of private investment companies, specializing in long-term equity investments in "small or start-up businesses").

63 There is no generally accepted definition of a "start-up" entity although it is generally used to refer to new business ventures. See, e.g., U.S. Census Bureau, Business Dynamics Statistics, available at http://www.ces.census.gov/index.php/bds/bds_overview (which tracks information on businesses, based on the size and age of the business, and assigns a "birth" year to a business beginning in the year in which it reports positive employment of workers on the payroll); The Kauffman Foundation, Where Will the Jobs Come From?, November 2009, at 5 (identifying

revenues.[65] Defining a portfolio company based on any one of these factors may inadvertently exclude too many start-up portfolio companies. For example, solely relying on the age of the company (e.g., first year since incorporation) fails to recognize that many companies may be incorporated for some period of time prior to initiating business operations or remain unincorporated for significant periods of time.[66] Likewise, payment of employment taxes assumes the hiring of employees, despite the fact that many new business ventures are sole proprietorships without employees.[67] Such a test could also have the unintended effect of discouraging hiring. Similarly, a bright-line revenue test set too low could exclude young or new

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"start-ups" as those firms younger than one year); Anastasia Di Carlo & Roger Kelly, Private Equity Market Outlook 27 (European Investment Fund, Working Paper 2010/005) (defining start-ups as companies that are "in the process of being set up or may have been in business for a short time, but have not sold their product commercially").

64 See, e.g., The Kauffman Foundation, An Overview of the Kauffman Firm Survey, Results from the 2004-2008 Data, May 2010, at 26 ("Overview of the Kauffman Firm Survey") (discussing the difficulties of compiling data on new businesses; start-up businesses were generally identified based on several factors: the payment of state unemployment taxes, the payment of Federal Insurance Contributions Act taxes, the existence of a legal entity, use of an employer identification number, and use of a schedule C to report business income on a personal tax return).

65 See, e.g., NVCA Yearbook 2010, supra note 41, at 61, 69, 111 (not defining "start-up" but classifying investments in "start-up/seed" companies and defining the "seed stage" of a company as "the state of a company when it has just been incorporated and its founders are developing their product or service," whereas an "early stage" company is one that is beyond the "seed stage" but has not yet generated revenues). Cf. PricewaterhouseCoopers MoneyTree Report Definitions, https://www.pwcmoneytree.com/MTPublic/ns/nav.jsp?page=definitions (last visited Sept. 23, 2010) (defining a "seed/start-up" company as one that has a concept or product in development but not yet operational and usually has been in existence for less than 18 months).

66 According to the Kauffman Survey, in 2004, 36.0% of all start-up companies were sole proprietorships; by 2008, 34.4% of all surviving companies were sole proprietorships. Overview of the Kauffman Firm Survey, supra note 64, at 8.

67 See, e.g., Ying Lowrey, Startup Business Characteristics and Dynamics: A Data Analysis of the Kauffman Firm Survey, Aug. 2009, at 6 (Working Paper) (based on a survey sample of businesses started in 2004, reporting that 59% of all start-up companies in 2004 had zero employees; a "start-up" business was any business that met any one of the five following criteria for being a start-up: the payment of state unemployment taxes, the payment of Federal Insurance Contributions Act taxes, the existence of a legal entity, use of an employer identification number, and use of a schedule C to report business income on a personal tax return).

businesses that generate significant revenues more quickly than other companies.[68] This could have the unintended consequence of venture capital funds that seek to fall within the definition investing in less promising, non-revenue generating, young companies.

We also considered defining a qualifying portfolio company as a small company. As in the case of defining "start-up," there is no single definition for what constitutes a "small company."[69] We are concerned that imposing a standardized metric such as net income, the

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68 According to the Kauffman Survey, which conducted a longitudinal study of "start-up" businesses that began in 2004, 46.5% of all such "start-up" companies in 2004 had zero revenues; by 2008, 30.2% of the surviving companies in the sample reported zero revenues. In comparison, in 2004, 15.3% of start-up companies reported revenues of more than $100,000 and in 2008, 36.1% of the surviving companies in the survey reported revenues of more than $100,000. Overview of the Kauffman Firm Survey, supra note 64, at 9.

69 Among countries that are members of the Organisation for Economic Co-operation and Development, "small and medium-sized enterprises" ("SMEs") are defined as non-subsidiary, independent firms employing fewer than the number of employees as is set by each country. The definition of SME may be used to determine funding or other programs sponsored by member countries. Although the European Union generally defines SMEs as businesses with fewer than 250 employees, the United States sets the threshold at fewer than 500 employees. Moreover, "small" firms are generally defined as those with fewer than 50 employees, while micro-enterprises have at most 10, or in some cases five, workers. In 2005, the European Union adopted additional tests for small businesses, defining small business (i.e., 10-49 employees) as those with no more than €10 million in annual revenue and no more than €10 million in assets as evidenced on their annual balance sheet. See, e.g., Organisation for Economic Co-operation and Development, Glossary of Statistical Terms, http://stats.oecd.org/glossary/detail.asp?ID=3123.

Under one regulatory framework in the United States, a business may be considered "small" depending on the specified number of employees or the net worth or net income of such business. Separate tests are specified for a business based on various factors, such as the size of the industry, its geographical concentration, and the number of market participants. See, e.g., SMALL BUSINESS ADMINISTRATION, SBA SIZE STANDARDS METHODOLOGY (Apr. 2009) at 8, http://www.sba.gov/idc/groups/public/documents/sba_homepage/size_standards_methodology.pdf (noting that the Small Business Administration ("SBA") decided to apply the net worth and net income measures to its Small Business Investment Company ("SBIC") financing program because investment companies typically evaluate businesses using these measures when determining whether or not to invest). For example, under the SBIC program administered by the SBA, SBA loans may be made to SBICs that invest in companies that are "small" (usually defined as having a net worth of $18 million or less and an average after-tax net income for the prior two years of no more than $6 million, although there are specific tests depending on the industry of the company that may be based on net income, net worth or number of employees). The size requirement is codified at 13 CFR 121.301(c)(2). See SBA, Investment Program Summary, http://www.sba.gov/financialassistance/borrowers/vc/sbainvp/index.html.

number of employees, or another single factor test could ignore the complexities of doing business in different industries or regions. As in the case of adopting a revenue-based test, there is the potential that even a low threshold for a size metric could inadvertently restrict venture capital funds from funding otherwise promising young small companies.

Other tests also present concerns. A test adopted by the California Corporations Commission and the U.S. Department of Labor requires that a venture capital company hold at least 50 percent of its assets in "operating companies," which are defined as companies primarily engaged in the production or sale of a product or services other than the investment of capital.[70]

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[70] Under section 260.204.9 of the California Code of Regulations (the "California VC exemption"), an adviser is exempt from the requirement to register if it provides investment advice only to "venture capital companies," which are generally defined as entities that, on at least one annual occasion (commencing with the first annual period following the initial capitalization), have at least 50% of their assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, in "venture capital investments." A venture capital investment is defined as an acquisition of securities in an operating company as to which the adviser has or obtains management rights. See CAL. CODE REGS. tit. 10, § 260.204.9(a), (b)(3), (b)(4) (2010). An "operating company" is defined to mean any entity "primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale (including any research or development) of a product or service other than the management or investment of capital but shall not include an individual or sole proprietorship." Id. tit. 10, § 260.204.9(b)(7). "Management rights" is defined as the "right, obtained contractually or through ownership of securities . . . to substantially participate in, to substantially influence the conduct of, or to provide (or offer to provide) significant guidance and counsel concerning, the management, operations or business objectives of the operating company in which the venture capital investment is made." Id. tit. 10, § 260.204.9(b)(6). Management rights may be held by the adviser, the fund or an affiliated person of the adviser, and may be obtained either through one person or through two or more persons acting together. Id.

The U.S. Department of Labor regulations ("VCOC exemption") are similar to the California VC exemption. The regulations define "operating company" to mean an entity that is "primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale of a product or service other than the investment of capital. The term 'operating company' includes an entity that is not described in the preceding sentence, but that is a 'venture capital operating company' described in paragraph (d) or a 'real estate operating company' described in paragraph (e)." 29 CFR 2510.3-101(c)(1). The regulations define a venture capital operating company ("VCOC") as any entity that, as of the date of the first investment (or other relevant time), has at least 50% of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, invested in venture capital investments. 29 C.F.R. 2510.3-101(d). A venture capital investment is defined as "an investment in an operating company (other than a venture capital operating company) as to which the investor has

Under the California exemption, a venture capital fund could invest in older and more mature companies that qualify as "operating companies" as well as in securities issued by publicly traded companies provided that the venture capital fund obtained management rights in such publicly traded companies.[71] Hence, although the California venture capital exemption is for advisers to so-called "venture capital companies," the rule provides a much broader exemption that would include many types of private equity and other types of private funds and thus does not appear consistent with our understanding of the intended scope of section 203(l).[72] We request comment on any of these approaches or alternative ones that we have not discussed.[73]

We also request comment on our approach to "follow-on" investments.[74] Under our proposed rule, a qualifying portfolio company is defined to include a company that is not publicly traded (or controlled by a publicly traded company) at the time of each fund investment,[75] but would not exclude a portfolio company that ultimately becomes a successful venture capital investment (typically when the company is taken "public"). Under this approach, an adviser could continue to rely on the exemption even if the venture capital fund's portfolio

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or obtains management rights" that are "contractual rights . . . to substantially participate in, or substantially influence the conduct of, the management of the operating company." 29 C.F.R. 2510.3-101(d)(3).

71 See CAL. CODE REG. tit. 10, § 260.204.9.

72 The California VC exemption does not limit permitted investments to companies that are start-up or privately held companies, which were cited as characteristic of venture capital investing in testimony to Congress. See McGuire Testimony, supra note 41; Loy Testimony, supra note 40.

73 See Letter of Keith P. Bishop (July 28, 2009) (recommending elements of the California VC exemption). Cf. Letter of P. James (August 21, 2010) (expressing the view that the provision of management services does not distinguish venture capital from private equity). We received these letters in response to our request for public views on rulemaking and other initiatives under the Dodd-Frank Act. See generally supra note 24.

74 See, e.g., Loy Testimony, supra note 40, at 3 (discussing the role of follow-on investments); NVCA Yearbook 2010, supra note 41, at 34 (statistics comparing initial investments versus follow-on investments made by venture capital funds at Figure 3.15).

75 See proposed rule 203(l)-1(c)(4)(i).

ultimately consisted entirely of publicly traded securities, a result that could be viewed as inconsistent with section 203(l) of the Advisers Act. We believe that our proposed approach would give advisers to venture capital funds sufficient flexibility to exercise their business judgment on the appropriate time to dispose of portfolio company investments – which may occur at a time when the company is privately held or publicly held.[76] Moreover, under the federal securities laws, a person that is deemed to be an affiliate of a publicly traded company may be limited in its ability to dispose of publicly traded securities.[77] Would our proposed approach to follow-on investments accommodate the way venture capital funds typically invest? Are there circumstances in which a venture capital fund would provide follow-on investments in a company that has become public? Should the rule specifically provide that a venture capital fund includes a fund that invests a limited percentage of its capital in publicly traded securities under certain circumstances (e.g., a follow-on investment in a company in which the fund's previous investments were made when the company was private)? If so, what is the appropriate percentage threshold (e.g., 5, 10 or 20 percent)?

We request comment on whether our definition should exclude any venture capital fund that holds any publicly traded securities or a specified percentage of publicly traded portfolio company securities. What percentage would be appropriate? What percentage would give venture capital funds sufficient flexibility to dispose of their publicly traded securities? Would 30 or 40 percent of the value of a venture capital fund's assets be appropriate?[78] Should the rule specify that publicly traded securities may only be held for a limited period of time, such as one-

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76 See supra note 55.

77 See, e.g., rule 144 under the Securities Act (17 CFR 230.144) (prohibiting the resale of certain restricted and control securities by "affiliates" unless certain conditions are met).

78 Cf. note 94 (discussing limits applicable to BDCs).

year, or that a venture capital fund's entire portfolio may not consist only of publicly traded securities except for a limited period of time, such as one-year or other period?

b. Equity Securities, Cash and Cash Equivalents and Short-Term U.S. Treasuries.

We propose to define venture capital fund for purposes of the exemption as a fund that invests in equity securities of qualifying portfolio companies, cash and cash equivalents and U.S. Treasuries with a remaining maturity of 60 days or less.[79] Under our proposed definition, a fund would not qualify as a venture capital fund for purposes of the exemption if it invested in debt instruments (unless they met the definition of "equity security") of a portfolio company or otherwise lent money to a portfolio company, strategies that are not the typical form of venture capital investing.[80] Congress received testimony that, unlike other types of private funds, venture capital funds "invest cash in return for an equity share of the company's stock."[81] As a consequence, venture capital funds avoid using financial leverage, and leverage appears to have raised systemic risk concerns for Congress.[82] Should our definition of venture capital fund include funds that invest in debt, or certain types of debt, issued by qualifying portfolio companies, or make certain types of loans to qualifying portfolio companies? We understand that some venture capital funds may extend "bridge" financing to portfolio companies in

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79 Proposed rule 203(l)-1(a)(2).

80 See Loy Testimony, supra note 40, at 2, 4; PINEDO, supra note 55, Vol. 1 at 12-2; LEVIN, supra note 55, at 1-5 (noting that venture capital funds focus on "common stock or common equivalent securities, with any purchase of subordinated debentures and/or preferred stock generally designed merely to fill a hole in the financing or to provide [the venture capitalist] with some priority over management in liquidation or return of capital"). See also Jesse M. Fried and Mira Ganor, Agency Costs of Venture Capitalist Control in Startups, 81 N.Y.U. LAW JOURNAL 967, 970 (2006) (venture capital funds investing in U.S. start-ups "almost always receive convertible preferred stock"); FENN et al., supra note 55, at 32.

81 McGuire Testimony, supra note 41, at 4; Loy Testimony, supra note 40, at 2.

82 See infra section II.A.3 of this Release.

anticipation of a future round of venture capital investment.[83] Such financings may take the form of investment in instruments that are ultimately convertible into a portfolio company's common or preferred stock at a subsequent investment stage and thus would meet the definition of "equity security."[84] Should our definition include any fund that extends bridge financing that does not meet the definition of "equity security" on a short-term limited basis to a qualifying portfolio company? Should our definition be limited to those funds that make bridge loans to a portfolio company that are convertible into equity funding only in the next round of venture capital investing? Under our proposed definition, debt investments or loans with respect to qualifying portfolio companies that did not meet the definition of "equity security" could not be made by a fund seeking to qualify as a venture capital fund. Should we modify the proposed rule so that such investments and loans could be made subject to a limit? If so, what would be an appropriate limit (e.g., 5 or 10 percent) and how should the limit be determined (e.g., as a percentage of the fund's capital commitments)?

We propose to use the definition of equity security in section 3(a)(11) of the Securities

83 See, e.g., Darian M. Ibrahim, Debt as Venture Capital, 4 U. ILL. L. REV. 1169, 1173, 1206 (2010) ("VCs sometimes [provide] bridge loans to their portfolio companies . . . [A] bridge loan . . . is [essentially] about 'funding to subsequent rounds of equity' rather than relying on the underlying start-up's ability to repay the loan through cash flows."); Alan Olsen, Venture Capital Financing: Structure and Pricing, VIRTUALSTREET (July 25, 2010), available at http://www20.csueastbay.edu/news/2010/07/alan-olsen-venture-capital.html ("Bridge financing is designed as temporary financing in cases where the company has obtained a commitment for financing at a future date, which funds will be used to retire the debt."); Thomas Flynn, Venture Capital: Current Trends and Lessons Learned, Ventures and Intellectual Property Letter (2003), available at http://www.shipmangoodwin.com/publications/Detail.aspx?pub=194 ("The bridge financing, intended to take the cash strapped company either to the next full round of venture investment or alternatively to a liquidity event or wind-up, has become a familiar fixture in the life cycle of a venture-backed company.").

84 Provided such financings were structured to satisfy the definition of equity security, we would view such transactions to satisfy the definition of qualifying portfolio company under proposed rule 203(l)-1(c)(4)(ii).

Exchange Act of 1934 ("Exchange Act") and rule 3a11-1 thereunder.[85] This definition is broad, and includes common stock as well as preferred stock, warrants and other securities convertible into common stock in addition to limited partnership interests.[86] This definition would include various securities in which venture capital funds typically invest and would provide venture capital funds with flexibility to determine which equity securities in the portfolio company capital structure are appropriate for the fund.[87] We request comment on the use of this definition. Should we consider a more limited definition of equity security? Do venture capital funds typically invest in other types of equity securities that are not covered by the proposed definition?

Under the proposed rule, we define a venture capital fund for purposes of the exemption as a fund that holds cash and cash equivalents or short-term U.S. Treasuries, in recognition of the

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85 See 15 U.S.C. 78c(a)(11) (defining "equity security" as "any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security."); rule 3a11-1 under the Exchange Act (17 CFR 240.3a11-1) (defining "equity security" to include "any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.").

86 See rule 3a11-1 under the Exchange Act (17 CFR 240.3a11-1) (defining "equity security" to include any "limited partnership interest").

87 Our proposed use of the definition of equity security under the Exchange Act acknowledges that venture capital funds typically invest in common stock and other equity instruments that may be convertible into equity common stock. See supra note 80. Our proposed definition does not otherwise specify the types of equity instruments that a venture capital fund could hold in deference to the business judgment of venture capital investors.

manner in which venture capital funds operate.[88] A venture capital fund may hold cash funded by its investors until the cash is allocated to an investment opportunity; subsequently, upon liquidation of the investment, the venture capital fund will receive cash as a return on its investment, which is then distributed to the fund's investors.[89] Thus, pending receipt of all capital commitments from investors or pending distribution of such proceeds to investors, a venture capital fund could hold cash and cash equivalents and short-term U.S. Treasuries.[90] We define "cash and cash equivalents" by reference to rule 2a51-1(b)(7)(i) under the Investment Company Act.[91] Rule 2a51-1, however, is used to determine whether an owner of an investment company excluded by reason of section 3(c)(7) of the Investment Company Act meets the definition of a qualified purchaser by examining whether such owner holds sufficient "investments" (generally securities and other assets held for investment purposes).[92] We do not propose to define a venture capital fund's cash holdings by reference to whether the cash is held "for investment purposes" or to the net cash surrender value of an insurance policy. Furthermore, since rule 2a51-1 does not explicitly include short-term U.S. Treasuries, which we

88 Proposed rule 203(l)-1(a)(2)(ii).

89 "[T]he capital supplied to a venture capital fund consists entirely of equity commitments provided as cash from investors in installments on an as-needed basis . . . . The 'capital calls' for investments generally happen in cycles over the full life of the fund on an 'as needed' basis as investments are identified by the general partners and then as further rounds of investment are made into the portfolio companies." Loy Testimony, supra note 40, at 2; PAUL A. GOMPERS & JOSH LERNER, THE VENTURE CAPITAL CYCLE, at 459 (MIT Press 2004) ("GOMPERS & LERNER") ("Venture capitalists can liquidate their position in the company by selling shares on the open market and then paying those proceeds to investors in cash.").

90 Proposed rule 203(l)-1(a)(2)(ii).

91 Rule 2a51-1(b)(7) under the Investment Company Act provides that cash and cash equivalents include foreign currencies "held for investment purposes" and "(i) [b]ank deposits, certificates of deposit, bankers acceptances and similar bank instruments held for investment purposes; and (ii) [t]he net cash surrender value of an insurance policy." 17 CFR 270.2a51-1(b)(7).

92 See generally sections 2(a)(51) and 3(c)(7) of the Investment Company Act; 17 CFR 270.2a51(b) and (c).

believe would be an appropriate form of cash equivalent for a venture capital fund to hold pending investment in a portfolio company or distribution to investors, our rule would include short-term U.S. Treasuries with a remaining maturity of 60 days or less among the investments a venture capital fund could hold.[93] Should we specify a shorter or longer period of remaining maturity for U.S. Treasuries?

We request comment on whether the proposed rule's provision for cash holdings is too broad or too narrow. Should the rule only specify that cash be held in anticipation of investments, or in connection with the payment of expenses or liquidations from underlying portfolio companies? Are there other types of cash instruments in which venture capital funds typically invest and/or that should be reflected in the proposed rule?

We do not propose to define venture capital fund for purposes of the exemption as one that invests solely in U.S. companies. In contrast, the BDC provisions in the Investment Company Act generally limit the exemption to U.S. companies and require that permitted investments generally be made in U.S. companies.[94] However, as we discuss below, there is no indication in the legislative record that Congress intended the venture capital exemption would

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93 We have treated debt securities with maturities of 60 days or less differently than debt securities with longer maturities under our rules. In particular, we have recognized that the potential for fluctuation in those shorter-term securities' market value has decreased sufficiently that, under certain conditions, we allow certain open-end investment companies to value them using amortized cost value rather than market value. See Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies, Investment Company Act Release No. 9786 (May 31, 1977) [42 FR 28999 (June 7, 1977)]. We believe that the same consideration warrants treating U.S. Treasury securities with a remaining maturity of 60 days or less as more akin to cash equivalents than Treasuries with longer maturities for purposes of the definition of venture capital fund.

94 See sections 2(a)(46) and 2(a)(48) of the Investment Company Act. Under section 55 of the Investment Company Act, a BDC is prohibited from acquiring any assets, except for permitted assets, unless, at the time the acquisition is made, permitted assets "represent at least 70 per centum of the value of [the BDC's] total assets." Permitted assets for this purpose generally mean securities of an "eligible portfolio company," which is defined in section 2(a)(46) of the Investment Company Act.

be available only to U.S. advisers or to advisers that invest fund assets solely in U.S. companies.[95] Should our proposed definition similarly define a venture capital fund as a fund formed under the laws of the United States and/or that invests exclusively or primarily in U.S. portfolio companies or a sub-set of such companies (e.g., U.S. companies operating in non-financial sectors)? Are venture capital funds that invest in non-U.S. portfolio companies more or less likely to have financial relationships that may pose systemic risk issues, a rationale that was presented and appeared significant to Congress in exempting advisers to venture capital funds?

c. Portfolio Company Leverage

Proposed rule 203(l)-1 would define a qualifying portfolio company for purposes of the exemption as one that does not borrow, issue debt obligations or otherwise incur leverage in connection with the venture capital fund's investments.[96] As a consequence, certain types of funds that use leverage or finance their investments in portfolio companies or the buyout of existing investors with borrowed money (e.g., leveraged buyout funds, which are a different subset of private equity funds) would not meet the proposed rule's definition of a venture capital fund.[97] As discussed in greater detail below, we believe that Congress did not intend the venture

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95 See infra section II.A.8 of this Release.

96 Proposed rule 203(l)-1(c)(4)(ii) (setting forth this requirement as a condition for the portfolio company to qualify as a "qualifying portfolio company").

97 A leveraged buyout fund is a private equity fund that will "borrow significant amounts from banks to finance their deals—increasing the debt-to-equity ratio of the acquired companies." U.S. GOVT. ACCOUNTABILITY OFFICE, PRIVATE EQUITY: RECENT GROWTH IN LEVERAGED BUYOUTS EXPOSED RISKS THAT WARRANT CONTINUED ATTENTION (2008) ("GAO PRIVATE EQUITY REPORT"), at 1. A leverage buyout fund in 2005 typically financed a deal with 34% equity and 66% debt. Id. at 13. See also FENN et al., supra note 55, at 23 (companies that have been taken private in an LBO transaction generally "spend less on research and development, relative to assets, and have a greater proportion of fixed assets; their debt-to-assets ratios are high, above 60%, and are two to four times those of venture-backed firms." Moreover, compared to venture capital backed companies, LBO-private equity backed companies that are taken public typically use proceeds from an IPO to reduce debt whereas new venture capital backed firms tend to use proceeds to fund growth.); Tresnowski Testimony, supra note 40, at 2 (indicating that portfolio

capital fund definition to apply to these other types of private equity funds.[98] This definition of qualifying portfolio company would only exclude companies that borrow in connection with a venture capital fund's investment, but would not exclude companies that borrow in the ordinary course of their business (e.g., to finance inventory or capital equipment, manage cash flows, and meet payroll). We would generally view any financing or loan (unless it met the definition of equity security) to a portfolio company that was provided by, or was a condition of a contractual obligation with, a fund or its adviser as part of the fund's investments as being a type of financing that is "in connection with" the fund's investment, although we recognize that other types of financings may also be "in connection with" a fund's investment. Should we provide guidance on other types of financing transactions as being "in connection with" a fund's investment in a qualifying portfolio company? If so, what types of financing transactions should such guidance address? We propose this element of the qualifying portfolio company definition because of the focus on leverage in the Dodd-Frank Act as a potential contributor to systemic risk as discussed by the Senate Committee report,[99] and the testimony before Congress that stressed the lack of leverage in venture capital investing.[100] Should we use a test other than whether the loan is "in connection with" the fund's investments? For example, should the test be whether the portfolio company currently intends to borrow at the time of the fund's investment?

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companies in which private equity funds invest typically have 60% debt and 40% equity).

98 See infra discussion in section II.A.1.d of this Release.

99 See S. REP. NO. 111-176, supra note 7, at 74 ("The Committee believes that venture capital funds, a subset of private investment funds specializing in long-term equity investment in small or start-up businesses, do not present the same risks as the large private funds whose advisers are required to register with the SEC under this title."); id. at 75 (concluding that private funds that use limited or no leverage at the fund level engage in activities that do not pose risks to the wider markets through credit or counterparty relationships).

100 See Loy Testimony, supra note 40, at 6 (noting that "many venture capital funds significantly limit borrowing"). See also McGuire Testimony, supra note 41, at 7 ("Not only are our partnerships run without debt but our portfolio companies are usually run without debt as well.").

Should the test depend only on how the portfolio company uses the proceeds of borrowing, such as by excluding companies that use proceeds to buyout investors or return capital to a fund?

Venture capital has been described as investing in companies that cannot borrow from the usual lending sources.[101] Should we define a qualifying portfolio company as a company that does not incur certain specified types of borrowing or other forms of leverage? Would such a definition narrow the current range of portfolio companies in which venture capital funds typically invest?

d. Capital Used for Operating and Business Purposes

Under proposed rule 203(l)-1, a venture capital fund is defined as a fund that holds equity securities of qualifying portfolio companies, and at least 80 percent of each company's equity securities owned by the venture capital fund were acquired directly from each such qualifying portfolio company.[102] This element reflects the distinction between venture capital funds that provide capital to portfolio companies for operating and business purposes (in exchange for an equity investment) and leveraged buyout funds, which acquire controlling equity interests in operating companies through the "buy out" of existing security holders. Hence, in addition to the definitional element that a venture capital fund is one that does not redeem or repurchase securities from other shareholders (i.e., a "buyout"), a related criterion in the rule specifies that a qualifying portfolio company is one that does not distribute company assets to other security holders in connection with the venture capital fund's investment in the company (which could be

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[101] See Loy Testimony, supra note 40, at 3. See also JAMES SCHELL, PRIVATE EQUITY FUNDS: BUSINESS STRUCTURE AND OPERATIONS (2010), at § 1.03[1] ("SCHELL") ("Venture Capital Funds provide investment capital to business enterprises early in their development cycle at a time when access to conventional financing sources is non-existent or extremely limited.").

[102] Proposed rule 203(l)-1(a)(2)(i).

an indirect buyout).[103]

One of the distinguishing features of venture capital funds is that, unlike many hedge funds and private equity funds, they invest capital directly in portfolio companies for the purpose of funding the expansion and development of the company's business rather than buying out existing security holders, otherwise purchasing securities from other shareholders, or leveraging the capital investment with debt financing.[104] Testimony received by Congress and our research suggest that venture capital funds provide capital to many types of businesses at different stages of development,[105] generally with the goal of financing the expansion of the company[106] and helping it progress to the next stage of its development through successive tranches of

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103 Proposed rule 203(l)-1(c)(4)(iii).

104 See Loy Testimony, supra note 40, at 2 ("Although venture capital funds may occasionally borrow on a short-term basis immediately preceding the time when the cash installments are due, they do not use debt to make investments in excess of the partner's capital commitments or 'lever up' the fund in a manner that would expose the fund to losses in excess of the committed capital or that would result in losses to counter parties requiring a rescue infusion from the government."). See also infra notes 109-111; Mark Heesen & Jennifer C. Dowling, National Venture Capital Association, Venture Capital & Adviser Registration, materials submitted in connection with the Commission's Government-Business Forum on Small Business Capital Formation ("Heesen") (summarizing the differences between venture capital funds and buyout and hedge funds), available at http://www.sec.gov/info/smallbus/2010gbforumstatements.htm.

105 See, e.g., McGuire Testimony, supra note 41, at 1; NVCA Yearbook 2010, supra note 41; PricewaterhouseCoopers/National Venture Capital Association MoneyTree Report, Q4 2009/Full-year 2009 Report (providing data on venture capital investments in portfolio companies); SCHELL, supra note 101, at §1.03[1]; GOMPERS & LERNER, supra note 89, at 178, 180 table 8.2 (displaying percentage of annual venture capital investments by stage of development and classifying "early stage" as seed, start-up, or early stage and "late stage" as expansion, second, third, or bridge financing).

106 See McGuire Testimony, supra note 41, at 1; Loy Testimony, supra note 40, at 3 ("Once the venture fund is formed, our job is to find the most promising, innovative ideas, entrepreneurs, and companies that have the potential to grow exponentially with the application of our expertise and venture capital investment."). See also William A. Sahlman, The Structure and Governance of Venture-Capital Organizations, JOURNAL OF FINANCIAL ECONOMICS 27 (1990), at 473, 503 ("SAHLMAN") (noting venture capitalists typically invest more than once during the life of a company, with the expectation that each capital investment will be sufficient to take the company to the next stage of development, at which point the company will require additional capital to make further progress).

investment (i.e., "follow-on" investments) if the company reaches agreed-upon milestones.[107]

In contrast, private equity funds that are identified as buyout funds typically provide capital to an operating company in exchange for majority or complete ownership of the company,[108] generally achieved through the buyout of existing shareholders or other security holders and financed with debt incurred by the portfolio company,[109] and compared to venture capital funds, hold the investment for shorter periods of time.[110] As a result of the use of the capital provided and the incurrence of this debt, following the buyout fund investment, the operating company may carry debt several times its equity and may devote significant levels of

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107 See SAHLMAN, at 503; Loy Testimony, supra note 40, at 3 ("[W]e continue to invest additional capital into those companies that are performing well; we cease follow-on investments into companies that do not reach their agreed upon milestones.").

108 GAO PRIVATE EQUITY REPORT, supra note 97, at 8 ("A private equity-sponsored LBO generally is defined as an investment by a private equity fund in a public or private company (or division of a company) for majority or complete ownership.").

109 See ANNALISA BARRETT et al., Prepared by the Corporate Library Inc., under contract for the IRRC Institute, WHAT IS THE IMPACT OF PRIVATE EQUITY BUYOUT FUND OWNERSHIP ON IPO COMPANIES' CORPORATE GOVERNANCE?, at 7 (June 2009) ("BARRETT et al.") ("In general, VC firms provide funding to companies in early stages of their development, and the money they provide is used as working capital for the firm. Buyout firms, in contrast, work with mature companies, and the funds they provide are used to compensate the firm's existing owners."); IEKE VAN DEN BURG AND POUL NYRUP RASMUSSEN, HEDGE FUNDS AND PRIVATE EQUITY: A CRITICAL ANALYSIS (2007), at 16-17 ("VAN DEN BURG"); SAHLMAN, supra note 106, at 517. See also TAX LEGISLATION: CRS REPORT, TAXATION OF HEDGE FUND AND PRIVATE EQUITY MANAGERS, TAX LAW AND ESTATE PLANNING COURSE HANDBOOK SERIES, PRACTICING LAW INSTITUTE (Nov. 2, 2007) at 2 (noting that in a leveraged buyout "private equity investors use the proceeds of debt issued by the target company to acquire all the outstanding shares of a public company, which then becomes private").

110 Unlike venture capital funds, which generally invest in portfolio companies for 10 years or more, private equity funds that use leveraged buyouts invest in their portfolio companies for shorter periods of time. See Loy Testimony, supra note 40, at 3 (citing venture capital fund investments periods in portfolio companies of five to 10 years or longer); VAN DEN BURG, at 19 (noting that LBO investors generally retain their investment in a listed company for 2 to 4 years or even less after the company goes public). See also Paul A. Gompers, The Rise and Fall of Venture Capital, BUSINESS AND ECONOMIC HISTORY, vol. 23, no. 2, Winter 1994, at 17 ("Gompers") (stating that "an LBO investment is significantly shorter than that of a comparable venture capital investment. Assets are sold off almost immediately to meet debt burden, and many companies go public again (in a reverse LBO) in a very short period of time").

its cash flow and corporate earnings to repaying the debt financing, rather than investing in capital improvement or business operations.[111]

We believe that these differences (i.e., the use of buyouts and associated leverage) distinguish venture capital funds from buyout private equity funds for which Congress did not provide an exemption.[112] Under our proposed rule, an exempt adviser relying on section 203(1) of the Advisers Act would not be eligible for the exemption if it advised these types of private equity funds that in effect acquire a majority of the equity securities of portfolio companies directly from other security holders.[113] Correspondingly, we also propose to define a qualifying portfolio company for purposes of the exemption as one that does not redeem or repurchase outstanding securities in connection with a venture capital fund's investment.[114] Because at least 80 percent of each portfolio company's equity securities in which the fund invests must be acquired directly from the portfolio company, a venture capital fund relying on the exemption could purchase the remainder of the securities directly from existing shareholders (i.e., a "buyout"). Under our proposed definition, however, a company that achieves an indirect buyout of its security holders, such as through the complete recapitalization or restructuring of the portfolio company capital structure would not be a qualifying portfolio company.[115] The 80

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111 See BARRETT et al., supra note 109. See also FENN et al., supra note 55, at 23 (when comparing venture capital backed companies that are taken public to LBO-private equity backed companies that are taken public, the common use of proceeds from an IPO are used by LBO-private equity backed companies to reduce debt whereas new firms use proceeds to fund growth).

112 See supra notes 39, 42, 43, 99 and accompanying text.

113 Proposed rule 203(l)-1(a)(2)(i).

114 Proposed rule 203(l)-1(c)(4)(iii).

115 For example, concurrently with the issuance of new securities to the venture capital fund, a portfolio company could redeem existing shareholders and use proceeds from the venture capital fund investment to pay such shareholders redemption proceeds. Similarly, existing shareholders may receive new securities that are subordinated to the securities issued to the venture capital fund in exchange for tendering their outstanding securities, partially funded with investments

percent test is not intended to preclude conversions of directly acquired securities into other equity securities. Similarly, we would not view a capital reorganization intended merely to simplify a qualifying portfolio company's capital structure and outstanding securities without any change in the existing beneficial owners' rights, priority, or economic terms as breaching the 80 percent condition.

We propose to define a venture capital fund by reference to ownership of equity securities of a qualifying portfolio company, wherein at least 80 percent of the securities owned were acquired directly from the company, in order to give venture capital funds relying on the exemption some flexibility to acquire securities from a portfolio company founder or "angel" investor who may seek liquidity from his or her initial investment.[116] We adopted this 80 percent threshold because we understand that many venture capital funds currently are managed in a manner that seeks to rely on provisions of the tax code providing favorable tax treatment for directly acquired equity securities of issuers that satisfy certain conditions.[117] Thus, using this threshold in our definition may not result in substantial changes to either investment strategies

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received from the venture capital fund. In each of these examples, the fund becomes a majority owner of the company by "buying out" the existing owners with investment capital initially provided by the fund.

116 See NVCA Yearbook 2010, supra note 41, at 57 (defining "angel" as "a wealthy individual that invests in companies in relatively early stages of development"). See also FENN et al., supra note 55, at 2 (defining angel capital as "investments in small, closely held companies by wealthy individuals, many of whom have experience operating similar companies [and] . . . may have substantial ownership stakes and may be active in advising the company, but they generally are not as active as professional managers in monitoring the company and rarely exercise control.").

117 See Int. Rev. Code § 1202(e)(1)(A) (26 U.S.C. 1202) ("IRC 1202") (which permits partial exclusion from income tax gain on directly acquired equity securities of certain issuers that, among other things, devote at least 80% of their assets to the conduct of their business as specified in IRC 1202). Under our proposed rule, at least 80% of the portfolio company securities owned by a venture capital fund must be acquired directly from the portfolio company, which in turn cannot redeem or repurchase existing security holders in connection with such venture capital fund investment. Thus we presume that venture capital funding proceeds (or at least 80% of such proceeds) will be used for operating and business expansion purposes, which is similar to the requirements under IRC 1202.

employed, or the compliance programs currently used, by venture capital advisers. Is our assumption that venture capital funds do not generally acquire portfolio company securities directly from existing shareholders correct? Is 80 percent the appropriate threshold? Should the threshold be set lower? Should direct acquisitions of equity securities be increased to 90 percent or 100 percent in order to more effectively prevent advisers to funds engaged in activities that are not characteristic of venture capital funds from relying on the exemption?

In contrast to leveraged buyout fund financing, venture capital received by a portfolio company is devoted to developing the company's business rather than repurchasing the securities of other shareholders or making payments to fund debt financing through the portfolio company. We request comment on this criterion. Does the definition's focus on a portfolio company's use of capital received from a venture capital fund impose any unnecessary burdens on the company's operation or business? Rather than define a venture capital fund by reference to the manner in which it acquires equity securities (or the manner in which qualifying portfolio companies may indirectly facilitate a buyout), should the proposed rule instead define the manner in which proceeds from a venture capital investment may be used? For example, should the rule specify that proceeds of borrowings or other financings not be used to finance the acquisition of equity securities by a venture capital fund or otherwise distribute company assets to equity owners? Would defining qualifying portfolio company in this manner facilitate compliance or would this approach make it easier for a company to achieve a "buyout" and thereby circumvent the intended scope of the exemption, given the fungibility of cash and the privately negotiated nature of typical venture capital transactions? We do not intend that a venture capital fund would not meet the proposed definition if it acquired equity securities from a portfolio company in connection with a capital reorganization intended to simplify the company's capital structure without changing the existing beneficial owners' rights, priority, or economic terms. Are there other capital reorganizations that would be consistent with the intent of our proposed rule but that would prevent a venture capital fund from satisfying the proposed definition?

e. Operating Companies

Proposed rule 203(l)-1 would define the term qualifying portfolio company for the purposes of the exemption to exclude any private fund or other pooled investment vehicle.[118] There is no indication that Congress intended the venture capital exemption to apply to funds of funds. Without this definition, a venture capital fund could circumvent the intended scope of the exemption by investing in other pooled investment vehicles that are not themselves subject to the definitional criteria under our proposed rule. For example, a venture capital fund could circumvent the intent of the proposed rule by incurring off-balance sheet leverage or indirectly investing in companies that may be publicly traded. Our proposed exclusion would be similar to the approach of other definitions of "venture capital" discussed above, which limit investments to operating companies and thus would exclude investments in other private funds or securitized asset vehicles.[119] We request comment on this definitional element. Under the proposed definition, a venture capital fund would not invest in another private fund, a commodity pool or other "investment companies." Should the proposed definition specifically identify other types of pooled investment vehicles (e.g., real estate funds or structured investment vehicles) in which a fund seeking to satisfy the proposed definition could not invest?

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118 Proposed rule 203(l)-1(c)(4)(iv). For this purpose, pooled investment vehicles include investment companies, investment companies relying on rule 3a-7 under the Investment Company Act and commodity pools.

119 See California VC exemption, supra notes 70-72; see also VCOC exemption under 29 CFR 2510.3-101(d), supra note 70.

2. Management Involvement

To qualify as a venture capital fund under our proposed definition, the fund or its investment adviser would: (i) have an arrangement under which it offers to provide significant guidance and counsel concerning the management, operations or business objectives and policies of the portfolio company (and, if accepted, actually provides the guidance and counsel) or (ii) control the portfolio company.[120] Because a key distinguishing characteristic of venture capital investing is the assistance beyond the mere provision of capital, we propose that advisers seeking to rely on the rule have a significant level of involvement in developing a fund's portfolio companies.[121] Managerial assistance generally takes the form of active involvement in the business, operations or management of the portfolio company, or less active forms of control

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120 Proposed rule 203(l)-1(a)(3). Under section 202(a)(12) of the Advisers Act, "control" is defined to mean "the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company."

121 See McGuire Testimony, supra note 41, at 1 ("[W]e build companies by actively partnering with each entrepreneur and management team to help propel their ideas into market leading businesses. We do this by providing a small amount of capital and a large amount of operating expertise and strategic counsel over a long period of time. While providing capital is the first order of business, it is the least time consuming of all our activities. We also recruit and attract employees at all levels [for the portfolio company]. We identify and structure strategic partnerships. We raise additional equity to help the [portfolio] company make it to the next milestone. And, we're available 24/7 to support great teams, solve problems, identify opportunities and detect 'land mines.' . . . We provide access to [our] expertise and network at all stages of a [portfolio] company's development and across all strategic areas of the business."). See also LEVIN, supra note 55, at 1-3 (noting that the "first feature distinguishing venture capital/private equity investing is the VC professional's active involvement in identifying the investment, negotiating and structuring the transaction, and monitoring the portfolio company after the investment has been made. Often, the VC professional will serve as a board member and/or financial advisor to the portfolio company. Hence, venture capital/private equity investing is significantly different from passive selection and retention of stock and debt investments by a money manager.") (emphasis in original); SAHLMAN, supra note 106, at 508 (noting that venture capitalists typically play a role in the operation of the company, help to establish tactics and strategy, work with suppliers and customers, and often assume more direct control by changing management and sometimes taking over day-to-day operations themselves). See also FENN et al., supra note 55, at 32-33 for a discussion of various control mechanisms available to venture capital and private equity funds, including preferred stock ownership, representation on the board and various contractual covenants.

of the portfolio company, such as through board representation or similar voting rights.[122] We also acknowledge that the nature of managerial assistance may evolve over time as the needs of qualifying portfolio companies change, and hence the proposed rule does not specify that managerial assistance has a fixed character.

We have modeled the proposed approach to managerial assistance in part on existing provisions under the Advisers Act and the Investment Company Act dealing with BDCs, which were added over the years to ease the regulatory burdens on venture capital and other private equity investments.[123] In 1980, when Congress first introduced BDCs into the Advisers Act and Investment Company Act, it acknowledged that the purpose of the BDC provisions was to support "venture capital" activity in capital formation for small business, and described BDCs as principally investing in and providing managerial assistance to small, growing and financially troubled businesses.[124] Because Congress modeled the definition of BDC under the Advisers and Investment Company Acts on the capital formation activities of venture capital funds, both

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122 See generally supra note 121. See also Alan T. Frankel, et al., Venture Capital: Financial and Tax Considerations, THE CPA JOURNAL (Aug. 2003) at 1 (noting that the "VC will also monitor the portfolio company after the investment has been made. Oftentimes, the VC will serve as a board member or financial and strategic advisor to the portfolio company.").

123 The term "business development company" was first introduced into the Investment Company Act and the Advisers Act in 1980 as part of the Small Business Investment Incentive Act of 1980 ("Small Business Act"), and was amended as part of the National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) ("NSMIA"). Congress introduced an alternative regulatory framework applicable to BDCs, which was designed to remove "unnecessary disincentives" for BDCs to provide capital to small businesses, while also preserving protection for investors and preventing fraud and abuse. See 1980 House Report, supra note 44, at 21-22.

In the Small Business Act, Congress modeled the definition of a BDC under section 202(a)(22) of the Advisers Act on the capital formation activities of venture capital funds. Congress recognized that the principal activity of a BDC is to invest in and provide managerial assistance to small, growing and financially troubled companies. See 1980 House Report, supra note 44, at 21. See also infra note 129 (definition of "making available significant managerial assistance" by a BDC under section 2(a)(47) of the Investment Company Act).

124 See 1980 House Report, supra note 44, at 21.

definitions under such Acts incorporate the requirement to make available significant managerial assistance to portfolio companies.[125]

Congress did not use the existing BDC definitions when determining the scope of the venture capital exemption,[126] and the primary policy considerations that led to the adoption of the BDC exemptions differed from those under the Dodd-Frank Act. However, we believe these provisions are instructive because they reflect many of the same characteristics of venture capital and private equity fund activity presented in testimony before Congress in connection with the Dodd-Frank Act.[127] Although Congress viewed BDC activities as typical of "venture capital" investing,[128] the BDC provisions are complex. Hence, we are proposing a modified version of the definition of "making available significant managerial assistance" in order to simplify the language and to reduce the potential for confusion that might arise in interpreting the meaning of the term.

125 See section 202(a)(22) of the Advisers Act; section 2(a)(48)(B) of the Investment Company Act. Generally, a BDC under the Advisers Act is any company that meets the definition of BDC under the Investment Company Act, except that certain requirements were modified for "private" BDCs under the Advisers Act. See also Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, Investment Advisers Act Release No. 2576 (Dec. 27, 2006) [72 FR 400 (Jan. 4, 2007)] ("Accredited Natural Person Release"), at n.69 (discussing the difference between the term BDC under the Investment Company Act and the Advisers Act). In 1996, as part of NSMIA, Congress sought to encourage greater investment in small businesses by giving BDCs more flexibility, and therefore expanded the class of eligible portfolio companies in which BDCs could invest without being required to provide "managerial assistance." See S. Rep. No. 104-293, at 13 (1996).

126 We have looked to the BDC definition to define a venture capital fund before. In 2006, we proposed to impose a qualification standard for all investors of private investment funds, excluding venture capital funds, which we proposed to define by reference to section 202(a)(22) of the Advisers Act. See Accredited Natural Person Release, supra note 125 (proposing to define the term "accredited natural person" as any natural person who satisfies the requirements in Regulation D as an accredited investor and who also owns investments of at least $2.5 million). We sought additional comment on this proposal in a subsequent release but a rule has not been adopted. See Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)].

127 See generally Loy Testimony, supra note 40; McGuire Testimony, supra note 41.

128 See 1980 House Report, supra note 44, at 21-2.

We request comment on the approach to managerial assistance in the definition of venture capital fund. As we have noted above, Congressional testimony asserted that a key characteristic of venture capital funds is the provision of managerial assistance. Is this true in the industry generally? We request comment on the description of managerial assistance in proposed rule 203(l)-1. Is this description easier to understand and apply than the definition in section 2(a)(47) of the Investment Company Act?[129] As under the definition of BDC in the Advisers and Investment Company Acts, the proposed definition specifies the fund or its adviser need only offer assistance. Should the rule specify that the fund or its adviser actually provide assistance? If so, what if a portfolio company that initially accepts the offer of assistance later

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129 Section 2(a)(47) of the Investment Company Act states:

"'Making available significant managerial assistance' by a business development company means—

(A) any arrangement whereby a business development company, through its directors, officers, employees, or general partners, offers to provide, and, if accepted, does so provide, significant guidance and counsel concerning the management, operations, or business objectives and policies of a portfolio company;

(B) the exercise by a business development company of a controlling influence over the management or policies of a portfolio company by the business development company acting individually or as part of a group acting together which controls such portfolio company; or

(C) with respect to a small business investment company licensed by the Small Business Administration to operate under the Small Business Investment Act of 1958, the making of loans to a portfolio company.

For purposes of subparagraph (A), the requirement that a business development company make available significant managerial assistance shall be deemed to be satisfied with respect to any particular portfolio company where the business development company purchases securities of such portfolio company in conjunction with one or more other persons acting together, and at least one of the persons in the group makes available significant managerial assistance to such portfolio company, except that such requirement will not be deemed to be satisfied if the business development company, in all cases, makes available significant managerial assistance solely in the manner described in this sentence."

In contrast to section 2(a)(47) of the Investment Company Act, our proposed definitional approach to managerial assistance does not specifically define managerial assistance by referring to a fund's directors, officers, employees, or general partners or address how managerial assistance is determined for funds that invest as a group.

refuses any actual or further assistance? We understand that when venture capital funds invest as a group, there may be an understanding among the funds and the portfolio company that while all fund advisers may be available to provide managerial assistance if necessary, one adviser is generally expected to provide most, if not all, of the assistance to the portfolio company. Is that understanding correct? Under proposed rule 203(l)-1, venture capital funds that invest as a group would only satisfy the definition if each venture capital fund (or its adviser) offered (and, if accepted, provided) managerial assistance or exercised control.[130] Should the rule specify how managerial assistance or control is to be determined in the case of venture capital funds that invest as a group if only one fund (or its adviser) provides the assistance? Should the rule specify the extent to which each fund (or its adviser) must offer or provide managerial assistance or adopt the approach of other regulatory definitions of "venture capital" funds, which impose strict numerical investment or ownership tests for determining whether a venture capital fund exercises supervision or influence over the operation or business of the operating company?[131] Does the fact that the assistance need only be offered render the condition so readily met that the criterion should be removed from the rule? Should our rule provide guidance on what constitutes "control" under our proposed definition? For example, instructions to Form ADV provide a presumption of control if a person has the power to vote 25 percent or more of a corporation's voting securities, or a person acts as manager of a limited liability company.[132]

130 According to one study, funds focusing on later-stage companies and middle-market buyout investing tend to invest alongside other funds, whereas venture capital funds focusing on early stage companies tend to invest individually in portfolio companies. See FENN et al., supra note 55, at 31.

131 See supra note 70 and accompanying text (discussing the California VC exemption and the VCOC exemption).

132 See Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010) [75 FR 49234 (Aug. 12, 2010)] ("Form ADV Release").

Should the proposed rule rely on similar or different presumptions?

Our proposed rule provides that when a fund controls the qualifying portfolio company, an offer to provide managerial assistance is not required. As in the case of "managerial assistance" as defined in the BDC provisions, the proposed rule presumes that when a fund acquires control, it is likely to be exercised. Should the rule specify that in all cases managerial assistance includes both the offer of assistance as well as the exercise of control? We request comment on whether venture capital funds (or their advisers) typically have the personnel to provide significant managerial assistance to all of their portfolio companies or only a subset. Would the requirement to offer and potentially provide managerial assistance to all of a fund's portfolio companies result in potential demands on a fund or its adviser that could not be satisfied if all or a significant subset of a fund's portfolio companies accepted the offer? Alternatively, does the proposed definition provide a venture capital fund (including those that invest as a group) with sufficient flexibility to determine the scope of any managerial assistance or control it may seek to offer (or provide) to a portfolio company?

3. Limitation on Leverage

Under proposed rule 203(l)-1, the definition of a venture capital fund for purposes of the exemption would be limited to a private fund that does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent of the fund's capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days.[133] Under the

133 Proposed rule 203(l)-1(a)(4). Similarly, our proposed rule would exclude from the definition of "qualifying portfolio company" a company that borrowed in connection with the venture capital fund's investments in the company. Proposed rule 203(l)-1(c)(4)(ii). See supra section II.A.1 of this Release.

proposed definition, a fund could borrow and still be a venture capital fund provided it did not borrow or otherwise use leverage in excess of the specified threshold.

By specifying that loans be non-renewable, we would avoid the transformation of short-term debt into long-term debt without full repayment to the lender. Should the rule specify other borrowing or financing terms or conditions that would nevertheless avoid this type of transformation? Do venture capital funds use lines of credit repeatedly but pay the outstanding amounts in full before drawing down additional credit? Should loans of this nature be included in the definition? Under our proposed definition, it would be possible for a venture capital fund to issue commercial paper on a short-term basis to potential investors because the proposed definition does not specify which types of instruments a venture capital fund issues. Should the proposed rule specifically exclude commercial paper from debt issuances to avoid the potential that a venture capital fund could convert short-term debt into long-term debt by continuing to roll over its commercial paper issuances?[134] This criterion regarding leverage at the venture capital fund level is in addition to the conditions relating to a qualifying portfolio company's debt

134 We note that because commercial paper issuers often refinance the repayment of maturing commercial paper with newly issued commercial paper, they may face roll-over risk, i.e., the risk that investors may not be willing to refinance maturing commercial paper. These risks became particularly apparent for issuers of asset-backed commercial paper beginning in August 2007. At that time, structured investment vehicles ("SIVs"), which are off-balance sheet funding vehicles sponsored by financial institutions, issued commercial paper to finance the acquisition of long-term assets, including residential mortgages. As a result of problems in the residential home mortgage market, short-term investors began to avoid asset-backed commercial paper tied to residential mortgages, regardless of whether the securities had substantial exposure to sub-prime mortgages. Unable to roll over their commercial paper, SIVs suffered severe liquidity problems and significant losses. See Money Market Fund Reform, Investment Company Act Release No. 28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)] ("Money Market Fund Reform Release") at nn.37-39 and preceding and accompanying text; MARCIN DACPERCZYK AND PHILIPP SCHNABL, WHEN SAFE PROVED RISKY: COMMERCIAL PAPER DURING THE FINANCIAL CRISIS OF 2007-2009 (Nov. 2009).

issuances in connection with the venture capital fund's investment.[135] Under this condition, a venture capital fund seeking to satisfy the definitional criteria could not avoid the borrowing element at the portfolio company level by incurring such leverage at the venture capital fund level.

Congress cited the implementation of trading strategies that use financial leverage by certain private funds as creating a potential for systemic risk.[136] In testimony before Congress, the venture capital industry identified the lack of financial leverage in venture capital funds as a basis for exempting advisers to venture capital funds[137] in contrast to other types of private funds

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135 See proposed rule 203(l)-1(c)(4)(ii); supra section II.A.1.c of this Release. Because private equity funds often engage in leveraged buy-out transactions in which the portfolio company, rather than the fund, incurs debt, our proposed definition would exclude leveraged buy-out funds.

136 See, e.g., section 115 of the Dodd-Frank Act (enumerating prudential standards for addressing systemic risks, including risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits, a contingent capital requirement, enhanced public disclosures, short-term debt limits, and overall risk management requirements). See also G20 WORKING GROUP 1, ENHANCING SOUND REGULATION AND STRENGTHENING TRANSPARENCY, at iii-iv (March 25, 2009) ("G20 WORKING GROUP REPORT"), at iii (noting contribution to "market turmoil" when "the financial system developed new structures and created new instruments, some with embedded leverage." Further, "[w]hile the build-up of leverage and the underpricing of credit risk were recognized in advance of the turmoil, their extent was under-appreciated and there was no coordinated approach to assess the implications of these systemic risks . . . ."); INTERNATIONAL MONETARY FUND, LESSONS OF THE GLOBAL CRISIS FOR MACROECONOMIC POLICY, February 19, 2009, at 6 (noting how "[l]everage . . . increases lender exposure by magnifying the impact of a price adjustment on borrowers' balance sheets and, thus on banks' losses and capital."). See generally DEPARTMENT OF TREASURY, FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION, June 2009, available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

137 See McGuire Testimony, supra note 41, at 7 ("Venture capital firms do not use long term leverage, rely on short term funding, or create third party or counterparty risk . . . . [F]rom previous testimony submitted by the buy-out industry, the typical capital structure of the companies acquired by a buyout fund is approximately 60% debt and 40% equity. In contrast, borrowing at the venture capital fund level, if done at all, typically is only used for short-term capital needs (pending drawdown of capital from its partners) and does not exceed 90 days. Not only are our partnerships run without debt but our portfolio companies are usually run without debt as well."); Loy Testimony, supra note 40, at 2 ("Although venture capital funds may occasionally borrow on a short-term basis immediately preceding the time when the cash installments are due, they do not use debt to make investments in excess of the partner's capital

such as hedge funds, which may engage in trading strategies that may contribute to systemic risk and affect the public securities markets.[138] For this reason, our proposed rule is designed to address concerns that financial leverage may contribute to systemic risk by excluding funds that incur more than a limited amount of leverage from the definition of venture capital fund.[139]

We also understand that venture capital funds generally do not rely on short-term financing,[140] which has been identified as another potential systemic risk factor.[141] Should we increase or reduce the 15 percent threshold for short-term borrowing? If so, what is the appropriate threshold (e.g., 20, 10, or 5 percent)? Or should we define a venture capital fund as a private fund that does not borrow at all or otherwise incur any financial leverage? Would even the limited ability to engage in short-term borrowing or other forms of leverage encourage venture capital funds to incur other investment risks different from those typically associated with venture capital investing today? To the extent that venture capital funds use short-term leverage or borrowing, 90 days has been cited as typical.[142] Would a 120-day period, as

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commitments or 'lever up' the fund in a manner that would expose the fund to losses in excess of the committed capital or that would result in losses to counter parties requiring a rescue infusion from the government.").

138 See S. REP. NO. 111-176, supra note 7, at 74-75.

139 In proposing an exemption for advisers to private equity funds, which would have required the Commission to define the term private equity fund, the Senate Banking Committee noted the difficulties in distinguishing some private equity funds from hedge funds and expected the Commission to exclude from the exemption private equity funds that raise significant potential systemic risk concerns. S. REP. NO. 111-176, supra note 7, at 75. See also G20 WORKING GROUP REPORT, supra note 136, at 7 (noting that unregulated entities such as hedge funds may contribute to systemic risks through their trading activities).

140 See Loy Testimony, supra note 40, at 7 ("[V]enture capital firms do not generally rely on short-term funding. In fact, quite the opposite is true."); SCHELL, supra note 101, at § 1.03[6] ("Venture Capital Funds rarely have the ability to borrow money, other than short-term loans to cover Partnership Expenses or to 'bridge' Capital Contributions."); Heesen, supra note 104, at 17.

141 See, e.g., Financial Crisis Inquiry Commission, Preliminary Staff Report, Shadow Banking and the Financial Crisis (May 4, 2010).

142 See McGuire Testimony, supra note 41, at 7.

specified in our proposed rule, create other investment risks for venture capital funds? Our proposed rule refers specifically to borrowing but also is designed to give venture capital funds the flexibility to issue debt (which is also a form of borrowing) for short-term purposes. Should the rule refer specifically to additional forms of borrowing not already identified? Do any or many venture capital funds borrow in excess of 120 days? Should the 15 percent limit not apply when a fund borrows in order to invest in a qualifying portfolio company and is repaid with capital called from the fund's investors? Would the 120-day limit alone achieve a similar result?

Our proposed rule specifies that the 15 percent calculation must be determined based on the fund's aggregate capital contributions and uncalled capital commitments. Unlike most registered investment companies or hedge funds, venture capital funds rely on investors funding their capital commitments from time to time in order to acquire portfolio companies.[143] A capital commitment is a contractual obligation to acquire an interest in, or provide the total commitment amount over time to, a fund, when called by the fund. Accordingly, advisers to venture capital funds manage the fund in anticipation of all investors fully funding their commitments when due and typically have the right to penalize investors for failure to do so.[144] Venture capital funds are

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143 SCHELL, supra note 101, at §1.03[8] ("The typical Venture Capital Fund calls for Capital Contributions from time to time as needed for investments."); id. at §2.05[2] (stating that "[venture capital funds] begin operation with Capital Commitments but no meaningful assets. Over a specific period of time, the Capital Commitments are called by the General Partner and used to acquire Portfolio Investments.").

144 See Loy Testimony, supra note 40, at 5 ("[Limited partners] make their investment in a venture fund with the full knowledge that they generally cannot withdraw their money or change their commitment to provide funds. Essentially they agree to "lock-up" their money for the life of the fund."). See also STEPHANIE BRESLOW & PHYLLIS SCHWARTZ, PRIVATE EQUITY FUNDS, FORMATION AND OPERATION 2010 ("BRESLOW & SCHWARTZ"), at § 2:5.6 (discussing the various remedies that may be imposed in the event an investor fails to fund its contractual capital commitment, including, but not limited to, "the ability to draw additional capital from non-defaulting investors;" "the right to force a sale of the defaulting partner's interests at a price

subject to investment restrictions, and calculate fees payable to an adviser, as a percentage of the total capital commitments of investors, regardless of whether or not the capital commitment is ultimately funded by an investor.[145] Venture capital fund advisers typically report and market themselves to investors on the basis of aggregate capital commitment amounts raised for prior or existing funds.[146] These factors would lead to the conclusion that, in contrast to other types of private funds, such as hedge funds, which trade on a more frequent basis, a venture capital fund would view the fund's total capital commitments as the primary metric for managing the fund's assets and for determining compliance with investment guidelines. Hence, we believe that calculating the leverage threshold to include uncalled capital commitments is appropriate, given that capital commitments are already used by venture capital funds themselves to measure investment guideline compliance.

The proposed 15 percent threshold would be determined based on the venture capital fund's aggregate capital commitments. In practice, this means that a venture capital fund relying on the exemption could leverage an investment transaction up to 100 percent when acquiring equity securities of a particular portfolio company as long as the investment amount does not

determined by the general partner;" and "the right to take any other action permitted at law or in equity").

145 See, e.g., BRESLOW & SCHWARTZ, supra note 144, at § 2:5.7 (noting that a cap of 10% to 25% of remaining capital commitments is a common limitation on follow-on investments). See also SCHELL, supra note 101, at §1.01 (noting that capital contributions made by the investors are used to "make investments . . . in a manner consistent with the investment strategy or guidelines established for the Fund."); id. at §1.03 ("Management fees in a Venture Capital Fund are usually an annual amount equal to a fixed percentage of total Capital Commitments."); see also Dow Jones, Private Equity Partnership Terms and Conditions, 2007 edition ("Dow Jones Report") at 15.

146 See, e.g., NVCA Yearbook 2010, supra note 41, at 16; John Jannarone, Private Equity's Cash Problem, WALL ST. J., June 23, 2010, http://online.wsj.com/article/SB10001424052748704853404575323073059041024.html#printMode.

exceed 15 percent of the fund's total capital commitments, albeit on a short-term basis that did not exceed 120 days. Should the 15 percent calculation be determined with respect to the total investment amount for each portfolio company? Would this standard be easier to apply?

Our proposed rule defines a venture capital fund by reference to a maximum of 15 percent of borrowings based on our understanding that venture capital funds typically would not incur borrowings in excess of 10 to 15 percent of the fund's total capital contributions and uncalled capital commitments.[147] We believe that imposing a maximum at the upper range of borrowings typically used by venture capitals may accommodate existing practices of the vast majority of industry participants.

4. No Redemption Rights

Proposed rule 203(l)-1 would define a venture capital fund as a fund that issues securities that do not provide investors redemption rights except in "extraordinary circumstances" but that do entitle investors generally to receive pro rata distributions.[148] Unlike hedge funds, venture capital funds do not typically permit investors to redeem their interests during the life of the fund,[149] but rather distribute assets generally as investments mature.[150] Although venture capital

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147 See Loy Testimony, supra note 40, at 6 ("[M]any venture capital funds significantly limit borrowing such that all outstanding capital borrowed by the fund, together with guarantees of portfolio company indebtedness, does not exceed the lesser of (i) 10-15% of total limited partner commitments to the fund and (ii) undrawn limited partner commitments.").

148 Proposed rule 203(l)-1(a)(5) (limiting venture capital funds to funds that "[o]nly issue[] securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata").

149 See SCHELL, supra note 101, at §1.03[7] (venture capital fund "redemptions and withdrawals are rarely allowed, except in the case of legal compulsion"); BRESLOW & SCHWARTZ, supra note 144, at §2:14.2 ("the right to withdraw from the fund is typically provided only as a last resort").

150 Loy Testimony, supra note 40, at 2-3 ("As portfolio company investments are sold in the later years of the [venture capital] fund – when the company has grown so that it can access the public markets through an initial public offering (an IPO) or when it is an attractive target to be bought –

funds typically return capital and profits to investors only through pro rata distributions, such funds may also provide extraordinary rights for an investor to withdraw from the fund under foreseeable but unexpected circumstances or rights to be excluded from particular investments due to regulatory or other legal requirements.[151] These events may be "foreseeable" because they are circumstances that are known to occur (e.g., changes in law, corporate events such as mergers) but are unexpected in their timing or scope. Thus, withdrawal or exclusion rights might be triggered by a change in the tax law after an investor invests in the fund, or the enactment of laws that may prohibit an investor's participation in the fund's investment in particular countries or industries.[152] The trigger events for these rights are typically beyond the control of the adviser

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the liquidity from these 'exits' is distributed back to the limited partners. The timing of these distributions is subject to the discretion of the general partner, and limited partners may not otherwise withdraw capital during the life of the venture [capital] fund."). Id. at 5 (Investors "make their investment in a venture [capital] fund with the full knowledge that they generally cannot withdraw their money or change their commitment to provide funds. Essentially they agree to 'lock-up' their money for the life of the fund, generally 10 or more years as I stated earlier."). See also Dow Jones Report, supra note 145, at 60 (noting that an investor in a private equity or venture capital fund typically does not have the right to transfer its interest).

151 See Hedge Fund Adviser Registration Release, supra note 17, at n.240 and accompanying text ("Many partnership agreements provide the investor the opportunity to redeem part or all of its investment, for example, in the event continuing to hold the investment became impractical or illegal, in the event of an owner's death or total disability, in the event key personnel at the fund adviser die, become incapacitated, or cease to be involved in the management of the fund for an extended period of time, in the event of a merger or reorganization of the fund, or in order to avoid a materially adverse tax or regulatory outcome. Similarly, some investment pools may offer redemption rights that can be exercised only in order to keep the pool's assets from being considered 'plan assets' under ERISA [Employee Retirement Income Security Act of 1974]."). See, e.g., BRESLOW & SCHWARTZ, supra note 144, at § 2:14.1 ("Private equity funds generally provide for mandatory withdrawal of a limited partner [i.e., investor] only in the case where the continued participation by a limited partner in a fund would give rise to a regulatory or legal violation by the investor or the fund (or the general partner [i.e., adviser] and its affiliates). Even then, it is often possible to address the regulatory issue by excusing the investor from particular investments while leaving them otherwise in the fund.").

152 See, e.g., BRESLOW & SCHWARTZ, supra note 144, at § 2:14.2 ("The most common reason for allowing withdrawals from private equity funds arises in the case of an ERISA violation where there is a substantial likelihood that the assets of the fund would be treated as 'plan assets' of any ERISA partner for purposes of Title I of ERISA or section 4975 of the Code."). See also SCHELL, supra note 101, at §9.04[3] ("Exclusion provisions allow the General Partner to exclude

and fund investor (e.g., tax and regulatory changes).

For these purposes, for example, a fund that permits quarterly or other periodic withdrawals would be considered to have granted investors redemption rights in the ordinary course even if those rights may be subject to an initial lock-up or suspension or restrictions on redemption. Is the phrase "extraordinary circumstances" sufficiently clear to distinguish the investor liquidity terms of venture capital funds, as they operate today, from hedge funds? Congressional testimony cited an investor's inability to withdraw from a venture capital fund as a key characteristic of venture capital funds and a factor for reducing their potential for systemic risk.[153] Although a fund prohibiting redemptions would be a venture capital fund for purposes of the exemption, the rule does not specify a minimum period of time for an investor to remain in the fund. Should the rule define when withdrawals by investors would be "extraordinary?" Should the rule specify minimum investment periods for investors? Could venture capital funds provide investors with "extraordinary" rights to redeem that could effectively result in redemption rights in the ordinary course?[154] Should we address this potential for circumvention of the definition by establishing a maximum amount that may be redeemed during any period of time (e.g., 10 percent of an investor's total capital commitments)? Would such a limit constrain investors in a way so as to prevent them from complying with other legal or regulatory

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a Limited Partner from participation in any or all investments if a violation of law or another material adverse effect would otherwise occur."); id. at Appendix D-31 (attaching model limited partnership agreement providing "The General Partner at any time may cancel the obligations of all Partners to make Capital Contributions for Portfolio Instruments if. . . changes in applicable law . . . make such cancellation necessary or advisable . . . .").

153 See supra notes 149-150 and accompanying text.

154 For example, a private fund's governing documents may provide that investors do not have any right to redeem without the consent of the general partner. In practice, if the general partner typically permits investors to redeem or transfer their otherwise non-redeemable, non-transferable interests on a periodic basis, then the fund would not be considered to have issued securities that "do not provide a holder with any right, except in extraordinary circumstances, to withdraw."

requirements?

5. Represents Itself as a Venture Capital Fund

Proposed rule 203(l)-1 would limit the definition of venture capital fund for the purposes of the exemption to a private fund that represents itself as being a venture capital fund to its investors and potential investors.[155] A private fund could satisfy this definitional element by, for example, describing its investment strategy as venture capital investing or as a fund that is managed in compliance with the elements of our proposed rule. Without this element, a fund that did not engage in typical venture capital activities could be treated as a venture capital fund simply because it met the other elements specified in our proposed rule (because for example it only invests in short term Treasuries, controls portfolio companies, does not borrow, does not offer investors redemption rights, and is not a registered investment company).[156] We believe that only funds that do not significantly differ from the common understanding of what a venture capital fund is,[157] and that are actually offered to investors as venture capital funds, should qualify for the exemption. Thus, an adviser to a venture capital fund that is otherwise relying on the exemption could not identify the fund as a hedge fund or multi-strategy fund (i.e., venture capital is one of several strategies used to manage the fund) or include the fund in a hedge fund database or hedge fund index.

We request comment on a venture capital fund's representations regarding itself as a criterion under the proposed definition. Is our criterion inconsistent with current practice? Does the proposed criterion regarding venture capital fund representations adequately address our

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155 Proposed rule 203(l)-1(a)(1).

156 We also note that a fund that represents to investors that it is one type of fund while pursuing a different type of fund strategy may raise concerns under rule 206(4)-8 of the Advisers Act.

157 See Gompers, supra note 110, at 6-7.

concern that advisers should not be eligible for the exemption if they advise funds that otherwise meet the definitional criteria in the rule but engage in activities that do not constitute venture capital investing?

6. Is a Private Fund

We propose to define a venture capital fund for the purposes of the exemption as a private fund, which is defined in the Advisers Act,[158] and exclude from the proposed definition funds that are registered investment companies (e.g., mutual funds) or have elected to be regulated as BDCs.[159] There is no indication that Congress intended this exemption to apply to advisers to these publicly available funds,[160] referring to venture capital funds as a "subset of private investment funds."[161] We request comment on this requirement and whether it appropriately reflects the expectation of Congress.

7. Other Factors

We request comment on whether the proposed rule should include other elements that were described in testimony as characteristic of venture capital funds or that distinguish venture capital funds from other types of private equity or private funds.[162] For example, testimony

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158 See section 202(a)(29) of the Advisers Act.

159 Proposed rule 203(l)-1(a)(6).

160 Legislative history does not indicate that Congress addressed this matter, nor does testimony before Congress suggest that this was contemplated. See, e.g., McGuire Testimony, supra note 41, at 3 (noting that venture capital funds are not directly accessible by individual investors); Loy Testimony, supra note 40, at 2 ("Generally . . . capital for the venture fund is provided by qualified institutional investors such as pension funds, universities and endowments, private foundations, and to a lesser extent, high net worth individuals."). See generally supra note 158 (definition of "private fund").

161 See S. REP. NO. 111-176, supra note 7, at 74 (describing venture capital funds as a subset of "private investment funds").

162 See, e.g., Heesen, supra note 104 (generally describing characteristics that distinguish venture capital funds from hedge funds and buyout funds).

presented to Congress indicated that venture capital funds typically have capital contributions from their advisers, generally up to five percent of the fund's total capital commitments.[163] Congress also received testimony that venture capital funds are generally not open to retail investors,[164] have long investment periods, generally of at least ten years,[165] and contribute to the U.S. economy by creating jobs, fostering competition and facilitating innovation.[166]

Are any of these characteristics appropriate to include as elements in the definition? If so, which elements should be included and what would be appropriate thresholds for application? Do venture capital advisers typically invest in the funds they manage? Should we modify the proposed rule to include as a condition that advisers relying on the exemption under section 203(l) would invest in the venture capital fund at a specified minimum threshold? If so, what is an appropriate investment threshold – less than one percent, one percent, three percent, five percent, or somewhere in between? Should the proposed rule be modified to specify that venture

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163 See Loy Testimony, supra note 40, at 2 ("[g]enerally, 95 to 99 percent of capital for the venture fund is provided by . . . investors . . . and we supply the rest of the capital for the fund from our own personal assets"); McGuire Testimony, supra note 41, at 3. Industry data confirm that such investments are typical in the venture capital industry. See, e.g., Dow Jones Report, supra note 145, at 23-24 (showing that, in a survey of 110 North American general partners, at least 83% contributed at least 1% of venture capital fund capital). We note that certain investors perceive an investment in the fund as aligning the interest of investors and advisers. See Institutional Limited Partners Association Private Equity Principles, September 9, 2009, at 3 (recommending that the "general partner should have a substantial equity interest in the fund to maintain a strong alignment of interest with the limited partners, and a high percentage of the amount should be in cash as opposed to being contributed through the waiver of the management fee."); Mercer Investment Consulting, Inc., Key Terms and Conditions for Private Equity Investing, 1996 at 13 ("Many limited partners view the 1% standard as an inadequate sharing of risk . . . .").

164 See McGuire Testimony, supra note 41, at 3 ("Venture capital funds are not sold directly to retail investors like mutual funds."); Loy Testimony, supra note 40, at 2 ("Generally, 95 to 99 percent of capital for the venture fund is provided by qualified institutional investors such as pension funds, universities and endowments, private foundations, and to a lesser extent, high net worth individuals.").

165 See Loy Testimony, supra note 40, at 2; McGuire Testimony, supra note 41, at 3.

166 See Loy Testimony, supra note 40, at 4; McGuire Testimony, supra note 41, at 5.

capital funds have a minimum term, for example, of 10 years? Should the proposed rule be modified to specify that a venture capital fund is one that does not have retail investors? If so, how should "retail investor" be defined? Should "retail investor" exclude persons who are not "qualified clients" for purposes of the Advisers Act?[167]

8. Application to Non-U.S. Advisers

Neither the statutory text of section 203(l) nor the legislative reports gives an indication of whether Congress intended the exemption to be available to advisers that operate principally outside of the United States but that invest in U.S. companies or solicit U.S. investors.[168] Testimony before Congress presented by members of the U.S. venture capital industry discussed the industry's role primarily in the U.S. economy including its lack of interconnection with the U.S. financial markets and "interdependence" with the world financial system.[169] Nevertheless, we expect that venture capital funds with advisers operating principally outside of the United States may seek to access the U.S. capital markets by investing in U.S. companies or soliciting U.S. investors; investors in the United States may also have an interest in venture capital opportunities outside of the United States. We request comment on whether the proposed rule should specify that an adviser with its principal office and place of business outside of the United States (a "non-U.S. adviser") is eligible to rely on the exemption even if it advises funds that do not meet our proposed definition of venture capital fund.

A non-U.S. adviser currently may rely on the private adviser exemption, if it meets the

167 Rule 205-3 generally defines a qualified client as any person who has at least $750,000 under management with an adviser immediately after entering into the contract or who has a net worth of more than $1,500,000 at the time the contract is entered into.

168 See section 203(l) of the Advisers Act; H. REP. NO. 111-517, supra note 7, at 867; S. REP. NO. 111-176, supra note 7, at 74-75.

169 See Loy Testimony, supra note 40, at 4-5; McGuire Testimony, supra note 41, at 5-6.

conditions of current section 203(b)(3) of the Advisers Act, including advising no more than 14 clients.[170] We have permitted such an adviser to count only clients that are residents of the United States,[171] and for this purpose permitted the adviser to treat a private fund incorporated outside of the United States as a non-resident of the United States, even if some or all of the investors in the private fund are residents of the United States.[172] A non-U.S. adviser may rely on the venture capital exemption if all of its clients, whether U.S. or non-U.S., are venture capital funds. In effecting the new venture capital exemption, should we specifically provide that a non-U.S. adviser may avail itself of the exemption even if it advises clients other than venture capital funds, provided such clients are non-United States persons, under the definition we propose for purposes of the other exemptions discussed below?[173] If we take this approach, should the non-U.S. adviser be able to rely on the venture capital exemption if it advises these other clients from within the United States?

If a non-U.S. adviser must advise solely venture capital funds (even those advisers that principally operate outside of the United States) our proposed definition may have the result of subjecting non-U.S. advisers to United States regulatory oversight because they advise funds offered only outside the United States. Under our proposed rule, only a private fund as defined

170 See supra note 5 and accompanying text.

171 See rule 203(b)(3)-1(b)(5).

172 See rule 203(b)(3)-1(a)(2). See also ABA Subcommittee on Private Investment Companies, SEC Staff No-Action Letter (Aug. 10, 2006) ("ABA Letter"). In the ABA Letter, Commission staff expressed the view that the substantive provisions of the Advisers Act do not apply to offshore advisers with respect to such advisers' dealings with offshore funds and other offshore clients to the extent described in prior staff no-action letters and the Hedge Fund Adviser Registration Release, supra note 17. The staff took the position, however, that an offshore adviser registered with the Commission under the Advisers Act must comply with the Advisers Act and the Commission's rules thereunder with respect to any U.S. clients (and any prospective U.S. clients) it may have.

173 See proposed rule 203(m)-1(e)(8); proposed rule 202(a)(30)-1(c)(2)(i).

under section 202(a)(29) may be a venture capital fund.[174] A non-U.S. fund that uses U.S. jurisdictional means in the offering of the securities it issues and relies on sections 3(c)(1) or 3(c)(7) would be a private fund.[175] A non-U.S. fund that does not make such a U.S. offering would not be a private fund and therefore could not qualify as a venture capital fund, even if operated as a venture capital fund in a manner that would otherwise meet the criteria under our proposed definition. If we adopt the approach we are proposing today, should we allow an adviser to treat such a non-U.S. fund as a private fund and, to the extent that the fund meets all of the other conditions of our proposed definition, as a venture capital fund for purposes of the exemption? If so, under what conditions? For example, should a non-U.S. fund be a private fund under the proposed rule if the non-U.S. fund would be deemed a private fund upon conducting a private offering in the United States in reliance on sections 3(c)(1) or 3(c)(7)?

9. Grandfathering Provision

We propose to include in the definition of "venture capital fund" any private fund that:

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174 See proposed rule 203(l)-1(a).

175 An issuer that is organized under the laws of the United States or of a state is a private fund if it is excluded from the definition of an investment company for most purposes under the Investment Company Act pursuant to sections 3(c)(1) or 3(c)(7). Section 7(d) of the Investment Company Act prohibits a non-U.S. fund from using U.S. jurisdictional means to make a public offering, absent an order permitting registration. A non-U.S. fund may conduct a private U.S. offering without violating section 7(d) only if the fund complies with either section 3(c)(1) or 3(c)(7) with respect to its U.S. investors (or some other available exemption or exclusion). Consistent with this view, a non-U.S. fund is a private fund if it makes use of U.S. jurisdictional means to, directly or indirectly, offer or sell any security of which it is the issuer and relies on either section 3(c)(1) or 3(c)(7). See Hedge Fund Adviser Registration Release, supra note 17, at n.226; Offer and Sale of Securities to Canadian Tax-Deferred Retirement Savings Accounts, Securities Act Release No. 7656 (Mar. 19, 1999) [64 FR 14648 (Mar. 26, 1999)], at nn.10, 20, 23; Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Securities Act Release No. 7516 (Mar. 23, 1998) [63 FR 14806 (Mar. 27, 1998)], at n.41. See also Dechert LLP, SEC Staff No-Action Letter (Aug. 24, 2009) at n.8; Goodwin, Procter & Hoar LLP, SEC Staff No-Action Letter (Feb. 28, 1997) ("Goodwin Procter Letter"); Touche Remnant & Co., SEC Staff No-Action Letter (Aug. 27, 1984).

(i) represented to investors and potential investors at the time the fund offered its securities that it is a venture capital fund; (ii) has sold securities to one or more investors prior to December 31, 2010; and (iii) does not sell any securities to, including accepting any additional capital commitments from, any person after July 21, 2011 (the "grandfathering provision").[176] The grandfathering provision thus would include any fund that has accepted capital commitments by the specified dates even if none of the commitments has been called.[177] As a result, any investment adviser that solely advises private funds that meet the definitions in either proposed rule 203(l)-1(a) or (b) would be exempt from registration.

We believe that most funds previously sold as venture capital funds likely would satisfy all or most of the conditions in the proposed rule. Nevertheless, we recognize that investment advisers currently seeking to sponsor new funds before the adoption of the final version of proposed rule 203(l)-1 will continue to face uncertainty regarding the precise terms of the definition and hence uncertainty regarding their eligibility for the new exemption. Thus, our proposed rule presumes that a fund that has commenced its offering (i.e., has initially sold securities by December 2010) and that also concludes its offering by the effective date of Title IV of the Dodd-Frank Act (i.e., July 21, 2011) is unlikely to have been structured to circumvent the intended scope of the exemption. Moreover, requiring existing venture capital funds to modify their investment conditions or characteristics, liquidate portfolio company holdings or alter the rights of investors in the funds in order to satisfy the proposed definition of

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176 Proposed rule 203(l)-1(b).

177 See also Electronic Filing and Revision of Form D, Securities Act Release No. 8891(Feb. 6, 2008) [73 FR 10592 (Feb. 27, 2008)], at section VIII, Form D, General Instructions – When to File (noting that a Form D is required to be filed within 15 days of the first sale of securities which would include "the date on which the first investor is irrevocably contractually committed to invest"), n.159 ("a mandatory capital commitment call would not constitute a new offering, but would be made under the original offering").

a venture capital fund would likely be impossible in many cases and yield unintended consequences for the funds and their investors.

Thus, we propose that an investment adviser may treat any existing private fund as a venture capital fund for purposes of section 203(l) of the Advisers Act if the fund meets the elements of the grandfathering provision. The current private adviser exemption does not require an adviser to identify or characterize itself as any type of adviser (or impose limits on advising any type of funds). Accordingly, we believe that advisers have not had an incentive to mis-characterize existing venture capital funds that have already been marketed to investors. As we note above, a fund that "represents" itself to investors as a venture capital fund is typically one that discloses it pursues a venture capital investing strategy and identifies itself as such. We do not expect funds identifying themselves as "private equity" or "hedge" would be able to rely on this exemption.

We request comment on this grandfathering provision. Should we include other conditions in addition to the fund representing itself as a venture capital fund? For example, should a fund seeking to be grandfathered also provide that its investors do not have any redemption rights except in extraordinary circumstances,[178] not incur leverage except on a short-term basis,[179] limit the securities that it acquires from portfolio companies to equity securities,[180] or provide significant managerial assistance to the portfolio companies in which the fund invests?[181] Should the grandfathering provision be modified to exclude other types of funds,

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178 See proposed rule 203(l)-1(a)(5); supra discussion in section II.A.4 of this Release.

179 See proposed rule 203(l)-1(a)(4); supra discussion in section II.A.3 of this Release.

180 See proposed rule 203(l)-1(a)(1); supra discussion in section II.A.1.b of this Release.

181 See proposed rule 203(l)-1(a)(3); supra discussion in section II.A.2 of this Release.

such as funds of venture capital funds or publicly available venture capital funds?[182] We understand that venture capital funds may be in the planning and initial offering stage for a considerable period of time.[183] Should funds that have their first sale of securities within a period of time such as 180 days after the final rule is adopted be able to rely on the proposed grandfathering provision? Does our grandfathering provision unnecessarily encourage the formation of new funds before December 31, 2010, and therefore should the grandfathering provision only apply to funds in existence on the date of this proposal or some other time before December 31, 2010? Would the dates specified in the grandfathering provision significantly shorten the fundraising periods for venture capital funds? Should we specify a date later than December 31, 2010 or earlier than July 21, 2011? Do venture capital fund advisers need more time or flexibility to determine eligibility for the grandfathering provision? Alternatively, would exempt advisers consider registering with the Commission in order to retain flexibility to raise capital for new venture capital funds without regard to the grandfathering provision?

B. Exemption for Investment Advisers Solely to Private Funds With Less Than $150 million in Assets Under Management

Section 203(m) of the Advisers Act directs the Commission to exempt from registration any investment adviser solely to private funds that has less than $150 million in assets under management in the United States.[184] We are proposing a new rule 203(m)-1 that would provide the exemption and address several interpretive questions raised by section 203(m). We will refer to this exemption as the "private fund adviser exemption."

182 See supra discussion in sections II.A.1.e and II.A.6 of this Release.

183 See BRESLOW & SCHWARTZ, supra note 144, at § 2:4.1 (private equity fundraising may take six to 12 months following the initial closing, depending upon whether the adviser has an existing investor base or a successful performance record).

184 Section 408 of the Dodd-Frank Act, which is codified in section 203(m) of the Advisers Act. See supra note 22.

1. Advises Solely Private Funds

Proposed rule 203(m)-1 would, like section 203(m) of the Advisers Act, limit an adviser relying on the exemption to advising "private funds" as that term is defined in that Act.[185] An adviser that acquires a different type of client would have to register under the Advisers Act unless another exemption is available. An adviser could advise an unlimited number of private funds, provided the aggregate value of the adviser's private fund assets is less than $150 million.

In the case of an adviser with a principal office and place of business outside of the United States (a "non-U.S. adviser"), we propose to provide the exemption as long as all of the adviser's clients that are United States persons are qualifying private funds.[186] As a consequence, a non-U.S. adviser could enter the U.S. market and take advantage of the exemption without regard to the type or number of its non-U.S. clients. Under this approach, a non-U.S. adviser would not lose the private fund adviser exemption as a result of its business activities outside the United States. Recognizing that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and in consideration of general principles of international comity, our rules have taken a similar approach by permitting a non-U.S. adviser to count only clients that are U.S. persons when determining whether it has 14 or fewer clients, and is thus eligible for the private adviser exemption.[187]

We request comment on our proposed application of the statute to non-U.S. advisers. Should we, alternatively, interpret section 203(m) as denying the private fund adviser exemption

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185 See proposed rule 203(m)-1(a) and (b). A "private fund" includes a private fund that invests in other private funds.

186 Proposed rule 203(m)-1(b)(1).

187 Rule 203(b)(3)-1(b)(5) ("If you have your principal office and place of business outside the United States, you are not required to count clients that are not United States residents, but if your principal office and place of business is in the United States, you must count all clients."). See infra note 207.

to a non-U.S. adviser that has other types of clients outside of the United States? This interpretation would have the effect of treating non-U.S. and U.S. advisers equally with respect to the types of clients they may have, but could also have the result of requiring many non-U.S. advisers to register because of the scope and nature of their non-U.S. advisory business, an outcome which the "assets under management in the United States" limitation in section 203(m) suggests was not a consideration relevant to the scope of the exemption. Under such an approach, moreover, the exemption would be unavailable to a non-U.S. adviser unless all of the non-U.S. funds it manages are offered to investors in the United States (and therefore meet the definition of "private fund").[188] If we adopt this alternative approach, should the exemption apply to a non-U.S. adviser even if not all of the non-U.S. funds it manages are offered in the United States?

2. Private Fund Assets

Under proposed rule 203(m)-1, an adviser would have to aggregate the value of all assets of private funds it manages in the United States to determine if the adviser remains below the $150 million threshold.[189] Proposed rule 203(m)-1 would require advisers to calculate the value of private fund assets by reference to Form ADV, under which we propose to provide a uniform method of calculating assets under management for regulatory purposes under the Advisers Act.[190] In the case of a sub-adviser, it would have to count only that portion of the private fund

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188 See supra note 174-175 and accompanying paragraph.

189 Proposed rule 203(m)-1(c).

190 See proposed rules 203(m)-1(a)(2); 203(m)-1(b)(2); 203(m)-1(e)(1) (defining "assets under management" to mean "regulatory assets under management" in proposed item 5.F of Form ADV, Part 1A); 203(m)-1(e)(4) (defining "private fund assets" to mean the assets under management attributable to a qualifying private fund). This uniform method of calculation would be used to determine whether an adviser qualifies to register with the Commission rather than the states, as well as to determine eligibility for the private fund adviser exemption and the foreign

assets for which it has responsibility.[191]

In addition to assets appearing on a private fund's balance sheet, advisers would include any uncalled capital commitments, which are contractual obligations of an investor to acquire an interest in, or provide the total commitment amount over time to, a private fund, when called by the fund.[192] Advisers to private funds that use capital commitments seek investments early in the life of the fund in anticipation of all investors fully paying in these capital commitments during the life of the fund, and fees payable to the adviser are calculated as a percentage of total capital commitments.[193] Many of these types of private funds are managed following investment guidelines and restrictions that are determined as a percentage of overall capital commitments, rather than as a percentage of current net asset value.[194] We request comment on whether the method for calculating the relevant assets under management should deviate from the method in the proposed amendments to Form ADV instructions by, for example, excluding proprietary assets, assets managed without compensation, or uncalled capital commitments.

Under proposed rule 203(m)-1, each adviser would have to determine the amount of its private fund assets quarterly, based on the fair value of the assets at the end of the quarter.[195] We

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private adviser exemption discussed in this Release. Under the proposed Form ADV instructions, advisers would include in their "regulatory assets under management" any proprietary assets, assets managed without receiving compensation, and assets of non-U.S. clients, all of which an adviser may currently exclude, as well as, in the case of private funds, uncalled capital commitments. Moreover, the adviser could not deduct liabilities, such as accrued fees and expenses or the amount of any borrowing. <u>See</u> Implementing Release, <u>supra</u> note 25, at section II.A.3 (discussing the rationale underlying the proposed new instructions for calculating assets under management under Form ADV).

191 <u>See</u> proposed Form ADV: Instructions for Part 1A, instr. 5.b(2).

192 <u>See</u> proposed Form ADV: Instructions for Part 1A, instr. 5.b(1).

193 <u>See supra</u> notes 143-145.

194 <u>Id</u>.

195 <u>See</u> proposed rule 203(m)-1(c); <u>supra</u> note 190; proposed Form ADV: Instructions for Part 1A,

propose that advisers use the fair value of private fund assets in order to ensure that, for purposes of this exemption, advisers value private fund assets on a meaningful and consistent basis. Use of the cost basis (i.e., the value at which the assets were originally acquired), for example, could under certain circumstances understate significantly the value of appreciated assets, and thus result in advisers availing themselves of the exemption. Use of the fair valuation method by all advisers, moreover, would result in more consistent asset calculations and reporting across the industry and, therefore, in a more coherent application of the Advisers Act's regulatory requirements and of our staff's risk assessment program.

We understand that many, but not all, private funds value assets based on their fair value in accordance with U.S. generally accepted accounting principles ("GAAP") or other international accounting standards.[196] Some private funds do not use fair value methodologies, which may be more difficult to apply when the fund holds illiquid or other types of assets that

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instr. 5.b(4). As discussed in the Implementing Release, we are proposing to require advisers to value private fund assets using fair value when calculating their assets under management for several purposes under the Advisers Act. See Implementing Release, supra note 25, at section II.A.3. A fund's governing documents may provide for a specific process for calculating fair value (e.g., that the general partner, rather than the board of directors, determines the fair value of the fund's assets). An adviser would be able to rely on such a process also for purposes of calculating its assets under management.

196 See, e.g., Comment Letter of National Venture Capital Association (July 28, 2009), at 2 (the "vast majority of venture capital funds provide their LPs [i.e., investors] quarterly and audited annual financial reports. These reports are prepared under generally accepted accounting principles, or GAAP, and audited under the standards established for all investment companies, including the largest mutual fund complexes."); Comment Letter of Managed Funds Association (July 28, 2009), at 3 (a "substantial proportion of hedge fund managers, whether or not they are registered with the Commission, provide independently audited financial statements of the [hedge] fund to investors."). These comment letters were submitted in connection with the Commission's proposed amendments to the custody rule, Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2876 (May 20, 2009) [74 FR 25354 (May 27, 2009)], and are available on the Commission's Internet website at http://www.sec.gov/comments/s7-09-09/s70909.shtml.

are not traded on organized markets.[197] Would the proposed approach result in advisers valuing their private fund assets in a generally uniform manner and in comparability of the valuations? We are not proposing to require advisers to determine fair value in accordance with GAAP. Should we adopt such a requirement? If not, should we specify that advisers may only determine the fair value of private fund assets in accordance with a body of accounting principles used in preparing financial statements? We understand that GAAP does not require some funds to fair value certain investments. Should we provide for an exception from the proposed fair valuation requirement with respect to any of those investments?

Should we adopt a different approach altogether and allow advisers to use a method other than fair value? Are there other methods that would not understate the value of fund assets? ~~Should the rule permit advisers to rely exclusively on the method set forth in a fund's governing~~ documents, or the method used to report the value of assets to investors or to calculate fees (or other compensation) for investment advisory services? What method should apply if a fund uses different methods for different purposes? Should we modify the proposed rule to require that the valuation be derived from audited financial statements or subject to review by auditors or another independent third party?

As discussed above, we are proposing that funds value assets no less frequently than quarterly, although such values are not subject to quarterly reporting to us.[198] As a consequence,

197 Those assets include, for example, "distressed debt" (such as securities of companies or government entities that are either already in default, under bankruptcy protection, or in distress and heading toward such a condition) or certain types of emerging market securities that are not readily marketable. See GERALD T. LINS et al., HEDGE FUNDS AND OTHER PRIVATE FUNDS: REG AND COMP § 5:22 (2009) ("At any given time, some portion of a hedge fund's portfolio holdings may be illiquid and/or difficult to value. This is particularly the case for certain types of hedge funds, such as those focusing on distressed securities, activist investing, etc.").

198 The proposed frequency of the calculation is consistent with section 2(a)(41)(A) of the Investment Company Act, which specifies the valuation of the assets of an issuer for purposes of

short-term market value fluctuations would not affect the availability of the exemption between the ends of calendar quarters. We request comment on our proposed quarterly calculation. Should compliance with the $150 million threshold be determined more or less frequently than quarterly? For purposes of reporting on proposed amendments on Form ADV, registered investment advisers (and exempt reporting advisers) would be required to report their regulatory assets under management annually.[199] Should the availability of the exemption under proposed rule 203(m)-1 be conditioned on annual valuation rather than quarterly valuation?

3. Assets Managed in the United States

Under proposed rule 203(m)-1, all of the private fund assets of an adviser with a principal office and place of business in the United States would be considered to be "assets under management in the United States," even if the adviser has offices outside of the United States.[200] A non-U.S. adviser, however, would need only count private fund assets it manages from a place of business in the United States toward the $150 million asset limit under the exemption.[201]

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determining whether it meets the definition of investment company under section 3 of that Act.

199 See proposed rules 204-1(a) and 204-4(a) and proposed General Instruction 3 to Form ADV. See Implementing Release, supra note 25, at section II.B.3. See also Form ADV Release, supra note 132, at 15 ("Advisers must update the amount of their assets under management annually (as part of their annual updating amendment) and make interim amendments only for material changes in assets under management when they are filing an 'other than annual amendment' for a separate reason.").

200 Proposed rule 203(m)-1(a). The proposed rule also would define the United States to have the same meaning as in rule 902(l) of Regulation S under the Securities Act, which is "the United States of America, its territories and possessions, any State of the United States, and the District of Columbia." Proposed rule 203(m)-1(e)(7).

201 Proposed rule 203(m)-1(b). Any assets managed from a U.S. place of business for clients other than private funds would make the exemption unavailable. We understand that others have supported a jurisdictional approach to regulation, which focuses on the primary market in which an adviser conducts its business. See, e.g., G20 WORKING GROUP REPORT, supra note 136, at 16; Testimony of W. Todd Groome, Chairman, The Alternative Investment Management Association, before the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, May 7, 2009, at 3. These commenters propose an approach that looks to the location where the primary business is conducted, which is similar to our territorial approach.

Rule 203(m)-1 would deem all of the assets managed by an adviser to be managed "in the United States" if the adviser's "principal office and place of business" is in the United States. We would look to an adviser's principal office and place of business as the location where the adviser controls, or has ultimate responsibility for, the management of private fund assets, and therefore as the place where all the advisers' assets are managed, although day-to-day management of certain assets may also take place at another location. This approach is similar to the way we have identified the location of the adviser for regulatory purposes under our current rules,[202] which define an adviser's principal office and place of business as the location where it "directs, controls and coordinates" its global advisory activities, regardless of the location where some of the advisory activities might occur.[203] For most advisers, this approach would avoid difficult attribution determinations that would be required if assets are managed by teams located in multiple jurisdictions, or if portfolio managers located in one jurisdiction rely heavily on research or other advisory services performed by employees located in another jurisdiction.

We considered but decided not to propose an approach that would presume that a non-U.S. adviser to private funds offered in the United States would have no assets managed from a location in the United States if its principal office and place of business is not "in the United

202 See rule 203A-3(c); rule 222-1. Both rules define "principal place of business" of an investment adviser as the executive office of the investment adviser from which the officers, partners or managers of the investment adviser direct, control and coordinate the activities of the investment adviser.

203 See proposed rule 203(m)-1(e)(3) (defining "principal office and place of business" as the adviser's executive office from which the officers, partners, or managers of the adviser direct, control, and coordinate the adviser's activities); proposed rule 203(m)-1(e)(2) (defining "place of business," by reference to proposed rule 222-1(a), as (i) an office where the investment adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients, and (ii) any other location that it holds out to the general public as a place where those activities take place).

States."[204] Such an interpretation of the statute would treat U.S. advisers the same as non-U.S. advisers, but would seem to ignore the fact that day-to-day management of some assets of the private fund does in fact take place "in the United States," even though that management is ultimately controlled from outside of the United States. Moreover, it would permit an adviser engaging in substantial advisory activities in the United States to escape our regulatory oversight merely because the adviser's principal office and place of business is outside the United States. This consequence seems at odds not only with section 203(m), but also with the "foreign private adviser" exemption discussed below in which Congress specifically set forth circumstances under which a non-U.S. adviser may be exempt provided it does not have any place of business in the United States, among other conditions.[205]

We request comment on our proposed approach, which is similar to the way we have administered the current private adviser exemption in section 203(b)(3) of the Advisers Act with respect to non-U.S. advisers. Under that exemption (as discussed above), an adviser with a principal office and place of business outside of the United States need only count clients that are residents of the United States towards the 14 client limit.[206] As with other Commission rules that

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204 Under our proposed rule, assets under management for purposes of the exemption are those assets for which the adviser provides "continuous and regular supervisory or management services." See proposed rule 203(m)-1(e)(1); proposed Form ADV: Instructions for Part 1A, instr. 5.b(3). For a non-U.S. adviser, the assets for which the adviser provides such services from a place of business in the United States would count towards the $150 million asset threshold under the exemption. See proposed rule 203(m)-1(b)(2). See also supra note 203 for the definition of "place of business" under proposed rule 203(m)-1(e)(2).

205 See section II.C of this Release.

206 Rule 203(b)(3)-1(b)(5) (adviser with principal office and place of business outside of the United States not required to count clients that are not United States residents, but adviser with principal office and place of business is in the United States must count all clients). Our staff has taken the position that under the existing private adviser exemption, a non-U.S. adviser need not count its non-U.S. clients, including an offshore fund, even if there are U.S. investors in the fund. See ABA Letter, supra note 172, at 2 and discussion infra section II.C.1 of this Release.

adopt a territorial approach, the private adviser exemption is available to a non-U.S. adviser (regardless of its non-U.S. advisory activities) in recognition of the fact that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and in consideration of general principles of international comity.[207] This approach to the exemption is designed to encourage the participation of non-U.S. advisers in the U.S. market by applying the U.S. securities laws in a manner that does not impose U.S. regulatory and operational requirements on an adviser's non-U.S. advisory business.[208]

Should we adopt a different approach that more broadly applies the availability of the private fund adviser exemption to U.S. advisers? We could treat U.S. and non-U.S. advisers alike, in which case a U.S. adviser could exclude assets it manages through non-U.S. offices. Under the proposed rule, would some or most advisers with non-U.S. branch offices re-organize those offices as subsidiaries in order to avoid attributing assets managed to the non-U.S. office? We understand that U.S. advisers that manage private fund assets in a non-U.S. country typically do so through one or more separate subsidiaries organized in such non-U.S. jurisdictions.[209] If

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207 See, e.g., Regulation S (adopting a territorial approach to offers and sales of securities); rule 15a-6 under the Exchange Act (17 CFR 240.15a-6) (providing an exemption from U.S. registration for non-U.S. broker-dealers who limit their activities and satisfy certain conditions).

208 See generally Division of Investment Management, SEC, Protecting Investors: A Half Century of Investment Company Regulation, May 1992, at 223-227 (recognizing that non-U.S. advisers that registered with the Commission were arguably subject to all of the substantive provisions of the Advisers Act with respect to their U.S. and non-U.S. clients, which could result in inconsistent regulatory requirements or practices imposed by the regulations of their local jurisdiction and the U.S. securities laws; in response, advisers could form separate and independent subsidiaries but this could result in U.S. clients having access to a limited number of advisory personnel and reduced access by the U.S. subsidiary to information or research by non-U.S. affiliates).

209 See, e.g., James D. Rosener, Legal Considerations for Establishing Operations in the United States, PEPPER HAMILTON LLP, June 25, 2002, http://www.pepperlaw.com/publications_article.aspx?ArticleKey=186 (creating separate subsidiaries offers benefits, including the ability to offset profits from one subsidiary against losses in another); see also EDWARD F. GREENE, et al., U.S. REGULATION OF THE

so, the proposed rule may have a limited effect on multi-national advisory firms, which for tax or business reasons keep their non-U.S. advisory activities separate from their U.S. advisory activities. Is this understanding correct? Such U.S. advisers would not generally have to count the assets managed by the non-U.S. affiliates under the proposed rule.[210] Should our rule determine "private fund assets" on an aggregated basis if, for example, U.S. and non-U.S. affiliates share advisory duties for a private fund, or if one affiliate provides subadvisory services to another affiliate?

Alternatively, should we interpret "assets under management in the United States" by reference to the source of the assets (i.e., U.S. private fund investors)? Under this approach, a non-U.S. adviser would count the assets of private funds attributable to U.S. investors towards the $150 million threshold, regardless of the location where it manages the private funds. We note that this approach could have the result that fewer non-U.S. advisers would be eligible for the exemption if there are significant assets of U.S. investors in those funds that the advisers manage from a non-U.S. location. This approach could also mean that a U.S. adviser managing assets from, for example, an office in New York City, could manage substantially in excess of $150 million in assets of one or more private funds as long as the investors in those funds were not U.S persons.

Do commenters view either of these alternatives, separately or in combination with our proposed approach, as more closely reflecting the intent of Congress in using the term "assets under management in the United States" and our regulatory interests? Would either alternative approach be easier for advisers to comply with than the one we are proposing to adopt? Would it

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INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS, § 11.02[2].

210 See infra note 270.

be easier for investors to understand the rationale for why an adviser is eligible for the exemption under the proposed approach or either of the alternative approaches?

4. United States Person

Under proposed rule 203(m)-1(b), a non-U.S. adviser could not rely on the exemption if it advised any client that is a United States person other than a private fund.[211] We propose to define a "United States person" generally by incorporating the definition of a "U.S. person" in our Regulation S.[212] Regulation S looks generally to the residence of an individual to determine whether the individual is a United States person,[213] and also addresses the circumstances under which a legal person, such as a trust, partnership or a corporation, is a United States person.[214] Regulation S generally treats legal partnerships and corporations as Unites States persons if they are organized or incorporated in the United States, and trusts by reference to the residence of the trustee.[215] It treats discretionary accounts generally as United States persons if the fiduciary is a resident of the United States.[216]

We are proposing to incorporate Regulation S because it would provide a well-developed body of law that would, in our view, appropriately address many of the questions that will arise under rule 203(m)-1. Moreover, managers to private funds and their counsel must today be familiar with the definition of "U.S. person" under Regulation S in order to comply with other

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211 Proposed rule 203(m)-1(b)(1).

212 Proposed rule 203(m)-1(e)(8).

213 17 CFR 230.902(k)(1)(i).

214 See, e.g., 17 CFR 230.902(k)(1) and (2).

215 17 CFR 230.902(k)(1)(ii) and (iv).

216 17 CFR 230.902(k)(1)(vii).

provisions of the federal securities laws.[217] We ask comment on the proposed use of the Regulation S definition of U.S. person. Should we use a different definition of United States person? We have previously suggested that advisers may rely on an alternative to Regulation S for certain types of clients.[218] Would that approach be less prone to abuse or circumvention or provide greater clarity?

Proposed rule 203(m)-1 contains a special rule for discretionary accounts maintained outside of the United States for the benefit of United States persons.[219] Under the proposed rule, an adviser must treat a discretionary or other fiduciary account as a United States person if the account is held for the benefit of a United States person by a non-U.S. fiduciary who is a related person of the adviser. An adviser could not rely on the exemption if it established discretionary accounts for the benefit of U.S. clients with an offshore affiliate that would then delegate the actual management of the account back to the adviser.[220] We request comment on this special

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217 For instance, our staff has generally taken the interpretive position that an investor that is not a U.S. person under Regulation S is not a U.S. person when determining whether a non-U.S. private fund meets the counting or qualification requirements that apply to U.S. beneficial owners or owners of a private fund under sections 3(c)(1) or 3(c)(7) of the Investment Company Act. We understand that many U.S. and non-U.S. advisers currently follow our staff's guidance and rely on this definition when determining whether a pooled investment vehicle qualifies as a private fund. See Goodwin Procter Letter, supra note 175; ABA Letter, supra note 172. Advisers apply the Regulation S definition of "U.S. person" also for other purposes. See infra note 259.

218 In connection with adopting rule 203(b)(3)-2 under the Advisers Act, we previously noted that commenters had suggested that we incorporate the definition of U.S. person from Regulation S. Pending our reconsideration of the use of the Regulation S definition, we indicated at the time that we would not object if advisers identified U.S. persons by looking: "(i) in the case of individuals to their residence, (ii) in the case of corporations and other business entities to their principal office and place of business, (iii) in the case of personal trusts and estates to the rules set out in Regulation S, and (iv) in the case of discretionary or non-discretionary accounts managed by another investment adviser to the location of the person for whose benefit the account is held." See Hedge Fund Adviser Registration Release, supra note 17, at n.201. We reconsidered the use of Regulation S and concluded it is appropriate as modified in our proposed rule.

219 Proposed rule 203(m)-1(e)(8).

220 Under Regulation S, a discretionary account maintained by a non-U.S. fiduciary (such as an investment adviser) is not a "U.S. person" even if the account is owned by a U.S. person. See

rule. Does our proposed rule adequately address the concern that an adviser could avoid the limitation of the exemption through non-U.S. discretionary accounts?

5. Transition Rule

We propose to include in proposed rule 203(m)-1 a provision giving an adviser one calendar quarter (three months) to register with the Commission after becoming ineligible to rely on the exemption due to an increase in the value of its private fund assets.[221] Because qualification for the exemption depends on remaining below the $150 million threshold on a quarterly basis, an adviser could exceed the limit based on market fluctuations without any new investments from existing or new investors. This three month period would enable the adviser to take steps to register and otherwise come into compliance with the requirements of the Advisers Act applicable to registered investment advisers, including the adoption and implementation of compliance policies and procedures.[222] It would be available only to an adviser that has complied with all applicable Commission reporting requirements.[223] We are not required to provide the safe harbor, and we do not believe it would be appropriate for an adviser to rely on it if the adviser has failed to comply with its reporting requirements. We request comment on this transition period. Is the calendar quarter period sufficient? Should the transition period be longer, such as two calendar quarters, or shorter, such as 30 days? If the adviser determines to expand its advisory business to manage assets other than private funds

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rule 902(k)(1)(vii); rule 902(k)(2)(i).

221 Proposed rule 203(m)-1(d). In effect, an adviser would register by the end of the calendar quarter following the quarter-end date at which private fund assets equaled or exceeded $150 million. If, however, on the succeeding calendar quarter end date, private fund assets have declined below $150 million, then registration would not be required.

222 See rule 206(4)-7.

223 See proposed rule 203(m)-1(d); see also, e.g., proposed rule 204-4 under the Advisers Act (discussed in the Implementing Release, supra note 25, at section II.B).

(e.g., separate accounts), should the transition period also be available? Should a transition period be available at all?

C. Foreign Private Advisers

Section 403 of the Dodd-Frank Act replaces the current private adviser exemption from registration under the Advisers Act with a new exemption for a "foreign private adviser," as defined in new section 202(a)(30).[224] The new exemption is codified as amended section 203(b)(3).

Under section 202(a)(30), a foreign private adviser is any investment adviser that: (i) has no place of business in the United States; (ii) has, in total, fewer than 15 clients in the United States and investors in the United States in private funds advised by the investment adviser; (iii) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million;[225] and (iv) does not hold itself out generally to the public in the United States as an investment adviser.[226] Section 202(a)(30) provides the Commission with authority to increase the $25 million threshold "in accordance with the purposes of this title."[227]

We are proposing a new rule, 202(a)(30)-1, which would define certain terms in section

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224 Section 402 of the Dodd-Frank Act (providing a definition of "foreign private adviser," to be codified at section 202(a)(30) of the Advisers Act). See supra note 23 and accompanying text.

225 Subparagraph (B) of section 202(a)(30) refers to the number of "clients and investors in the United States in private funds," while subparagraph (C) refers to assets of "clients in the United States and investors in the United States in private funds" (emphasis added). We interpret these provisions consistently so that only clients in the United States and investors in the United States should be counted for purposes of subparagraph (B).

226 In addition, the exemption is not available to an adviser that "acts as (I) an investment adviser to any investment company registered under the [Investment Company Act]; or (II) a company that has elected to be a business development company pursuant to section 54 of [that Act] and has not withdrawn its election." Section 202(a)(30)(D)(ii). We interpret subparagraph (II) to prevent an adviser that advises a business development company from relying on the exemption.

227 Section 202(a)(30)(C).

202(a)(30) for use by advisers seeking to avail themselves of the foreign private adviser exemption. Because eligibility for the new foreign private adviser exemption, like the current private adviser exemption, is determined, in part, by the number of clients an adviser has, we propose to include in rule 202(a)(30)-1 the safe harbor rules and many of the client counting rules that appear in rule 203(b)(3)-1, as currently in effect.[228] In addition, we propose to define other terms used in the definition of "foreign private adviser" in section 202(a)(30), including: (i) "investor;" (ii) "in the United States;" (iii) "place of business;" and (iv) "assets under management."[229]

1. Clients

For purposes of the definition of "foreign private adviser," proposed rule 202(a)(30)-1 would include the safe harbor for counting clients currently in rule 203(b)(3)-1, as modified to account for its use in the foreign private adviser context and to eliminate a provision allowing advisers not to count those clients from which they receive no compensation. We note, however, that the foreign private adviser exemption provides a much more limited exemption in this regard than our current rule 203(b)(3)-1 because section 202(a)(30) requires an adviser to also count the number of "investors" of an issuer that is a "private fund" (a term that is defined

228 Rule 203(b)(3)-1, as currently in effect, provides a safe harbor for determining who may be deemed a single client for purposes of the private adviser exemption. We would not, however, carry over from rule 203(b)(3)-1 a provision that distinguishes between advisers whose principal places of business are inside or outside of the United States. Under the definition of "foreign private adviser," an adviser may not have any place of business in the United States. See section 402 of the Dodd-Frank Act (defining "foreign private adviser"); rule 203(b)(3)-1(b)(5). We would also not include rule 203(b)(3)-1(b)(7), which specifies that a client who is an owner of a private fund is a resident where the client resides at the time of the client's investment in the fund. The provision was vacated by Goldstein. See supra note 18. As discussed below, we are proposing to include another, similar, provision in rule 202(a)(30)-1, which would apply to both clients and investors for purposes of the foreign private adviser exemption. See infra note 257 and accompanying text.

229 Proposed rule 202(a)(30)-1(c).

in section 202(a)(29)) managed by the adviser.[230]

Specifically, proposed rule 202(a)(30)-1, like current rule 203(b)(3)-1, would allow an adviser to treat as a single client a natural person and: (i) that person's minor children (whether or not they share the natural person's principal residence); (ii) any relative, spouse, or relative of the spouse of the natural person who has the same principal residence; (iii) all accounts of which the natural person and/or the person's minor child or relative, spouse, or relative of the spouse who has the same principal residence are the only primary beneficiaries; and (iv) all trusts of which the natural person and/or the person's minor child or relative, spouse, or relative of the spouse who has the same principal residence are the only primary beneficiaries.[231] Proposed rule 202(a)(30)-1 would also retain other provisions of rule 203(b)(3)-1 that permit an adviser to treat as a single "client" (i) a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization to which the adviser provides investment advice based on the organization's investment objectives, and (ii) two or more legal organizations that have identical shareholders, partners, limited partners, members, or beneficiaries.[232]

230 See supra note 9.

231 Proposed rule 202(a)(30)-1(a)(1). If a client relationship involving multiple persons does not fall within the rule, the question of whether the relationship may appropriately be treated as a single "client" must be determined on the basis of the facts and circumstances involved.

232 Proposed rule 202(a)(30)-1(a)(2). In addition, proposed rule 202(a)(30)-1(b)(1) through (3) would retain the following related "special rules": (1) an adviser must count a shareholder, partner, limited partner, member, or beneficiary (each, an "owner") of a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization, as a client if the adviser provides investment advisory services to the owner separate and apart from the legal organization; (2) an adviser is not required to count an owner as a client solely because the adviser, on behalf of the legal organization, offers, promotes, or sells interests in the legal organization to the owner, or reports periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters; and (3) any general partner, managing member or other person acting as an investment adviser to a limited partnership or limited liability company must treat the partnership or limited liability company as

We would not include the "special rule" providing advisers with the option of not counting as a client any person for whom the adviser provides investment advisory services without compensation.[233] As noted above, we propose to require advisers to include the assets of such clients in their "regulatory assets under management,"[234] and we propose the same approach with respect to counting clients.[235]

Finally, we propose to add a provision that would avoid double-counting private funds and their investors by advisers.[236] This provision would specify that an adviser need not count a private fund as a client if the adviser counted any investor, as defined in the rule, in that private fund as an investor in that private fund for purposes of determining the availability of the exemption.[237]

We are proposing to include the current rule 203(b)(3)-1 safe harbor for counting clients in proposed rule 202(a)(30)-1 because we believe that application of this provision (as we

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a client.

233 See rule 203(b)(3)-1(b)(4).

234 In the Implementing Release, we are proposing to adopt a uniform method for calculating assets under management for purposes of registration pursuant to which an adviser would count assets that are managed without compensation. In this Release, we propose to apply the proposed method of calculation to the foreign private adviser exemption and the private fund adviser exemption. See infra section II.C.5 of this Release; Implementing Release, supra note 25, at section II.A.3.

235 As discussed in the Implementing Release, our proposed changes to the method of calculating assets under management would remove the option of excluding certain assets from an adviser's calculation in order to avoid registration with the Commission and regulatory requirements associated with registration. See Implementing Release, supra note 25, nn.44-50 and accompanying and following text. Allowing an adviser not to count as clients persons in the United States that do not compensate the adviser would similarly allow certain advisers to avoid registration through reliance on the foreign private adviser exemption despite the fact that the adviser provides advisory services to such persons.

236 See proposed rule 202(a)(30)-1(b)(4).

237 See proposed rule 202(a)(30)-1(b)(4); 202(a)(30)-1(c)(1). See also infra section II.C.2 of this Release (discussing the definition of investor).

propose to modify it) will operate to effect the purposes of the foreign private adviser exemption. Congress replaced the private adviser exemption with the foreign private adviser exemption, both of which require advisers to count clients. As Congress was aware of rule 203(b)(3)-1's counting guidelines when it incorporated a limitation on the number of "clients" in the definition of "foreign private adviser," we believe it would be consistent with Congress's amendment to preserve generally the method for counting clients, together with the requirement to count clients.

We request comment generally on our approach to counting "clients" in proposed rule 202(a)(30)-1 and on each of the specific proposed provisions. Is it appropriate to derive the definition of "client" in proposed rule 202(a)(30)-1 from rule 203(b)(3)-1's definition? Are there alternative approaches we should consider instead? Is including the "special rules" in proposed rule 202(a)(30)-1 appropriate? Are there any that are not appropriate in this context and should not be included in the proposed rule? In particular, should we have maintained the special rule allowing an adviser not to count as a client any person for whom the adviser provides investment advisory services without compensation, even though such person may be treated as a client for other purposes (<u>e.g.</u>, reporting on Form ADV)? Should we modify the proposed rule that allows an adviser not to count a private fund as a client if it counts any investor in that private fund by also providing that an adviser may avoid counting as a client any person it counts as an investor? Finally, are there any further modifications to the definition that we should make?

2. Private Fund Investor

Section 202(a)(30) provides that a "foreign private adviser" eligible for the new registration exemption cannot have more than 14 clients "or investors in the United States in private funds" advised by the adviser. We propose to define "investor" in a private fund in rule

202(a)(30)-1 as any person who would be included in determining the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act, or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of that Act.[238] In order to avoid double-counting, an adviser would be able to treat as a single investor any person who is an investor in two or more private funds advised by the investment adviser.[239]

The term "investor" is not currently defined under the Advisers Act or the rules under the Advisers Act. Defining the term as proposed would ensure consistent application of the statutory provision and prevent, for example, non-U.S. advisers from circumventing the limitations in section 203(b)(3) by using nominee accounts that would aggregate investors into a single nominal investor for purposes of the counting requirement of section 202(a)(30). Under section 203(b)(3), an adviser relying on the foreign private adviser exemption may only have advisory relationships with private funds with a limited number of U.S. investors. Advisers should not be able to avoid this limitation by setting up intermediate accounts through which investors may access a private fund and not be counted for purposes of the exemption.

Defining investors by reference to sections 3(c)(1) and 3(c)(7) of the Investment Company Act may best achieve these purposes. Funds and their advisers must determine who is a beneficial owner for purposes of section 3(c)(1) or whether an owner is a qualified purchaser for purposes of section 3(c)(7).[240] Typically, a prospective investor in a private fund must

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238 See proposed rule 202(a)(30)-1(c)(1); supra notes 8-13 and accompanying text. Under the proposed rule, knowledgeable employees with respect to the private fund (and certain persons related to them) and beneficial owners of short-term paper issued by the private fund would also count as investors. See infra note 246 and accompanying text.

239 See proposed rule 202(a)(30)-1(c)(1), at note to paragraph (c)(1).

240 See supra notes 11 and 13.

complete a subscription agreement that includes representations or confirmations that it is qualified to invest in the fund and whether it is a U.S. person. This information is designed to allow the adviser (on behalf of the fund) to make the above determination. Therefore, an adviser seeking to rely on the foreign private adviser exemption will have ready access to this information.

More important, defining the term "investor" by reference to sections 3(c)(1) and 3(c)(7) appears to appropriately limit the ability of a non-U.S. adviser to avoid application of the registration provisions of the Advisers Act. For example, under the proposed rule, holders of both equity and debt securities would be counted as investors.[241] Advisers, moreover, would have to "look though" nominee and similar arrangements to the underlying holders of private fund-issued securities to determine whether they have fewer than 15 clients and private fund investors in the United States.[242]

Under the proposed rule, an adviser would determine the number of investors in a private fund based on facts and circumstances and in light of the applicable prohibition not to do indirectly, or through or by any other person, what is unlawful to do directly.[243] In the following circumstances, for example, an adviser relying on the exemption would have to count as an investor a person who is not the nominal owner of a private fund's securities. First, the adviser to a master fund in a master-feeder arrangement would have to treat as investors the holders of the securities of any feeder fund formed or operated for the purpose of investing in the master

241 Sections 3(c)(1) and 3(c)(7) of the Investment Company Act refer to beneficial owners and owners, respectively, of "securities" (which is broadly defined in section 2(a)(36) of that Act to include debt and equity).

242 Proposed rule 202(a)(30)-1(c)(1). See generally sections 3(c)(1) and 3(c)(7) of the Investment Company Act.

243 See section 208(d) of the Advisers Act.

fund rather than the feeder funds, which act as conduits.[244] Second, an adviser would need to count as an investor any holder of an instrument, such as a total return swap, that effectively transfers the risk of investing in the private fund from the record owner of the private fund's securities. The record owner of private fund securities could enter into a total return swap transaction to transfer to a third party any profits or losses that the record owner could incur as a result of its investment in the private fund. Thus, even though the record owner would remain the nominal owner of private fund securities, the associated risks of an investment in the securities would have been transferred to the third party who has made the determination to invest in the private fund indirectly through the record owner. In such a case, the third party would be counted as a beneficial owner under section 3(c)(1), or be required to be a qualified purchaser under section 3(c)(7).[245] Accordingly, the third party would be counted as an investor in the private fund for purposes of the foreign private adviser exemption.

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244. A "master-feeder fund" is an arrangement in which one or more funds with identical investment objectives ("feeder funds") invest all of their assets in a single fund ("master fund") with the same investment objective and strategies. We have taken the same approach within our rules that expressly require a private fund to "look-through" any investor that is formed for the specific purpose of investing in a private fund. See rule 2a51-3(a) under the Investment Company Act (17 CFR 270.2a51-3(a)) (a company is not a qualified purchaser if it is "formed for the specific purpose of acquiring the securities" of an investment company that is relying on section 3(c)(7) of the Investment Company Act, unless each of the company's beneficial owners is also a qualified purchaser). See also Privately Offered Investment Companies, Investment Company Act Release No. 22597 (Apr. 3, 1997) [62 FR 17512 (Apr. 9, 1997)] ("NSMIA Release") (explaining that rule 2a51-3(a) would limit the possibility that "a company will be able to do indirectly what it is prohibited from doing directly [by organizing] . . . a 'qualified purchaser' entity for the purpose of making an investment in a particular Section 3(c)(7) Fund available to investors that themselves did not meet the definition of 'qualified purchaser.").

245 As noted above, we have recognized that in certain circumstances it is appropriate to "look through" an investor (i.e., attribute ownership of a private fund to another person who is the ultimate owner). See, e.g., NSMIA Release, supra note 244 ("The Commission understands that there are other forms of holding investments that may raise interpretative issues concerning whether a Prospective Qualified Purchaser 'owns' an investment. For instance, when an entity that holds investments is the 'alter ego' of a Prospective Qualified Purchaser (as in the case of an entity that is wholly owned by a Prospective Qualified Purchaser who makes all the decisions with respect to such investments), it would be appropriate to attribute the investments held by such entity to the Prospective Qualified Purchaser.").

We are also proposing to treat as investors beneficial owners (i) who are "knowledgeable employees" with respect to the private fund, and certain other persons related to such employees (we refer to these, collectively, as "knowledgeable employees");[246] and (ii) of "short-term paper"[247] issued by the private fund,[248] even though these persons are not counted as beneficial owners for purposes of section 3(c)(1), and knowledgeable employees are not required to be qualified purchasers under section 3(c)(7).[249] We are proposing to count knowledgeable employees as investors under the same approach we take with our proposal that advisers count in their calculation of assets under management assets they manage without being compensated, which often include assets of knowledgeable employees.[250] Under our proposed rule, holders of short-term paper, like other debt holders, would also be counted as investors because a private fund's losses directly affect these holders' interest in the fund just as they affect the interest of

246 See proposed rule 202(a)(30)-1(c)(1)(A) (referencing rule 3c-5 under the Investment Company Act (17 CFR 270.3c-5(b)), which excludes from the determinations under sections 3(c)(1) and 3(c)(7) of that Act any securities beneficially owned by knowledgeable employees of a private fund; a company owned exclusively by knowledgeable employees; and any person who acquires securities originally acquired by a knowledgeable employee through certain transfers of interests, such as a gift or a bequest).

247 See proposed rule 202(a)(30)-1(c)(1)(B) (referencing the definition of "short-term paper" contained in section 2(a)(38) of the Investment Company Act, which defines "short-term paper" to mean "any note, draft, bill of exchange, or banker's acceptance payable on demand or having a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof payable on demand or having a maturity likewise limited; and such other classes of securities, of a commercial rather than an investment character, as the Commission may designate by rules and regulations.")

248 See proposed rule 202(a)(30)-1(c)(1).

249 See section 3(c)(1) of the Investment Company Act; rule 3c-5(b) under the Investment Company Act.

250 See supra note 190. As discussed above, our proposed changes to the method of calculating assets under management would preclude some advisers from excluding certain assets from their calculation in order to avoid registration with the Commission and regulatory requirements associated with registration. Allowing an adviser not to count as investors persons that do not compensate the adviser, such as knowledgeable employees, would similarly allow certain advisers to avoid registration by relying on the foreign private adviser exemption.

others debt holders in the fund.[251]

We request comment on our definition of "investor." Does the term require further definition? Does our definition of "investor" appropriately reflect Congress's intent in providing an exemption for foreign private advisers? Under our proposal, advisers would not be able to consolidate investors for counting purposes in the same manner they would be able to consolidate clients under certain circumstances. Should we consider extending to investors the "special rules" for counting clients under proposed rule 202(a)(30)-1? Would this lead to either under-counting or over-counting of investors? Is it appropriate to count as a single investor a person that invests in two or more private funds advised by the adviser? Is it appropriate to treat as investors beneficial owners who are "knowledgeable employees" with respect to the private fund, and of short-term paper issued by the fund?

3. In the United States

Section 202(a)(30)'s definition of "foreign private adviser" employs the term "in the United States" in several contexts including: (i) limiting the number of – and assets under management attributable to – an adviser's "clients" "in the United States" and "investors" "in the United States" in private funds advised by the adviser; (ii) exempting only those advisers without a place of business "in the United States;" and (iii) exempting only those advisers that do not hold themselves out to the public "in the United States" as an investment adviser.[252] We are proposing to define "in the United States" to provide clarification of the term for all of the above

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251 Various types of investment vehicles make significant use of short-term paper for financing purposes so holders of this type of security are, in practice, exposed to the investment results of the security's issuer. See Money Market Fund Reform Release, supra note 134, at nn.37-39 and preceding and accompanying text (discussing how money market funds were exposed to substantial losses during 2007 as a result of exposure to debt securities issued by structured investment vehicles).

252 See section 402 of the Dodd-Frank Act.

purposes as well as provide specific instruction as to the relevant time for making the related determination.

Proposed rule 202(a)(30)-1 defines "in the United States" generally by incorporating the definition of a "U.S. person" and "United States" under Regulation S.[253] In particular, we would define "in the United States" in proposed rule 202(a)(30)-1(c)(2) to mean: (i) with respect to any place of business located in the "United States," as that term is defined in Regulation S;[254] (ii) with respect to any client or private fund investor in the United States, any person that is a "U.S. person" as defined in Regulation S,[255] except that any discretionary account or similar account that is held for the benefit of a person "in the United States" by a non-U.S. dealer or other professional fiduciary is deemed "in the United States" if the dealer or professional fiduciary is a related person of the investment adviser relying on the exemption; and (iii) with respect to the public in the "United States," as that term is defined in Regulation S.[256] In addition, we are proposing to add a note to paragraph (c)(2)(i) specifying that for purposes of that definition, a person that is "in the United States" may be treated as not being "in the United States" if such person was not "in the United States" at the time of becoming a client or, in the case of an investor in a private fund, at the time the investor acquires the securities issued by the fund.[257] We believe that without this note this rule might be burdensome because an adviser

253 Proposed rule 202(a)(30)-1(c)(2). As discussed above, we are also proposing to reference Regulation S's definition of a "U.S. person" for purposes of the definition of "United States person" in rule 203(m)-1. See sections II.B.3 and II.B.4 of this Release (discussing proposed rules 203(m)-1(e)(7) through (8)).

254 See 17 CFR 230.902(l).

255 See 17 CFR 230.902(k).

256 See 17 CFR 230.902(l).

257 Proposed rule 202(a)(30)-1, at note to paragraph (c)(2)(i) ("A person that is in the United States may be treated as not being in the United States if such person was not in the United States at the time of becoming a client or, in the case of an investor in a private fund, at the time the investor

would have to monitor the location of clients and investors on an ongoing basis, and might have to choose between registering with us or terminating the relationship with any client that moved to the United States, or redeeming the interest in the private fund of any investor that moved to the United States.

We believe that the use of Regulation S is appropriate for purposes of the foreign private adviser exemption because Regulation S provides more specific rules when applied to various types of legal structures.[258] Advisers, moreover, already apply the Regulation S definition of U.S. person with respect to both clients and investors for other purposes and therefore are familiar with the definition.[259] The proposed references to Regulation S with respect to a place of business "in the United States" and the public in the "United States" would also allow us to maintain consistency across our rules.

Similar to our approach in proposed rule 203(m)-1(e)(8),[260] we treat as persons "in the United States" for purposes of the foreign private adviser, certain persons that would not be considered "U.S. persons" under Regulation S. We are proposing to treat as a U.S. person

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acquires the securities issued by the fund.").

258 See supra notes 214-216 and accompanying text. See also Letter of Paul, Hastings, Janofsky & Walker LLP (Oct. 29, 2010) ("Paul Hastings Letter") (addressing the foreign private adviser exemption in response to our request for public views, and recommending that we rely on a modified Regulation S definition of "U.S. person" for purposes of defining "in the United States" with respect to clients and investors). See generally supra note 24.

259 Many non-U.S. advisers identify whether a client is a "U.S. person" under Regulation S in order to determine whether such client may invest in certain private funds and certain private placement offerings exempt from registration under the Securities Act. With respect to "investors," our staff has generally taken the interpretive position that an investor that does not meet that definition is not a U.S. person when determining whether a non-U.S. private fund meets the section 3(c)(1) and 3(c)(7) counting or qualification requirements. See supra note 217. Many non-U.S. advisers, moreover, currently determine whether a private fund investor is a "U.S. person" under Regulation S for purposes of the safe harbor for offshore offers and sales.

260 See supra discussion in section II.B.4 of this Release regarding the definition of United States persons and the treatment of discretionary accounts.

discretionary accounts owned by a U.S. person and managed by a non-U.S. affiliate of the adviser in order to discourage non-U.S. advisers from creating such discretionary accounts with the goal of circumventing the exemption's limitation with respect to persons in the United States.[261]

We request comment on the definition of "in the United States" in proposed rule 202(a)(30)-1(c)(2). Is our definition appropriate as it relates to a "place of business?" Is it appropriate as it relates to "clients" and "investors in a private fund?" Is it appropriate as it relates to the "public?" Is it necessary to define "in the United States" for purposes of the definition of "foreign private adviser" in new section 202(a)(30)? Is our understanding of non-U.S. advisers' application of the Regulation S definition correct? Since private funds already rely on the Regulation S definition of U.S. person to determine which investors must qualify to invest in the fund, would adopting a different definition increase regulatory burdens associated with determining eligibility for the proposed exemption?[262] Are there alternatives that would better reflect the intent of Congress in creating a new category of "foreign private advisers" and providing them with an exemption from registration? Is our proposed note regarding the relevant time for determining whether a person is "in the United States" appropriate? If not, how should we modify it?

4. Place of Business

Proposed rule 203(a)(30)-1, by reference to proposed rule 222-1,[263] defines "place of

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261 See supra notes 219-220 and accompanying paragraph.

262 See supra note 217 and accompanying and following text.

263 Rule 222-1(a) (defining "place of business" of an investment adviser as: "(1) An office at which the investment adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; and (2) Any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services,

business" to mean any office where the investment adviser regularly provides advisory services, solicits, meets with, or otherwise communicates with clients, and any location held out to the public as a place where the adviser conducts any such activities.[264] We believe this definition appropriately identifies a location where an adviser is doing business for purposes of section 202(a)(30) of the Advisers Act and thus provides a basis for an adviser to determine whether it can rely on the exemption in section 203(b)(3) of the Advisers Act for foreign private advisers. Because both the Commission and the state securities authorities use this definition to identify an unregistered foreign adviser's place of business for purposes of determining regulatory jurisdiction,[265] it appears to be logical as well as efficient to use the rule 222-1(a) definition of "place of business" for purposes of the foreign private adviser exemption.

We request comment on our definition of "place of business" as it relates to the definition of "foreign private adviser." Is this definition of "place of business" appropriate in this context? Do commenters recommend any alternative definitions?

5. Assets Under Management

For purposes of rule 202(a)(30)-1 we propose to define "assets under management" by reference to the calculation of "regulatory assets under management" for Item 5 of Form ADV.[266] As discussed above, in Item 5 of Form ADV we are proposing to implement a uniform method of calculating assets under management that can be used for several purposes under the

solicits, meets with, or otherwise communicates with clients.").

264 Proposed rule 202(a)(30)-1(c)(3).

265 Under section 222(d) of the Advisers Act, a state may not require an adviser to register if the adviser does not have a "place of business" within, and has fewer than six clients resident in, the state.

266 See proposed rule 202(a)(30)-1(c)(4); instructions to Item 5.F of Form ADV, Part 1A. As discussed above, we are proposing to take the same approach under proposed rule 203(m)-1. See supra section II.B.2 of this Release.

Advisers Act, including the foreign private adviser exemption.[267] Because the foreign private adviser exemption is also based on assets under management, we believe that all advisers should use the same method for calculating assets under management to determine if they are required to register or may be eligible for the exemption. We believe that uniformity in the method for calculating assets under management would result in more consistent asset calculations and reporting across the industry and, therefore, in a more coherent application of the Advisers Act's regulatory requirements and of our staff's risk assessment program.[268]

We request comment on our definition of "assets under management" as it relates to the definition of "foreign private adviser." Is this definition of "assets under management" appropriate in this context? Are there any special considerations relevant to foreign private advisers? Do commenters recommend any alternative definitions? Should assets under management be calculated at a particular point of time? Should we, as proposed, require foreign private advisers to calculate assets under management consistent with the proposed "regulatory assets under management" calculation for Form ADV? Or should we require a different calculation? For example, should foreign private advisers be permitted to exclude proprietary assets or assets they manage without compensation?

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267 See supra note 190 and accompanying text.

268 Id. See also Letter of Shearman and Sterling LLP (Nov. 3, 2010) ("Shearman & Sterling Letter") (in response to our request for public views, arguing that "[w]hile each [exemption related asset threshold established by the Dodd-Frank Act] serves a different purpose, it appears to us that any steps that might be taken in the way of harmonization will facilitate both compliance with the requirements by the industry and their administration by the Commission and its Staff," and suggesting that as an example, we raise the assets under management threshold under the foreign private adviser exemption to $150 million in line with the assets threshold under the private fund adviser exemption). See generally supra note 24.

D. Subadvisory Relationships and Advisory Affiliates

We generally interpret advisers as including subadvisers,[269] and therefore believe it is appropriate to permit subadvisers to rely on each of the new exemptions, provided that subadvisers satisfy all terms and conditions of the applicable proposed rules. We are aware that in many subadvisory relationships a subadviser has contractual privity with a private fund's primary adviser rather than the private fund itself. Although both the private fund and the fund's primary adviser may be viewed as clients of the subadviser, we would consider a subadviser eligible to rely on section 203(m) if the subadviser's services to the primary adviser relate solely to private funds and the other conditions of the exemptions are met. Similarly, a subadviser may be eligible to rely on section 203(l) if the subadviser's services to the primary adviser relate solely to venture capital funds and the other conditions of the rule are met.

We anticipate that an adviser with advisory affiliates will encounter interpretative issues as to whether it may rely on any of the exemptions discussed in this Release without taking into account the activities of its affiliates. The adviser, for example, might have advisory affiliates that are registered or that provide advisory services that are inconsistent with an exemption on which the adviser may seek to rely.[270] We request comment on whether any proposed rule should provide that an adviser must take into account the activities of its advisory affiliates when determining eligibility for an exemption. For example, should the rule specify that the

[269] See, e.g., Pay to Play Release, supra note 10, at n.391-94 and accompanying and following text; Hedge Fund Adviser Registration Release, supra note 17, at n.243.

[270] Generally, a separately formed advisory entity that operates independently of an affiliate may be eligible for an exemption if it meets all of the criteria set forth in the relevant rule. However, the existence of separate legal entities may not by itself be sufficient to avoid integration of the affiliated entities. The determination of whether the advisory businesses of two separately formed affiliates may be required to be integrated is based on the facts and circumstances. Our staff has taken this position in Richard Ellis, Inc., SEC Staff No-Action Letter (Sept. 17, 1981) (discussing the staff's views of factors relevant to the determination of whether a separately formed advisory entity operates independently of an affiliate).

exemption is not available to an affiliate of a registered investment adviser?[271]

III. REQUEST FOR COMMENT

The Commission requests comment on the proposed rules in this Release. We also request suggestions for additional changes to existing rules, and comments on other matters that might have an effect on the proposals contained in this Release. Commenters are requested to provide empirical data to support their views.

IV. PAPERWORK REDUCTION ACT ANALYSIS

The proposed rules do not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[272] Accordingly, the Paperwork Reduction Act is not applicable.

V. COST-BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. We have identified certain costs and benefits of the proposed rules, and we request comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in this analysis. We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in this analysis, and request that commenters provide data that may be relevant to these cost estimates. In addition, we seek

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271 We have received a number of letters requesting interpretative guidance on whether and to what extent certain prior staff positions would apply to the new exemptions provided by the Dodd-Frank Act. See, e.g., Letter of Katten Muchin Rosenman LLP (Sept. 14, 2010); Letter of TA Jones (Sept. 25, 2010); Letter of Ropes & Gray LLP (Nov. 1, 2010) in response to our solicitation for public views. See generally supra note 24. We acknowledge that such determinations will depend on the particular facts and circumstances of non-U.S. advisers. Advisers should consider whether they may avail themselves of either the foreign private adviser exemption or the private fund adviser exemption as proposed in this Release, and are encouraged to submit comment letters addressing with particularity and specificity interpretative issues that may not be addressed in our proposed rules.

272 44 U.S.C. 3501.

estimates and views regarding these benefits and costs for advisers solely to venture capital funds, private fund advisers with less than $150 million in aggregate assets under management and foreign private advisers as well as any other costs or benefits that may result from the adoption of the proposed rules. Where possible, we request commenters provide empirical data to support any positions advanced.

As discussed above, we are proposing rules 203(l)-1, 203(m)-1 and 202(a)(30)-1 to implement certain provisions of the Dodd-Frank Act. As a result of the Dodd-Frank Act's repeal of the private adviser exemption, some advisers that previously were eligible to rely on that exemption will be required to register under the Advisers Act unless these advisers are eligible for a new exemption. Thus, the benefits and costs associated with registration are attributable to the Dodd-Frank Act. The Commission has discretion, however, to adopt rules to define the terms used in the Advisers Act, and we undertake below to discuss the benefits and costs of the defined terms that we are proposing.

A. Definition of Venture Capital Fund

Our proposed rule is designed to: (i) implement the directive from Congress to define the term venture capital fund in a manner that reflects Congress' understanding of what venture capital funds are, and as distinguished from other private equity funds and hedge funds; and (ii) facilitate the transition to the new exemption. Our proposal would define the term venture capital fund consistently with what we believe Congress understood venture capital funds to be, and in light of other provisions of the federal securities laws that seek to achieve similar objectives.[273]

Using these characteristics as our model, we propose to define a venture capital fund as a

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273 See supra notes 38-43 and accompanying and following text.

private fund that: (i) invests in equity securities of private companies in order to provide operating and business expansion capital (i.e., "qualifying portfolio companies") and at least 80 percent of each company's equity securities owned by the fund were acquired directly from the qualifying portfolio company; (ii) directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, the qualifying portfolio company; (iii) does not borrow or otherwise incur leverage (other than limited short-term borrowing); (iv) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (v) represents itself as a venture capital fund to investors; and (vi) is not registered under the Investment Company Act and has not elected to be treated as a BDC.[274]

We propose to define a "qualifying portfolio company" as any company that: (i) is not publicly traded; (ii) does not incur leverage in connection with the investment by the private fund; (iii) uses the capital provided by the fund for operating or business expansion purposes rather than to buy out other investors; and (iv) is not itself a fund (i.e., is an operating company).[275]

We also propose to grandfather existing funds by including in the definition of "venture capital fund" any private fund that: (i) represented to investors and potential investors at the time the fund offered its securities that it is a venture capital fund; (ii) prior to December 31, 2010, has sold securities to one or more investors that are not related persons of any investment adviser of the venture capital fund; and (iii) does not sell any securities to, including accepting any additional capital commitments from, any person after July 21, 2011 (the "grandfathering

274 Proposed rule 203(l)-1(a).

275 Proposed rule 203(l)-1(c)(4).

provision").[276] An adviser seeking to rely on the exemption under section 203(l) of the Advisers Act would be eligible for the venture capital exemption only if it exclusively advised venture capital funds that met all of the elements of the proposed definition or grandfathering provision.

1. Benefits

Based on the testimony presented to Congress and our research, we believe that venture capital funds today would meet most, if not all, of the elements of our proposed definition of venture capital fund. Our proposed definition includes one specific element, however, that may not be characteristic of some existing venture capital funds. The proposed rule defines a venture capital fund as one that does not issue debt or provide guarantees except on a short-term basis (and correspondingly defines a qualifying portfolio company as one that does not borrow or otherwise incur leverage in connection with the venture capital fund investment). We propose this element of the qualifying portfolio company definition because of the focus on leverage in the Dodd-Frank Act as a potential contributor to systemic risk as discussed by the Senate Committee report,[277] and the testimony before Congress that stressed the lack of leverage in venture capital investing.[278] Our research suggests that on occasion, however, some venture capital funds may provide financing on a short-term basis to portfolio companies as a "bridge" between funding rounds.[279] It is possible that certain types of bridge financing currently used by

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276 Proposed rule 203(l)-1(b).

277 See supra note 99. See also S. REP. NO. 111-176, supra note 7, at 73 - 74 (stating that advisers of venture capital funds are not required to register with the SEC because they do not present the same risks as advisers to other private funds that are required to register, and specifying that the Commission shall require advisers of private funds to report systemic risk data including, among other things, information on the "use of leverage, counterparty credit risk exposure, trading and investment positions"). See also supra notes 136-137 and accompanying text.

278 See supra note 100.

279 See, e.g., supra note 83 and accompanying text.

venture capital funds may not satisfy the definition of equity security under our proposed rule.

Although the limitation on acquiring debt securities from portfolio companies may not be characteristic of some existing venture capital funds, the failure of existing venture capital funds to meet the proposed definition would not preclude advisers to those funds from relying on the exemption in section 203(l) of the Advisers Act under our proposed rule. An adviser of existing venture capital funds could avail itself of the exemption under the proposed grandfathering provision provided that each fund (i) has represented to investors that it is a venture capital fund, (ii) has initially sold interests by December 31, 2010, and (iii) does not sell any additional interests after July 21, 2011.[280] We expect that all advisers to existing venture capital funds that currently rely on the private adviser exemption would be exempt from registration in reliance on the proposed grandfathering provision. As a result of this provision, we expect that advisers to existing venture capital funds that do not meet our proposed definition would benefit because those advisers could continue to manage existing funds without having to (i) weigh the relative costs and benefits of registration and modification of fund operations to conform existing funds with our proposed definition and (ii) incur the costs associated with registration with the Commission or modification of existing funds. Advisers to venture capital funds that are in formation that would be able to launch by December 31, 2010 and meet the July 21, 2011 deadline for sales of all securities also would benefit from the grandfathering provision because they would not have to incur these costs.

Going forward, we recognize that some advisers to existing venture capital funds that seek to rely on the exemption in section 203(l) of the Advisers Act might have to structure new funds differently to meet the proposed limitation on qualified portfolio company leverage. To

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280. Proposed rule 203(l)-1(b).

the extent that advisers choose not to change how they structure or manage new funds they launch, those advisers would have to register with the Commission,[281] which offers many benefits to the investing public and facilitates our mandate to protect investors. Registered investment advisers are subject to periodic examinations by our staff and are also subject to our rules including rules on recordkeeping, custody of client funds and compliance programs. We believe that in general Congress considered registration to be beneficial to investors because of, among other things, the added protections offered by registration. Accordingly, Congress limited the section 203(l) exemption to advisers to venture capital funds. As noted above, we proposed certain elements in the portfolio company definition because of the focus on leverage in the Dodd-Frank Act as a potential contributor to systemic risk as discussed by the Senate Committee report,[282] and the testimony before Congress that stressed the lack of leverage in venture capital investing.[283] We expect that distinguishing between venture capital funds and other private funds that pursue investment strategies involving financial leverage that Congress highlighted for concern would benefit financial regulators mandated by the Dodd-Frank Act (such as the Financial Stability Oversight Council) with monitoring and assessing potential systemic risks. Because advisers that manage funds with these characteristics would be required to register, we expect that financial regulators could more easily obtain information and data regarding these financial market participants, which should benefit those regulators to the extent it helps to reduce the overall cost of systemic risk monitoring and assessment.[284]

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281 See infra text following note 294; notes 299-303 and accompanying text for a discussion of potential costs for advisers that would have to choose between registering or restructuring venture capital funds formed in the future.

282 See supra note 99.

283 See supra note 100.

284 See S. REP. NO. 111-176, supra note 7, at 39 (explaining the requirement that private funds

In addition to the benefits discussed above, we expect that investment advisers that seek to rely on the exemption would benefit from the flexibility in the proposed definition of venture capital fund than a more rigid or narrow definition, which should allow them more easily to structure and operate funds that meet the definition. This flexibility should facilitate compliance with the proposed rule and transition to the new exemption. For example, we propose to define equity securities broadly to cover many types of equity securities in which venture capital funds typically invest, rather than limit the definition solely to common stock.[285] To meet the proposed definition, at least 80 percent (not 100 percent) of the equity securities of a portfolio company in which a venture capital fund invests must be acquired directly from the issuing portfolio company (including securities that have been converted into equity securities), but there is no limit as to how the remaining 20 percent could be acquired.[286] Furthermore, under the proposed definition, the venture capital fund may offer or provide managerial assistance to or alternatively control the qualified portfolio company directly, or may do so through its advisers. As noted above, we have modeled this element of the definition in part on existing provisions under the Advisers Act and Investment Company Act dealing with BDCs.[287] Our proposed definition also is designed to be a simplified version of the definition of "making available significant managerial assistance" under the BDC provisions, which we expect would reduce confusion and

disclose information regarding their investment positions and strategies, including information on fund size, use of leverage, counterparty credit risk exposure, trading and investment positions and any other information that the Commission in consultation with the Financial Stability Oversight Council determines is necessary and appropriate to protect investors or assess systemic risk).

285 See supra notes 85-87 and accompanying text.

286 See supra section II.A.1.d of this Release.

287 See supra notes 123-128 and accompanying text.

facilitate understanding of the proposed rule.[288] This approach would preserve flexibility for venture capital funds that invest as a group to determine which members of the group are best qualified, or best able, to control the portfolio company or alternatively to offer (and/or provide) managerial assistance to the portfolio company.

Our proposed definition of qualifying portfolio company is similarly broad because the definition does not restrict qualifying companies to "small or start-up" companies. As we have noted above, we believe that such definitions would be too restrictive and provide venture capital fund advisers with too little flexibility and limited options with respect to potential portfolio company investments.[289] In addition, we propose to define a "qualifying portfolio company" as a company that does not borrow from, or issue debt in connection with the investment from, venture capital funds. Thus, a qualifying portfolio company could borrow for working capital or other operating needs from other lenders, such as banks, without jeopardizing the venture capital fund adviser's eligibility for the exemption. These proposed broad definitions and criteria should benefit advisers that intend to rely on the exemption because they give the adviser flexibility to structure transactions and investments in underlying portfolio companies in a manner that meets their business objectives without unduly creating systemic or other risks of the kind that Congress suggested should require registration of the fund's adviser. For commenters

288 See supra note 128 and accompanying and following text. For example, unlike the BDC provision, the proposed definition does not specifically define managerial assistance by referring to a fund's directors, officers, employees or general partners. In addition, like the BDC provision, the proposed definition would require the venture capital fund to control the qualifying portfolio company (if it does not offer or provide significant managerial assistance), but without reference to exercising a controlling influence because the ability to exercise a controlling influence is inherent in the control relationship. See section 202(a)(12) of the Advisers Act (defining control to mean the power to exercise a controlling influence over the management or policies of a company unless such power is solely the result of an official position with such company). See supra note 129 for the definition of "making available significant managerial assistance" by a BDC.

289 See supra discussion in section II.A.1.a of this Release.

recommending more narrow elements for our definition, we request comment on the costs to advisers of having to change their business practices to comply with such narrower elements.

We believe that the grandfathering provision would promote efficiency because it will allow advisers to existing venture capital funds to continue to rely on the exemption without having to restructure funds that may not meet the proposed definition. It also would allow advisers to funds that are currently in formation and can meet the requirements of the grandfathering provision to rely on the exemption without the potential costs of having to renegotiate with potential investors and restructure those funds within the limited period before the rule must be adopted. Advisers that seek to form new funds should have sufficient time and notice to structure those funds to meet the proposed definition should they seek to rely on the exemption in section 203(l) of the Advisers Act.

Finally, we believe that our proposed definition would include an additional benefit for investors and regulators. Section 203(l) of the Advisers Act provides an exemption specifically for advisers that "solely" advise venture capital funds. Currently none of our rules requires that an adviser exempt from registration specify the basis for the exemption. We are proposing, however, to require exempt reporting advisers to identify the exemption(s) on which they are relying.[290] Requiring that venture capital funds represent themselves as such to investors should allow the Commission and the investing public (particularly potential investors in venture capital funds) to determine, and confirm, an adviser's rationale for remaining unregistered with the Commission. This element is designed to deter advisers to private funds other than venture capital funds from claiming to rely on an exemption from registration for which they are not eligible.

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290 See Implementing Release, supra note 25, at n.130 and accompanying text.

We request comment on the potential benefits we have identified above. Are there benefits of the proposed definition that we have not identified?

2. Costs

Costs for advisers to existing venture capital funds. As discussed above, we do not expect that the proposed rule would result in any significant costs for unregistered advisers to venture capital funds currently in existence and operating. We estimate that currently there are 800 advisers to venture capital funds.[291] We expect that all these advisers, which we assume currently are not registered in reliance on the private adviser exemption, would continue to be exempt after the repeal of that exemption on July 21, 2011 in reliance on the proposed grandfathering provision.[292] We anticipate that such advisers to grandfathered funds would incur minimal costs, at most, to confirm that existing venture capital funds managed by the adviser meet the conditions of the grandfathering provision. We estimate that these costs would

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291 See NVCA Yearbook 2010, supra note 41, at figure 1.04 (providing number of "active" venture capital advisers who have raised a venture capital partnership within the past eight years).

292 We estimate that these advisers (and any other adviser that seeks to remain unregistered in reliance on the exemption under section 203(l) of the Advisers Act) would incur, on average, $2,041 per year to complete and update related reports on Form ADV, including Schedule D information relating to private funds. See Implementing Release, supra note 25, at section IV.B.2. This estimate includes internal costs to the adviser of $1,764 to prepare and submit an initial report on Form ADV and $277 to prepare and submit annual amendments to the report. These estimates are based on the following calculations: $1,764 = ($3,528,000 aggregate costs ÷ 2,000 advisers); $277 = ($554,400 aggregate costs ÷ 2,000 advisers). Id., at nn.337, 339 and accompanying text. We estimate that one exempt reporting adviser would file Form ADV-H per year at a cost of $204 per filing. Id., at n.344 and accompanying text. We further estimate that three exempt reporting advisers would file Form ADV-NR per year at a cost of $57 per filing. Id., at nn.347, 349 and accompanying text. We anticipate that filing fees for exempt reporting advisers would be the same as those for registered investment advisers. See infra note 300. These reporting costs are attributable to the Dodd-Frank Act, which directs the Commission to require advisers to venture capital funds to provide such annual and other reports as we determine necessary or in the public interest or for the protection of investors. See section 203(l) of the Advisers Act.

be no more than $800 to hire outside counsel to assist in this determination.[293]

We recognize, however, that advisers to funds that are currently in the process of being formed and negotiated with investors may incur costs to determine whether they qualify for the grandfathering provision. For example, these advisers may need to assess the impact on the fund of selling interests to initial third party investors by December 31, 2010 and selling interests to all investors no later than July 21, 2011. We do not expect that the cost of evaluating the grandfathering provision would be significant, however, because we believe that most funds in formation represent themselves as being venture capital funds or funds that pursue a venture capital investing strategy to their potential investors and the typical fundraising period for a venture capital fund is approximately 12 months.[294] Thus, we do not anticipate that venture capital fund advisers would have to alter typical business practice to structure or raise capital for venture capital funds being formed. Nevertheless, we recognize that after the final rule goes into effect, exempt advisers of such funds in formation may forgo the opportunity to accept investments from investors that may seek to invest after July 21, 2011 in order to comply with the grandfathering provision.

We request comment on the potential costs of this aspect of our proposed rule. Are there advisers to existing venture capital funds or venture capital funds in formation that would not be covered by the grandfathering provision? We request commenters to quantify the number of

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293 We expect that a venture capital adviser would need no more than 2 hours of legal advice to learn the differences between its current business practices and the conditions for reliance on the proposed grandfathering provision. We estimate that this advice would cost $400 per hour per firm based on our understanding of the rates typically charged by outside consulting or law firms.

294 See BRESLOW & SCHWARTZ, supra note 144, at 2-22 ("Once the first closing [of a private equity fund] has occurred, subsequent closings are typically held over a defined period of time [the marketing period] of approximately six to twelve months."). See also Dow Jones Report, supra note 145, at 22.

these advisers and provide us with specific examples of why such advisers would not be able to rely on the grandfathering provision.

Costs for new advisers and advisers to new venture capital funds. We expect that existing advisers that seek to form new venture capital funds and investment advisory firms that seek to enter the venture capital industry would incur one-time "learning costs" to determine how to structure new funds they may manage to meet the elements of our proposed definition. We estimate that on average, there are 24 new advisers to venture capital funds each year.[295] We expect that the one-time learning costs would be no more than between $2,800 and $4,800 on average for an adviser if it hires an outside consulting or law firm to assist in determining how the elements of our proposed definition may affect intended business practices.[296] Thus, we estimate the aggregate cost to existing advisers of determining how the proposed definition would affect funds they plan to launch would be from $67,200 to $115,200.[297] We request comment on whether these estimates accurately reflect the fees an adviser would be likely to pay to consulting and law firms it hires. As they launch new funds and negotiate with potential investors, these advisers would have to determine whether it is more cost effective to register or to structure the venture capital funds they manage to meet the proposed definition. Such considerations of legal or other requirements, however, comprise a typical business and operating expense of conducting new business. New advisers that enter into the business of

295 This is the average annual increase in the number of venture capital advisers between 1980 and 2009. See NVCA Yearbook 2010, supra note 41, at figure 1.04.

296 We expect that a venture capital adviser would need between 7 and 12 hours of consulting or legal advice to learn the differences between its current business practices and the proposed definition, depending on the experience of the firm and its familiarity with the elements of the proposed rule. We estimate that this advice would cost $400 per hour per firm based on our understanding of the rates typically charged by outside consulting or law firms.

297 This estimate is based on the following calculations: $2,800 x 24 = $67,200; 24 x $4,800 = $115,200.

managing venture capital funds also would incur such ordinary costs of doing business in a regulated industry.[298]

We believe that existing advisers to venture capital funds meet most, if not all, of the elements of the proposed definition because it is modeled on current business practices of venture capital funds. We thus do not anticipate that many venture capital fund advisers would have to change significantly the structure of new funds they launch. Under our proposed definition, an adviser would not be able to rely on the exemption if a venture capital fund invested in securities that were not equity securities issued by qualifying portfolio companies. Although we believe this practice is not common in the industry, this element of our proposed rule may result in some venture capital funds incurring costs to structure and acquire equity investments that possess terms and protections typically found in debt instruments. To the extent that venture capital funds might not be able to structure equity investments in this way, and portfolio companies would have to forgo debt issuance, the proposal could have an adverse effect on capital formation.

We also recognize that some existing venture capital funds may have characteristics that differ from the elements of the proposed definition other than the limitation on investments in debt securities issued by portfolio companies. To the extent that investment advisers seek to form new venture capital funds with these characteristics, those advisers would have to choose whether to structure new venture capital funds to conform to the proposed definition, forgo forming new funds, or register with the Commission. In any case, each investment adviser would assess the costs associated with registering with the Commission relative to the costs of

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298 For estimates of the costs of registration for those advisers that would choose to register, see infra notes 299-304.

remaining unregistered (and hence structuring funds to meet our proposed definition in order to be eligible for the exemption). We expect that this assessment would take into account many factors, including the size, scope and nature of its business and investor base. Such factors will vary from adviser to adviser, but each adviser would determine whether registration, relative to other choices, is the most cost-effective or strategic business option for itself.

To the extent that advisers choose to structure new venture capital funds to conform to the proposed definition, or choose not to form new funds in order to avoid registration, these choices could result in fewer investment choices for investors, less competition and less capital formation. To the extent that advisers choose to register in order to structure new venture capital funds without regard to the proposed definitional elements or in order to expand their business (e.g., pursue additional investment strategies beyond venture capital investing or expand the potential investor base to include investors that are required to invest with registered advisers), these choices may result in greater investment choices for investors, greater competition and greater capital formation.

Investment advisers to new venture capital funds that would not meet the proposed definition would have to register and incur the costs associated with registration (assuming the adviser could not rely on the private fund adviser exemption). We estimate that the internal cost to register with the Commission would be $11,526 on average for a private fund adviser,[299] excluding the initial filing fees and annual filing fees to the Investment Adviser Registration

299 This estimate is based upon the following calculations: $11,526 = ($7,699,860 aggregate costs to complete Form ADV ÷ 750 advisers) + ($1,197,000 aggregate costs to complete private fund reporting requirements ÷ 950 advisers). See Implementing Release, supra note 25, at nn.355-361. This also assumes that an adviser's registration process would be conducted by a senior compliance examiner and a compliance manager at an estimated cost of $210 and $294 per hour, respectively. See Implementing Release, supra note 25, at nn.354 and accompanying text.

Depository ("IARD") system operator.[300] These registration costs include the costs attributable to completing and periodically amending Form ADV, preparing brochure supplements, and delivering codes of ethics to clients.[301] In addition to the internal costs described above, we estimate that for an adviser choosing to use outside legal services to complete its brochure, such costs would be $3,000 to $5,000.[302]

New registrants would also face costs to bring their business operations into compliance with the Advisers Act and the rules thereunder. These costs would vary depending on the size, scope and nature of the adviser's business, but in any case would be an ordinary business and operating expense of entering into any business that is regulated. We estimate that the one-time costs to new registrants to establish a compliance infrastructure would range from $10,000 to $45,000, while ongoing annual costs of compliance and examination would range from $10,000 to $50,000.[303]

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300 The initial filing fee and annual filing fee for advisers with $25 million to $100 million of assets under management is $150 and for advisers with $100 million or more of assets under management is $200. See Electronic Filing for Investment Advisers on IARD: IARD Filing Fees, available at http://www.sec.gov/divisions/investment/iard/iardfee.shtml.

301 Part 1 of Form ADV requires advisers to answer basic identifying information about their business, their affiliates and their owners, information that is readily available to advisers, and thus should not result in significant costs to complete. Registered advisers must also complete Part 2 of Form ADV and file it electronically with us. Part 2 requires disclosure of certain conflicts of interest and could be prepared based on information already contained in materials provided to investors, which could reduce the costs of compliance even further.

302 See Implementing Release, supra note 25, at n.363, 421 (noting the cost estimate for compliance consulting services related to initial preparation of the amended Form ADV ranges from $3,000 for smaller advisers to $5,000 for medium-sized advisers).

303 We expect that most advisers that might choose to register have already built compliance infrastructures as a matter of good business practice. Nevertheless, we expect advisers will incur costs for outside legal counsel to evaluate their compliance procedures initially and on an ongoing basis. We estimate that the costs to advisers to establish the required compliance infrastructure will be, on average, $20,000 in professional fees and $25,000 in internal costs including staff time. These estimates were prepared in consultation with attorneys who, as part of their private practice, have counseled private fund advisers establishing their registrations with the Commission. We have included a range because we believe there are a number of unregistered

We do not believe that the proposed definition of venture capital fund is likely to affect whether advisers to venture capital funds would choose to launch new funds or whether persons would choose to enter into the business of advising venture capital funds because, as noted above, we believe the proposed definition reflects the way most venture capital funds currently operate. For this reason, we expect that the proposed definition is not likely to significantly affect the way in which investment advisers to these funds do business and thus compete. For the same reason, we do not believe that our proposed rule is likely to have a significant effect on overall capital formation.

We request comment on the costs we have discussed above. Are there costs of the proposed definition that we have not identified? How many advisers to venture capital funds are likely to choose to register or structure new venture capital funds differently from their existing funds in order to meet the proposed definition? How costly would it be for advisers to structure new venture capital funds to conform to the proposed definition in order to qualify for an exemption from registration? Would advisers choose not to launch new funds or not enter the venture capital industry in order to avoid the costs associated with structuring venture capital funds to conform to the definition or registration?[304]

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private funds whose compliance operations are already substantially in compliance with the Advisers Act and that would therefore experience only minimal incremental ongoing costs as a result of registration. In connection with previous estimates we have made regarding compliance costs for registered advisers, we received comments from small advisers estimating that their annual compliance costs would be $25,000 and could be as high as $50,000. See, e.g., Comment Letter of Joseph L. Vidich (Aug. 7, 2004). Cf. Comment Letter of Venkat Swarna (Sept. 14, 2004) (estimating costs of $20,000 to $25,000). These comment letters were submitted in connection with Hedge Fund Adviser Registration Release, supra note 17, and are available on the Commission's Internet website at http://www.sec.gov/rules/proposed/s73004.shtml.

304 Commission staff estimates that the one-time costs of registration for a venture capital fund adviser with $150 million in assets under management in the United States (i.e., an adviser that would not qualify for the exemption under section 203(m) of the Advisers Act), would be approximately 0.01% of assets, and annual costs of compliance and examination would range

B. Exemption for Investment Advisers Solely to Private Funds with Less than $150 Million in Assets Under Management

As discussed in Section II.B., proposed rule 203(m)-1 would exempt any investment adviser solely to private funds that has less than $150 million in assets under management in the United States. Our proposed rule is designed to implement the private fund adviser exemption, as directed by Congress, in section 203(m) of the Advisers Act and includes provisions for determining the amount of an adviser's private fund assets for purposes of the exemption and when those assets are deemed managed in the United States.[305]

1. Benefits

As discussed above and in the Implementing Release, we are proposing a uniform method of calculating assets under management in the instructions to Form ADV, which would be used to determine whether an adviser qualifies to register with the Commission rather than the states, and to determine eligibility for the private fund adviser exemption under section 203(m) of the Advisers Act and the foreign private adviser exemption under section 203(b)(3) of the Advisers Act.[306] We anticipate that this uniform approach would benefit regulators (both state

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from 0.007% to 0.03% of assets under management. These figures are based on the following calculations: ($11,526 (registration costs) + $3,000 (lower estimate of external costs to prepare brochure)) ÷ $150,000,000 = 0.000097; ($11,526 (registration costs) + $5,000 (higher estimate of external costs to prepare brochure)) ÷ $150,000,000 = 0.0001); $10,000 (lower estimate of ongoing costs) ÷ $150,000,000 = 0.000067; $50,000 (higher estimate of ongoing costs) ÷ $150,000,000 = 0.000333).

305 See supra sections II.B.2-3 of this Release.

306 See supra note 190 and accompanying text; Implementing Release, supra note 25, at nn.58-59 and accompanying text. Thus, under proposed rule 203(m)-1, to determine its assets under management for purposes of the proposed private fund adviser exemption, an adviser would calculate its "regulatory assets under management" attributable to private funds according to the instructions to Form ADV. Proposed rule 203(m)-1(a)(2), (b)(2) (conditioning the exemption on an adviser managing private fund assets of less than $150 million); proposed rule 203(m)-1(e)(1) (defining "assets under management" for purposes of the proposed rule's exemption); proposed rule 203(m)-1(e)(4) (defining "private fund assets" as the investment adviser's assets under management attributable to a qualifying private fund).

and federal) as well as advisers, because only a single determination of assets under management would be required for purposes of registration and exemption from federal registration.

The instructions to Form ADV currently permit, but do not require, advisers to exclude certain types of managed assets.[307] As a result, it is not possible to conclude that two advisers reporting the same amount of assets under management are necessarily comparable because either adviser may elect to exclude all or some portion of certain specified assets that it manages. By specifying that assets under management must be calculated according to the instructions to Form ADV, our proposed approach should benefit advisers by increasing administrative efficiencies because advisers would have to calculate assets under management only once for multiple purposes.[308] We expect this would minimize costs relating to software modifications, recordkeeping, and training required to determine assets under management for regulatory purposes. We also anticipate that the consistent calculation and reporting of assets under management would benefit investors and regulators because it would provide enhanced transparency and comparability of data, and allow investors and regulators to analyze on a more cost effective basis whether any particular adviser may be required to register with the Commission or is eligible for an exemption.

We anticipate that the valuation of private fund assets under proposed rule 203(m)-1 would benefit private fund advisers that seek to rely on the exemption.[309] Under proposed rule 203(m)-1, each adviser would determine the amount of its private fund assets based on the fair value of the assets at the end of each quarter. We propose that advisers use fair

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307 See proposed Form ADV: Instructions to Part 1A, instr. 5.b(1).

308 See Shearman & Sterling Letter, supra note 268.

309 See proposed rule 203(m)-1(c); Implementing Release, supra note 25, proposed Form ADV: Instructions to Part 1A, instr. 5.b(4).

value of private fund assets in order to ensure that, for purposes of this exemption, advisers value private fund assets on a meaningful and consistent basis. We understand that many, but not all, advisers to private funds value assets based on their fair value in accordance with GAAP or other international accounting standards.[310] We acknowledge that some advisers to private funds may not use fair value methodologies, which may be more difficult to apply when the fund holds illiquid or other types of assets that are not traded on organized markets.

Proposed rule 203(m)-1(c) specifies that an adviser relying on the exemption would determine the amount of its private fund assets quarterly, which we believe would benefit advisers. We understand that a quarterly calculation of assets under management is consistent with business practice – many types of private funds calculate fees payable to advisers and other service providers on at least a quarterly basis.[311] The quarterly calculation also would allow advisers that rely on the exemption to maintain the exemption despite short-term market value fluctuations that might result in the loss of the exemption if, for example, the rule required daily valuation. We expect that quarterly valuation would also benefit these advisers by allowing them to avoid the cost of more frequent valuations, including costs (such as third party quotes) associated with valuing illiquid assets, which may be particularly difficult to value more often because of the lack of frequency with which such assets are traded.

Under proposed rule 203(m)-1(a), all of the private fund assets of an adviser with a principal office and place of business in the United States would be considered to be "assets under management in the United States," even if the adviser has offices outside of the United

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310 See supra note 196.

311 See supra section II.B.2 of this Release; see, e.g., BRESLOW & SCHWARTZ, supra note 144, at § 2.8.2[C].

States.[312] A non-U.S. adviser would need only count private fund assets it manages from a place of business in the U.S. toward the $150 million limit under the exemption. As discussed below, we believe that this interpretation of "assets under management in the United States" would offer greater flexibility to advisers and reduce many costs associated with compliance. These costs could include difficult attribution determinations that would be required if assets are managed by teams located in multiple jurisdictions or if portfolio managers located in one jurisdiction rely heavily on research or other advisory services performed by employees located in another jurisdiction.

To the extent that this interpretation may increase the number of advisers subject to registration under the Advisers Act, we anticipate that our proposal also would benefit investors by providing more information about those advisers (e.g., information that would become available through Form ADV, Part I). We further anticipate that this would enhance investor protection by increasing the number of advisers registering pursuant to the Advisers Act and by improving the Commission's ability to exercise its investor protection and enforcement mandates over those newly registered advisers. As discussed above, registration offers benefits to the investing public, including periodic examination of the adviser and compliance with rules requiring recordkeeping, custody of client funds and compliance programs.[313]

Under proposed rule 203(m)-1(b), a non-U.S. adviser with no U.S. place of business could avail itself of the exemption under section 203(m) even if it advised non-U.S. clients that

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312 As discussed above, the proposed rule looks to an adviser's principal office and place of business as the location where it directs, controls and coordinates its global advisory activities. Proposed rule 203(m)-1(e)(3). See supra notes 202-203 and accompanying text.

313 See supra text following note 281 and preceding and accompanying text.

are not private funds, provided that it did not advise any U.S. clients other than private funds.[314] We anticipate that the proposed approach to the exemption under section 203(m) of the Advisers Act, which would look primarily to the principal office and place of business of an adviser to determine eligibility for the exemption, would increase the number of non-U.S. advisers that may be eligible for the exemption. As with other Commission rules that adopt a territorial approach, the private fund adviser exemption would be available to a non-U.S. adviser (regardless of its non-U.S. advisory activities) in recognition that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and in consideration of general principles of international comity. This approach to the exemption is designed to encourage the participation of non-U.S. advisers in the U.S. market by applying the U.S. securities laws in a manner that does not impose U.S. regulatory and operational requirements on an adviser's non-U.S. advisory business.[315] We anticipate that our proposed interpretation of the availability of the private fund adviser exemption for non-U.S. advisers may benefit those advisers by facilitating their continued participation in the U.S. market with limited disruption to their non-U.S. advisory business practices.[316] This approach also might benefit U.S. investors and facilitate competition in the market for advisory services to the extent that it would maintain or increase U.S. investors' access to potential advisers. Furthermore, because non-U.S. advisers that elect to avail themselves of the exemption would be subject to certain reporting requirements,[317] our proposed approach would increase the availability of information publicly available to U.S. investors who

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314 By contrast, a U.S. adviser could "solely advise private funds" as specified in the statute. Compare proposed rule 203(m)-1(a)(1) with proposed rule 203(m)-1(b)(1).

315 See supra note 208 and accompanying text.

316 See supra section II.B.3 of this Release.

317 See Implementing Release, supra note 25, at section II.B.

invest in the private funds advised by such exempt but reporting non-U.S. advisers.

We request comment on the potential benefits we have identified above. Are there benefits of the proposed rule that we have not identified?

2. Costs

As noted above, under proposed rule 203(m)-1, we would look to an adviser's principal office and place of business as the location where the adviser directs, controls or has responsibility for, the management of private fund assets and therefore as the place where all the adviser's assets are managed. Thus, a U.S. adviser would include all its private fund assets under management in determining whether it exceeds the $150 million limit under the exemption. We also look to where day-to-day management of private fund assets may occur for purposes of a non-U.S. adviser, whose principal office and place of business is outside the United States.[318] A non-U.S. adviser therefore would count only the private fund assets it manages from a place of business in the United States in determining the availability of the exemption. This approach is similar to the way we have defined the location of the adviser for regulatory purposes under our current rules,[319] and thus we believe it is the way in which most advisers would interpret the exemption without our proposed rule.[320] We anticipate that our proposed approach would

318 See supra paragraph accompanying note 205.

319 See supra note 202 and accompanying text.

320 We do not believe that the statutory text refers to where the assets themselves may be located or traded or the location of the account where the assets are held. In today's market, using the location of assets would raise numerous questions of where a security with no physical existence is "located." Although physical stock certificates were once sent to investors as proof of ownership, stock certificates are now centrally held by securities depositories, which perform electronic "book-entry" changes in their records to document ownership of securities. This arrangement reduces transmittal costs and increases efficiencies for securities settlements. See generally BANK FOR INTERNATIONAL SETTLEMENTS, THE DEPOSITORY TRUST COMPANY: RESPONSE TO THE DISCLOSURE FRAMEWORK FOR SECURITIES SETTLEMENT SYSTEMS (2002), http://www.bis.org/publ/cpss20r3.pdf. An account also has no physical location even if the prime broker, custodian or other service that holds assets on behalf of the customer does. Each of these

promote efficiency because advisers are familiar with it, and we do not anticipate that U.S. investment advisers to private funds would likely change their business models, the location of their private funds, or the location where they manage assets as a result of the proposed rule. We anticipate, however that non-U.S. advisers may incur minimal costs to determine whether they have assets under management in the U.S. We estimate that these costs would be no greater than $6,940 to hire U.S. counsel and perform an internal review to assist in this determination, in particular to assess whether a non-U.S. affiliate manages a discretionary account for the benefit of a United States person under the proposed rule.[321]

As noted above, because our rule is designed to encourage the participation of non-U.S. advisers in the U.S. market, we anticipate that it would have minimal regulatory and operational burdens on foreign advisers and their U.S. clients. Non-U.S advisers would be able to rely on proposed rule 203(m)-1 if they manage U.S. private funds with more than $150 million in assets from a non-U.S. location as long as the private fund assets managed from a U.S. place of business are less than $150 million. This could affect competition with U.S. advisers, which must register when they have $150 million in private fund assets under management regardless of where the assets are managed.

To avail themselves of proposed rule 203(m)-1, some advisers might choose to move their principal office and place of business outside the United States and manage private funds from that location. This might result in costs to U.S. investors in private funds that are managed by these advisers because they would not have the investor protection and other benefits that

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approaches would be confusing and extremely difficult to apply on a consistent basis.

321 We expect that a non-U.S. adviser would need no more than 10 hours of external legal advice (at $400 per hour) and 10 hours of internal review by a senior compliance officer (at $294 per hour) to evaluate whether the adviser would qualify for the exemption under section 203(l).

result from an adviser's registration under the Advisers Act. We do not expect that many advisers would be likely to relocate for purposes of avoiding registration, however, because we understand that the primary reasons for advisers to locate in a particular jurisdiction involve tax and other business considerations. We also note that if an adviser did relocate, it would incur the costs of regulation under the laws of most of the foreign jurisdictions in which it may be likely to relocate. We do not believe, in any case, that the adviser would relocate if relocation would result in a material decrease in the amount of assets managed because that loss would likely not justify the benefits of avoiding registration, and thus we do not believe our proposed rule would have an adverse effect on capital formation.

Our proposed rule incorporates the valuation methodology in the instructions to Form ADV. More specifically, proposed instruction 5.b(4) to Form ADV would require advisers to use fair value of private fund assets for determining regulatory assets under management. We acknowledge that there may be some private fund advisers that may not use fair value methodologies.[322] The costs incurred by these advisers to use fair valuation methodology would vary based on factors such as the nature of the asset, the number of positions that do not have a market value, and whether the adviser has the ability to value such assets internally or would rely on a third party for valuation services.[323] Nevertheless, we do not believe that the requirement to use fair value methodologies would result in significant costs for these advisers. We understand that private fund advisers, including those that may not use fair value methodologies for reporting purposes, perform administrative services, including valuing assets, internally as a

322 See supra note 310 and accompanying and following text.

323 See supra note 197.

matter of business practice.[324] Commission staff estimates that such an adviser would incur $1,224 in internal costs to conform its internal valuations to a fair value standard.[325] In the event a fund does not have an internal capability for valuing specific illiquid assets, we expect that it could obtain pricing or valuation services from an outside administrator or other service provider. In the event a fund does not have an internal capability for valuing specific illiquid assets, we expect that it could obtain pricing or valuation services from an outside administrator or other service provider. Staff estimates that the cost of such a service would range from $1,000 to $120,000 annually, which could be borne by several funds that invest in similar assets or have similar investment strategies.[326] We request comment on these estimates. Do advisers that do

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324 For example, a hedge fund adviser may value fund assets for purposes of allowing new investments in the fund or redemptions by existing investors, which may be permitted on a regular basis after an initial lock-up period. An adviser to private equity funds may obtain valuation of portfolio companies in which the fund invests in connection with financing obtained by those companies. Advisers to private funds also may value portfolio companies each time the fund makes (or considers making) a follow-on investment in the company. Private fund advisers could use these valuations as a basis for complying with the fair valuation requirement we propose with respect to private fund assets.

325 This estimate is based upon the following calculation: 8 hours x $153/hour = $1,224. The hourly wage is based on data for a fund senior accountant from SIFMA's Management and Earnings in the Securities Industry 2009, 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.

326 These estimates are based on conversations with valuation service providers. We understand that the cost of valuation for illiquid fixed income securities generally ranges from $1.00 to $5.00 per security, depending on the difficulty of valuation, and is performed for clients on weekly or monthly basis. We understand that appraisals of privately placed equity securities may cost from $3,000 to $5,000 with updates to such values at much lower prices. For purposes of this cost benefit analysis, we are estimating the range of costs for (i) a private fund that holds 50 fixed income securities at a cost of $5.00 to price and (ii) a private fund that holds privately placed securities of 15 issuers that each cost $5,000 to value initially and $1,000 thereafter. We believe that costs for funds that hold both fixed-income and privately placed equity securities would fall within the maximum of our estimated range. We note that funds that have significant positions in illiquid securities are likely to have the in-house capacity to value those securities or already subscribe to a third party service to value them. We note that many private funds are likely to have many fewer fixed income illiquid securities in their portfolios, some or all of which may cost less than $5.00 per security to value. Finally, we note that obtaining valuation services for a small number of fixed income positions on an annual basis may result in a higher cost for each security or require a subscription to the valuation service for those that do not already purchase

not use fair value methodologies for reporting purposes have the ability to fair value private fund assets internally? If not, what would be the costs to retain a third party valuation service? Are there certain types of advisers (e.g., advisers to real estate private funds) that would experience special difficulties in performing fair value analyses? If so, why?

Our earlier discussion of the proposed rule also seeks comment on an alternative interpretation of "assets under management in the United States," which would reference the source of the assets (i.e., U.S. private fund investors).[327] Under this approach, a non-U.S. adviser would count the assets of private funds attributable to U.S. investors towards the $150 million threshold, regardless of the location where it manages private funds, and a U.S. adviser would exclude assets that are not attributable to U.S. investors. As a result, under this alternative more U.S. advisers might be able to rely on rule 203(m)-1 than under our proposed approach. To the extent that non-U.S. advisers have U.S. investors in funds that they manage from a non-U.S. location, fewer non-U.S. advisers would be eligible for the exemption under this approach than under our proposal. Thus, this alternative could increase costs for those non-U.S. advisers who would have to register but reduce costs for those U.S. advisers who would not have to register. We seek comment on the number of U.S. advisers that would be able to avail themselves of the private fund adviser exemption under this alternative approach, but would not be able to rely on proposed rule 203(m)-1.

This alternative approach could discourage U.S. advisers that may want to avoid registration from managing U.S. investor assets, which could affect competition for the management of those assets. We believe this is unlikely however, because to the extent the

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such services. The staff's estimate is based on the following calculations: (50 x $5.00 x 4 = $1,000; (15 x $5,000) + (15 x $1,000 x 3) = $120,000).

327 See supra paragraph following note 210.

adviser would manage fewer assets we do not believe the loss of managed assets would justify the savings from avoiding registration.

Under either the proposed approach or the alternative, each adviser may incur costs to evaluate whether it would be able to avail itself of the exemption. We estimate that each adviser may incur between $800 to $4,800 in legal advice to learn whether it may rely on the exemption.[328] Each adviser that registers would incur registration costs, which we estimate would be $11,526.[329] They also would incur estimated initial compliance costs ranging from $10,000 to $45,000 and ongoing annual compliance costs from $10,000 to $50,000.[330] Nevertheless, to the extent there would be an increase in registered advisers, as we have noted above, there are benefits to registration for both investors and the Commission.[331]

We seek comment on our analysis of the costs associated with the approach we have proposed and the costs of the alternative on which we seek comment. Are there costs of the proposed rule or the alternative approach that we have not identified?

C. Foreign Private Adviser Exemption

Section 403 of the Dodd-Frank Act replaces the current private adviser exemption from registration under the Advisers Act with a new exemption for a "foreign private adviser," as defined in new section 202(a)(30) of the Advisers Act.[332] We are proposing new rule

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328 We expect that a private fund adviser would obtain between 2 and 12 hours of external legal advice (at a cost of $400 per hour) to determine whether it would be eligible for the private fund adviser exemption.

329 This range is attributable to the amount of assets under management, which affects the magnitude of filing fees associated with registration, and whether the adviser chooses to retain outside legal services to prepare its brochure. See supra notes 300-302 and accompanying text.

330 See supra note 303 and accompanying text.

331 See supra text following note 281.

332 See supra note 224 and accompanying text. The new exemption is codified as amended

202(a)(30)-1, which would define certain terms in section 202(a)(30) for use by advisers seeking to avail themselves of the foreign private adviser exemption.[333] Because eligibility for the new foreign private adviser exemption, like the current private adviser exemption, is determined, in part, by the number of clients an adviser has, we propose to include in rule 202(a)(30)-1 the safe harbor and many of the client counting rules that appear in rule 203(b)(3)-1, as currently in effect.[334] In addition, we propose to define other terms used in the definition of "foreign private adviser" under section 202(a)(30) including: (i) "investor;" (ii) "in the United States;" (iii) "place of business;" and (iv) "assets under management."[335]

Proposed rule 202(a)(30)-1 clarifies several provisions used in the statutory definition of "foreign private adviser." First, the proposed rule would include the safe harbor for counting clients currently in rule 203(b)(3)-1, as modified to account for its use in the foreign private adviser context. Under the safe harbor, an adviser would count certain natural persons as a single client under certain circumstances.[336] Proposed rule 202(a)(30)-1 would also retain another provision of rule 203(b)(3)-1 that permits an adviser to treat as a single "client" an entity that receives investment advice based on the entity's investment objectives and two or more entities that have identical owners.[337] As mentioned above, we would not include the

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section 203(b)(3).

333 See supra section II.C of this Release.

334 See supra section II.C.1 of this Release. Rule 203(b)(3)-1, as currently in effect, provides a safe harbor for determining who may be deemed a single client for purposes of the private adviser exemption. We would not, however, carry over rules 203(b)(3)-1(b)(4), (5), or (7). See supra notes 228 and 233 and accompanying text.

335 Proposed rule 202(a)(30)-1(c). See supra section II.C.2-4 of this Release.

336 Proposed rule 202(a)(30)-1(a)(1).

337 Proposed rule 202(a)(30)-1(a)(2)(i)-(ii). In addition, proposed rule 202(a)(30)-1(b)(1) through (3) would retain the following related "special rules": (1) an adviser must count a shareholder, partner, limited partner, member, or beneficiary (each, an "owner") of a corporation, general partner, limited partner, member, or beneficiary

"special rule" that allows advisers not to count as a client any person for whom the adviser provides investment advisory services without compensation.[338] Finally, we propose to add a provision that would permit advisers to avoid double-counting private funds and their investors.[339]

Second, section 202(a)(30) provides that a "foreign private adviser" eligible for the new registration exemption cannot have more than 14 clients "or investors." We propose to define "investor" in a private fund in rule 202(a)(30)-1 as any person that would be included in determining the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act, or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of that Act.[340] We are also proposing to treat as investors beneficial owners (i) who are "knowledgeable employees" with respect to the private fund;[341] and (ii) of "short-term paper"[342] issued by the private fund,

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partnership, limited partnership, limited liability company, trust, or other legal organization, as a client if the adviser provides investment advisory services to the owner separate and apart from the legal organization; (2) an adviser is not required to count an owner as a client solely because the adviser, on behalf of the legal organization, offers, promotes, or sells interests in the legal organization to the owner, or reports periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters; and (3) any general partner, managing member or other person acting as an investment adviser to a limited partnership or limited liability company must treat the partnership or limited liability company as a client.

338 See rule 203(b)(3)-1(b)(4); supra notes 233-235 and accompanying text.

339 See proposed rule 202(a)(30)-1(b)(4) (specifying that an adviser would not be required to count a private fund as a client if it counted any investor, as defined in the proposed rule, in that private fund as an investor in the United States in that private fund).

340 See proposed rule 202(a)(30)-1(c)(1); supra section II.C.2 of this Release. In order to avoid double-counting, we would allow an adviser to treat as a single investor any person that is an investor in two or more private funds advised by the investment adviser. See proposed rule 202(a)(30)-1(c)(1), at note to paragraph (c)(1).

341 See proposed rule 202(a)(30)-1(c)(1)(A); supra note 246 and accompanying text.

342 See proposed rule 202(a)(30)-1(c)(1)(B); supra notes 247-248 and accompanying text.

even though these persons are not counted as beneficial owners for purposes of section 3(c)(1), and knowledgeable employees are not required to be qualified purchasers under section 3(c)(7).[343]

Third, proposed rule 202(a)(30)-1 defines "in the United States" generally by incorporating the definition of a "U.S. person" and "United States" under Regulation S.[344] In particular, we would define "in the United States" in proposed rule 202(a)(30)-1 to mean: (i) with respect to any place of business located in the "United States," as that term is defined in Regulation S;[345] (ii) with respect to any client or private fund investor in the United States, any person that is a "U.S. person" as defined in Regulation S,[346] except that under the proposed rule, any discretionary account or similar account that is held for the benefit of a person "in the United States" by a non-U.S. dealer or other professional fiduciary is a person "in the United States" if the dealer or professional fiduciary is a related person of the investment adviser relying on the exemption; and (iii) with respect to the public in the "United States," as that term is defined in Regulation S.[347] Fourth, proposed rule 202(a)(30)-1 defines "place of business" to have the same meaning as in Advisers Act rule 222-1(a).[348] Finally, for purposes of rule 202(a)(30)-1 we

343 See rule 3c-5(b) under the Investment Company Act; section 3(c)(1) of the Investment Company Act. See also supra note 249 and accompanying text.

344 Proposed rule 202(a)(30)-1(c)(2). See supra notes 253-261 and accompanying paragraphs.

345 See 17 CFR 230.902(l).

346 See 17 CFR 230.902(k). We would allow foreign advisers to determine whether a client or investor is "in the United States" by reference to the time the person became a client or an investor. See proposed rule 202(a)(30)-1's note to paragraph (c)(2)(i).

347 See 17 CFR 230.902(l).

348 See proposed rule 202(a)(30)-1(c)(3); proposed rule 222-1(a) (defining "place of business" of an investment adviser as: "(i) An office at which the investment adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; and (ii) Any other location that is held out to the general public as a location at which the investment

propose to define "assets under management" by reference to "regulatory assets under management" as determined under Item 5 of Form ADV.[349]

1. Benefits

We are proposing to define certain terms included in the statutory definition of "foreign private adviser" in order to clarify the meaning of these terms and reduce the potential administrative and regulatory burdens for advisers that seek to rely on the foreign private adviser exemption. As discussed above, our proposed rule references definitions set forth in other Commission rules under the Advisers Act, the Investment Company Act and the Securities Act, all of which are likely to be familiar to foreign advisers active in the U.S. capital markets. We anticipate that by defining these terms, we would benefit foreign advisers by providing clarity with respect to the proposed terms that advisers would otherwise be required to interpret (and which they would likely interpret with reference to the rules we reference).[350] The proposal would provide consistency among these other rules and the new exemption. This would limit foreign advisers' need to undertake additional analysis with respect to these terms for purposes of determining the availability of the foreign private adviser exemption.[351] We believe that the

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adviser provides investment advisory services, solicit, meets with, or otherwise communicates with clients."). See supra section II.C.4 of this Release.

349 See proposed rule 202(a)(30)-1(c)(4); proposed Form ADV: Instructions to Part 1A, instr. 5.b(4). See also supra section II.C.5 of this Release.

350 See Paul Hastings Letter, supra note 258 (in response to our request for public views, urging us to provide guidance on the interpretation of the terms of the statutory definition of "foreign private adviser"). See generally supra note 24.

351 This is true for all of the proposed definitions except for "assets under management." An adviser that relies on the foreign private adviser exemption would need to calculate its assets under management according to the proposed instructions to Item 5 of Form ADV only for purposes of the availability of the exemption. As discussed, above, proposed rule 202(a)(30)-1 includes a reference to Item 5 of Form ADV in order to ensure consistency in the calculation of assets under management for various purposes under the Advisers Act. See supra note 266 and accompanying text.

consistency and clarity that would result from the proposed rule would promote efficiency for foreign advisers and the Commission.

For example, for purposes of determining eligibility for the foreign private adviser exemption, advisers would count clients substantially in the same manner they count clients under the current private adviser exemption.[352] In identifying "investors," advisers could rely on the determination made to assess whether the private fund meets the counting or qualification requirements under sections 3(c)(1) and 3(c)(7) of the Investment Company Act.[353] In determining whether a client, an investor, or a place of business is "in the United States," or whether it holds itself out as an investment adviser to the public "in the United States," an adviser would apply the same analysis it would otherwise apply under Regulation S.[354] In identifying whether it has a place of business in the United States, an adviser would use the definition of "place of business" under section 222 of the Advisers Act, which is used to determine whether a state may assert regulatory jurisdiction over the adviser.[355]

As noted above, the proposed definitions of "investor" and "United States" under our proposed rule would rely on existing definitions, with slight modifications.[356] Our proposed rule also would incorporate the current safe harbor in rule 203(b)(3)-1 for counting clients, except that it would no longer allow an adviser to disregard clients for whom the adviser provides

352 See supra section II.C.1 of this Release.

353 See supra paragraph accompanying note 240.

354 See supra notes 258-259 and accompanying paragraph.

355 See supra section II.C.3 of this Release. Under section 222 of the Advisers Act a state may not require an adviser to register if the adviser does not have a "place of business" within, and has fewer than 6 client residents of, the state.

356 See supra notes 238, 246-251, 253-257 and accompanying text.

services without compensation.[357] We propose these modifications in order to preclude some advisers from excluding certain assets or clients from their calculation so as to avoid registration with the Commission and the regulatory requirements associated with registration.[358] We believe that without a definition of these terms, advisers would likely rely on the same definitions we propose to cross reference in rule 202(a)(30)-1, but without the proposed modifications. Our proposal, therefore, would likely have the practical effect of narrowing the scope of the exemption, and thus would result in more advisers registering.

We believe that any increase in registration as compared to the number of foreign advisers that might register if we did not propose rule 202(a)(30)-1 would benefit investors. Investors whose assets are, directly or indirectly, managed by the foreign advisers that would be required to register would benefit from the increased protection afforded by federal registration of the adviser and application to the adviser of all of the requirements of the Advisers Act. As noted above, registration offers benefits to the investing public, including periodic examination of the adviser and compliance with rules requiring recordkeeping, custody of client funds and compliance programs.[359]

We request comment on the potential benefits we have identified above. Are there benefits of the proposed rule that we have not identified?

2. Costs

We do not believe that the proposed definitions would result in significant costs for foreign advisers. We anticipate that each foreign adviser that seeks to avail itself of the foreign

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357 See supra notes 336-339 and accompanying text.

358 See supra notes 246-251, 253-257 and accompanying text. See also infra notes 362-363 and accompanying text for an estimate of the costs associated with registration.

359 See supra text accompanying and following note 281.

private adviser exemption may incur costs to determine whether it is eligible for the exemption. We expect that these advisers would consult with outside U.S. counsel and perform an internal review of the extent to which an advisory affiliate manages discretionary accounts owned by a U.S. person that would be counted toward the limitation on clients and investors in the United States. We estimate these costs would be $6,940.[360]

Without the proposed rule, we expect that most advisers would interpret the new statutory provision by reference to the same rules we propose to cross reference in rule 202(a)(30)-1. Without our proposal, some advisers would likely incur additional costs because they would seek guidance in interpreting the terms used in the statutory exemption. By defining the statutory terms in a rule, we believe that we can provide certainty for foreign advisers and limit the time, compliance costs and legal expenses foreign advisers might incur in seeking an interpretation, all of which costs could inhibit capital formation or reduce efficiency. We expect that advisers also would be less likely to seek additional assistance from us because they could rely on relevant guidance we have previously provided with respect to the definitions we propose to cross reference. We also believe that foreign advisers' ability to rely on the definitions that we have referenced in the proposed rule and the guidance provided with respect to the referenced rules may reduce Commission resources that would be otherwise applied to administering the private foreign adviser exemption, which resources could be allocated to other matters.

We anticipate that our proposed instruction allowing foreign advisers to determine whether a client or investor is "in the United States" by reference to the time the person became a

360 This estimate is based on consultation with outside counsel (at a cost of $400 per hour) of 10 hours and an internal review of discretionary accounts owned by U.S. persons performed by a senior compliance officer (at a cost of $294 per hour) of 10 hours. The calculation is as follows: (10 hours x $400) + (10 hours x $294) = $6,940.

client or an investor, would also reduce advisers' costs.[361] Advisers would make the determination only once and would not be required to monitor changes in the status of each client and private fund investor. Moreover, if a client or an investor moved to the United States, under our approach the adviser would not be forced to choose among registering with us, terminating the relationship with the client, or forcing the investor out of the the private fund.

The proposed modifications may result in some costs for foreign advisers who might change their business practices in order to rely on the exemption. Some foreign advisers may have to choose to limit the scope of their contacts with the United States in order to rely on the statutory exemption for foreign private advisers or to register with us. As noted above, we have estimated the costs of registration to be $11,526.[362] In addition, registered advisers would incur initial costs to establish a compliance infrastructure, which we estimate would range from $10,000 to $45,000 and ongoing annual costs of compliance and examination, which we estimate would range from $10,000 to $50,000.[363] In either case, foreign advisers would assess the costs of registering with the Commission relative to relying on the exemption. This assessment, however, would take into account many factors, which would vary from one adviser to another, to determine whether registration, relative to other options, is the most cost-effective business option for the adviser to pursue. If a foreign adviser limited its activities within the United States in order to rely on the exemption, the modifications might have the effect of reducing competition in the market for advisory services. Were the foreign adviser to register, competition among registered advisers would increase. Furthermore, to the extent that the

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361 See proposed rule 202(a)(30)-1, at note to paragraph (c)(2)(i); supra notes 267-268 and accompanying text.

362 See supra note 299 and accompanying text.

363 See supra note 303 and accompanying text.

modifications included in the definition of "investor" (in particular the one concerning knowledgeable employees) would limit a foreign adviser's ability to attract certain private fund investors, those modifications may have an adverse effect on capital formation.

By referencing the method of calculating assets under management under Form ADV, certain foreign private advisers would use the valuation method provided in the instructions to Form ADV to verify compliance with the $25 million asset threshold included in the foreign private adviser exemption.[364] More specifically, proposed instruction 5.b(4) to Form ADV would require advisers to use fair value of private fund assets for determining regulatory assets under management. Some foreign advisers to private funds may value assets based on their fair value in accordance with GAAP or other international accounting standards, while other advisers to private funds may not use fair value methodologies.[365] As discussed above, the costs associated with fair valuation would vary based on factors such as the nature of the asset, the number of positions that do not have a market value, and whether the adviser has the ability to value such assets internally or would rely on a third party for valuation services.[366] Nevertheless, we do not believe that the requirement to use fair value methodologies would result in significant costs for these advisers to these funds.[367] Commission staff estimates that such advisers would each incur $1,224 in internal costs to conform its internal valuations to a fair value standard.[368] In the event a fund does not have an internal capability for valuing illiquid assets, we expect that it could obtain pricing or valuation services from an outside administrator or other service

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364 See supra section II.C.5 of this Release.

365 See supra note 310 and accompanying and following text.

366 See supra notes 322-325 and accompanying paragraph.

367 See supra note 324 and accompanying text.

368 See supra note 325.

provider. Staff estimates that the annual cost of such a service would range from $1,000 to $120,000 annually which could be borne by several funds that invest in similar assets or have similar investment strategies.[369] We request comment on these estimates. Do foreign advisers that do not use fair value methodologies for reporting purposes have the ability to fair value private fund assets internally? If not, what would be the costs to retain a third party valuation service? Are there certain types of foreign advisers (e.g., advisers to real estate private funds) that would experience special difficulties in performing fair value analyses? If so, why?

We request comment on the potential costs we have identified above. Are there costs of the proposed rule that we have not identified?

D. Request for Comment

The Commission requests comments on all aspects of the cost-benefit analysis, including the accuracy of the potential costs and benefits identified and assessed in this Release, as well as any other costs or benefits that may result from the proposals. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[370] the Commission also requests information regarding the potential annual effect of the proposals on the U.S. economy. Commenters are requested to provide empirical data to support their views.

VI. REGULATORY FLEXIBILITY ACT CERTIFICATION

Pursuant to section 605(b) of the Regulatory Flexibility Act,[371] the Commission hereby

369 See supra note 326 and accompanying text.

370 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).

371 5 U.S.C. 605(b)

certifies that proposed rules 203(l)-1 and 203(m)-1 under the Advisers Act would not, if adopted, have a significant economic impact on a substantial number of small entities. Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year ("small adviser").[372]

Investment advisers solely to venture capital funds and advisers solely to private funds in each case with assets under management of less than $25 million would remain generally ineligible for registration with the Commission under section 203A of the Advisers Act.[373] We expect that any small adviser solely to existing venture capital funds that would not be ineligible to register with the Commission would be able to avail itself of the exemption from registration under the grandfathering provision. If an adviser solely to a new venture capital fund could not avail itself of the exemption because, for example, the fund it advises did not meet the proposed definition of "venture capital fund," we anticipate that the adviser could avail itself of the exemption in section 203(m) of the Advisers Act as implemented by proposed rule 203(m)-1. Similarly, we expect that any small adviser solely to private funds would be able to rely on the exemption in section 203(m) of the Advisers Act as implemented by proposed rule 203(m)-1.

372 Rule 0-7(a) (17 CFR 275.0-7(a)).

373 Section 203A of the Advisers Act (prohibiting an investment adviser that is regulated or required to be regulated as an investment adviser in the State in which it maintains its principal office and place of business from registering with the Commission unless the adviser has $25 million or more in assets under management or is an adviser to a registered investment company).

We further believe that these advisers would be able to avail themselves of the exemption for private fund advisers regardless of whether our implementing rules required them to calculate assets under management as proposed approach or under the alternative method on which we request comment.[374]

Thus, we believe that small advisers solely to venture capital funds and small advisers to other private funds would generally be ineligible to register with the Commission. Those small advisers that may not be ineligible to register with the Commission, we believe, would be able to rely on the venture fund exemption under section 203(l) of the Advisers Act or the private fund adviser exemption under section 203(m) of that Act as implemented by our proposed rules. For these reasons, we are certifying that proposed rules 203(l)-1 and 203(m)-1 under the Advisers Act would not, if adopted, have a significant economic impact on a substantial number of small entities.

The Commission requests written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small businesses and provide empirical data to support the extent of the impact.

VII. STATUTORY AUTHORITY

The Commission is proposing rule 202(a)(30)-1 under the authority set forth in sections 403 and 406 of the Dodd-Frank Act, to be codified at sections 203(b) and 211(a) of the Advisers Act, respectively (15 U.S.C. 80b-3(b), 80b-11(a)). The Commission is proposing rule 203(l)-1 under the authority set forth in sections 406 and 407 of the Dodd-Frank Act, to be codified at sections 211(a) and 203(l) of the Advisers Act, respectively (15 U.S.C. 80b-11(a), 80b-3(l)). The Commission is proposing rule 203(m)-1 under the authority set forth in sections 406 and 408

374 See supra section II.B.2 of this Release.

of the Dodd-Frank Act, to be codified at sections 211(a) and 203(m) of the Advisers Act, respectively (15 U.S.C. 80b-11(a), 80b-3(m)).

List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements; Securities

TEXT OF PROPOSED RULES

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

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 is amended by adding authority citations for §275.203(l)-1 and 275.203(m)-1 to read as follows:

Authority: 15 U.S.C. 80b-2(a)(G)(11)(G), 80b-2(a)(17), 80b-3, 80b-4, 80b-6(4), 80b-6(a), and 80b-11, unless otherwise noted.

* * * * *

2. Section 275.202(a)(30)-1 is added to read as follows:

§ 275.202(a)(30)-1 Foreign private advisers.

(a) Client. You may deem the following to be a single client for purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)):

(1) A natural person, and:

(i) Any minor child of the natural person;

(ii) Any relative, spouse, or relative of the spouse of the natural person who has the same principal residence;

(iii) All accounts of which the natural person and/or the persons referred to in this paragraph (a)(1) are the only primary beneficiaries; and

(iv) All trusts of which the natural person and/or the persons referred to in this paragraph (a)(1) are the only primary beneficiaries;

(2)(i) A corporation, general partnership, limited partnership, limited liability company, trust (other than a trust referred to in paragraph (a)(1)(iv) of this section), or other legal organization (any of which are referred to hereinafter as a "legal organization") to which you provide investment advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members, or beneficiaries (any of which are referred to hereinafter as an "owner"); and

(ii) Two or more legal organizations referred to in paragraph (a)(2)(i) of this section that have identical owners.

(b) Special rules regarding clients. For purposes of this section:

(1) You must count an owner as a client if you provide investment advisory services to the owner separate and apart from the investment advisory services you provide to the legal organization, provided, however, that the determination that an owner is a client will not affect the applicability of this section with regard to any other owner;

(2) You are not required to count an owner as a client solely because you, on behalf of the legal organization, offer, promote, or sell interests in the legal organization to the owner, or report periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters;

(3) A limited partnership or limited liability company is a client of any general partner, managing member or other person acting as investment adviser to the partnership or limited liability company; and

(4) You are not required to count a private fund as a client if you count any investor, as that term is defined in paragraph (c)(1) of this section, in that private fund as an investor in the

United States in that private fund.

Note to paragraphs (a) and (b): These paragraphs are a safe harbor and are not intended to specify the exclusive method for determining who may be deemed a single client for purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)).

(c) Definitions. For purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)),

(1) Investor means any person that would be included in determining the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(1)), or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of that Act (15 U.S.C. 80a-3(c)(7)), except that any of the following persons is also an investor:

(A) Any beneficial owner of the private fund that pursuant to § 270.3c-5 of this title would not be included in the above determinations under section 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(1), (7)); and

(B) Any beneficial owner of any outstanding short-term paper, as defined in section 2(a)(38) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(38)), issued by the private fund.

Note to paragraph (c)(1): You may treat as a single investor any person that is an investor in two or more private funds you advise.

(2) In the United States means with respect to:

(i) Any client or investor, any person that is a "U.S. person" as defined in § 230.902(k) of this title, except that any discretionary account or similar account that is held for the benefit of a person in the United States by a dealer or other professional fiduciary is in the

United States if the dealer or professional fiduciary is a related person of the investment adviser relying on this section and is not organized, incorporated, or (if an individual) resident in the United States.

Note to paragraph (c)(2)(i): A person that is in the United States may be treated as not being in the United States if such person was not in the United States at the time of becoming a client or, in the case of an investor in a private fund, at the time the investor acquires the securities issued by the fund.

(ii) Any place of business, in the United States, as that term is defined in § 230.902(l) of this title; and

(iii) The public, in the United States, as that term is defined in § 230.902(l) of this title.

(3) Place of business has the same meaning as in § 275.222-1(a) of this title.

(4) Assets under management means the regulatory assets under management as determined under Item 5.F of Form ADV (§ 279.1 of this title).

(d) Holding out. If you are relying on this section, you shall not be deemed to be holding yourself out generally to the public in the United States as an investment adviser, within the meaning of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)), solely because you participate in a non-public offering in the United States of securities issued by a private fund under the Securities Act of 1933 (15 U.S.C. 77a).

* * * * *

3. Section 275.203(l)-1 is also issued under 15 U.S.C. 80b-3(l):

§ 275.203(l)-1 Venture capital fund defined.

(a) Venture capital fund defined. For purposes of section 203(l) of the Act (15

U.S.C. 80b-3(l)), a venture capital fund is any private fund that:

(1) Represents to investors and potential investors that it is a venture capital fund;

(2) Owns solely:

(i) Equity securities issued by one or more qualifying portfolio companies, and at least 80 percent of the equity securities of each qualifying portfolio company owned by the fund was acquired directly from the qualifying portfolio company; and

(ii) Cash and cash equivalents, as defined in § 270.2a51-1(b)(7)(i), and U.S. Treasuries with a remaining maturity of 60 days or less;

(3) With respect to each qualifying portfolio company, either directly or indirectly through each investment adviser not registered under the Act in reliance on section 203(l) thereof:

(i) Has an arrangement whereby the fund or the investment adviser offers to provide, and if accepted, does so provide, significant guidance and counsel concerning the management, operations or business objectives and policies of the qualifying portfolio company; or

(ii) Controls the qualifying portfolio company;

(4) Does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent of the private fund's aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days;

(5) Only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; and

(6) Is not registered under section 8 of the Investment Company Act of 1940

(15 U.S.C. 80a-8), and has not elected to be treated as a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-53).

(b) Certain pre-existing venture capital funds. For purposes of section 203(l) of the Act (15 U.S.C. 80b-3(l)) and in addition to any venture capital fund as set forth in paragraph (a), a venture capital fund also includes any private fund that:

(1) Has represented to investors and potential investors at the time of the offering of the private fund's securities that it is a venture capital fund;

(2) Prior to December 31, 2010, has sold securities to one or more investors that are not related persons, as defined in § 275.204-2(d)(7), of any investment adviser of the private fund; and

(3) Does not sell any securities to (including accepting any committed capital from) any person after July 21, 2011.

(c) Definitions. For purposes of this section,

(1) Committed capital means any commitment pursuant to which a person is obligated to acquire an interest in, or make capital contributions to, the private fund.

(2) Equity securities has the same meaning as in section 3(a)(11) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(11)) and § 240.3a11-1 of this chapter.

(3) Publicly traded means, with respect to a company, being subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), or having a security listed or traded on any exchange or organized market operating in a foreign jurisdiction.

(4) Qualifying portfolio company means any company that:

(i) At the time of any investment by the private fund, is not publicly traded and does not control, is not controlled by or under common control with another company, directly or indirectly, that is publicly traded;

(ii) Does not borrow or issue debt obligations, directly or indirectly, in connection with the private fund's investment in such company;

(iii) Does not redeem, exchange or repurchase any securities of the company, or distribute to pre-existing security holders cash or other company assets, directly or indirectly, in connection with the private fund's investment in such company; and

(iv) Is not an investment company, a private fund, an issuer that would be an investment company but for the exemption provided by § 270.3a-7, or a commodity pool.

* * * * *

4. Section 275.203(m)-1 is also issued under 15 U.S.C. 80b-3(m):

§ 275.203(m)-1 Private fund adviser exemption.

(a) United States investment advisers. For purposes of section 203(m) of the Act (15 U.S.C. 80b-3(m)), an investment adviser with its principal office and place of business in the United States is exempt from the requirement to register under section 203 of the Act if the investment adviser:

(1) Acts solely as an investment adviser to one or more qualifying private funds; and

(2) Manages private fund assets of less than $150 million.

(b) Non-United States investment advisers. For purposes of section 203(m) of the Act (15 U.S.C. 80b-3(m)), an investment adviser with its principal office and place of business outside of the United States is exempt from the requirement to register under section 203 of the Act if:

(1) The investment adviser has no client that is a United States person except for one

or more qualifying private funds; and

(2) All assets managed by the investment adviser from a place of business in the United States are solely attributable to private fund assets, the total value of which is less than $150 million.

(c) Calculations. For purposes of this section, private fund assets are calculated as the total value of such assets as of the end of each calendar quarter.

(d) Transition rule. With respect to the calendar quarter period immediately following the calendar quarter end date that the investment adviser ceases to be exempt from registration under section 203(m) of the Act (15 U.S.C. 80b-3(m)) due to having $150 million or more in private fund assets, the Commission will not assert a violation of the requirement to register under section 203 of the Act (15 U.S.C. 80b-3) by an investment adviser that was previously exempt in reliance on section 203(m) of the Act; provided that such investment adviser has complied with all applicable Commission reporting requirements.

(e) Definitions. For purposes of this section,

(1) Assets under management means the regulatory assets under management as determined under Item 5.F of Form ADV (§ 279.1 of this title).

(2) Place of business has the same meaning as in § 275.222-1(a) of this title.

(3) Principal office and place of business of an investment adviser means the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.

(4) Private fund assets means the investment adviser's assets under management attributable to a qualifying private fund.

(5) Qualifying private fund means any private fund that is not registered under

section 8 of the Investment Company Act of 1940 (15 U.S.C 80a-8) and has not elected to be treated as a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-53).

(6) Related person has the meaning set forth in § 275.204-2(d)(7) of this title.

(7) United States has the meaning set forth in § 230.902(l) of this title.

(8) United States person means any person that is a "U.S. person" as defined in § 230.902(k) of this title, except that any discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser relying on this section and is not organized, incorporated, or (if an individual) resident in the United States.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 19, 2010

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 230, 240 and 260

[Release Nos. 33-9158; 34-63348; 39-2472; File No. S7-02-09]

RIN 3235-AK26

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

AGENCY: Securities and Exchange Commission.

ACTION: Final temporary rules; extension.

SUMMARY: We are extending the expiration dates in our temporary rules that provide exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for certain credit default swaps in order to continue facilitating the operation of one or more central counterparties for those credit default swaps until the implementation of the clearing provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under the amendments, the expiration dates of the temporary rules are extended to July 16, 2011.

DATES: Effective Date: This rule is effective [insert date of publication in the Federal Register], and the expiration dates for the temporary rules and amendments published January 22, 2009 (74 FR 3967) and extended in a release published on September 17, 2009 (74 FR 47719) are extended from November 30, 2010 to July 16, 2011.

FOR FURTHER INFORMATION CONTACT: Amy M. Starr, Senior Special Counsel, or Michael J. Reedich, Special Counsel, Office of Chief Counsel, Division of Corporation Finance, at (202) 551-3500, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

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

I. BACKGROUND

In January 2009, we adopted interim final temporary Rule 239T and a temporary amendment to Rule 146 under the Securities Act, interim final temporary Rules 12a-10T and 12h-1(h)T under the Exchange Act, and interim final temporary Rule 4d-11T under the TIA (collectively, the "Temporary Rules"), and in September 2009, we extended the expiration date of these rules from September 25, 2009 to November 30, 2010. We adopted these rules in connection with temporary exemptive orders[4] we issued to clearing agencies acting as central counterparties ("CCP"), which exempted the CCPs from the requirement to register as clearing agencies under Section 17A of the Exchange Act[5] solely to perform the functions of a clearing agency for certain credit default swap ("CDS") transactions.[6] The exemptive orders also

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

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

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

4 See generally Securities Exchange Act Release Nos. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) and 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited); Securities Exchange Act Release Nos. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) and 61975 (Apr. 23, 2010), 75 FR 22641(Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG); Securities Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.); Securities Exchange Act Release Nos. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009), and 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) (temporary exemptions in connection with CDS clearing by ICE Trust U.S. LLC); Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) and other Commission actions discussed in several of these orders.

5 15 U.S.C. 78q-1.

6 See Exchange Act Release No. 59246 (Jan. 14, 2009).

exempted certain eligible contract participants[7] and others from certain Exchange Act requirements with respect to certain CDS.[8] Also at that time, we temporarily exempted any exchange that effects transactions in certain CDS from the requirements under Sections 5 and 6 of the Exchange Act[9] to register as a national securities exchange, and any broker or dealer that effects transactions on an exchange in certain CDS from the requirements of Section 5 of the Exchange Act.

We adopted the Temporary Rules and the CCP exemptive orders because we believed and continue to believe that the existence of CCPs for CDS would be important in helping to reduce counterparty risks inherent in the CDS market. Today, CDS agreements generally are negotiated and entered into bilaterally, but eligible trades may be submitted to the CCP for novation, which results in the CCP becoming the buyer to the original seller and the seller to the original buyer.[10] The operation of a well-regulated CCP can significantly reduce counterparty risks by preventing the failure of a single-market participant from having a disproportionate effect on the overall market, since bilateral counterparty risk is eliminated as the creditworthiness of the original counterparties is replaced by the creditworthiness of the CCP.

At the time of the adoption of the Temporary Rules and the CCP exemptive orders, the OTC market for CDS was a source of concern to us and other financial regulators due to the systemic risk posed by CDS, the possible inability of parties to meet their obligations as counterparties under the CDS, and the potential resulting adverse effects on other markets and

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

8 See generally the actions noted in footnote 4, supra.

9 15 U.S.C. 78e and 78f.

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

the financial system.[11] In response, in January 2009, we took action to help foster the prompt development of CCPs for CDS, including granting conditional exemptions from certain provisions of the federal securities laws.

In September 2009, we extended the expiration date of the Temporary Rules to November 30, 2010 because, among other reasons, a number of legislative initiatives relating to the regulation of derivatives, including CDS, had been introduced by members of Congress and recommended by the United States Department of the Treasury ("Treasury"), and Congress had not yet taken definitive action with respect to any of the legislative initiatives or the Treasury proposals.[12]

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") became law.[13] The Dodd-Frank Act is intended to address regulatory gaps in the existing regulatory structure for the over-the-counter ("OTC") derivatives markets by providing the Commission and the Commodity Futures Trading Commission ("CFTC") the authority to regulate OTC derivatives. The primary goals of Title VII of the Dodd-Frank Act, among others, are to increase the transparency, efficiency and fairness of the OTC derivatives markets, improve investor protection and to reduce the potential for counterparty and systemic

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

12 See, e.g., Derivatives Trading Integrity Act of 2009 (S. 272) (introduced by Senator Tom Harkin in January 2009); The Derivatives Markets Transparency and Accountability Act (H.R. 977) (introduced by Representative Collin Peterson in February 2009); Authorizing the Regulation of Swaps Act (S. 961) (introduced by Senator Carl Levin and Senator Susan Collins in May 2009); Treasury's framework for regulatory reform (released in June 2009); Derivative Trading Accountability and Disclosure Act (H.R. 3300) (introduced by Representative Michael McMahon in July 2009); Description of Principles for OTC Derivatives Legislation (announced by Representative Barney Frank and Representative Collin Peterson in July 2009); Senator Charles Schumer's announcement regarding a potential bill establishing central trade repositories for OTC derivatives markets (August 2009); and Over-the-Counter Derivatives Markets Act of 2009 (prepared by Treasury and sent to Congress in August 2009).

13 The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. No. 111-203, H.R. 4173).

risk.[14] To this end, Title VII of the Dodd-Frank Act imposes a comprehensive regime for the regulation of "swaps" and "security-based swaps" (as those terms are defined in the Dodd-Frank Act), including the clearing, exchange trading, and reporting of transactions in security-based swaps.[15] Certain CDS are security-based swaps as defined under the Dodd-Frank Act.

The Dodd-Frank Act amends the Exchange Act to require, among other things, that transactions in security-based swaps be cleared through a clearing agency that is registered with the Commission or that is exempt from registration if the transactions are of a type that the Commission determines must be cleared, unless an exemption from mandatory clearing applies.[16] Title VII of the Dodd-Frank Act also provides that a derivatives clearing organization that is registered with the CFTC and cleared swaps pursuant to an exemption from registration as a clearing agency prior the date of enactment of the Dodd-Frank Act, is deemed registered as a clearing agency for the purposes of clearing security-based swaps ("Deemed Registered Provision").[17] The Deemed Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, become effective on July 16, 2011.[18]

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14 See e.g., S.Rep. No. 111-176 at 2 (2010).

15 Section 761(a)(6) of the Dodd-Frank Act defines a "security-based swap" as any agreement, contract, or transaction that is a swap based on a narrow-based security index, a single security or loan, including any interest therein or on the value thereof; or the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

16 See Section 763(a) of the Dodd-Frank Act, added as Section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78a.

17 See Section 763(b) of the Dodd-Frank Act, added as Section 17A(l) of the Exchange Act, 15 U.S.C. 78q-1.

18 Section 774 of the Dodd-Frank Act states, "[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle."

The Dodd-Frank Act also directs us to adopt regulations regarding, among other things, clearing agencies for, and the clearing of, security-based swaps, which include CDS. Under the Dodd-Frank Act, all security-based swaps, including certain types of CDS, are defined as securities under the Securities Act and the Exchange Act. In separate rulemakings, we will be proposing rules to implement the clearing provisions of the Dodd-Frank Act, among others.[19] As part of our review of the application of the Securities Act, the Exchange Act and the TIA to security-based swaps and the implications for the clearing and exchange trading provisions of the Dodd-Frank Act and our rules implementing them, we will be evaluating the necessity and appropriateness of exemptions from the registration requirements of the Securities Act and Exchange Act and the indenture qualification provisions of the TIA for security-based swaps that will be cleared by clearing agencies. Pending the effective date of the relevant provisions of the Dodd-Frank Act, however, the Temporary Rules are needed to enable the CCPs to continue to clear eligible CDS in accordance with the exemptive orders we have provided. The Temporary Rules are an interim measure that will be supplanted by the comprehensive regulatory regime required by the Dodd-Frank Act.

At the time of adoption of the Temporary Rules in January 2009, we requested comment on various aspects of the Temporary Rules. We received a total of 15 letters, only two of which commented specifically on the Temporary Rules.[20] Although those two letters generally supported allowing CCPs to clear and settle CDS transactions in accordance with the terms of the Temporary Rules, neither of the commenters specifically addressed the duration of the

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19 Under the Dodd-Frank Act, we are responsible for proposing and adopting numerous rulemakings relating to Title VII and many other rules implementing other provisions of such Act.

20 The public comments we received are available for website viewing and printing at the Commission's Public Reference Room at 100 F St. N.E., Washington, DC 20549 in File No. S7-02-09. They are also available online at http://www.sec.gov/comments/s7-02-09/s70209.shtml.

Temporary Rules and temporary amendments.[21] The other commenters raised issues not directly related to this rulemaking. No comments have been submitted to us regarding the Temporary Rules since that time.

The Temporary Rules expire on November 30, 2010. As we discuss above, until the effective date of the clearing provisions of Title VII of the Dodd-Frank Act and our rules implementing them, it is important that the CCPs continue to be able to clear eligible CDS without concern that the Temporary Rules are unavailable. As a result, we have determined that it is necessary and appropriate to extend the expiration date to July 16, 2011.[22]

We are only extending the expiration date of the Temporary Rules; we are not making any other changes to the Temporary Rules. The Temporary Rules were modeled on other exemptions we have provided in the past to facilitate trading in certain securities.[23] They are limited in scope; in general, they facilitate the operation of the CCPs under the exemptive orders.[24]

II. AMENDMENT OF EXPIRATION DATE OF THE TEMPORARY RULES

In January 2009, we adopted the Temporary Rules on a temporary basis until September 25, 2009. We subsequently extended the expiration date to November 30, 2010 to allow CCPs that were clearing and settling CDS transactions in the U.S. and in Europe to continue to clear and settle CDS transactions. The Temporary Rules also enable other CCPs that

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21 See letters from the Yale Law School Capital Markets and Financial Instruments Clinic (March 23, 2009) and from IDX Capital (March 23, 2009).

22 See Section III, infra, for a discussion of why the extension of time is necessary.

23 See, e.g., Securities Act Section 3(a)(14) [15 U.S.C. 77c(a)(14)], Securities Act Rule 238 [17 CFR 230.238]; Exchange Act Section 12(a) [15 U.S.C. 78l(a)], and Exchange Act Rule 12h-1(d) and (e) [17 CFR 240.12h-1(d) and (e)] (providing similar exemptions from provisions of the federal securities laws for standardized options and securities futures products).

24 For a fuller discussion of the exemptive rules, see Exchange Act Release 59246 (Jan. 14, 2009).

obtain exemptive orders to start clearing and settling CDS transactions in the manner contemplated by the exemptive orders.

Since the adoption of the Temporary Rules and issuance of the exemptive orders, ICE Trust U.S. LLC ("ICE Trust"), and ICE Clear Europe, Ltd. ("ICE Clear Europe") have been actively engaged as CCPs in clearing CDS transactions in reliance on our exemptions. As of October 25, 2010, ICE Trust has cleared 157,691 CDS transactions with a notional value of $7.8 trillion. As of October 25, 2010, ICE Clear Europe has cleared 175,102 CDS transactions with a notional value of €3.8 trillion. We believe that the clearing of CDS transactions by ICE Trust and ICE Clear Europe has contributed and we anticipate will continue to contribute to increased transparency and the reduction of systemic risk in the CDS market.

We also granted exemptive orders to three other CCPs to clear CDS that have functioned as CCPs in clearing CDS transactions in accordance with our exemptions.[25] Two of these CCPs, The Chicago Mercantile Exchange and Eurex Clearing AG have advised our staff that they intend to continue to work with participants in the CDS market to promote their CCP services.

The extension of the Temporary Rules and the exemptive orders will terminate at the time that the clearing provisions and rules implementing of Title VII of the Dodd-Frank Act become effective. The extension of such Temporary Rules is designed to the foster continued development and operation of CCPs for eligible CDS, which we believe is in the public interest. Once the Dodd-Frank Act provisions become effective, a new permanent and comprehensive regulatory regime for all security-based swaps will be implemented and the Temporary Rules

[25] See Exchange Act Release Nos. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) and 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) (temporary exemptions for Eurex Clearing AG); Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions for Chicago Mercantile Exchange Inc.); and Exchange Act Release No. 59164 (Dec. 24, 2008) 74 FR 139 (Jan. 2, 2009) (temporary exemption for LIFFE A&M and LCH.Clearnet Ltd.). LIFFE A&M and LCH Clearnet Ltd., allowed their temporary exemption to expire.

affecting solely eligible CDS will no longer be necessary or appropriate. Therefore, due to the limited time the Temporary Rules will be needed, and our ongoing efforts to implement the provisions of the Dodd-Frank Act, we are extending the Temporary Rules until July 16, 2011.

III. CERTAIN ADMINISTRATIVE LAW MATTERS

Section 553(b) of the Administrative Procedure Act ("APA") generally requires an agency to publish notice of a proposed rule making in the Federal Register. This requirement does not apply, however, if the agency "for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." For the reasons we discuss throughout this release, we believe that there is good cause to extend these rules until July 16, 2011 without further notice or opportunity for comment.

We sought comment on the Temporary Rules and as noted above, we received little comment when they were originally promulgated. In addition to the specific comments that we sought and received in connection with the Temporary Rules in January 2009, we have sought public input on implementing the provisions of the Dodd-Frank Act, which requires extensive public notice and comment rulemaking that will supplant and subsume the exemptive rules we have crafted as a temporary measure.[26] Further, we will seek public comment in connection with the proposed rulemaking to implement the specific provisions of the Dodd-Frank Act relating to the treatment of security-based swaps under the Securities Act and the Exchange Act. Commenters will have full opportunity to provide their views on this new comprehensive regulatory regime.

[26] See Public Comments on SEC Regulatory Initiatives Under the Dodd-Frank Act, located at http://www.sec.gov/spotlight/regreformcomments.shtml. None of these comments addressed the Temporary Rules.

Absent the extension of the Temporary Rules, such Temporary Rules would expire at the end of November 2010, prior to the effective date of the provisions of Title VII of the Dodd-Frank Act. The rules have been in place since January 2009, and CCPs have relied on them in clearing eligible CDS. Extending the expiration date of the Temporary Rules would not affect the substantive provisions of those rules. Without further extending the expiration date of the Temporary Rules to the time of effectiveness of the provisions of Title VII of the Dodd-Frank Act, CCPs would not be able to continue to clear eligible CDS in accordance with the exemptive orders they have received from us. Extending the expiration date of the Temporary Rules will allow exempt CCPs to continue to clear eligible CDS until the provisions of the Dodd-Frank Act, including the rules promulgated under such Act, become effective. This will occur by the July 2011 expiration of the Temporary Rules. Therefore, we believe there is good cause to extend the Temporary Rules until July 16, 2011 and find that notice and solicitation of comment on the extension to be impracticable, unnecessary, or contrary to the public interest.[27]

The APA also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.[28] However, this requirement does not apply if the agency finds good cause not to delay the effective date.[29] For reasons similar to those explained above, the Commission finds good cause not to delay the effective date.

IV. PAPERWORK REDUCTION ACT

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

28 5 U.S.C. 553(d).

29 5 U.S.C. 553(d)(3).

The Temporary Rules do not impose any new "collections of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA"),[30] nor do they create any new filing, reporting, recordkeeping, or disclosure reporting requirements for a CCP that is or will be issuing or clearing eligible CDS. Accordingly, we did not submit the Temporary Rules to the Office of Management and Budget for review in accordance with the PRA when we adopted them in January 2009.[31] We requested comment on whether our conclusion that there are no collections of information is correct, and we did not receive any comment. The extension of the expiration dates does not change our analysis.

V. COST-BENEFIT ANALYSIS

In January 2009, we adopted the Temporary Rules, which exempt eligible CDS that are or will be issued or cleared by a CCP and offered and sold only to eligible contract participants from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provision, as well as from the registration requirements under Section 12 of the Exchange Act and from the provisions of the TIA. In September 2009, we adopted amendments to such rules to extend their expiration date to November 30, 2010. The Temporary Rules were intended to facilitate the operation of one or more CCPs to act as a clearing agency in the CDS market to reduce some of the risks in the CDS market. Today, we are adopting amendments to such rules to extend their expiration date to July 16, 2011.

Since the adoption of the Temporary Rules and issuance of the exemptive orders, ICE Trust and ICE Clear Europe have been actively engaged as a CCP in clearing CDS transactions in accordance with our exemptions.

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30 44 U.S.C. 3501 et seq.

31 44 U.S.C. 3507(d) and 5 CFR 1320.11.

On July 21, 2010, the Dodd-Frank Act was enacted. Among other things, the Dodd-Frank Act amends the Exchange Act to require that transactions in security-based swaps be cleared through a clearing agency that is either registered with the Commission or exempt from registration if the transactions are of a type that the Commission determines must be cleared, unless an exemption from mandatory clearing applies. As noted above, the Dodd-Frank Act directs us to regulate, among other things, clearing agencies for, and the clearing of, security-based swaps, which include certain CDS, and in separate rulemakings we will be proposing rules to implement the clearing provisions of the Dodd-Frank Act, among others. Extending the expiration dates of the Temporary Rules until July 16, 2011 will allow us to propose those rules, which will be subject to notice and comment. Pending the effective date of the clearing provisions of the Dodd-Frank Act, however, the Temporary Rules are needed to enable the CCPs to continue to clear eligible CDS in accordance with the exemptive orders we have provided.

A. Benefits

The Temporary Rules and the CCP exemptive orders facilitate the operation of CCPs in the CDS market. We believe that extending the Temporary Rules and the CCP exemptive orders will continue to facilitate the operation of CCPs[32] and the use by eligible contract participants of CDS CCPs while enabling us to provide some oversight of the non-excluded CDS market.[33] We believe that the operation of two CCPs in accordance with our exemptions has increased transparency,[34] increased available information about exposures to particular reference entities or

32 See Karen Brettell, Banks to submit 95 pct of eligible CDS for clearing (Sep. 1, 2009), available at http://www.reuters.com/article/euRegulatoryNews/idUSN0150814420090901?pageNumber=1&virtualBrandChannel=10522.

33 See e.g., Exchange Act Release No. 59527, supra Note 10 (our exemptions require that the CCPs provide us with, among other things, access to conduct on-site inspections of facilities, records and personnel).

34 See Testimony of Mark Lenczowski, supra Note 12.

reference securities,[35] and reduced risks to participants in the market for CCP-cleared CDS.[36] Not extending the termination date could cause significant disruptions in this market. Therefore, we believe that extending the termination date of the Temporary Rules provides important benefits to CDS market participants.

B. Costs

Absent the exemptions provided by the Temporary Rules, a CCP may have to file a registration statement covering the offer and sale of the eligible CDS, may have to satisfy the applicable provisions of the TIA, and may have to register the class of eligible CDS that it has issued or cleared under the Exchange Act, which would provide investors with the disclosures and other protections of these requirements, including civil remedies in addition to antifraud remedies.

We recognize that a consequence of extending the exemptions will be the unavailability of certain remedies under the Securities Act and the Exchange Act and certain protections under the TIA. While an investor would be able to pursue an antifraud action in connection with the purchase and sale of eligible CDS under Exchange Act Section 10(b),[37] it would not be able to pursue civil remedies under Sections 11 or 12 of the Securities Act.[38] We could still pursue an antifraud action in the offer and sale of eligible CDS issued or cleared by a CCP.[39] We believe that the incremental costs from the extension of the expiration date of the Temporary Rules will be minimal because the amendments are merely an extension of such Temporary Rules and such

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35 See e.g., Exchange Act Release No. 59527, supra Note 26.

36 See IntercontinentalExchange, supra Note 13.

37 15 U.S.C. 78j(b).

38 15 U.S.C. 77k and 77l.

39 See 15 U.S.C. 77q and 15 U.S.C. 78j(b).

extension will not affect the information and remedies available to investors as a result of the Temporary Rules.

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

Section 23(a)(2) of the Exchange Act[40] 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 that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Section 2(b)[41] of the Securities Act and Section 3(f)[42] of the Exchange Act require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

The Temporary Rules we are extending today exempt eligible CDS issued or cleared by a CCP from all provisions of the Securities Act, other than the Section 17(a) antifraud provision, as well as from the registration requirements under Section 12 of the Exchange Act and the provisions of the TIA. Because these exemptions are available to any CCP offering and selling eligible CDS, we do not believe that extending the exemptions imposes a burden on competition. We also anticipate that extending the ability to settle CDS through CCPs will continue to improve the transparency of the CDS market and provide greater assurance to participants as to the capacity of the eligible CDS counterparty to perform its obligations under the eligible CDS. ICE Trust, for example, makes available on its website information about open interests, or net

40 15 U.S.C. 78w(a)(2).

41 15 U.S.C. 77b(b).

42 15 U.S.C. 78c(f).

exposure, volume and pricing of CDS transactions. We believe that increased transparency in the CDS market could help to decrease further market turmoil and thereby facilitate the capital formation process.

VII. REGULATORY FLEXIBILITY ACT CERTIFICATION

The Commission hereby certifies pursuant to 5 U.S.C. 605(b) that extending Temporary Rules will not have a significant economic impact on a substantial number of small entities. The Temporary Rules exempt eligible CDS that are or will be issued or cleared by a CCP. None of the entities that are eligible to meet the requirements of the exemption from registration under Section 17A is a small entity.

VIII. STATUTORY AUTHORITY AND TEXT OF THE RULES AND AMENDMENTS

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

List of Subjects

17 CFR Parts 230, 240 and 260

Reporting and recordkeeping requirements, Securities.

TEXT OF THE RULES AND AMENDMENTS

Accordingly, we are temporarily amending 17 CFR parts 230, 240, and 260 as follows and the expiration date for the temporary rules published January 22, 2009 (74 FR 3967), and extended to November 30, 2010, is further extended from November 30, 2010, to July 16, 2011.

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

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

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

* * * * *

§§ 230.146 and 230.239T [Amended]

2. In §230.146(c)T, in the last sentence, remove the words "November 30, 2010" and add, in their place, the words "July 16, 2011".

3. In §230.239T(e), remove the words "November 30, 2010" and add, in their place, the words "July 16, 2011".

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

4. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78o-4, 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; and 12 U.S.C. 5221(e)(3) unless otherwise noted.

* * * * *

§§ 240.12a-10T and 240.12h-1 [Amended]

5. In §240.12a-10T(b), remove the words "November 30, 2010" and add, in their place, the words "July 16, 2011".

6. In §240.12h-1(h)T, in the last sentence, remove the words "November 30, 2010" and add, in their place, the words "July 16, 2011".

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

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

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

§ 260.4d-11T [Amended]

8. In §260.4d-11T, in the last sentence, remove the words "November 30, 2010" and add, in their place, the words "July 16, 2011".

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

November 19, 2010

Commissioner Casey
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-3110; File No. S7-36-10

RIN 3235-AK82

Rules Implementing Amendments to the Investment Advisers Act of 1940

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing new rules and rule amendments under the Investment Advisers Act of 1940 to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules and rule amendments are designed to give effect to provisions of Title IV of the Dodd-Frank Act that, among other things, increase the statutory threshold for registration by investment advisers with the Commission, require advisers to hedge funds and other private funds to register with the Commission, and require reporting by certain investment advisers that are exempt from registration. In addition, we are proposing rule amendments, including amendments to the Commission's pay to play rule, that address a number of other changes to the Advisers Act made by the Dodd-Frank Act.

DATES: Comments must be received on or before [insert date 45 days after publication in Federal Register].

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

Electronic comments:

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

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-36-10 on the subject line; or

- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-36-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing 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: Jennifer R. Porter, Attorney-Adviser, Daniele Marchesani, Senior Counsel, Melissa A. Roverts, Senior Counsel, Devin F. Sullivan, Senior Counsel, Matthew N. Goldin, Branch Chief, Daniel S. Kahl, Branch Chief, or Sarah A. Bessin, Assistant Director, at (202) 551-6787 or IArules@sec.gov, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is proposing rules 203A-5 and 204-4 [17 CFR 275.203A-5 and 275.204-4] under the Investment Advisers Act of 1940 [15 U.S.C.

80b] ("Advisers Act" or "Act"),[1] amendments to rules 0-7, 203A-1, 203A-2, 203A-3, 204-1, 204-2, 206(4)-5, 222-1, and 222-2 [17 CFR 275.0-7, 275.203A-1, 275.203A-2, 275.203A-3 , 275.204-1, 275.204-2, 275.206(4)-5, 275. 222-1, and 275.222-2] under the Advisers Act, and amendments to Form ADV, Form ADV-H, and Form ADV-NR [17 CFR 279.1, 279.3, and 279.4] under the Advisers Act. The Commission is also proposing to rescind rule 203A-4 [17 CFR 275.203A-4] under the Advisers Act.

TABLE OF CONTENTS

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[1] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified, and when we refer to rule 0-7, rule 202(a)(11)-1, rule 203(b)(3)-1, rule 203(b)(3)-2, rule 203A-1, rule 203A-2, rule 203A-3, rule 203A-4, rule 203A-5, rule 204-1, rule 204-2, rule 204-4, rule 206(4)-5, rule 222-1, or rule 222-2, or any paragraph of these rules, we are referring to 17 CFR 275.0-7, 17 CFR 275.202(a)(11)-1, 17 CFR 275.203(b)(3)-1, 17 CFR 275.203(b)(3)-2, 17 CFR 275.203A-1, 17 CFR 275.203A-2, 17 CFR 275.203A-3, 17 CFR 275.203A-4, 17 CFR 275.203A-5, 17 CFR 275.204-1, 17 CFR 275.204-2, 17 CFR 275.204-4, 17 CFR 275.206(4)-5, 17 CFR 275.222-1, or 17 CFR 275.222-2, respectively, of the Code of Federal Regulations, in which these rules are published, or would be published, if adopted.

I. BACKGROUND

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") which, among other things, amends certain provisions of the Advisers Act.[2] Title IV of the Dodd-Frank Act includes most of the amendments to the Advisers Act. These amendments include provisions that reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers, *i.e.*, those that have between $25 and $100 million of assets under management.[3] This provision will require a significant number of advisers currently registered with the Commission to withdraw their registrations with the Commission and to switch to registration with one or more state securities authorities. In addition, Title IV repeals the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act under

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2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 *See* section 410 of the Dodd-Frank Act; Advisers Act section 203A. *See also* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, § 303 (1996) ("NSMIA") (allocating to states responsibility for small investment advisers with less than $25 million in assets under management).

which advisers, including those to many hedge funds, private equity funds and venture capital funds, had relied in order to avoid registration under the Act and our oversight.[4] In eliminating this provision, Congress created, or directed us to adopt other, in some ways narrower, exemptions for advisers to certain types of private funds – *e.g.*, venture capital funds – which provide that the Commission shall require such advisers to submit reports "as the Commission determines necessary or appropriate in the public interest."[5] These provisions in Title IV of the Dodd-Frank Act will be effective on July 21, 2011.[6]

We are proposing to adopt new rules and amend existing rules and forms to give effect to these provisions. In addition, we are proposing rule amendments, including amendments to the Commission's "pay to play" rule, that address a number of other changes to the Advisers Act made by the Dodd-Frank Act. Also, in light of our increased responsibility for oversight of

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[4] *See* section 403 of the Dodd-Frank Act. Section 203(b)(3) exempts from registration any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1) ("Investment Company Act"), or a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act (15 U.S.C. 80a-54). Section 403 of the Dodd-Frank Act eliminates this "private adviser" exemption from section 203(b)(3) and replaces it with a new exemption for "foreign private advisers." We are proposing a rule to clarify the definition of a "foreign private adviser" in a separate release. *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3111 (November 19, 2010) [[•] FR [•] ([•], 2010)] ("Exemptions Release"). Commenters wishing to address issues related to foreign private advisers should submit comments on the Exemptions Release.

[5] *See* sections 407 and 408 of the Dodd-Frank Act ("The Commission shall require [such advisers to] provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors"). Section 407 of the Dodd-Frank Act, which adds section 203(l) to the Advisers Act, exempts advisers solely to one or more venture capital funds. Section 408, which added section 203(m) to the Advisers Act, exempts advisers solely to private funds with assets under management in the United States of less than $150 million.

[6] *See* section 419 of the Dodd-Frank Act. For purposes of this Release, when we refer to the effective date of the Dodd-Frank Act, we are referring to the effective date of Title IV, which is July 21, 2011, unless we indicate otherwise.

private funds, we are proposing to require advisers to those funds to provide us with additional information about the operation of those funds. As discussed in more detail below, this information would permit us to provide better oversight of these advisers by focusing our examination and enforcement resources on those advisers to private funds that appear to present greater compliance risks. Finally, we are proposing additional changes to Form ADV that we believe would enhance our oversight of advisers and also will enable us to identify advisers that are subject to the Dodd-Frank Act's requirements concerning certain incentive-based compensation arrangements.[7]

II. DISCUSSION

A. Eligibility for Registration with the Commission: Section 410

Section 203A of the Advisers Act generally prohibits an investment adviser regulated by the state in which it maintains its principal office and place of business from registering with the Commission unless it has at least $25 million of assets under management,[8] and preempts certain state laws regulating advisers that are registered with the Commission.[9] This provision, enacted

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7 *See* section 956 of the Dodd-Frank Act.

8 Advisers Act section 203A(a)(1). The prohibition does not apply if the investment adviser is an adviser to an investment company registered under the Investment Company Act, or the adviser is eligible for one of six exemptions the Commission has adopted. *See id.*; rule 203A-2; *infra* section II.A.5. of this Release. Section 403 of the Dodd-Frank Act also added exemptions to Section 203 of the Advisers Act for: (i) any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor and advises a private fund; and (ii) any investment adviser, other than a business development company, that solely advises certain small business investment companies.

9 An investment adviser must register with the Commission unless it is prohibited from registering under section 203A of the Advisers Act or is exempt from registration under section 203(b). Advisers Act section 203(a). Investment advisers that are prohibited from registering with the Commission are subject to regulation by the states, but the anti-fraud provisions of the Advisers Act continue to apply to them. *See* Advisers Act sections 203A(b), 206. For SEC-registered investment advisers, state laws requiring registration, licensing and qualification are preempted, but states may investigate and bring enforcement actions alleging fraud or deceit, may require notice filings of documents filed with the Commission, and may require investment advisers to pay state notice filing fees. *See* Advisers Act section 203A(b); NSMIA, *supra* note 3, at sections

in 1996 as part of the National Securities Markets Improvement Act ("NSMIA"), eliminated the duplicative regulation of advisers by the Commission and state securities authorities, making the states the primary regulators of smaller advisers and the Commission the primary regulator of larger advisers.[10]

Section 410 of the Dodd-Frank Act creates a new group of "mid-sized advisers" and shifts primary responsibility for their regulatory oversight to the state securities authorities. It does this by prohibiting from registering with the Commission an investment adviser that is registered as an investment adviser in the state in which it maintains its principal office and place of business and that has assets under management between $25 million and $100 million.[11] Unlike a small adviser, a mid-sized adviser is not prohibited from registering with the Commission: (i) if the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; (ii) if registered, the adviser would not be subject to examination as an investment adviser by that securities commissioner; or (iii) if the adviser is required to register in 15 or more states.[12] Section 203A(c) of the Advisers Act, which was not amended by the Dodd-Frank Act, permits the Commission to exempt advisers from the

307(a) and (b). The Dodd-Frank Act did not amend sections 203A(a)(1) or 203(a) of the Advisers Act. *See* section 410 of the Dodd-Frank Act.

10 *See* S. REP. NO. 104-293, at 4 (1996). *See also Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1633, section I (May 15, 1997) [62 FR 28112 (May 22, 1997)] ("NSMIA Adopting Release").

11 *See* section 410 of the Dodd-Frank Act. This amendment increases the threshold above which all investment advisers must register with the Commission from $25 million to $100 million. *See* S. REP. NO. 111-176, at 76 (2010) ("Senate Committee Report").

12 *See* section 410 of the Dodd-Frank Act. A mid-sized adviser also will be required to register with the Commission if it is an adviser to a registered investment company or business development company under the Investment Company Act. *Id.* As a result, mid-sized advisers to registered investment companies and business development companies will not have to withdraw their Commission registrations. *Compare* section 410 of the Dodd-Frank Act *with* Advisers Act section 203A(a)(1).

prohibition on Commission registration, including small and mid-sized advisers, if the application of the prohibition from registration would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes" of section 203A.[13] Under this authority, we have adopted six exemptions from the prohibition on registration.[14]

As a consequence of section 410 of the Dodd-Frank Act, we estimate that approximately 4,100 SEC-registered advisers will be required to withdraw their registrations and register with one or more state securities authorities.[15] We are working closely with the state securities authorities to assure an orderly transition of investment adviser registrants to state regulation. In addition, we are today proposing rules and rule amendments that would provide us a means of identifying advisers that must transition to state regulation, clarify the application of new statutory provisions, and modify certain of the exemptions from the prohibition on registration that we have adopted under section 203A of the Act.

1. Transition to State Registration

We are proposing a new rule, rule 203A-5, which would require *each* investment adviser registered with us on July 21, 2011 to file an amendment to its Form ADV no later than August

13 The Commission's exercise of this authority would not only permit registration with the Commission, but would result in the preemption of state law with respect to the advisers that register with us as a result of the exemption. *See* Advisers Act sections 203(a), 203A(b) and (c).

14 *See* rule 203A-2 (permitting the following types of advisers to register with the Commission: (i) nationally recognized statistical rating organizations ("NRSROs"); (ii) pension consultants; (iii) investment advisers affiliated with an adviser registered with the Commission; (iv) investment advisers expecting to be eligible for Commission registration within 120 days of filing Form ADV; (v) multi-state investment advisers; and (vi) internet advisers).

15 According to data from the Investment Adviser Registration Depository ("IARD") as of September 1, 2010, 4,136 SEC-registered advisers either: (i) had assets under management between $25 million and $100 million and did not indicate on Form ADV Part 1A that they are relying on an exemption from the prohibition on Commission registration; or (ii) were permitted to register with us because they rely on the registration of an SEC-registered affiliate that has assets under management between $25 million and $100 million and are not relying on an exemption.

20, 2011, 30 days after the July 21, 2011 effective date of the amendments to section 203A, and to report the market value of its assets under management determined within 30 days of the filing.[16] This filing would be the first step by which an adviser no longer eligible for Commission registration would transition to state registration. It would require each investment adviser to determine whether it meets the revised eligibility criteria for Commission registration, and would provide the Commission and the state regulatory authorities with information necessary to identify those advisers required to transition to state registration and to understand the reason for the transition or basis for continued Commission registration.[17] An adviser no longer eligible for Commission registration would have to withdraw its Commission registration by filing Form ADV-W no later than October 19, 2011 (60 days after the required refiling of Form ADV).[18] We would expect to cancel the registration of advisers that fail to file an amendment or withdraw their registrations in accordance with the rule.[19] Finally, the proposed rule would permit us to postpone the effectiveness of, and impose additional terms and

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16 Proposed rule 203A-5(a). We propose to give advisers 30 days from the effective date of the Dodd-Frank Act to prepare and submit the amended Form ADV. This approach would avoid requiring an adviser to respond to items about its eligibility to register with the Commission *before* the statutory changes affecting that eligibility will be effective on July 21, 2011. The additional 30 days would provide an adviser with the opportunity to evaluate the effect of the legislation (and our rules) on its eligibility and seek the advice of legal counsel, if necessary, before submitting an amendment. By permitting a 30-day period we also seek to avoid a large volume of filings on a single day (*i.e.*, July 21).

17 Proposed amended Item 2.A. of Form ADV, Part 1A would reflect the requirements of the Advisers Act (as amended by the Dodd-Frank Act) and the related rules, and would require an investment adviser to mark Item 2.A.(13) if the adviser is no longer eligible to remain registered with the Commission. For a discussion of the proposed rules, see *infra* sections II.A.5. and II.A.7. of this Release, and for a discussion of Item 2.A, see *infra* section II.A.2. of this Release.

18 Proposed rule 203A-5(b).

19 *See* Advisers Act section 203(h). As provided in the Advisers Act, an adviser would be given appropriate notice and opportunity for hearing to show why its registration should not be cancelled. Advisers Act section 211(c).

conditions on, an adviser's withdrawal from SEC registration if we institute certain proceedings before the adviser files Form ADV-W.[20]

We propose to use our exemptive authority under section 203A(c)[21] to provide for a transitional process with two "grace periods," the first providing 30 days from the July 21, 2011 effective date of the Dodd-Frank Act for an adviser to determine whether it is eligible for Commission registration and to file an amended Form ADV, and the second providing an additional 60 days (following the end of the first 30-day period) for an adviser to register in the states and to arrange for its associated persons to qualify for investment adviser representative registration, which may include preparing for and passing an examination, before withdrawing from Commission registration.[22] We are proposing a 90-day transition process, which is shorter than the 180-day transition period that our rules currently provide for advisers switching from SEC to state registration, in order to promptly implement this Congressional mandate and accommodate the processing of renewals and fees for state registration and licensing via the IARD system, while allowing for an orderly transition.[23]

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20 Proposed rule 203A-5(c) ("If, prior to the effective date of the withdrawal from registration of an investment adviser on Form ADV-W, the Commission has instituted a proceeding pursuant to section 203(e)...to suspend or revoke registration, or pursuant to section 203(h)...to impose terms or conditions upon withdrawal, the withdrawal from registration shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors."). This language largely is consistent with rule 203A-5 adopted after NSMIA. *See* NSMIA Adopting Release, *supra* note 10.

21 *See supra* note 13 and accompanying text.

22 Proposed rule 203A-5. We would also amend the instructions on Form ADV to explain this process. *See* proposed Form ADV: General Instructions (special one-time instruction for Dodd-Frank transition filing for SEC-registered advisers).

23 Our current rule provides an SEC-registered adviser that has to switch to state registration a period of 180 days after its fiscal year end to file an annual amendment to Form ADV and to withdraw its SEC registration after reporting to us that it is no longer eligible to remain registered with us. *See* rule 203A-1(b)(2) ; *cf.* rule 204-1(a) (requiring an adviser to file an annual amendment 90 days after its fiscal year end).

We request comment on proposed rule 203A-5. Specifically, we request comment on the proposed transition process, including the amount of time we propose for advisers to transition to state registration by filing an amended Form ADV within 30 days after July 21, 2011 and withdrawing from Commission registration within 60 days after the required Form ADV filing. We request comment on whether a transition process is necessary (*e.g.*, whether we should require advisers that do not meet the new eligibility requirements to withdraw from Commission registration as of July 21, 2011), whether two grace periods are necessary (*e.g.*, whether we should require the Form ADV filing and withdrawal of an adviser's registration to occur within the same period), or whether we should provide for a longer period (*e.g.*, whether we should provide 180 days to parallel our current switching rule).[24] Further, should the rule permit us to postpone the effectiveness of, and impose additional terms and conditions on, an adviser's withdrawal from SEC registration?

Our ability to effect the timely transition to state regulation of advisers no longer eligible to register with the Commission may also be affected by our need to re-program the IARD system, through which advisers will file their amendments to Form ADV. We are working closely with the Financial Industry Regulatory Authority ("FINRA"), our IARD contractor, to make the needed modifications, but the programming may not be completed until after we adopt these rules. If IARD is unable to accept filings of Form ADV, including the proposed revisions discussed below to Item 2 of Part 1A, we may need to use our exemptive authority to further delay implementation of the increased threshold for mid-sized adviser registration until the system can accept electronic filing of the revised form. Should we instead require an alternative

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[24] *See* rule 203A-1(b)(2); *cf.* 204-1(a).

procedure, such as a paper filing, for advisers to indicate their eligibility for registration or lack thereof?[25]

Since the enactment of the Dodd-Frank Act, our staff has received inquiries from state-registered advisers and advisers registering for the first time expressing concern that they might be required to register with the Commission (because their assets under management are more than $30 million) only to have to withdraw their registration next year when we implement section 410 of the Dodd-Frank Act (raising the threshold for Commission registration to $100 million of assets under management). To avoid such regulatory burdens, we will not object if any state-registered or newly registering adviser is not registered with us if, on or after January 1, 2011 until the end of the transition process (which would be October 19, 2011 under proposed rule 203A-5), the adviser reports on its Form ADV that it has between $30 million and $100 million of assets under management, provided that the adviser is registered as an investment adviser in the state in which it maintains its principal office and place of business, and it has a reasonable belief that it is required to be registered with, and is subject to examination as an investment adviser by, that state.[26] Such advisers should remain registered with, or in the case of a newly registering adviser, apply for registration with, the state securities authorities.[27]

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25 *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968, n. 53 (Dec. 30, 2009) [75 FR 1456 (Jan. 11, 2010)] (requiring paper filing of Form ADV-E until IARD was upgraded to accept the form electronically); NSMIA Adopting Release at section II.A. (requiring advisers to file a separate paper form (Form ADV-T) to indicate whether they were eligible for SEC registration).

26 For a discussion of these requirements, see *infra* section II.A.7. of this Release.

27 As discussed above, the Dodd-Frank Act amendments to Advisers Act section 203A(a) will not be effective until July 21, 2011. *See supra* note 6 and accompanying text. Until that date, section 203A continues to apply, and all investment advisers registered with the Commission that remain eligible for registration under the current requirements must maintain their registrations and comply with the Advisers Act.

2. Amendments to Form ADV

Item 2 of Part 1A of Form ADV requires each investment adviser applying for registration to indicate its basis for registration with the Commission and to report annually whether it is eligible to remain registered. Item 2 reflects the current statutory threshold for registration with the Commission as well as our current rules. We propose to revise Item 2 to reflect the new statutory threshold and the revisions we propose to make to related rules as a result of the Dodd-Frank Act.[28] More specifically, we propose to amend Item 2 to require each adviser registered with us (and each applicant for registration) to identify whether, under section 203A, as amended, it is eligible to register with the Commission because it: (i) is a large adviser (having $100 million or more of regulatory assets under management);[29] (ii) is a mid-sized adviser that does not meet the criteria for state registration and examination;[30] (iii) has its principal office and place of business in Wyoming (which does not regulate advisers) or outside the United States;[31] (iv) meets the requirements for one or more of the exemptive rules under section 203A of the Act (as we propose to amend and discuss below);[32] (v) is an adviser (or subadviser) to a registered investment company;[33] (vi) is an adviser to a business development

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28 We also propose to revise the terms used in the rules and Form ADV to refer to the securities authorities in each state with a single defined term, "state securities authority." *Compare* proposed rules 203A-1, 203A-2(c) and (d), 203A-3(e); proposed Form ADV: Glossary *with* rules 203A-1(b)(1), 203A-2(e)(1), 203A-4; Form ADV: Glossary. *See generally* section 410 of the Dodd-Frank Act.

29 Proposed Form ADV, Part 1A, Item 2.A.(1). We are proposing to revise Form ADV to use the term "regulatory assets under management" instead of "assets under management." For a discussion of regulatory assets under management, see *infra* section II.A.3. of this Release.

30 Proposed Form ADV, Part 1A, Item 2.A.(2). For a discussion of the criteria for state registration and examination for mid-sized advisers, see *infra* section II.A.7. of this Release.

31 Proposed Form ADV, Part 1A, Items 2.A.(3), 2.A.(4).

32 Proposed Form ADV, Part 1A, Items 2.A.(7)-2.A.(11). For a discussion of the exemptive rules, see *infra* section II.A.5. of this Release.

33 Proposed Form ADV, Part 1A, Item 2.A.(5).

company and has at least $25 million of regulatory assets under management;[34] or (vii) has some other basis for registering with the Commission.[35] We also expect to modify IARD to prevent an applicant from registering with us, and an adviser from continuing to be registered with us, unless it represents that it meets the eligibility criteria set forth in the Advisers Act and our rules.[36] We request comment on each of the changes we propose to make to Item 2. Are the requirements clearly stated? Do the proposed changes fairly reflect the new eligibility requirements under the Dodd-Frank Act and the amendments we are proposing to make to our rules?

3. Assets Under Management

In most cases, the amount of assets an adviser has under management will determine whether the adviser must be registered with the Commission or the states. Section 203A(a)(2) of the Act defines "assets under management" as the "securities portfolios" with respect to which an adviser provides "continuous and regular supervisory or management services."[37] Instructions to Form ADV provide advisers with guidance in applying this provision, including a list of certain types of assets that advisers may (but are not required to) include.[38] Today, we are proposing revisions to these instructions in order to implement a uniform method to calculate

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34 Proposed Form ADV, Part 1A, Item 2.A.(6).

35 Proposed Form ADV, Part 1A, Item 2.A.(12). We also propose to delete current Item 2.A.(5) for NRSROs. For a discussion of NRSROs, see *infra* section II.A.5.a. of this Release.

36 We would also amend Item 2.A and the related items in Schedule D to reflect proposed revisions to rule 203A-2, which provides exemptions from the prohibition on registration with the Commission. *See* proposed Form ADV Items 2.A.(7), (10) and Section 2.A.(10) of proposed Schedule D; *infra* section II.A.5. of this Release. Additionally, we propose to make conforming changes to the instructions for Form ADV. *See* proposed Form ADV: Instructions for Part 1A, instr. 2.

37 Advisers Act section 203A(a)(2). The Dodd-Frank Act renumbered current paragraph 203A(a)(2) as 203A(a)(3), but did not amend this definition. *See* section 410 of the Dodd-Frank Act.

38 *See* Form ADV: Instructions for Part 1A, instr. 5.b. These assets include proprietary assets, assets an adviser manages without receiving compensation, and assets of foreign clients.

assets under management that can be used under the Act for purposes in addition to assessing whether an adviser is eligible to register with the Commission.[39] We also propose to amend rule 203A-3 to continue to require that the calculation of "assets under management" for purposes of Section 203A be the calculation of the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services, as reported on the investment adviser's Form ADV.[40]

We provided the current instructions on calculating assets under management in 1997 as part of our implementation of the $25 million of assets threshold for registering with the Commission provided for in NSMIA.[41] In that limited context, we provided some options for advisers in determining what assets must be included, and which are not mandated by the Advisers Act. In light of the additional uses of the term "assets under management" by the Dodd-Frank Act[42] and any new regulatory requirements related to systemic risk that might be triggered by registration with the Commission,[43] we are proposing to eliminate the choices we

39 *Compare* Form ADV: Instructions for Part 1A, instr. 5.b *with* proposed Form ADV: Instructions for Part 1A, instr. 5.b.

40 *See* proposed rule 203A-3(d).

41 *See* NSMIA Adopting Release at section II.B.

42 *See* sections 402(a) and 408 of the Dodd-Frank Act (adding section 202(a)(30) of the Act defining a foreign private adviser as having "assets under management" attributable to U.S. clients and private fund investors of less than $25 million, and section 203(m) directing the Commission to provide for an exemption for advisers solely to private funds with assets under management in the United States of less than $150 million).

43 Section 404 of the Dodd-Frank Act gives the Commission authority to impose on investment advisers registered with the Commission reporting and recordkeeping requirements for systemic risk assessment purposes. The Commission could require registered advisers that meet a certain threshold of assets under management to submit systemic risk data pursuant to our authority in section 404 of the Dodd-Frank Act. *See also* section 203(n) of the Advisers Act, as amended by section 408 of the Dodd-Frank Act ("In prescribing regulations to carry out the requirements of [Section 203 of the Act] with respect to investment advisers acting as investment advisers to mid-sized private funds, the Commission shall take into account the size . . . of such funds to determine whether they pose systemic risk, and shall provide for registration and examination

have given advisers in the Form ADV instructions.[44] Our proposed change would eliminate an adviser's ability to opt into or out of state or federal regulation (by including or excluding a class of assets such as proprietary assets) and any such regulatory requirements. We also would provide additional guidance to advisers on how to count assets managed through private funds.[45] Finally, we propose to alter the terminology we use in Part 1A of Form ADV to refer to an adviser's "regulatory assets under management" in order to acknowledge the distinction from the amount of assets under management the adviser discloses to clients in Part 2 of Form ADV, which need not necessarily meet the requirements of section 203A.[46]

More specifically, we propose to require all advisers to include in their regulatory assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are proprietary assets, assets managed without receiving compensation, or assets of foreign clients, all of which an adviser currently may (but is not required to) exclude.[47] In addition, we would not allow an adviser to subtract outstanding indebtedness and other accrued but unpaid liabilities, which remain in a client's account and are managed by the adviser.[48]

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procedures with respect to the investment advisers of such funds which reflect the level of systemic risk posed by such funds.").

44 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1).

45 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1), (4). *See also* section 402 of the Dodd-Frank Act (defining private fund as "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act"); Exemptions Release at section II.A.8. (discussing when a fund qualifies as a private fund) and at section II (providing additional descriptions of the proposed rules and their application for purposes of the new exemptions available to private fund advisers).

46 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.; *Amendments to Form ADV*, Investment Advisers Act Release No. 3060 (July 28, 2010) [75 FR 49234 (Aug. 12, 2010)] ("Part 2 Release").

47 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1).

48 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(2). Accordingly, an adviser would not be able to deduct accrued fees, expenses, or the amount of any borrowing.

We are proposing these changes in order to preclude some advisers from excluding certain assets from their calculation and thus remaining below the new assets threshold for registration with the Commission. The changes would result in some advisers reporting greater assets under management than they do today, but the assets we would require advisers to include in their assets under management are, in fact, assets managed by the adviser and allowing advisers to exclude such assets may have substantially more significant regulatory consequences than in 1997. The management of such assets, for example, may suggest that the adviser's activities are of national concern or have implications regarding the reporting for the assessment of systemic risk, a matter Congress considered important in enacting amendments to the Advisers Act in the Dodd-Frank Act.[49] The Commission, moreover, is proposing that advisers be required to include these assets so that the calculations would be more consistent among advisers. The Commission also believes that requiring that these assets be included in the calculation would better achieve the objective of the Dodd-Frank Act regarding which advisers must register with the Commission, which advisers must register with the states, and which advisers are exempt from Commission registration.

We also propose, as discussed below, to provide guidance regarding how an adviser that advises private funds determines the amount of assets it has under management. Form ADV currently provides no specific instructions applicable to this circumstance. We have designed our proposed instructions both to provide advisers with greater certainty in their calculation of regulatory assets under management, which they would also use as a basis to determine their eligibility for certain exemptions that we are proposing today in the Exemptions Release,[50] as

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49. *See supra* note 43. Congress did not address these systemic risk implications when it adopted NSMIA.

50. *See* Exemptions Release at sections II.B.2. and II.C.5.

well as to prevent advisers from understating those assets to avoid registration. First, we would require an adviser to include in its regulatory assets under management the value of any private fund over which it exercises continuous and regular supervisory or management services, regardless of the nature of the assets held by the fund.[51] As would be required for any other securities portfolio, a sub-adviser to a private fund would include in its assets under management only that portion of the value of the portfolio for which it provides sub-advisory services.

Second, we propose to require such adviser to include in its calculation of regulatory assets under management the amount of any uncalled capital commitments made to the fund.[52] Private funds, such as venture capital and private equity funds, typically make investments following capital calls on their investors, who are contractually obligated to fund their committed capital amounts.[53] Advisers to these types of private funds provide supervisory or management services to the funds in anticipation of all investors fully funding their capital commitments, describe the size of their funds on the basis of these capital commitments and, in the early years of a fund's life, typically earn fees based on the total amount of capital committed.[54]

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51 *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(1).

52 *Id.* A capital commitment is a contractual obligation of an investor to acquire an interest in, or provide the total commitment amount over time to, a private fund, when called by the fund.

53 *See, e.g.*, JAMES SCHELL, PRIVATE EQUITY FUNDS: BUSINESS STRUCTURE AND OPERATIONS §1.01 (2010) ("SCHELL") (typical private equity fund partnership agreement requires investors to commit to make capital contributions to the fund, which would be paid as needed rather than upfront and would be used to pay expenses and make investments); STEPHANIE BRESLOW & PHYLLIS SCHWARTZ, PRIVATE EQUITY FUNDS, FORMATION AND OPERATION 2010, at § 2:5.6 (discussing the various remedies that may be imposed in the event an investor fails to fund its contractual capital commitment, including, but not limited to, "the ability to draw additional capital from non-defaulting investors;" "the right to force a sale of the defaulting partner's interests at a price determined by the general partner;" and "the right to take any other action permitted at law or in equity").

54 *See, e.g.*, SCHELL, *supra* note 53 at §1.01 (noting that capital contributions made by the investors are used to "make investments in a manner consistent with the investment strategy or guidelines for the Fund.") and at §1.03 ("Management fees in a Venture Capital Fund are usually an annual amount equal to a fixed percentage of total Capital Commitments.").

Third, we propose to add an instruction to require advisers to use the fair value of private fund assets in order to ensure that advisers value private fund assets on a more meaningful and consistent basis.[55] Use of the cost basis (*i.e.*, the value at which the assets were originally acquired), for example, could under certain circumstances grossly understate the value of appreciated assets, and thus result in advisers avoiding registration with the Commission. Use of the fair valuation method by all advisers, moreover, would result in more consistent asset calculations and reporting across the industry and, therefore, in a more coherent application of the Act's regulatory requirements and of our staff's risk assessment program. We understand that many, but not all, private funds value assets based on their fair value in accordance with U.S. generally accepted accounting principles ("GAAP") or other international accounting standards.[56] We acknowledge some private funds do not use fair value methodologies, which may be more difficult to apply when the fund holds illiquid or other types of assets that are not traded on organized markets.[57] We believe, however, that for the reasons stated above it is

[55] *See* proposed Form ADV: Instructions for Part 1A, instr. 5.b.(4). A fund's governing documents may provide for a specific process for calculating fair value (*e.g.*, that the general partner, rather than the board of directors, determines the fair value of the fund's assets). An adviser would be able to rely on such a process also for purposes of calculating its "regulatory assets under management."

[56] *See, e.g.*, Comment Letter of National Venture Capital Association, dated July 28, 2009, at 2, commenting on the Commission's proposed custody rule (Investment Advisers Act Release No. 2876) (the "vast majority of venture capital funds provide their LPs [*i.e.*, investors] quarterly and audited annual financial reports. These reports are prepared under generally accepted accounting principles, or GAAP, and audited under the standards established for all investment companies, including the largest mutual fund complexes."); Comment Letter of Managed Funds Association, dated July 28, 2009, at 3 (a "substantial proportion of hedge fund managers, whether or not they are registered with the Commission, provide independently audited financial statements of the [hedge] fund to investors."). Furthermore, advisers to private funds that prepare and distribute financial statements prepared in accordance with GAAP may be deemed to satisfy certain requirements of our custody rule. *See* rule 206(4)-2(b)(4) under the Advisers Act.

[57] Those assets include, for example, "distressed debt" (such as securities of companies or government entities that are either already in default, under bankruptcy protection, or in distress and heading toward such a condition) or certain types of emerging market securities that are not readily marketable. *See* GERALD T. LINS *et al.*, HEDGE FUNDS AND OTHER PRIVATE FUNDS: REG

important for all advisers to use the fair valuation method to calculate their private fund assets under management.

Advisers, as discussed below, would apply this revised method to calculate assets under management for various purposes under the Advisers Act. As they do today, advisers would calculate their assets under management for purposes of assessing whether they are eligible to register with the Commission. As a result of the proposed amendments to rule 203A-1, which would remove the requirement that an adviser determine its eligibility for registration by the assets under management reported on Form ADV, we are proposing a new provision, rule 203A-3(d), to retain the requirement that the calculation of "assets under management" under section 203A and the related rules be made in accordance with the Form ADV calculation.[58] Advisers would also apply the method for purposes of the new exemptions for foreign private advisers and with respect to certain private fund advisers, which we address in the Exemptions Release. For purposes of calculating the assets under management relevant under the exemptions, our proposed rules cross-reference the method for calculating "regulatory assets under management" under Form ADV.[59] A uniform method of calculating assets under management for purposes of determining eligibility for SEC registration, reporting assets under management on Form ADV, and the new exemptions from registration under the Advisers Act would result in a more

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AND COMP § 5:22 (2009) ("At any given time, some portion of a hedge fund's portfolio holdings may be illiquid and/or difficult to value. This is particularly the case for certain types of hedge funds, such as those focusing on distressed securities, activist investing, etc.").

58 *See* proposed rule 203A-3(d) (requiring advisers to determine "assets under management" by calculating the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services as reported on the investment adviser's Form ADV). This new provision reflects the current requirement in subsection (a) of rule 203A-1 that we propose to eliminate to remove the $5 million buffer, which also requires advisers to determine their eligibility to register with the Commission based on the amount of assets under management reported on Form ADV. *See* rule 203A-1(a).

59 *See* Exemptions Release at sections II.B.2. and II.C.5.; proposed rules 202(a)(30)-1 (definitions of foreign private adviser exemption terms) and 203(m)-1 (private fund adviser exemption).

coherent application of the Act's regulatory requirements and more consistent reporting across the industry.

We request comment on our proposed changes to the instructions relating to the calculation of "regulatory assets under management." Are changes to the rule and instructions necessary? Should we instead consider different changes? If so, in what way should we amend them? In particular, is our understanding that most private funds prepare financial statements using fair value accounting correct? Would the proposed approach result in advisers valuing their private fund assets in a generally uniform manner and in comparability of the valuations? We are not proposing to require advisers to determine fair value in accordance with GAAP. Should we adopt such a requirement? If not, should we specify that advisers may only determine the fair value of private fund assets in accordance with a body of accounting principles used in preparing financial statements? We understand that GAAP does not require some funds to fair value certain investments. Should we provide for an exception from the proposed fair valuation requirement with respect to any of those investments?

Should we adopt a different approach altogether and allow advisers to use a method other than fair value? Are there other methods that would not understate the value of fund assets? Should the instructions permit advisers to rely on the method set forth in a fund's governing documents, or the method used to report the value of assets to investors or to calculate fees (or other compensation) for investment advisory services? What method should apply if a fund uses different methods for different purposes? Should we modify the proposed rule to require that the valuation be derived from audited financial statements or be subject to review by auditors or another independent third party?

Advisers are currently only required to update their assets under management reported on Form ADV annually.[60] Should we require more frequent updating? For instance, should we require an adviser to update its regulatory assets under management quarterly or any time the adviser files an other-than-annual amendment?[61]

4. Switching Between State and Commission Registration

Rule 203A-1 currently contains two means of preventing an adviser from having to switch frequently between state and Commission registration as a result of changes in the value of its assets under management or the departure of one or more clients.[62] First, the rule provides for a $5 million buffer that permits an investment adviser having between $25 million and $30 million of assets under management to remain registered with the states and does not subject the adviser to cancellation of its Commission registration until its assets under management fall below $25 million.[63] Second, the rule permits an adviser to rely on the firm's assets under management reported annually in the firm's annual updating amendments for purposes of determining its eligibility to register with the Commission, allowing an adviser to avoid the need to change registration status based upon fluctuations that occur during the course of the year.[64] If

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60 *See* General Instruction 4 to Form ADV.

61 *See, e.g.*, Exemptions Release at section II.B.2. (proposed rule 203(m)-1 would require quarterly evaluation of private fund assets); Part 2 Release, *supra* note 46, at nn.46-48 and accompanying text (requiring advisers to update the amount of assets under management reported in Part 2 annually and when there are material changes if the adviser files an interim amendment for a separate reason).

62 *See* rule 203A-1(a), (b); NSMIA Adopting Release, *supra* note 10, at section II.C.; *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1601, section II.C. (Dec. 20, 1996) [61 FR 68480 (Dec. 27, 1996)] ("NSMIA Proposing Release").

63 Rule 203A-1(a).

64 Rule 203A-1(b). *See also* rule 204-1(a) (requiring annual amendment to Form ADV within 90 days of fiscal year end); General Instruction 4 (annual amendment to Form ADV must update amount of assets under management reported). Other criteria to determine an adviser's eligibility to register with the Commission must also be determined annually. *See* rule 203A-1(b)(2).

an adviser is no longer eligible for Commission registration, the rule provides a 180-day grace period from the adviser's fiscal year end to allow it to switch to state registration.[65]

We propose to amend rule 203A-1 to eliminate the $5 million buffer for advisers having between $25 million and $30 million of assets under management, but to retain the ability of an adviser to avoid the need to change registration status based upon intra-year fluctuations in its assets under management for purposes of determining its eligibility to register with the Commission.[66] The current buffer seems unnecessary in light of Congress's determination generally to require most advisers having between $30 million and $100 million of assets under management to be registered with the states.[67] Moreover, at this time, we believe it is not necessary to increase the $100 million threshold in order to provide a similar buffer for advisers crossing that threshold and becoming registered with the Commission under the amended statutory provisions. We believe that the requirement that advisers only assess their eligibility for registration annually and the grace periods provided to switch to and from state registration will be sufficient to address the concern that an investment adviser with assets under management approaching $100 million or affected by changes in other eligibility requirements will frequently have to switch between state and federal registration.[68]

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65 Rule 203A-1(b)(2).

66 *See* proposed rule 203A-1. In addition, the proposed rule would permit an adviser to rely on an affirmation of other criteria reported in its annual updating amendments for purposes of determining its eligibility to register with the Commission. *See* proposed rule 203A-1(b) (continuing to require an adviser filing an annual updating amendment to its Form ADV reporting that it is not eligible for Commission registration to withdraw its registration within 180 days of its fiscal year end).

67 *See* H.R. REP. NO. 111-517, at 867 (2010) ("Conference Committee Report") (discussing fact that legislation "raise[d] the assets threshold for federal regulation of investment advisers from $30 million to $100 million.").

68 If during the 180-day grace period to switch to state registration an adviser's assets under management increase, making the adviser eligible for Commission registration again, the adviser could amend its Form ADV to indicate the new amount of assets under management and continue

We request comment on our proposed elimination of the $5 million buffer. Do many advisers currently use this buffer? Should we retain the buffer given the new provisions regarding mid-sized advisers? Should we adopt a similar buffer for the new $100 million dollar threshold in amended section 203A? If so, what should be the amount of the buffer? Should it be $5 million, or higher or lower, and why? Do Item 2.A of Form ADV, Part 1A and the related instructions provide sufficient information to advisers about their eligibility to register with the Commission, or is additional guidance necessary?

5. Exemptions from the Prohibition on Registration with the Commission

Section 203A(c) of the Advisers Act provides the Commission with the authority to permit investment advisers to register with the Commission even though they would be prohibited from doing so otherwise.[69] As also noted above, under this authority, we have adopted six exemptions in rule 203A-2 from the prohibition on registration.[70] Our authority under this provision was unchanged by the Dodd-Frank Act and therefore extends to the new mid-sized adviser category in section 203A(a)(2) of the Act, as amended.[71] As a result, as

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to remain registered with the Commission. *See* proposed rule 203A-1(b) (adviser must withdraw from SEC registration within 180 days of its fiscal year end unless it then is eligible for registration).

69 *See* Advisers Act section 203A(c). An investment adviser exempted from the prohibition on registration must register with the Commission, unless it otherwise qualifies for an exemption from registration under section 203(b) of the Advisers Act. Advisers Act section 203(a).

70 *See supra* note 14 and accompanying text. The Commission has permitted six types of investment advisers to register with the Commission under rule 203A-2: (i) NRSROs; (ii) pension consultants; (iii) investment advisers affiliated with an adviser registered with the Commission; (iv) investment advisers expecting to be eligible for Commission registration within 120 days of filing Form ADV; (v) multi-state investment advisers; and (vi) internet advisers.

71 Today, rule 203A-2 provides that advisers meeting the criteria for a category of advisers under the rule will not be prohibited from registering with us by Advisers Act section 203A(a). *See* rule 203A-2; NSMIA Adopting Release at section II.D. We are not proposing to amend this part of rule 203A-2. The new prohibition on mid-sized advisers registering with the Commission also is established under Advisers Act section 203A(a); therefore, mid-sized advisers meeting the requirements for a category of exempt advisers under rule 203A-2 would be eligible to register with us. *See* section 410 of the Dodd-Frank Act; proposed rule 203A-2.

currently drafted, each of these exemptions would, by its terms, apply to mid-sized advisers–exempting them from the prohibition on registering with the Commission if they meet the requirements of rule 203A-2. We are proposing amendments to three of the exemptions to reflect developments since their adoption, including the enactment of the Dodd-Frank Act. We request comment on whether we should amend the rules so that some, or all, of the exemptions should not be available to mid-sized advisers.[72]

a. NRSROs

We propose an amendment to eliminate the exemption in rule 203A-2(a) from the prohibition on Commission registration for nationally recognized statistical rating organizations ("NRSROs"). Since we adopted this exemption, Congress amended the Act to exclude NRSROs from the Act[73] and provided for a separate regulatory regime for NRSROs under the Securities Exchange Act of 1934 ("Exchange Act").[74] Only one NRSRO remains registered as an investment adviser under the Act and reports that it has more than $100 million of assets under management and thus would not rely on the exemption.[75] Should we retain this exemption? If so, why?

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72 We are also renumbering and making minor conforming changes to, rule 203A-2(c), (d) and (f) regarding investment advisers affiliated with an SEC-registered adviser, newly formed advisers expecting to be eligible for Commission registration within 120 days, and internet advisers. *See* proposed rule 203A-2(b), (c) and (e).

73 Credit Rating Agency Reform Act of 2006, P.L. 109-291, 120 Stat. 1327, § 4(b)(3)(B) (2006) ("Credit Rating Agency Reform Act"). *See also* Advisers Act section 202(a)(11)(F) (excluding an NRSRO from the definition of investment adviser unless it issues recommendations about purchasing, selling, or holding securities or engages in managing assets that include securities).

74 Credit Rating Agency Reform Act, *supra* note 73, at sections 4(a), 5.

75 Based on IARD data as of September 1, 2010.

b. Pension Consultants

We propose to amend the exemption available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets from $50 million to $200 million.[76] Pension consultants typically do not have "assets under management," but we have required these advisers to register with us because their activities have a direct effect on the management of large amounts of pension plan assets.[77] We had set the threshold at $50 million of plan assets for these advisers to ensure that, in order to register with us, a pension consultant's activities are significant enough to have an effect on national markets.[78] We propose to increase this threshold to $200 million in light of Congress's determination to increase from $25 million to $100 million the amount of "assets under management" that requires all advisers to register with the Commission.[79] This threshold would maintain a ratio to the statutory threshold that is the same as the ratio of the $50 million plan asset threshold and $25 million assets under management threshold currently in place. As a result, advisers currently relying on the pension consultant

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76 *See* proposed rule 203A-2(a).

77 *See* NSMIA Adopting Release at section II.D.2.; NSMIA Proposing Release at section II.D.2. Pension consultants provide services to pension and employee benefit plans and their fiduciaries, including assisting them to select investment advisers that manage plan assets. *See* rule 203A-2(b)(2), (3); NSMIA Adopting Release at section II.D.2. The exemption does not apply to pension consultants that solely provide services to plan participants. *See* NSMIA Adopting Release at section II.D.2.

78 *See* NSMIA Adopting Release at n. 60 (the $50 million "higher threshold is necessary to demonstrate that a pension consultant's activities have an effect on national markets."). The higher asset requirement also reflects that a pension consultant has substantially less control over client assets than an adviser that has "assets under management." *Id.* To determine the aggregate value of plan assets, a pension consultant may only include the portion of the plan's assets for which the consultant provided investment advice. Rule 203A-2(b)(3).

79 *See* section 410 of the Dodd-Frank Act.

exemption advising plan assets of less than $200 million may be required to register with one or more states.[80]

We request comment on our proposed amendment. Does an adviser advising plan assets of $200 million or more have an impact on national markets? Should we use another amount instead? Does an adviser advising a smaller amount of plan assets also have an impact on national markets? Should we instead increase the threshold by the same amount that Congress increased the statutory threshold of assets under management, which would be $125 million of plan assets?

c. Multi-state Advisers

We propose to amend the multi-state adviser exemption to align the rule with the multi-state exemption Congress built into the mid-sized adviser provision under section 410 of the Dodd-Frank Act.[81] Under rule 203A-2(e), the prohibition on registration with the Commission does not apply to an investment adviser that is required to register in 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register in at least 25 states.[82] The Dodd-Frank

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80 We note, however, that a pension consultant required to register in 15 or more states would be eligible to register with the SEC pursuant to proposed rule 203A-2(d). *See infra* section II.A.5.c. of this Release.

81 *See* proposed rule 203A-2(d).

82 Rule 203A-2(e)(1). An investment adviser relying on this exemption also must: (i) include a representation on Schedule D of Form ADV that the investment adviser has concluded that it must register as an investment adviser with the required number of states; (ii) undertake to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that it would be required by the laws of fewer than 25 states to register as an investment adviser with the state; and (iii) maintain a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register. Rule 203A-2(e)(2)-(4). Advisers relying on rule 203A-2(e) may not include in the number of states those in which they are not required to register because of applicable state laws or the national *de minimis* standard of section 222(d) of the Advisers Act. *See Exemption for Investment Advisers Operating in Multiple States; Revisions to Rules Implementing Amendments to the Investment Advisers Act of 1940; Investment Advisers with Principal Offices and Places of Business in*

Act provides that a mid-sized adviser that otherwise would be prohibited may register with the Commission if it would be required to register with 15 or more states.[83]

We believe that this provision of the Dodd-Frank Act reflects a Congressional view on the number of states with which an adviser must be required to be registered before the regulatory burdens associated with such regulation warrant registration solely with the Commission and application of the preemption provision.[84] Thus, we are reconsidering the threshold of our multi-state exemption, and propose to amend rule 203A-2(e) to permit all investment advisers required to register as an investment adviser with 15 or more states to register with the Commission.[85] We also propose to eliminate the provision in the rule that permits advisers to remain registered until the number of states in which they must register falls below 25 states, and we are not proposing a similar cushion for the 15-state threshold.[86] The Dodd-Frank Act contains no such cushion for mid-sized advisers.[87] We also believe that the requirement that advisers only assess their eligibility for registration annually and the grace periods provided to switch to and from state

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Colorado or Iowa, Investment Advisers Act Release No. 1733, n. 17 (July 17, 1998) [63 FR 39708 (July 24, 1998)] ("Multi-State Adviser Adopting Release").

83 *See* section 410 of the Dodd-Frank Act ("…if by effect of this paragraph an investment adviser would be required to register with 15 or more States, then the adviser may register under section 203."). Section 203A(a)(1) of the Advisers Act does not include a similar exemption from the prohibition on Commission registration for small advisers required to register in a particular number of states.

84 *See* Conference Committee Report, *supra* note 67, at 867 (bill "raises the assets threshold for federal regulation of investment advisers from $30 million to $100 million. Those advisers who qualify to register with their home state must register with the SEC should the adviser operate in more than 15 states.").

85 *See* proposed rule 203A-2(d)(1).

86 *See* proposed rule 203A-2(d)

87 *See* section 410 of the Dodd-Frank Act.

registration may be sufficient to address the concern that an investment adviser required to register in 15 states would frequently have to switch between state and federal registration.[88]

We request comment on whether the 15-state threshold should be applied to small advisers as well as mid-sized advisers. If not, should the threshold of 30 or more states continue to apply to small advisers? Should we, as proposed, eliminate the "cushion" that permits advisers to remain registered with us even if they are no longer registered in five of the states in which they were initially registered? Should we retain that provision or, alternatively, include a different number of states? Does the grace period currently provided in rule 203A-1 prevent the transient registration problems that the five-state cushion was designed to address?[89]

6. Elimination of Safe Harbor

Rule 203A-4 provides a safe harbor from Commission registration for an investment adviser that is registered with the state securities authority of the state in which it has its principal office and place of business, based on a reasonable belief that it is prohibited from registering with the Commission because it does not have sufficient assets under management.[90] Advisers have not, in our experience, asserted, as a defense, the availability of this safe harbor, which protects only against enforcement actions by us and not any private actions, and we are not proposing to extend it to the higher threshold established by the Dodd-Frank Act. This rule was designed for smaller advisory businesses with assets under management of less than $30

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88 *See supra* notes 66-68 and related text. We also note that proposed rule 203A-2(d) would permit an adviser to choose to maintain its state registrations and not switch to SEC registration. *See* proposed rule 203A-2(d)(2) (adviser elects to rely on the exemption by making the required representations on Form ADV).

89 *See* proposed rule 203A-1; *supra* notes 66-68 and related text; Multi-State Adviser Adopting Release at section II.A. (five-state provision creates a cushion to prevent an adviser from having to de-register and then re-register with the Commission frequently as a result of a change in registration obligations in one or a few states).

90 Rule 203A-4.

million,[91] which may not employ the same tools or otherwise have a need to calculate assets as precisely as advisers with greater assets under management. We view it as unlikely that an adviser would be reasonably unaware that it has more than $100 million of regulatory assets under management when it is required to report its regulatory assets under management on Form ADV.[92] Commenters are requested to address whether advisers do, in fact, rely on this safe harbor today. We also request comment on whether we should, as we propose, rescind this safe harbor or, alternatively, extend its availability to the higher registration threshold of the Dodd-Frank Act.

7. Mid-Sized Advisers

As discussed above, section 203A(a)(2) of the Advisers Act, as amended by the Dodd-Frank Act, will prohibit mid-sized advisers from registering with the Commission, but only if: (i) the adviser is required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; and (ii) if registered, the adviser would be subject to examination as an investment adviser by such commissioner, agency, or office.[93] The Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority.[94] We propose to incorporate into Form ADV an explanation of how we construe these provisions.[95]

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91 *See* rule 203A-4; NSMIA Adopting Release at section II.B.3.

92 We believe that whether an adviser has $100 million of assets under management is unlikely to be determined by whether non-discretionary assets could be treated as assets under management or whether the adviser provides continuous and regular supervisory or management services with respect to certain assets, which was the basis for the safe harbor. *See* NSMIA Adopting Release at section II.B.3.; NSMIA Proposing Release at section II.B.4.

93 *See* section 410 of the Dodd-Frank Act.

94 The Advisers Act defines the term "state" to include any U.S. state, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. Advisers Act

a. Required to be Registered

Under section 203A(a)(1) of the Act, an adviser that is not regulated or required to be regulated as an investment adviser in the state in which it has its principal office and place of business must register with the Commission regardless of the amount of assets it has under management.[96] We have interpreted "regulated or required to be regulated" to mean that a state has enacted an investment adviser statute, regardless of whether the adviser is actually registered in that state.[97] This interpretation has two relevant consequences. First, advisers with a principal office and place of business in Wyoming, or in foreign countries, must register with the Commission regardless of whether they have assets under management and would not otherwise be eligible for one of our exemptive rules.[98] Second, some smaller advisers exempt from state registration are not subject to registration with either the Commission or any of the states.[99]

We believe that Congress was concerned with the latter consequence when it passed this provision of the Dodd-Frank Act. The bills originally introduced and passed in the House and Senate increased up to $100 million the threshold for Commission registration under the

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section 202(a)(19). For purposes of section 203A of the Advisers Act and the rules thereunder, rule 203A-3(c) defines "principal office and place of business" to mean the executive office of the investment adviser from which its officers, partners, or managers direct, control, and coordinate its activities. We are not proposing changes to this definition. *See* rule 203A-3(c). For a discussion of amendments we propose to make to the calculation of assets under management, see *supra* section II.A.3. of this Release.

95 *See* proposed Form ADV: Instructions for Part 1A, instr. 2.b.

96 Advisers Act section 203A(a)(1). *See also* Advisers Act section 203(a).

97 *See* NSMIA Adopting Release at section II.E.1.

98 *See* NSMIA Adopting Release at section II.E.; NSMIA Proposing Release at section II.E. Currently, all U.S. states except Wyoming require certain investment advisers to register. *See Transition Rule for Ohio Investment Advisers*, Investment Advisers Act Release No. 1794, n. 4 (Mar. 25, 1999) [64 FR 15680 (Apr. 1, 1999)].

99 *See, e.g.*, Advisers Act section 203A(a)(1); Uniform Securities Act §§ 102(15), 403(b) (2002) ("Uniform Securities Act") (defining "investment adviser" and providing exemptions from state registration as an investment adviser).

"regulated or required to be regulated" standard that is used today in section 203A(a)(1).[100] Accordingly, some advisers with a significant amount (more than $25 million) of assets under management could have escaped oversight by either the Commission or any of the states by taking advantage of state registration exemptions. Perhaps to avoid this possibility, the Conference Committee included a provision to prohibit a mid-sized adviser from registering with the Commission if, among other things, it is "required to be registered" as an adviser with the state securities authority where it maintains its principal office and place of business.[101] A mid-sized adviser that can and does rely on an exemption under the law of the state in which it has its principal office and place of business such that it is "not required to be registered" with the state securities authority[102] must register with the Commission, unless an exemption from registration with the Commission otherwise is available.[103] An adviser not registered under a state adviser statute in contravention of the statute, however, would not be eligible for registration with the Commission.

We are proposing changes to Form ADV to require a mid-sized adviser filing with us to affirm, upon application and annually thereafter, that it is not required to be registered as an adviser with the state securities authority in the state where it maintains its principal office and

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100 *See* The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 7418 (2009) (requiring an adviser with between $25 million and $100 million of assets under management that "is regulated and examined, or required to be regulated and examined, by a State" to register with and be subject to examination by such state); Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. § 410 (2010) (prohibiting an investment adviser with assets under management of less than $100 million from registering with the Commission if the adviser "is regulated or required to be regulated as an investment adviser" in the state where it maintains its principal office and place of business).

101 *See* section 410 of the Dodd-Frank Act.

102 *See, e.g.*, Uniform Securities Act, *supra* note 99, at sections 102(15), 403(b).

103 *See, e.g.*, Advisers Act sections 203(a) and (b), 203A(b); rule 203A-2. Such an adviser could not voluntarily register with the state securities authorities to avoid SEC registration.

place of business.[104] An adviser reporting that it is no longer able to make such an affirmation thereafter would have 180 days from its fiscal year end to withdraw from Commission registration.[105] Thus, the rule would operate to permit an adviser to rely on this affirmation reported in its annual updating amendments for purposes of determining its eligibility to register with the Commission.[106] Should these requirements apply to mid-sized advisers? Are there alternative interpretations of "required to be registered" that we should consider and why?

b. Subject to Examination

Not all state securities authorities conduct compliance examinations of advisers registered with them.[107] Congress therefore determined to require a mid-sized adviser to register with the Commission if the adviser is not subject to examination as an investment adviser by the state in which the adviser has its principal office and place of business.[108]

The Commission does not intend either to review or evaluate each state's investment adviser examination program.[109] Instead, we will correspond with each state securities commissioner (or official with similar authority) and request that each advise us whether an

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104 *See* proposed Form ADV, Part 1A, Item 2.A.(2)(a). For a discussion of proposed changes to Form ADV, Part 1A, Item 2, see *supra* section II.A.2. of this Release.

105 *See* proposed rule 203A-1(b).

106 This would allow an adviser to change registration status based upon a change during the course of the year regarding whether it is required to be registered with a state.

107 *See, e.g.,* North American Securities Administrators Association, Inc., *State Securities Regulators Report on Regulatory Effectiveness and Resources with Respect to Broker-Dealers and Investment Advisers*, 7 (2010) ("NASAA Report"). The NASAA Report was submitted in connection with the Commission's study regarding obligations of brokers, dealers, and investment advisers, and is available on the Commission's website at http://www.sec.gov/comments/4-606/4606-2789.pdf.

108 *See* section 410 of the Dodd-Frank Act.

109 The bill introduced in the House included a requirement that we publish a list of the states that regulate and examine, or require regulation and examination of, investment advisers. *See* The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 7418 (2009). Congress did not include this requirement in the Dodd-Frank Act. *See* section 410 of the Dodd-Frank Act.

investment adviser registered in the state would be subject to examination as an investment adviser by that state's securities commissioner (or agency or office with similar authority).[110] We believe that the states, being most familiar with their own circumstances, are in the best position to determine whether advisers in their state are subject to examination. Using the responses that we receive, we will identify for advisers filing on IARD the states in which the securities commissioner did not certify that advisers are subject to examination and incorporate that list into IARD to ensure that only mid-sized advisers with their principal office and place of business in one of those states (or, as discussed above, mid-sized advisers that are not registered with the states where they maintain their principal office and place of business) will register with the Commission.[111] We request comment on whether the Commission should take additional steps to determine whether an investment adviser would be subject to examination in a state, as well as any alternatives the Commission may adopt. We also request comment on the steps the Commission should take if a state determines not to respond to our request.

B. Exempt Reporting Advisers: Sections 407 and 408

As discussed above, the Dodd-Frank Act, effective July 21, 2011, also repealed the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act on which advisers to many hedge funds and other pooled investment vehicles had relied in order to avoid registration under the Act.[112] In eliminating this provision, Congress amended the Act to create,

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110 We also will request that each state notify the Commission promptly if advisers in the state will begin to be subject to examination or will no longer be subject to examination.

111 *See* proposed Form ADV, Part 1A, Item 2.A.(2)(b). We will also make the list available on our website at http://www.sec.gov.

112 Section 403 of the Dodd-Frank Act. Section 203(b)(3) exempts from registration any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act, or a company which has elected to be a business development company pursuant to Section 54 of the Investment Company Act (15 U.S.C. 80a-53).

or direct us to adopt, other, in many ways narrower, exemptions for advisers to certain types of "private funds." Both section 203(l) of the Advisers Act (which provides an exemption for an adviser that advises solely one or more "venture capital funds") and section 203(m) of the Advisers Act (which instructs the Commission to exempt any adviser that acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million) provide that the Commission shall require such advisers to maintain such records, which we have the authority to examine,[113] and to submit reports "as the Commission determines necessary or appropriate in the public interest."[114] We refer to these advisers in this release as "exempt reporting advisers."

To implement sections 203(l) and 203(m), we are proposing a new rule to require exempt reporting advisers to submit, and to periodically update, reports to us by completing a limited subset of items on Form ADV.[115] We are also proposing amendments to Form ADV to permit the form to serve as a reporting, as well as a registration, form and to specify the seven items exempt reporting advisers must complete.[116]

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113 Under section 204(a) of the Advisers Act, the Commission has the authority to examine records, unless the adviser is "specifically exempted" from the requirement to register pursuant to section 203(b) of the Advisers Act. Investment advisers that are exempt from registration in reliance on section 203(l) or 203(m) of the Advisers Act are not "specifically exempted" from the requirement to register pursuant to section 203(b).

114 *See* sections 407 and 408 of the Dodd-Frank Act, adding Advisers Act sections 203(l) and (m). See *supra* note 45 for a discussion of the term "private fund." *See also* Exemptions Release at section II. *See also* current section 204(a) of the Advisers Act and section 204(b)(5), as added by section 404 of the Dodd-Frank Act.

115 Recordkeeping requirements for exempt reporting advisers will be addressed in a future release. *See* sections 407 and 408 (providing that the Commission shall require investment advisers exempt from registration under either section 407 or 408 to maintain such records as the Commission determines necessary or appropriate in the public interest or for the protection of investors.).

116 For a discussion of additional amendments we are proposing to Part 1 of Form ADV, see *infra* section II.C. of this Release.

1. Reporting Required

We are proposing a new rule, rule 204-4, to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.[117] Rule 204-4 would require these advisers to submit their reports through the IARD using the same process as registered investment advisers.[118] Each Form ADV would be considered filed with the Commission upon acceptance by the IARD,[119] and advisers filing the form would be required to pay a filing fee.[120] As we do for IARD filings by registered advisers, we would approve, by order, the amount of the filing fee charged by FINRA.[121] We anticipate that filing fees would be the same as those for registered investment advisers, which currently range from $40 to $200, based on the amount of assets an adviser has under management.[122] The filing fees would be set at amounts that are designed to pay the reasonable costs associated with the filing and the maintenance of the IARD.

The reports filed by exempt reporting advisers would be publicly available on our website.[123] Exempt reporting advisers unable to file electronically as a result of unanticipated technical difficulties may qualify for a temporary hardship exemption.[124] We also are proposing

117 Proposed rule 204-4(a).

118 Proposed rule 204-4(b). *See* General Instructions 6, 7, 8 and 9 (providing guidance about the IARD entitlement process, signing the form, and submitting it for filing).

119 Proposed rule 204-4(c). *Cf.* rule 0-4(a)(2) ("All filings required to be made electronically with the . . . [IARD] shall, unless otherwise provided by the rules and regulations in this part, be deemed to have been filed with the Commission upon acceptance by the IARD.").

120 Proposed rule 204-4(d).

121 *See* section 204(b) of the Advisers Act.

122 The current fee schedule may be found on our website at http://www.sec.gov/divisions/investment/iard/iardfee.shtml.

123 The Investment Adviser Public Disclosure System ("IAPD") allows the public to access the most recent Form ADV filing made by an investment adviser and is available at http://www.adviserinfo.sec.gov. We would, however, make it clear to the public viewing reports filed by an exempt reporting adviser on IAPD that the adviser is not registered with us.

124 *See* proposed rule 204-4(e) (providing a temporary hardship exemption for an adviser having unanticipated technical difficulties that prevent submission of a filing to IARD). The temporary

technical amendments to Form ADV-H, the form advisers use to request a hardship exemption from electronic filing, and Form ADV-NR, used to appoint the Secretary of the Commission as an agent for service of process for certain non-resident advisers.[125]

We are proposing to require reporting on Form ADV through the IARD to avoid the expense and delay of developing a new form and because the IARD already has the capacity to accept electronic filing of the form. Moreover, much of the information we propose that exempt reporting advisers would provide is required by Form ADV. Because exempt reporting advisers may be required to register on Form ADV with one or more state securities authorities,[126] use of the existing form and filing system would also permit exempt reporting advisers to satisfy both state and Commission requirements with a single electronic filing.[127] Our proposed approach

hardship exemption is based on a similar exemption for registered advisers contained in rule 203-3(a) under the Act [17 CFR 275.203-3(a)], which provides an exemption of no more than seven business days after the filing was due.

125 *See* proposed amended Form ADV-H, proposed amended Form ADV-NR, and proposed General Instruction 18. The amendments to Form ADV-H and Form ADV-NR would reflect that exempt reporting advisers would be filing on IARD and the forms would be used in the same way and for the same purpose as they are currently used by registered investment advisers.

126 The Dodd-Frank Act exempts exempt reporting advisers from registration with the Commission. *See* sections 407 and 408 of the Dodd-Frank Act. It does not, however, exempt these advisers from registering or filing reports with state securities regulators. *See also* section 410 of the Dodd-Frank Act (re-allocating SEC and state jurisdiction over investment advisers); proposed rule 203A-1 (proposing the process for switching to or from state or SEC registration); and proposed General Instruction 13 to Form ADV (noting that exempt reporting advisers who file reports with the SEC may continue to be subject to state registration, reporting, or other obligations).

127 Form ADV is used by advisers both to register with the Commission and with state securities authorities. At the request of the state securities authorities, we expect to add to Form ADV a check box and instructions that would permit exempt reporting advisers to direct the filing of reports filed with the Commission to the state securities authorities. Because these revisions to Form ADV and the obligation to file the report with the state securities authorities would not arise from a federal law or Commission rule, we are not proposing them for comment. We urge interested persons to submit comments directly to the North American Securities Administrators Association, Inc. ("NASAA") for consideration by the state securities authorities at the following e-mail address: advcomments@nasaa.org. In addition, we understand that NASAA may propose a model rule that would exempt certain exempt reporting advisers from state registration but would require these advisers to submit to the states a report identical to the report an exempt

would permit an adviser to transition from filing reports with us to applying for registration under the Act by simply amending its Form ADV; the adviser would check the box to indicate it is filing an initial application for registration, complete the items it did not have to answer as an exempt reporting adviser, and update the pre-populated items that it already has on file.[128]

We request comment on proposed rule 204-4 and its requirement that exempt reporting advisers file reports by responding to a subset of items on Form ADV and filing the report through IARD. Should we instead create a new form and/or a new filing system for exempt reporting advisers? Rather than use IARD or a new system, should we instead require exempt reporting advisers to use EDGAR? Should we not make this information available to the public on our website? Are there alternative approaches to reporting by exempt reporting advisers that we should consider? If so, please explain. Are there additional ways the Commission could distinguish between registered advisers and exempt reporting advisers?

2. Information in Reports

We are proposing several amendments to Form ADV to facilitate filings by exempt reporting advisers. First, we would re-title the form to reflect its dual purpose as both the "Uniform Application for Investment Adviser Registration," as well as the "Report by Exempt Reporting Advisers." Second, we are proposing to amend the cover page so that exempt reporting advisers would indicate the type of report they are filing.[129] Finally, we propose to amend Item 2 of Part 1A, which requires advisers to indicate their eligibility for SEC

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reporting adviser would be required to submit to the SEC. Interested persons should visit the NASAA website at http://www.nasaa.org for the full text of any proposed rule and to respond to any request for comment.

128 See proposed General Instruction 14 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser). *See also infra* note 140.

129 An adviser would indicate whether it is submitting an initial report, an annual updating amendment, an other-than-annual-amendment, or a final report. We also propose corresponding changes to General Instruction 2.

registration, by adding a new subsection C that would require an exempt reporting adviser to identify the exemption(s) that it is relying on to report, rather than register, with the Commission.[130]

Form ADV is today designed to obtain information from registered advisers that provide a wide variety of types of advisory services, including providing advice to private funds. Therefore, the information that we propose to collect from exempt reporting advisers is for the most part currently required by Form ADV.[131] We would provide an instruction to these advisers to complete only certain items in the form, but we do not propose to change the content of the items for exempt reporting advisers.[132] As noted above, we propose to require exempt reporting advisers to complete a limited subset of Form ADV items, which would provide us and the public with some basic information about the adviser and its business, but is not all of the information we require registered advisers to submit to us, and which is designed to support our regulatory program. We propose to require exempt reporting advisers to complete the following items in Part 1A of Form ADV: Items 1 (Identifying Information), 2.C. (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization), 6 (Other Business Activities), 7 (Financial Industry Affiliations and Private Fund Reporting), 10 (Control Persons), and 11

130 An adviser would check that it qualifies for an exemption from registration: (i) as an adviser solely to one or more venture capital funds; and/or (ii) because it acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million. *See* proposed Form ADV, Part 1A, Item 2.C. An adviser relying on the latter exemption, for private fund advisers, would also be required to indicate the amount of private fund assets it manages in Section 2.C. of Schedule D to Form ADV, Part 1A. Investment advisers who have their principal office and place of business outside of the United States, however, would need only to include private fund assets that they manage from a place of business in the United States. *See* Exemptions Release at section II.B.2.

131 Some of the amendments we propose to Form ADV would apply to both registered and exempt reporting advisers. *See infra* section II.C. of this Release.

132 We propose amending General Instruction 3 to explain which portions of Form ADV are applicable to exempt reporting advisers.

(Disclosure Information). In addition, exempt reporting advisers would have to complete corresponding sections of Schedules A, B, C, and D. We would not require exempt reporting advisers to complete and file with us other Items in Part 1A or prepare a client brochure (Part 2).[133]

Congress gave us broad authority to require exempt reporting advisers to file reports as necessary or appropriate in the public interest or for the protection of investors.[134] The Dodd-Frank Act neither specifies the types of information we could require in the reports nor specifies the purpose for which we would use the information.[135] We have sought information that we believe would assist us to identify the advisers, their owners, and their business models. The items that we have proposed would also provide us with information as to whether these advisers or their activities might present sufficient concerns as to warrant our further attention in order to protect their clients, investors, and other market participants. We have also considered the broader public interest in making this information generally available and believe there may be benefits of providing information about their activities to the public. We acknowledge that there may be costs associated with providing this information to us, and that the adviser may provide some or all of this information to private fund investors or prospective investors, however we believe there will be benefits, which we describe in more detail below.

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133 Part 2 of Form ADV, which requires advisers to prepare a narrative, plain English client brochure, contains 18 items including information on the adviser's business practices, conflicts of interest, and background. Part 2 also requires advisers to prepare brochure supplements that include information about advisory personnel on whom clients rely for investment advice. Currently, only a *registered* adviser must deliver a brochure under rule 204-3, and only an adviser that must deliver a brochure must prepare and file one as part of its Form ADV. *See* rule 203-1.

134 *See* sections 407 and 408 of the Dodd-Frank Act.

135 The Dodd-Frank Act does, however, specify that the reports are those "the Commission determines necessary or appropriate in the public interest or for the protection of investors." *Id.*

Items 1, 3, and 10 would elicit basic identification details about an exempt reporting adviser such as name, address, contact information, form of organization, and who owns the adviser. Items 6 and 7.A. would provide us with details regarding other business activities that the adviser and its affiliates are engaged in, which would permit us to identify conflicts that the adviser may have with its clients that may suggest significant risks to those clients. Item 11 would require advisers to disclose the disciplinary history for the adviser and its employees. An exempt reporting adviser that has, for example, an officer that has been found guilty of fraud or other crimes or has committed substantial regulatory infractions would be of concern to us and to investors and prospective investors in funds advised by the exempt reporting adviser.

Because exempt reporting advisers manage private funds, we also propose to require them to complete Item 7.B. and Section 7.B of Schedule D for the private funds they advise. As discussed in more detail in Section II.C. below, we are proposing significant amendments to Section 7.B.1. of Schedule D that are designed to provide us with a comprehensive overview, or census, of private funds.[136] Exempt reporting advisers' responses to Item 7.B., and Section 7.B.1. of Schedule D, in conjunction with information provided by registered advisers, would provide us with important data about these funds that we would use to identify risks to their investors.

Do commenters agree with our judgments regarding the items applicable to exempt reporting advisers? We have not proposed to require exempt reporting advisers to complete Items 4, 5, 8, 9, or 12 of Part 1 of Form ADV. We request comment on whether we should

136 For instance, advisers who complete section 7.B.1. of Schedule D would have to provide identifying information about each private fund, such as its name and domicile, as well as information about its ownership, service providers, and its total and net assets. *See* proposed Form ADV, Part 1A, Schedule D, Section 7.B.1.

require exempt reporting advisers to complete any of these items to provide us and investors with the information required by those items.

Part 2 of Form ADV, the client brochure, is required of registered advisers to provide clients and potential clients with detailed information about their qualifications, investment strategies, and business practices. Our proposal would not require exempt reporting advisers to prepare Part 2 of Form ADV. Should we require exempt reporting advisers to complete Part 2 of Form ADV, file it with us on IARD, and make it available to the public on our website? Would some or all of this information be helpful to clients and potential clients of these advisers? Should we not require exempt reporting advisers to complete certain items of Part 2? For example, should we exclude those items that would require information similar to those items of Part 1 that we are not proposing to require exempt reporting advisers to complete? Are there other items we should include or not include? Should we require these advisers to complete brochure supplements? Would the information in the brochure supplements be helpful to the clients of these advisers? Do investors currently receive this type of information as a result of their investment in a private fund?

Should the reporting requirements be identical for exempt reporting advisers as they are for registered advisers? Are there items that we have proposed to apply to exempt reporting advisers that we should not apply or are unnecessary, and why? Is any of the information we propose to require not readily available to an exempt reporting adviser? Would any of the items require disclosure of proprietary or competitively sensitive information? If so, which items, and if competitively sensitive, describe the competitive impact. Would any of these disclosure requirements, either individually or cumulatively, impose a significant burden? Would they require disclosure of proprietary or competitively sensitive information such that they could impact or influence business or other decisions by these advisers? Would they materially affect a decision by an adviser whether to form a private fund? If so, why?

3. Updating Requirements

We are also proposing to amend rule 204-1 under the Advisers Act, which requires advisers to update their Form ADV filings, to require exempt reporting advisers to file updating amendments to reports filed on Form ADV.[137] Proposed rule 204-1(a) would require an exempt reporting adviser, like a registered adviser, to amend its reports on Form ADV: (i) at least annually, within 90 days of the end of the adviser's fiscal year; and (ii) more frequently, if required by the instructions to Form ADV. Consequently, we are proposing to amend General Instruction 4 to Form ADV to require an exempt reporting adviser to update Items 1 (Identification Information), 3 (Form of Organization), or 11 (Disciplinary Information) promptly if they become inaccurate in any way, and to update Item 10 (Control Persons) if it becomes materially inaccurate.[138] We are proposing the same updating requirements with respect to these Items as are applicable to registered advisers because we believe it is equally important for exempt reporting advisers to report information on a timely basis. We also believe it could create confusion to apply different updating standards *within* each item of the form depending on who completes the item. Consequently, we are proposing to require exempt reporting advisers to follow the same instructions applicable to the items they must complete, although they are required to complete fewer items than a registered adviser.

We request comment on the proposed amendments to rule 204-1 to extend its requirements to exempt reporting advisers. Should exempt reporting advisers be permitted to

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137 Proposed rule 204-1. We also propose to amend the title of the rule to be "Amendments to Form ADV," rather than "Amendments to application for registration," to reflect use of the Form by exempt reporting advisers.

138 *See* General Instruction 4 to Form ADV.

update Form ADV, or certain items, less frequently? If so, what should be the updating requirements, and should we be concerned that, as a result, an exempt reporting adviser that is also registered with a state securities regulator would have to update its Form ADV on a different schedule than an exempt reporting adviser that is not also registered with a state? Would less frequent reporting result in information that is less useful or materially inaccurate? Should exempt reporting advisers be required to update other items more frequently than annually?

We propose to include a provision in rule 204-4 to require an exempt reporting adviser to file an amendment to its Form ADV when it ceases to be an exempt reporting adviser.[139] The exempt reporting adviser would indicate in this amendment that it is filing a final report pursuant to rule 204-4 in order to alert us that the adviser no longer will be filing reports, and allow us to distinguish such a filer from one that is inattentive to its filing obligations.[140] We request comment on this proposed final report requirement. Is there an alternative approach we could take?

Finally, we propose amending the instructions to Form ADV to provide guidance to exempt reporting advisers who file final reports because they must register with the Commission. Such a transition may occur, for example, if an adviser relying on the "venture capital exemption" in section 203(l) of the Advisers Act accepts a client that is not a venture capital fund,[141] or the value of the assets under management in the United States of an adviser relying on the "private fund exemption" in section 203(m) of the Advisers Act meets or exceeds $150 million.[142] A transitioning adviser would file an amendment to its Form ADV simultaneously

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139 *See* proposed rule 204-4(f).

140 Proposed rule 204-4(f). Advisers filing a final report would not be required to pay a filing fee. We note that failure to file a final report would result in a violation of the rule.

141 *See* section 407 of the Dodd-Frank Act.

142 *See* section 408 of the Dodd-Frank Act.

indicating that the filing will be its final "report" on Form ADV and applying for registration with the Commission.[143] We request comment on this proposed guidance.

4. Transition

We propose requiring each exempt reporting adviser to file its initial report with us on Form ADV no later than August 20, 2011, 30 days after the July 21, 2011 effective date of the Dodd-Frank Act.[144] We believe this would provide sufficient time to enable an adviser to determine whether it must report to us and to take the steps necessary to complete and submit its initial filing. We request comment on our proposed transition, including the amount of time we propose for exempt reporting advisers to submit their initial reports.

As discussed above, our ability to effect this transition may be affected by our need to re-program IARD.[145] We are working closely with FINRA, our IARD contractor, to make the needed modifications, but the programming may not be completed until after we adopt these rules. If IARD is unable to accept filings of amended Form ADV by that time, we may want to delay the reporting deadline until the system can accept electronic filing of the revised form. Should we instead require an alternative procedure, such as a paper filing, for advisers to indicate their eligibility for this exemption from registration and to satisfy their reporting requirements?

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143 *See* proposed General Instruction 14. In the Exemptions Release we propose that an adviser relying on the private fund adviser exemption would have three months from the end of a calendar quarter at which it failed to qualify for the exemption because of a fluctuation in private fund assets to apply to the Commission for registration unless it qualifies for another exemption. *See* proposed rule 203(m)-1(d).

144 *See* sections 403, 407, 408, and 419 of the Dodd Frank Act.

145 *See supra* section II.A.1. of this Release.

C. Form ADV

Data collected from Form ADV is of critical importance to our regulatory program and our ability to protect investors. We use information reported to us on Form ADV for a number of purposes, one of which is to efficiently allocate our examination resources based on the risks we discern or the identification of common business activities from information provided by advisers. The information is used to create risk profiles of investment advisers and permits our examiners to better prepare for, and more efficiently conduct, their on-site examinations. Moreover, the information in Form ADV allows us to better understand the investment advisory industry and evaluate the implications of policy choices we must make in administering the Advisers Act.

To enhance our ability to oversee investment advisers, we are proposing to require advisers to provide us additional information about three areas of their operations.[146] First, we are proposing to require advisers to provide information regarding private funds they advise. Second, we are proposing to expand the data advisers provide about their advisory business, (including data about the types of clients they have, their employees, and their advisory activities), as well as about their business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals). Third, we are proposing to require additional information about advisers' non-advisory activities and their financial industry affiliations. We are also proposing certain additional changes intended to improve our ability to assess compliance risks and also to identify advisers that are subject to the Dodd-Frank Act's requirements concerning certain incentive-

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[146] In addition, we are proposing several clarifying or technical amendments based on frequently asked questions we receive from advisers as well as in our experience administering the form. *See infra* section II.C.6. of this release.

based compensation arrangements.[147] We understand that advisers would have ready access to all of the new information as part of their normal operations or compliance programs, and thus these new requirements should impose few additional regulatory burdens. We request comment on whether our understanding is correct. In addition to (or instead of) these three areas of operations, are there other areas about which we should require advisers to report additional information?

1. Private Fund Reporting: Item 7.B.

We propose to expand the information we require advisers to provide us about the private funds they advise in response to Item 7.B., and Schedule D. Both registered and exempt reporting advisers would complete this Item. The information would provide us with a more complete understanding of the private funds advised by advisers and would permit us to enhance our assessment of private fund advisers for purposes of targeting our examinations. The information also would help us identify particular practices that may harm investors. We have been concerned that unregistered funds have been used as a vehicle for perpetrating fraud on investors.[148] The private fund reporting requirements we are proposing would provide a level of transparency that we believe would help us to identify practices that may harm investors,[149] and would deter advisers' fraud and facilitate earlier discovery of potential misconduct.[150]

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147 *See* section 956 of the Dodd-Frank Act.

148 For example, since January 2009, the Commission has brought more than 50 enforcement cases in which we assert hedge fund advisers have defrauded hedge fund investors or used the fund to defraud others.

149 For instance, census data about a private fund's gatekeepers, including administrators and auditors, would be available on proposed Section 7.B.1. of Schedule D and would be verifiable by investors and the Commission. Recent enforcement actions suggest that the availability of such information could be helpful. *See, e.g., SEC v. Grant Ivan Grieve, et al.*, Litigation Release No. 21402 (Feb. 2, 2010) (default judgment against hedge fund adviser that was alleged to have fabricated and disseminated false financial information for the fund that was "certified" by a sham independent back-office administrator and phony accounting firm); *See In the Matter of John Hunting Whittier*, Investment Advisers Act Release No. 2637 (Aug. 21, 2007) (settled

Currently, Item 7 requires each adviser to complete Section 7.B. of Schedule D for any "investment-related limited partnership" that the adviser or a related person advises. A separate Schedule D must be completed for each partnership. We propose to modify the scope of Item 7 by requiring completion of Section 7.B. only for a private fund that the adviser (and not a related person) advises. This amendment would incorporate the new term "private fund," defined in section 202(a)(29) of the Act, the primary effect of which would be to require advisers to report pooled investment vehicles regardless of whether they are organized as limited partnerships.[151] We would no longer require an adviser to report to us funds that are advised by affiliates, which in many cases would now be reported to us by an affiliate that is either registered under the Act or is now an exempt reporting adviser.[152]

To avoid multiple reporting for each private fund, we propose to permit a sub-adviser to exclude private funds for which an adviser is reporting on another Schedule D,[153] and would

action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not).

150 *See, e.g.*, Second Amended Complaint, *SEC v. Hoover*, Civil Action No. 01-10751-RGS, (D. Mass. Mar. 20, 2002) *available at* http://www.sec.gov/litigation/complaints/complr17487.htm (adviser allegedly participated in a scheme to defraud clients of his advisory firm by, among other things, misappropriating assets and overbilling expenses. When he became aware that the Commission staff was investigating his firm, he established a separate, unregistered advisory firm and perpetuated his fraud through use of a hedge fund he created and controlled.); *SEC v. Hoover*, Litigation Release No. 17981 (Feb. 11, 2003) (announcing final judgment by consent).

151 *See supra* note 45 (discussing the definition of private fund). In 2004, the Commission adopted amendments to Form ADV to require reporting of "private fund" information, including a similar amendment to Item 7. A federal appeals court vacated the 2004 amendments to Item 7 that we had adopted for private funds. *See Registration under the Advisers Act of Certain Hedge Fund Advisers*, Investment Advisers Act Release No. 2333 (Dec. 2, 2004) [69 FR 72054 (Dec. 10, 2004)] ("Hedge Fund Adviser Registration Release"); *Goldstein v. Securities and Exchange Commission*, 451 F.3d 873 (D.C. Cir. June 23, 2006) ("*Goldstein*"). The amendments we propose would, in part, reinstate these amendments we adopted in 2004.

152 Currently, a related person may be able to rely on the private adviser exemption from registration, which, as discussed above, was repealed by the Dodd Frank Act effective July 21, 2011. *See supra* at sections I, II.B. of this Release.

153 If an investment adviser completes section 7.B.1. of Schedule D for a private fund, other advisers to that fund (most of which are likely to be sub-advisers) would not have to complete section

permit an adviser sponsoring a master-feeder arrangement to submit a single Schedule D for the master fund and all of the feeder funds that would otherwise be submitting substantially identical data.[154] Finally, we propose to permit an adviser with a principal office and place of business outside the United States to omit a Schedule D for a private fund that is not organized in the United States and that is not offered to, or owned by, "United States persons."[155] This approach is designed to limit the reporting burden imposed on foreign advisers with respect to funds in which U.S. investors have no direct interest.

We request comment on the scope of the Schedule D filing requirements about private funds. Should we, as proposed, require exempt reporting advisers to file Section 7.B of Schedule D? Would the disclosure of private fund information by exempt reporting advisers impact or influence business or other decisions by these advisers, such as whether to form additional private funds or discourage entry into management of private funds all together?

7.B.1. for that private fund. *See* proposed Form ADV, Part 1A, Note to Item 7.B.; proposed Section 7.B.2. of Schedule D. When filing Section 7.B.1. of Schedule D for a private fund, an adviser would acquire a unique identification number to the fund. The adviser would be required to continue to use the same identification number whenever it amends Section 7.B.1. for that fund. Any adviser that files a Section 7.B.1. for a private fund for which an identification number has already been acquired by another adviser would not be permitted to acquire a new identification number, but would be required to instead utilize the existing number. *See* proposed Form ADV: Instructions for Part 1A, instr. 6.b.

154 *See* proposed Form ADV: Instructions for Part 1A, instr. 6. In a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). Advisers would report on a single Schedule D if their responses to certain questions of Section 7.B.1. of Schedule D would be identical for each master and feeder fund. Our staff estimates that most master-feeder arrangements involving private funds would meet this condition. An adviser filing a single Schedule D for a master-feeder arrangement would complete its Schedule D under the name of the master fund, following our proposed instructions for Section 7.B.

155 *Id. See also* proposed Form ADV: Glossary. We propose to define "United States person" by reference to the definition in proposed rule 203(m)-1(e)(8), which tracks the definition of a "U.S. person" under Regulation S, except that it contains a special rule for discretionary accounts maintained for the benefit of United States persons. *See* Exemptions Release at section II.B.4. As discussed in the Exemptions Release, our proposed use of the Regulation S definition for various purposes under the Advisers Act would lessen the burden imposed on advisers, which are familiar with the definition because they apply it for other purposes under the securities laws.

Should we require advisers to report information also about other pooled investment vehicles they may advise, such as foreign funds not offered to U.S. persons? Specifically, are there sufficient investor protection or other concerns that the Commission should seek to require this information? Is information about these funds important to understand conduct that directly involves U.S. investors? Are the instructions eliminating multiple filing of Section 7.B. by advisers helpful? Are there different approaches we might take to achieve our intended goals? We request that commenters review our proposed instructions and identify any ambiguities that we should address.

We propose to amend Section 7.B. of Schedule D, which currently requires very limited information about limited partnerships established by an adviser, and which provides us with little data about the operations of the many large hedge funds and other types of private funds advised by a growing number of advisers registered with the Commission.[156] New Section 7.B.1. would expand on the identifying information currently required to be reported in order to provide us with basic organizational, operational and investment characteristics of the fund; the amount of assets held by the fund; the nature of the investors in the fund; and the fund's service providers.[157] Although we are proposing several new items of information that would be reported to us, much of the information should be readily available to private fund advisers (*e.g.*,

156 Today, Section 7.B. of Schedule D requires an adviser to a private fund that is a limited partnership or limited liability company to identify: (1) the name of the fund; (2) the name of the general partner or manager; (3) whether the adviser's clients are solicited to invest in the fund; (4) the approximate percentage of the adviser's clients that have invested in the fund; (5) the minimum investment commitment; and (6) the current value of the total assets of the fund.

157 We have considered the potential application of section 210(c) of the Advisers Act (which precludes us from requiring advisers to disclose to us the "identity, investments, or affairs" of any of its clients) to the information about private fund clients of advisers and have concluded that the Dodd-Frank Act permits us to require this information in Form ADV. *See, e.g.*, section 404(2) of the Dodd-Frank Act, adding Advisers Act section 204(b)(1)(A) (authorizing the Commission to require any investment adviser registered under the Act "to maintain such records of, and file with the Commission such reports regarding, private funds advised by the investment adviser, as necessary and appropriate in the public interest and for the protection of investors…").

the amount of fund assets) and the responses to many of the items are unlikely to change from year to year (*e.g.*, on which exclusion from the Investment Company Act the fund relies) and thus the additional reporting should not involve a significant reporting burden. As discussed in more detail below, the information will help us identify potential compliance risks and inform our regulatory activities.

Part A of the Section would require identifying information, including the name of the private fund. We propose to add an instruction to the item to permit an adviser that seeks to preserve the anonymity of a private fund client by maintaining its identity in code in its records to identify the private fund in Schedule D using the same code.[158] We request comment on this new instruction.

We also propose to revise Part A to require an adviser to identify the state or country where the private fund is organized, and the name of its general partner, directors, trustees or persons occupying similar positions.[159] The item would ask information about the organization of the fund, including whether it is a master or a feeder fund, and some information about the regulatory status of the fund and its adviser, including the exclusion from the Investment Company Act on which it relies, whether the adviser is subject to a foreign regulatory authority, and whether the fund relies on an exemption from registration of its securities under the

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158 Rule 204-2(d) permits any books and records required to be maintained by the rule "in such manner that the identity of any client to whom such investment adviser renders investment supervisory services is indicated by numerical or alphabetical code or some similar designation." We included the provision in the rule in 1961 to reconcile our then new examination authority (the exercise of which has required us to examine client records) with section 210(c) of the Act. *See Notice of Proposed Rule to Require Investment Advisers to Maintain Specified Books and Records Under the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 111 (Jan. 25, 1961) [26 FR 987 (Feb. 1, 1961)]. We are proposing to add the instruction to permit the few advisers that in our experience have sought to encode the identity of their clients to do so.

159 *See* proposed Form ADV, Part 1A, Section 7.B.1.A. of Schedule D, questions 2-3.

Securities Act of 1933.[160] The Item also would contain questions regarding whether the adviser is a subadviser to the private fund and would require the adviser to identify by name and SEC file number any other advisers to the fund.[161] We are proposing several questions to help us better understand the private fund's investment activities and other areas of potential investor protection concerns. For example, we would ask about the size of the fund, including both its gross and net assets, from which we could better understand the scope of its operations and the extent of leverage it employs.[162] We would ask the adviser to identify within seven broad categories (which the applicable instruction would define) the type of investment strategy employed by the adviser,[163] and to break down the assets and liabilities held by the fund by class and categorization in the fair value hierarchy established under U.S. generally accepted accounting principles (GAAP).[164] Many private funds managed by investment advisers that would be reporting to us prepare financial statements in accordance with GAAP.[165] Others may use international accounting standards requiring substantially similar information. Their adviser, therefore, should have access to this information from such financial statements. We would ask about both the number and the types of investors in the fund, as well as the minimum amounts

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160 *Id.* questions 4-7 and questions 23-24 (asking whether the fund relies on Regulation D and what is the fund's Form D file number, if any).

161 *Id.* questions 19-20.

162 *Id.* question 11.

163 *Id.* question 10. The categories include: (i) hedge fund; (ii) liquidity fund; (iii) private equity fund; (iv) real estate fund; (v) securitized asset fund; (vi) venture capital fund; and (vii) other private fund.

164 *Id.* question 12. *See* FASB ASC 820-10-50-2b. We also propose to ask whether the fund invests in securities of registered investment companies, which is relevant to evaluating compliance with the fund of funds provision of the Investment Company Act, section 12(d)(1). *See* section 12(d)(1) of the Investment Company Act; proposed Form ADV, Part 1A, Section 7.B.1.A. of Schedule D, question 9.

165 *See supra* note 56. In addition, advisers to private funds that prepare and distribute financial statements prepared in accordance with GAAP may be deemed to satisfy certain requirements of our custody rule. *See* Advisers Act rule 206(4)-2(b)(4).

required to be invested by fund investors to get a better idea of the types of investors the fund is intended to serve and to get a sense of the extent to which investors may themselves be in a position to exercise oversight of the adviser.[166] Finally, some items would ask information about characteristics of the fund that may present the fund manager with conflicts of interest with fund investors of the sort that may implicate the adviser's fiduciary obligations to the fund and, in some cases, create risks for the fund investors. Thus we would continue to ask whether clients of the adviser are solicited to invest in the fund and what percentage of the other clients has invested in the fund.[167]

In Part B of the Section, we propose to require advisers to report information concerning five types of service providers that generally perform important roles as "gatekeepers" for private funds (*i.e.*, auditors, prime brokers, custodians, administrators and marketers).[168] We would require that an adviser identify them, provide their location, and state whether they are related persons. For each of these service providers, we would also require specific information that would clarify the services they provide and include certain identifying information such as registration status. This information includes the following for each service provider. For the auditors, whether they are independent, registered with the Public Company Accounting Oversight Board (PCAOB) and subject to its regular inspection, and whether audited statements are distributed to fund investors.[169] For the prime broker, whether it is SEC-registered and

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166 *See* proposed Form ADV, Part 1A, Section 7.B.1.A. of Schedule D, questions 13-18.

167 *Id.* questions 21-22.

168 *See* proposed Form ADV, Part 1A, Section 7.B.1.B. of Schedule D.

169 *See* proposed Form ADV, Part 1A, Section 7.B.1.B. of Schedule D, question 25. We are also proposing amendments to the instructions contained in Item 9 to avoid having advisers reporting overlapping information (relevant to compliance with rule 206(4)-2, the "custody rule") under Section 9 and Section 7.B. of Schedule D.

whether it acts as custodian for the private fund.[170] For the custodian, whether it is a related person of the adviser.[171] For the administrator, whether it prepares and sends to investors account statements and what percentage of the fund's assets are valued by the administrator or another person that is not a related person of the adviser.[172] Finally, for marketers, whether they are related persons of the adviser, their SEC file number (if any), and the address of any website they use to market the fund.[173] The questions in Part B are generally designed to improve our ability to assess conflicts and potential risks, identify funds with service provider arrangements that raise a "red flag," and identify firms for examination. For instance, it would be relevant to us to know that a private fund is using a service provider that we are separately investigating for alleged misconduct.

The information we propose to require advisers to report on private funds is similar to (although less extensive than) the information that we understand investors in hedge funds and other private funds commonly seek in their due diligence questionnaires.[174] Professional investors use information acquired as part of their vetting process before they invest. We likewise are seeking to acquire the information to help us identify private fund advisers that present investors with greater compliance or other risks. Each particular item of information may not itself indicate an elevated risk of a compliance failure, but could serve as an input to the risk metrics by which our staff identifies potential risk and allocates examination resources. The

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170 *See id.* question 26.

171 *See id.* question 27. "Related Person" is defined in Form ADV: Glossary.

172 *See id.* question 28.

173 *See id.* question 29. For purposes of this question, marketers include placement agents, consultants, finders, introducers, municipal advisors or other solicitors, or similar persons.

174 *See, e.g.*, AIMA's Illustrative Questionnaire For Due Diligence of Hedge Fund Managers, *available at* (registration required) http://www.aima.org/en/knowledge_centre/index.cfm.

staff conducts similar analyses today, but have limited inputs, which constrains their effectiveness.

The information would be publicly available as is other information on Form ADV, and we expect it would be used by investors to supplement their due diligence efforts. We expect the use of these data could further help investors and other industry participants protect against fraud. For example, using the IARD data, auditors would be able to compare their list of funds they audit with those whose advisers report them as auditor in order to uncover false representations.[175] Investors (and their consultants) would be able to compare representations made on Schedule D with those made in private offering documents or other material provided to prospective investors.

We request comment on our proposed amendments to Section 7.B. of Schedule D. Should we modify our requests for information? Is there information requested in due diligence questionnaires that would yield additional or more relevant risk information and that we should require? For instance, should we require advisers to report information regarding their legal counsel? If so, what information? Is the information we request readily available to fund managers, and in particular to sub-advisers? If not, is there information that is readily available that could serve the same purpose?

In crafting these new disclosure items, we have sought to avoid requiring disclosure of proprietary information that could harm the interests of the fund or fund investors. Have we succeeded? Commenters asserting that information not be reported should identify the specific harm asserted. Do commenters agree with our belief that reporting and disclosure of private

175 *See In the Matter of John Hunting Whittier*, Investment Advisers Act Release No. 2637 (Aug. 21, 2007) (settled action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not.)

fund information will be beneficial to investors (although they may currently receive some or all of this information) as well as prospective investors and other market participants?

Will it be burdensome for registered or exempt reporting advisers to use for purposes of Question 12 the valuation hierarchy established under GAAP with respect to those funds that do not have financial statements prepared in accordance with GAAP? If we require all advisers to fair value their private fund assets under management as proposed,[176] would advisers be able to rely on such a valuation for purposes of Question 12? Should we require that the information provided in response to Question 12 be part of audited financial statements or be subject to review by auditors or another independent third party? Are there additions, deletions, or changes to the definitions of the seven categories of private fund we would require advisers to use to identify a private fund that we should consider? Should some of the items apply only to certain types of private funds (*e.g.*, hedge funds)? If so, which items and why?

2. Advisory Business Information: Employees, Clients and Advisory Activities: Item 5

Item 5 of Part 1A requires an adviser to provide basic information regarding the business of the adviser that allows us to identify the scope of the adviser's business, the types of services it provides, and the types of clients to whom it provides those services. The item requires information from the adviser about the number of its employees, the amount of assets it manages, the number and types of its clients, and the types of advisory services provided. The modifications we are proposing today, which primarily refine or expand existing questions, would help us better understand the operations of advisers.

First, we propose to seek additional information about the adviser's employees. Currently, Item 5 asks for the number of employees that are registered representatives of a

176 *See supra* section II.A.3.

broker-dealer, which we would expand to ask for the number of employees that are registered as investment adviser representatives or insurance agents.[177] In order to obtain more precise data, we also propose that advisers provide a single numerical approximate response to the questions about employees, instead of checking a box corresponding to a range of numbers, as is currently required.[178] This additional employee data would, for instance, permit us to develop ratios (*e.g.*, number of employees to assets under management of clients) that we can use to identify advisers to inform our risk-based examination program.

Second, we propose to add some questions to help us better understand an adviser's business by reference to the types of clients the adviser services. Items 5.C. and D. currently require an adviser to report how many clients it has (in ranges) and to indicate the types of clients, *e.g.* high net worth individuals, investment companies. We propose to expand the list of types of clients provided in Item 5.D., to include business development companies, insurance companies, and other investment advisers, as well as to distinguish pension and profit-sharing plans subject to ERISA[179] from those that are not. As amended, this Item also would require an adviser to indicate the approximate amount of its regulatory assets under management attributable to each client type.[180] We also propose to ask approximately what percentage of the adviser's clients are not United States persons.[181] This additional information would allow us to better understand the focus of an adviser's business.

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177 Proposed Form ADV, Part 1A, Items 5.B.(3) and (5).

178 For instance, proposed Item 5.B.(1) asks how many of an adviser's employees perform advisory functions. Under the current Form, an adviser with seven such employees would check a box for "6-10." We propose the adviser simply fill in a blank with the number "7."

179 Employee Retirement Income Security Act of 1974 (29 U.S.C. 18).

180 Proposed Form ADV, Part 1A, Item 5.D. We are also proposing amendments to the calculation of an adviser's regulatory assets under management. *See supra* section II.A.3. of this Release.

181 Proposed Form ADV, Part 1A, Item 5.C.(2). *See supra* note 155 (discussing the definition of "United States person"). We also propose to add an instruction to Item 5.C., 5.D. and 5.H. to

Third, we are proposing two amendments related to the advisory activities that are reported in Item 5. Item 5.G. requires an adviser to select from a list the advisory services that it provides, such as financial planning or portfolio management. We propose to expand the list of advisory activities to include portfolio management for pooled investment vehicles, *other* than registered investment companies, and educational seminars or workshops.[182] We would also require advisers to provide the SEC file number for a registered investment company if they check the box for portfolio management for an investment company, which would permit our examination staff to link information reported on Form ADV to information reported on forms filed through our EDGAR system by investment companies managed by these advisers.[183] We are proposing new Item 5.J. that would require advisers to select from a list the types of investments about which they provided advice during the fiscal year for which they are reporting.[184] These changes would provide us with more details regarding the services an adviser provides, allowing us to better identify candidates if, for instance, we choose to do a risk-targeted examination of advisers based on the nature of the advice they provide.

We request comment on our proposed amendments to Item 5. Would advisers readily have access to the additional data we request? Does the switch from ranges to a single approximate number of employees in Items 5.A. and 5.B. pose any significant problems or burdens for advisers? If so, would providing an instruction to permit an adviser to round its

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clarify that advisers should not count as clients the investors in a private fund they advise unless they have a separate advisory relationship with them.

182 Proposed Form ADV, Part 1A, Item 5.G.

183 Proposed Form ADV, Part 1A, Schedule D, Section 5.G.(3).

184 Advisers would also be required to indicate the types of investments, such as various types of swaps and variable life insurance, about which they provided advice. Proposed Form ADV, Part 1A, Item 5.J.

responses up or down help? Are there additional types of clients, advisory activities, and investments we should add to our proposed lists in Items 5.D., 5.G., and 5.J., respectively?

3. Other Business Activities and Financial Industry Affiliations: Items 6 and 7

Items 6 and 7 of Part 1A require advisers, including exempt reporting advisers, to report those financial services the adviser or a related person is actively engaged in providing from lists of financial services set forth in the items. We are proposing several changes to these Items that would provide us with a more complete picture of the activities of an adviser and its related persons, which would better allow us to assess the conflicts of interest and risks that may be created by those relationships and to identify affiliated financial service businesses. We propose to expand the lists in both Items 6 and 7 to include business as a trust company, registered municipal advisor, registered security-based swap dealer, and major security-based swap participant, the latter three of which are new SEC-registrants under the Dodd-Frank Act's amendments to the Exchange Act.[185] We also propose to add accountants (or accounting firms) and lawyers (or law firms) to the list in Item 6, to parallel current Item 7. We are also proposing to move from Item 7.B. to Item 7.A. the question that asks whether a related person is a sponsor or the general partner or managing member of a pooled investment vehicle.[186] Finally, we would

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185 Proposed Form ADV, Part 1A, Items 6.A. and 7.A. Section 975 of the Dodd-Frank Act amends the Exchange Act to require "municipal advisors" to register with the Commission, Section 761 of that Act amends the Exchange Act to define the terms "security-based swap dealer" and "major security-based swap participant," and section 764 amends the Exchange Act to require these entities to register with the Commission.

186 The question we propose to ask in Item 7.A. would, therefore, retain information about related persons that would otherwise not be required as a result of our proposed changes to Item 7.B. As discussed above, we are proposing to require advisers to report in Item 7.B. and section 7.B.1. of Schedule D private fund information only about funds they advise, not funds advised by a related person. *See supra* section II.C.1. of this Release. We would also delete "investment company" from the list in Item 7 as duplicative of information we obtain in Item 5. *See, e.g.*, Form ADV, Part 1A, Items 5.D., 5.G., and proposed Form ADV, Part 1A, Section 5.G.(3) of Schedule D. *See also supra* note 183 and accompanying text.

clarify in the instruction to Item 7 that advisers are to include related persons that are foreign affiliates.

We are also proposing to require additional reporting in the corresponding sections of Schedule D for Items 6 and 7. First, we propose a new Section 6.A. of Schedule D that would require an adviser that checks the box that it is engaged in another business under a different name to list those other business names and the other lines of business in which the adviser engages using that name.[187] Second, we propose a similar modification to Item 6.B. to require advisers primarily engaged in another business under a different name to also provide that name in Section 6.B. of Schedule D. Third, we propose to amend Section 7.A. of Schedule D, which currently requires that advisers provide identifying information for related persons that are investment advisers or broker-dealers. We propose to require advisers to provide this same information with respect to *any* type of related person listed in Item 7.A. We also propose to expand the information we collect regarding these related persons to include more details about the relationship between the adviser and the related person, whether the related person is registered with a foreign financial regulatory authority, and how they share personnel and confidential information.[188] This additional information on related persons would allow us to link disparate pieces of information that we have access to concerning an adviser and its affiliates as well as identifying whether the adviser controls the related person or vice versa. It would also provide us with a tool to identify where there may be advisory activities by unregistered affiliates. Finally, we propose to relocate to this section a question currently under

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187 For example, an adviser registered with us under the name "Adam Bob Charlie Advisers LLC" that is also actively engaged in business as an insurance agent under the name "ABC Insurance LLC" would put the name "ABC Insurance LLC" in Section 6.A. of Schedule D and would check the box for "Insurance broker or agent."

188 Proposed Form ADV, Part 1A, Section 7.A., questions 1, 2, 5 and 6.

Section 9 that requires reporting of whether a related person bank or futures commission merchant is a qualified custodian for client assets under the adviser custody rule, and to ask, if the adviser is reporting a related person investment adviser, whether the related person is exempt from registration.[189]

We request comment on these proposed amendments. Should we request additional information about advisers' and their related persons' other business? Should we request less information? Are there other types of financial services providers we should include in the lists contained in Items 6 and 7? Are there other questions in Section 7.A. that we should ask to determine additional conflicts of interest advisers face through related persons? Is the information advisers need to complete the proposed additional questions contained in Section 7.A. readily available?

4. Participation in Client Transactions: Item 8

Item 8 requires an adviser to report information about its transactions, if any, with clients, including whether the adviser or a related person engages in transactions with clients as a principal, sells securities to clients, or has discretionary authority over client assets. This item also currently requires an adviser to indicate if it has discretionary authority to determine the brokers or dealers for client transactions and if it recommends brokers or dealers to clients.[190] We propose to further ask whether any of the brokers or dealers are related persons of the adviser.[191] An adviser that indicates that it receives "soft dollar benefits" would also report whether all those benefits qualify for the safe harbor under section 28(e) of the Exchange Act for

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189 Proposed Form ADV, Part 1A, Section 7.A., questions 3 and 4. We are also proposing a technical change to remove the same question in section 9.D. of Schedule D.

190 Form ADV, Part 1A, Items 8.C.3. and 8.E.

191 Proposed Form ADV, Part 1A, Items 8.F.

eligible research or brokerage services.[192] Finally, we would add a new question requiring an adviser to indicate whether it or its related person *receives* direct or indirect compensation for client referrals to complement the existing question concerning whether the adviser compensates any person for client referrals.[193] The amendments we are proposing would enhance our ability to identify additional conflicts of interest that advisers may face that we have identified through our experience administering the Advisers Act.

We request comment on our proposed amendments. Should we request additional information about advisers' receipt of soft dollar benefits, such as requiring advisers to quantify the benefits they receive or disclose the names of the brokers or dealers from whom the adviser receives soft dollar benefits? Is there other information that would assist us in identifying conflicts of interest?

5. Reporting $1 Billion in Assets: Item 1

Section 956 of the Dodd-Frank Act requires us, jointly with certain other federal regulators, to adopt rules or guidelines addressing certain excessive incentive-based compensation arrangements, including those of investment advisers with $1 billion or more in assets.[194] To enable us to identify those advisers that would be subject to section 956, we propose to require each adviser to indicate in Item 1 whether or not the adviser had $1 billion or

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192 Proposed Form ADV, Part 1A, Item 8.G.(2). *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Release No. 54165 (July 18, 2006) [71 FR 41978 (July 24, 2006)].

193 Proposed Form ADV, Part 1A, Item 8.I.

194 *See* sections 956(a)-(c), (e)(2)(D), (f) of the Dodd-Frank Act. The other federal regulators include the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, and the Federal Housing Finance Agency.

more in assets as of the last day of the adviser's most recent fiscal year.[195] We propose that for purposes of this reporting requirement, the amount of assets would be the adviser's total assets determined in the same manner as the amount of "total assets" is determined on the adviser's balance sheet for its most recent fiscal year end.[196] We request comment on whether Form ADV generally, and the proposed requirement in particular, is the appropriate method to identify these investment advisers. Should we identify these advisers by other means, and if so, what other means? We also request comment on the proposed method that advisers must use to determine the amount of their assets.

6. Other Amendments to Form ADV

The proposed amendments also include a number of additional changes unrelated to the Dodd-Frank Act that are intended to improve our ability to assess compliance risks. First, we propose changes to improve certain identifying information we obtain from other items of Part 1A of Form ADV. Item 1 currently requires an adviser to provide contact information for an employee designated to handle inquiries regarding the adviser's Form ADV. We propose instead to require an adviser to provide contact information for its chief compliance officer to give us direct access to the person designated to be in charge of its compliance program.[197] Advisers

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195 *See* proposed Form ADV, Part 1A, Item 1.O. (adviser would mark "yes" or "no" to indicate whether it had $1 billion or more in assets).

196 *See* proposed Form ADV: Instructions for Part 1A, instr. 1.b. We construe section 956 as specifying, and thus propose to define "assets" to mean, the total assets of the advisory firm rather than the total "assets under management," *i.e.*, assets managed on behalf of clients.

197 Proposed Form ADV, Part 1A, Item 1.J. An adviser is currently required to provide the name of its chief compliance officer on Schedule A of Form ADV, but not other identifying information. *See also* 17 CFR 275.206(4)-7; *Compliance Programs of Investment Companies and Investment Advisers*, Investment Advisers Act Release No. 2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] (adopting rule 206(4)-7 requiring registered investment advisers to designate a chief compliance officer). An exempt reporting adviser that does not have a chief compliance officer would instead provide a designated person's contact information in Item 1.K. Proposed Form ADV, Part 1A, Item 1.K. Likewise, we would not require an exempt reporting adviser to provide the name of a chief compliance officer on Schedule A of Form ADV.

would have the option, in Item 1.K., to provide an additional regulatory contact for Form ADV, neither of which would be viewable by the public on our website.[198] We also propose to amend Item 1 to require an adviser to indicate whether it or any of its control persons is a public reporting company under the Exchange Act.[199] This would provide a signal, not only to us, but to investors and to prospective investors, that additional public information is available about the adviser and/or its control persons. In addition, we propose to add "Limited Partnership" as another choice advisers may select to indicate how their organization is legally formed.[200]

We are also proposing to add an additional custody question to Item 9 to require advisers to indicate the *total* number of persons that act as qualified custodians for the adviser's clients in connection with advisory services the adviser provides to its clients.[201] We recently modified Item 9 to elicit information about the adviser or its related person(s) acting as qualified custodian.[202] We did not, however, request information about *other* qualified custodians. We expect this discrete piece of additional data to provide us with a more complete picture of an adviser's custodial practices.[203]

Finally, we are proposing three technical changes with respect to the reporting of disciplinary events. First, we propose to add a box to Item 11 for advisers to check if any disciplinary information reported in that item and the corresponding disclosure reporting pages is

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198 Proposed Form ADV, Part 1A, Item 1.K. We note that clients will be provided with a supervisory contact in brochure supplements. *See* Part 2 Release, *supra* note 46.

199 Proposed Form ADV, Part 1A, Items 1.N., 10.B., and Section 10.B. of Schedule D.

200 Proposed Form ADV, Part 1A, Item 3.A.

201 Proposed Form ADV, Part 1A, Item 9.F.

202 *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) [75 FR 1456 (Jan. 11, 2010)].

203 Consistent with the updating requirements for Items 9.A.(2), 9.B.(2), and 9.E., we propose requiring new Item 9.F. to be updated only annually. *See* proposed General Instruction 4.

being reported about the adviser or any of its supervised persons.[204] This would enable us to easily determine if an adviser is only reporting disciplinary events for its affiliates, and would facilitate our ability to focus examination and enforcement resources on those advisers that appear to present the greatest compliance risks. Second, we propose to add a third reason to each disclosure reporting page (DRP) that permits an adviser to remove the DRP from its filing by adding a box an adviser could check if it was filed in error. Third, we propose to amend Item 3.D. of Part 2B, the brochure supplement, to correct a drafting error regarding when a brochure supplement would need to include disclosure regarding the revocation or suspension of a professional attainment, designation, or license. The amendment would replace "proceeding" in that item with "hearing or formal adjudication."[205] By using the term "proceeding," which is defined in the Form ADV Glossary, this item limits the required disclosure to actions initiated by a government agency, self-regulatory organization or foreign financial regulatory authority. The item was intended to require disclosure of actions taken by the designating authority to revoke or suspend the use of the attainment, designation, or license that it administers, and not actions taken by regulatory authorities who are unlikely to bring an action to revoke or suspend a professional designation.

We request comment on these proposed changes. Are there additional items we should consider amending, and why? We are considering whether to add an additional reporting requirement to Item 1 that would require advisers to provide a unique identification code to

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204 Proposed Form ADV, Part 1A, Item 11.

205 If adopted, the revised item would state "[A]ny other hearing or formal adjudication in which a professional attainment, designation, or license of the supervised person was revoked or suspended because of a violation of rules relating to professional conduct. If the supervised person resigned (or otherwise relinquished the attainment, designation, or license) in anticipation of such a hearing or formal adjudication (and the adviser knows, or should have known, of such resignation or relinquishment), disclose the event."

provide additional uses for the data that we collect. For example, the Office of Financial Research (OFR) is required to publish a financial company reference database as part of its role in assisting the Financial Stability Oversight Council (FSOC) under the Dodd-Frank Act.[206] Would a unique identification code assigned by, on behalf of, or otherwise used by FSOC or OFR that is reported on Form ADV permit cross-referencing of the data we collect with this future database? Is there a reason why we should not require an adviser to report such an identifier on Form ADV if one is provided?

Should we consider accelerating any of the updating requirements for Form ADV to improve the usefulness of the form to the Commission and to investors? For instance, while we have accelerated filing deadlines in for other types of reports,[207] since 1979, advisers have had 90 days from their fiscal year ends to provide an annual update to Form ADV.[208] To provide more timely information to us and the public, should advisers be required to file their annual amendments to Form ADV within 60 days of the end of the adviser's fiscal year or some other shorter time period?

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206 *See* sections 154(b)(2)(A) and 201(a)(11) of the Dodd Frank Act.

207 *See, e.g., Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports*, Exchange Act Release No. 46464 (Sept. 5, 2002) [67 FR 58480 (Sept. 16, 2002)], at nn. 22-24 and accompanying text (noting that the deadline to file Form 10-K within 90 days after a company's fiscal year end had not been changed in 32 years and accelerating it to 60 days for "large accelerated filers" and 75 days for "accelerated filers," each as defined in rule 12b-2 under the Exchange Act, in order to modernize the periodic reporting system and improve the usefulness of periodic reports to investors).

208 *See Investment Adviser Requirements Concerning Disclosure, Recordkeeping, Applications for Registration and Annual Filings*, Investment Advisers Act Release No. 664 (Jan. 30, 1979) [44 FR 7870 (Feb. 7, 1979)] (adopting rule 204-1).

D. Other Amendments

1. Amendments to "Pay to Play" Rule

Adopted last July, rule 206(4)-5, generally prohibits registered and certain unregistered advisers from engaging directly or indirectly in pay to play practices identified in the rule.[209] We are proposing three amendments to the rule that we believe are needed as a result of the enactment of the Dodd-Frank Act.

First, we propose to amend the scope of the rule to make it apply to exempt reporting advisers and foreign private advisers.[210] Rule 206(4)-5 currently applies to advisers that are either registered with the Commission, or unregistered in reliance on the exemption under section 203(b)(3) of the Advisers Act.[211] As a consequence of the repeal of the private adviser exemption in section 203(b)(3), many unregistered advisers will register under the Act and will be subject to rule 206(4)-5 (albeit pursuant to a different clause of the rule).[212] In addition, the Dodd-Frank Act has added an exemption for "foreign private advisers" in section 203(b)(3) of the Act, which will result in these advisers being subject to the pay to play rule.[213] However,

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209 *Political Contributions by Certain Investment Advisers,* Investment Advisers Act Release No. 3043 (July 1, 2010) [75 FR 41018, 41024 (July 14, 2010)] ("Pay to Play Release"). The rule prohibits covered advisers from (i) providing advisory services for compensation to a government client for two years after the adviser or certain of its executives or employees makes certain political contributions; (ii) paying any third party to solicit advisory business from any government entity unless the person is a "regulated person," subject to similar pay to play restrictions; and (iii) soliciting others, or coordinating, contributions to certain elected officials or candidates or payments to political parties where the adviser is providing or seeking government business. *See id.*

210 Proposed rule 206(4)-5(a).

211 *See* rule 206(4)-5(a)(1) and (2).

212 Instead of being subject to the rule as advisers "unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act," they will be subject to the rule as advisers "registered (or required to be registered)" under the Act. Rule 206(4)-5(a)(1) and (2).

213 *See* section 402 of the Dodd-Frank Act (defining "foreign private adviser"); section 403 of the Dodd-Frank Act (amending section 203(b)(3) of the Advisers Act to strike the current language

some unregistered advisers to which the rule currently applies because of section 203(b)(3) will remain exempt from registration because of the new exemptions for exempt reporting advisers, which we did not contemplate when we adopted rule 206(4)-5, and will no longer be subject to the rule. To prevent unintended narrowing of the application of the rule as a result of the amendments to the Advisers Act, we are proposing to extend the rule to apply it to exempt reporting advisers, as well as foreign private advisers.

We request comment on our proposal to make rule 206(4)-5 applicable to exempt reporting advisers and foreign private advisers. Should either of these types of unregistered advisers be excluded from the rule? If so, what protections should apply instead? We are not proposing to require advisers that will become subject to state registration as a result of the Dodd-Frank Act to comply with the pay to play rule.[214] Should we?

Second, we propose to amend the provision of rule 206(4)-5 that prohibits advisers from paying persons (*e.g.*, "solicitors" or "placement agents") to solicit government entities unless such persons are "regulated persons" (*i.e.*, registered investment advisers or broker-dealers subject to rules of a registered national securities association, such as the Financial Industry Regulatory Authority ("FINRA"), that restricts its members from engaging in pay to play activities).[215] Instead, we would permit an adviser to pay any "regulated municipal advisor" to solicit government entities on its behalf. A regulated municipal advisor under the proposed rule

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exempting certain "private advisers" from registration and inserting language exempting "foreign private advisers" from registration).

Applying rule 206(4)-5 to foreign private advisers, unlike exempt reporting advisers, does not require any amendment of the rule specifically regarding these advisers because the rule currently cross-references section 203(b)(3) of the Advisers Act.

214 For a discussion of the Dodd-Frank Act's reallocation of responsibility for regulation of investment advisers between the Commission and the states, see *supra* section II.A. of this Release.

215 Rule 206(4)-5(a)(2)(i). FINRA is currently the only national securities association registered under section 19(a) of the Exchange Act (15 U.S.C. 78s(a)).

would be a person that is registered under section 15B of the Securities Exchange Act and subject to pay to play rules adopted by the MSRB.[216]

The Dodd-Frank Act creates a new category of person known as a "municipal advisor," which it defines to include persons that undertake "a solicitation of a municipal entity."[217] These persons include, among others, any third-party solicitor, including registered investment advisers and broker-dealers, seeking business on behalf of an investment adviser from a municipal entity, including a pension fund.[218] These municipal advisors are subject to MSRB rules, and we understand that the MSRB intends to consider subjecting municipal advisors to pay to play rules

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216 Proposed rule 206(4)-5(a)(2), (f)(9). As provided in the proposed rule, these pay to play rules must prohibit municipal advisors from engaging in distribution or solicitation activities if certain political contributions have been made. In addition, the Commission must find that they both impose substantially equivalent or more stringent restrictions on municipal advisors than rule 206(4)-5 imposes on investment advisers and that they are consistent with the objectives of rule 206(4)-5.

217 Section 975 of the Dodd-Frank Act. In creating this new municipal advisor category, Congress expressed its intent that municipal advisors be permitted to solicit government clients. *See* Senate Committee Report, *supra* note 11, at 148 ("The SEC recently proposed new rules under the Investment Advisers Act of 1940 relating to the provision by registered investment advisers of investment advisory services to municipal entities in which, among other things, the SEC proposed prohibiting investment advisers from making payments to unrelated persons for solicitation of municipal entities for investment advisory services on behalf of investment advisers. Rather than effectively prohibiting such third-party solicitation for investment advisory services, [section 975] would provide that activities of a municipal advisor, broker, dealer or municipal securities dealer to solicit a municipal entity to engage an unrelated investment adviser to provide investment advisory services to a municipal entity or to engage to undertake underwriting, financial advisory or other activities for a municipal entity in connection with the issuance of municipal securities would be subject to regulation by the MSRB...").

218 *See* Section 975(e) of the Dodd-Frank Act (defining: (i) "municipal advisor," in relevant part, as "a person . . . that . . . undertakes a solicitation of a municipal entity;" (ii) "municipal entity," in relevant part, as "any State, political subdivision of a State, or municipal corporate instrumentality of a State, including . . . any plan, program, or pool of assets sponsored or established by the State, political subdivision . . . or any agency, authority or instrumentality thereof. . . ;" and (iii) "solicitation of a municipal entity or obligated person," in relevant part, as "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of . . . an investment adviser (as defined in section 202 of the Investment Advisers Act of 1940) that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person . . . of an investment adviser to provide investment advisory services to or on behalf of a municipal entity.").

similar to its rules governing municipal securities dealers.[219] Broker-dealers acting as placement agents or solicitors and investment advisers acting as solicitors of municipal entities and obligated persons generally meet the statutory definition of a municipal advisor and thus would be subject to MSRB rules.[220] Our proposed amendment would, like the current rule, permit advisers to pay persons to solicit government entities on their behalf only if such third parties are registered with us and subject to pay to play rules.[221] Given the new regulatory regime applicable to municipal advisors, including solicitors of government entities that meet the definition of "regulated person" under rule 206(4)-5,[222] broker-dealer solicitors are expected to be subject to MSRB's pay to play rules, rendering it unnecessary at this time for FINRA to adopt

219 *See* MSRB, *Municipal Securities Rulemaking Board Issues Statement on Financial Reform Legislation,* Press Release, July 15, 2010, *available at* http://www.msrb.org/News-and-Events/Press-Releases/2010/MSRB-Issues-Statement-on-Financial-Reform-Legislation.aspx ("The transition [to a majority public governing board] will be coordinated with a rulemaking program designed to ensure careful but prompt development of rules fulfilling the MSRB's expanded mission. The MSRB will develop rules in the areas of fair practice and fiduciary duties, pay to play and other conflicts of interest, gifts, disclosures, professional qualifications, continuing education and other areas identified by the new governing board."); MSRB rule G-37. MSRB rule G-37 is available on the MSRB's website at http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-37.aspx.

220 *See supra* note 218. While section 15B(e)(4)(C) of the Exchange Act excludes from the definition of municipal advisor "a broker, dealer, or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933)," we interpret this exclusion to apply solely to a broker, dealer, or municipal securities dealer serving as an underwriter on behalf of a municipal issuer in connection with the issuance of municipal securities. Congress enacted section 975 of the Dodd-Frank Act, which added the definition of "municipal advisor" to Section 15B of the Exchange Act, to subject the relationship between a municipal advisor and a municipal entity to regulation by the MSRB. *See* Senate Committee Report, *supra* note 11, at 148 (noting the need to subject activities such as solicitation of a municipal entity to engage an investment adviser to MSRB regulation). The Commission expects to consider a proposal for a permanent municipal advisor registration program, including requirements for the registration of municipal advisors. *See Temporary Registration of Municipal Advisors,* Exchange Act Release No. 62824 (Sept. 1, 2010) [75 FR 54465 (Sept. 8, 2010)].

221 *See* Pay to Play Release at section II.B.2.(b). We note that a person that solicits investors to invest in investment interests that are securities also may need to consider whether that person is acting as a broker. *See* Pay to Play Release at n. 326.

222 *See* rule 206(4)-5(f)(9)(ii) (defining "regulated person" to include a broker-dealer that is registered with the Commission and is a member of a national securities association registered under section 15A of the Exchange Act (currently limited to FINRA)).

a pay to play rule that would satisfy rule 206(4)-5(f)(9)(ii). We are proposing, therefore, to replace references in rule 206(4)-5 to FINRA's pay to play rules with references to MSRB rules that we find are consistent with the objectives of rule 206(4)-5 and impose substantially equivalent or more stringent pay to play restrictions.

We are not proposing to amend the compliance date of rule 206(4)-5's limitation on payments to third-party solicitors, which is September 13, 2011. MSRB staff has informed our staff that the pay to play rules it expects to consider would likely be in effect by that date.[223] If rule 206(4)-5 is amended as proposed, an investment adviser subject to the rule would be prohibited from paying any third party to solicit government entities on its behalf that is not registered with us under Section 15B of the Securities Exchange Act and thus not subject to the MSRB's pay to play rules.

We request comment on our proposal to permit investment advisers to hire registered municipal advisors to solicit government entities on their behalf, if those registered municipal advisors are subject to pay to play restrictions under MSRB rules. Could our proposal result in rule 206(4)-5's solicitation limitations applying to certain solicitors affiliated with an investment adviser?[224] Should we amend rule 206(4)-5 expressly to allow advisers to pay these investment adviser-affiliated solicitors? Should we amend rule 206(4)-5 to provide that any person that

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223 If it appears that the MSRB will not be able to adopt pay to play rules for municipal advisors by September 13, 2011 that would meet the requirements of rule 206(4)-5, we will consider whether to take alternative action.

224 *See* section 15B(e)(4) of the Exchange Act (defining "municipal advisor" to include "a person (who is not a municipal entity or an employee of a municipal entity) that…undertakes a solicitation of a municipal entity"); section 15B(e)(9) of the Exchange Act (defining "solicitation of a municipal entity or obligated person" to mean "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of… [an] investment adviser… *that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation* for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person…of an investment adviser to provide investment advisory services to or on behalf of a municipal entity" (emphasis added)).

controls, is controlled by, or is under common control with an investment adviser (and, if that person is an entity, its personnel) would be deemed to be a "covered associate" of the investment adviser if the investment adviser pays or agrees to pay such person (or such personnel) to solicit a government entity on its behalf?

Finally, we are proposing a minor amendment to rule 206(4)-5's definition of a "covered associate"[225] of an investment adviser to clarify that a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser would meet the definition. Under the rule as adopted, "covered associate" includes any owner and personnel of an adviser and political action committees the owner, personnel, or adviser control for purposes of the rule's restrictions. Currently, the owners of an adviser included in the definition of "covered associate" are: "[a]ny general partner, managing member . . . or other individual with a similar status or function."[226] We are proposing to replace the word "individual" with the word "person." Unlike the other proposed amendments to rule 206(4)-5, this proposed amendment is not related to the Dodd-Frank Act, but instead is meant to clarify the rule and the Commission's original intent that "covered associate" include legal entities as well as natural persons, and to respond to interpretive questions our staff has received.

225 *See* rule 206(4)-5(f)(2) (defining a "covered associate" of an investment adviser as: "(i) Any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) Any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) Any political action committee controlled by the investment adviser or by [any other covered associate].").

226 *See id.*

2. Technical and Conforming Amendments

a. Rules 203(b)(3)-1 and 203(b)(3)-2

We intend, at the adoption of rule and form amendments to implement provisions of the Dodd-Frank Act, to rescind rules 203(b)(3)-1[227] and 203(b)(3)-2,[228] which specify how advisers "count clients" for purposes of determining whether the adviser is eligible for the private adviser exemption of section 203(b)(3) of the Advisers Act (which, as discussed above, Congress repealed in section 403 of the Dodd-Frank Act). In the Exemptions Release, we are proposing a new client counting rule, rule 202(a)(30)-1, for purposes of the new foreign private adviser exemption.[229]

b. Rule 204-2

We are proposing to amend rule 204-2 under the Advisers Act, the "books and records" rule, to update the rule's "grandfathering provision" for investment advisers that are currently exempt from registration under the "private adviser" exemption, but will be required to register when the Dodd-Frank Act's elimination of the "private adviser" exemption becomes effective on July 21, 2011. At that time, these advisers would become subject to the recordkeeping requirements of the Act, including the requirement to keep certain records relating to performance.[230] We propose that these advisers would not be obligated to keep certain performance-related records so long as they did not actually register when they were eligible for the "private adviser" exemption; however, to the extent that these advisers preserved these

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227 Rule 203(b)(3)-1.

228 Rule 203(b)(3)-2. We adopted rule 203(b)(3)-2 in 2004 in order to require certain hedge fund advisers to register under the Act. *See* Hedge Fund Adviser Registration Release. That rule, and certain amendments to rule 203(b)(3)-1 and other rules, were vacated by a federal appeals court in *Goldstein,* but have remained in the Code of Federal Regulations.

229 *See* Exemptions Release at section II.C.1.

230 *See* rule 204-2(a)(16).

performance-related records without being required to do so by current rule 204-2, the proposed grandfathering provision would require them to continue to preserve them.[231] In addition, we are proposing to amend rule 204-2(e)(3)(ii) to cross-reference the new definition of "private fund" added to the Dodd-Frank Act.[232] Finally, we expect to rescind rule 204-2(l)[233] because it was vacated by the federal appeals court in *Goldstein* and because the Dodd-Frank Act's addition of section 204(b)(2) to the Advisers Act codifies this concept in the statute itself.[234]

c. Rule 0-7

Rule 0-7(a)(1) under the Advisers Act, which defines "small entities" under the Advisers Act for purposes of the Regulatory Flexibility Act, cross-references section 203A(a)(2) of the Advisers Act.[235] The Dodd-Frank Act has renumbered section 203A(a)(2) of the Advisers Act to

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231 *See* proposed amendment to rule 204-2(e)(3)(ii) (stating, "[i]f you are an investment adviser that was, prior to July 21, 2011, exempt from registration under section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)), as in effect on July 20, 2011, [this rule] does not require you to maintain or preserve books and records that would otherwise be required to be maintained or preserved under [certain sections of this rule] to the extent those books and records pertain to the performance or rate of return of such private fund (*as defined in section 202(a)(29) of the Act (15 U.S.C. 80b-2(a)(29))*, or other account you advise for any period ended prior to July 21, 2011, *provided that* you were not registered with the Commission as an investment adviser during such period, and *provided further* that you continue to preserve any books and records in your possession that pertain to the performance or rate of return of such private fund or other account for such period." (emphasis added)). Advisers to private funds that registered with the Commission based on adoption of rule 203(b)(3)-2 in the Hedge Fund Adviser Registration Release and then withdrew their registration based upon the *Goldstein* decision would be permitted to rely on the proposed grandfathering provision.

232 *See* rule 204-2(e)(3)(ii) (using the term private fund without reference to a definition). We are proposing to add a parenthetical noting that the term is defined in section 202(a)(29) of the Advisers Act.

233 Rule 204-2(l) states that books and records of a private fund are, under certain circumstances, treated as books and records of its adviser.

234 Section 404 of the Dodd-Frank Act (adding section 204(b)(2) to the Advisers Act, which states, "The records and reports of any private fund to which an investment adviser registered under this title provides investment advice shall be deemed to be the records and reports of the investment adviser.").

235 Rule 0-7(a)(1) (stating that the term "small business" or "small organization" for purposes of the Advisers Act means an investment advisers that: "Has assets under management, as defined under Section 203(a)(2) of the Act (15 U.S.C. 80b-3a(a)(2)) and reported on its annual updating

203A(a)(3)), and thus we are proposing to amend rule 0-7(a)(1) to cross-reference section 203A(a)(3) rather than section 203A(a)(2).[236]

d. Rule 222-1

We are proposing to replace the term "principal place of business" in rule 222-1(b)[237] under the Advisers Act, which contains definitions relevant to section 222 of the Advisers Act's provisions regarding state regulation of investment advisers, with the term "principal office and place of business" to conform to the Dodd-Frank Act's amendments to that section.[238] We are not proposing to modify the definition.

e. Rule 222-2

We are proposing technical amendments to rule 222-2 to define "client" for purposes of the national *de minimis* standard by cross-referencing the definition of "client" in proposed rule 202(a)(30)-1 rather than the definition in rule 203(b)(3)-1 because we expect to rescind rule 203(b)(3)-1.[239] We also propose to change a cross-reference to paragraph (b)(6) of existing rule 203(b)(3)-1 to paragraph (b)(4) of proposed rule 202(a)(30)-1 to account for the changed location of that particular provision. Finally, because proposed rule 202(a)(30)-1, unlike rule 203(b)(3)-1, does not include a "special rule" specifying that an adviser is not required to count as a client any person for whom the adviser provides investment advisory services without

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amendment to Form ADV [17 CFR 279.1], of less than $25 million, or such higher amount as the Commission may by rule deem appropriate . . . .").

236 Proposed amendment to rule 0-7(a)(1).

237 Rule 222-1(b) (defining "principal place of business" of an investment adviser as "the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.").

238 *See* section 985 of the Dodd-Frank Act (replacing the term "principal place of business" each time it appears – *i.e.*, six times – with the term "principal office and place of business" in section 222 of the Advisers Act).

239 *See supra* section II.D.2.a. of this Release (discussing rescinding rule 203(b)(3)-1); Exemptions Release at section II.C.1. (discussing the definition of "client" in proposed rule 202(a)(30)-1).

compensation, we are proposing to include this instruction in rule 222-2. We request comment on our proposed amendments to rule 222-2. Should we preserve the instruction that an adviser is not required to count as a client any person for whom the adviser provides investment advisory services without compensation for purposes of the national *de minimis* standard?

f. Rule 202(a)(11)-1

We intend, at the adoption of rule and form amendments to implement the Dodd-Frank Act, to rescind rule 202(a)(11)-1.[240] Although the rule was vacated by a federal appeals court (and is therefore not in effect),[241] it has remained in the CFR.

III. GENERAL REQUEST FOR COMMENT

The Commission requests comment on the rules, and rule and form amendments proposed in this Release, suggestions for additional changes to the existing rules and comment on other matters that might have an effect on the proposals contained in this Release. Commenters should provide empirical data to support their views.

IV. COST-BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits of its rules. The new rules and rule and form amendments we are proposing would give effect to provisions in Title IV of the Dodd-Frank Act that: (i) reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers; (ii) repeal the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act; and (iii) provide for reporting by advisers to certain types of private funds that are exempt from registration. As part of these amendments, we are also proposing amendments to the Advisers Act pay to play rule, rule 206(4)-5. Additionally, we propose to identify the advisers that are subject to the Dodd-

240 Rule 202(a)(11)-1.

241 *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

Frank Act's requirements concerning certain incentive-based compensation arrangements. Because many of our proposals would implement or clarify provisions of the Dodd-Frank Act, they would not create benefits and costs separate from the benefits and costs considered by Congress in passing the Dodd-Frank Act.[242] However, certain of our proposals, if adopted, would generate costs and benefits independent of those generated by the Dodd-Frank Act itself. These costs and benefits are discussed below.

A. Benefits

1. Eligibility to Register with the Commission: Section 410

Section 410 of the Dodd-Frank Act amends section 203A of the Advisers Act to create a new group of "mid-sized advisers" and shifts primary responsibility for their regulatory oversight to the state securities authorities.[243] It does this by prohibiting from registering with the Commission an investment adviser that is required to be registered and subject to examination as an investment adviser in the state in which it maintains its principal office and place of business and that has assets under management between \$25 million and \$100 million.[244] We are proposing rules and rule amendments that would provide us a means of identifying advisers that must transition to state regulation, clarify the application of new statutory provisions, and modify certain of the exemptions we have adopted under section 203A of the Act.

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242 *See* Dodd-Frank Act, *supra* note 2; Conference Committee Report, *supra* note 67; Senate Committee Report, *supra* note 11; *supra* section I. of this Release. Proposals not generating costs and benefits independent of those generated by the Dodd-Frank Act include the proposed amendments to rules 0-7, 204-2, 222-1, 222-2 and our proposal to rescind rule 203(b)(3)-1.

243 *See supra* section II.A.7. of this Release.

244 *See supra* notes 11-12 and accompanying text (discussing section 410 of the Dodd-Frank Act, which amends Section 203A of the Advisers Act to increase the threshold above which all investment advisers must register with the Commission from \$25 million to \$100 million).

Transition to State Registration

We are proposing a new rule, rule 203A-5, which would require *each* investment adviser registered with us on July 21, 2011 to file an amendment to its Form ADV no later than August 20, 2011 (30 days after the July 21, 2011 effective date of the amendments to section 203A), and withdraw from Commission registration by October 19, 2011 (60 days after the required filing of Form ADV), if no longer eligible.[245] As a consequence of section 410 of the Dodd-Frank Act, we estimate that approximately 4,100 advisers currently registered with the Commission will be required to withdraw their registration and register with one or more state securities authorities.[246] Given this significant re-alignment of regulatory authority over numerous advisers, our proposed rule would allow us to easily and efficiently identify the advisers that are subject to our regulatory authority after the Dodd-Frank Act's amendment to section 203A becomes effective, and which advisers have switched to state registration due to the amendment to section 203A. The proposed rule would confer this same benefit on state securities authorities. This would promptly implement the Congressional mandate, and accommodate the IARD processing of renewals and fees for state registration and licensing, while allowing for an orderly transition. It would also help minimize any potential uncertainty about the effects of the Dodd-Frank Act on the registration status of a particular adviser among investors and other market participants by providing a simple, efficient means of determining the adviser's post-Dodd-Frank registration status through the IARD system as of a specific date. To the extent that rule 203A-5 would minimize uncertainty among investors and other market participants, it could help minimize any disruption in advisory business that such uncertainty could provoke, and

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[245] Proposed rule 203A-5(a), (b). *See supra* section II.A.1. of this Release.

[246] *See supra* note 15 and accompanying text.

investors would know clearly whether an adviser that advises them is subject to state or Commission registration and regulation.

Switching Between State and Commission Registration

Rule 203A-1 currently contains two means of preventing an adviser from having to switch frequently between state and Commission registration as a result of changes in its assets under management or the departure of one or more clients.[247] We propose to amend rule 203A-1 to eliminate the $5 million buffer that permits an investment adviser having between $25 million and $30 million of assets under management to remain registered with the states and that does not subject the adviser to cancellation of its Commission registration until its assets under management fall below $25 million.[248] We are proposing to eliminate the current $5 million buffer because it seems unnecessary in light of Congress's determination generally to require most advisers having between $30 million and $100 million of assets under management to be registered with the states.[249] Elimination of this portion of the rule also promotes efficiency and competition by making the registration requirements for advisers with assets under management between $25 million and $30 million consistent with the requirements for advisers with assets under management between $30 million and $100 million. Moreover, we are proposing to retain the 180-day grace period from the adviser's fiscal year end to address concerns about advisers frequently having to register and then de-register with the Commission as a result of changes in their eligibility to register.[250]

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247 *See supra* note 62-65 and accompanying text.

248 *See supra* note 66.

249 *See supra* note 67.

250 *See* proposed rule 203A-1(b); *supra* notes 66-68 and accompanying text.

Exemptions from the Prohibition on Registration with the Commission

We are proposing amendments to three exemptions from the prohibition on registration in rule 203A-2 to reflect developments since their initial adoption, including the enactment of the Dodd-Frank Act.[251] First, we are proposing to eliminate the exemption in rule 203A-2(a) from the prohibition on Commission registration for NRSROs.[252] Since we adopted this exemption, Congress amended the Act to exclude NRSROs from the Act and provided for a separate regulatory regime for NRSROs under the Exchange Act.[253] Only one NRSRO remains registered as an investment adviser under the Act and reports that it has more than $100 million of assets under management and thus would not need to rely on the exemption.[254] Given that NRSROs do not currently rely on the exemption and that Congress has excluded NRSROs from the Act, we do not believe that our proposed amendment would generate any benefits or costs and would not impact efficiency, competition or capital formation, separate from the benefit of simplifying our rules by eliminating an unused exemption.

Second, we are proposing to amend the exemption available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets from $50 million to $200 million.[255] We had set the threshold at $50 million of plan assets for these advisers to ensure that a pension consultant's activities are significant enough to have an effect on national markets.[256] We propose to increase this threshold to $200 million in light of Congress's determination to increase from $25 million to $100 million the amount of "assets under management" that

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251 *See* proposed rule 203A-2; *supra* section II.A.5. of this Release. We would also make conforming amendments to renumber rule 203A-2(b) through (f).

252 *See supra* section II.A.5.a. of this Release.

253 *See supra* notes 73-74.

254 Based on IARD data as of September 1, 2010.

255 *See* proposed rule 203A-2(a); *supra* section II.A.5.b. of this Release.

256 *See supra* note 78.

requires advisers to register with the Commission without regard to state regulatory requirements.[257] This amendment would maintain the same ratio of plan assets to the statutory assets under management requirements currently in place, and would provide the regulatory benefit of allowing the Commission to focus its resources on oversight of those pension consultants that are more likely to have an effect on national markets.

Finally, we propose to amend the multi-state adviser exemption in rule 203A-2(e) to align the rule with the multi-state exemption Congress built into the mid-sized adviser provision under section 410 of the Dodd-Frank Act.[258] Under rule 203A-2(e), the prohibition on registration with the Commission does not apply to an investment adviser that is required to register in 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register in at least 25 states.[259] We propose to amend rule 203A-2(e) to permit all investment advisers required to register as an investment adviser with 15 or more states to register with the Commission.[260] We believe this reflects a Congressional view on the number of states with which an adviser must be required to be registered before the regulatory burdens associated with such regulation warrants registration with the Commission and application of the preemption provision.[261] This amendment reduces the regulatory burdens on advisers required to be registered with at least 15 states, but less than 30, by allowing them to register with a single securities regulator — the Commission. Additionally, the amendment promotes efficiency and reduces the effect on competition between small and mid-sized investment advisers by imposing a consistent multi-

257 *See supra* note 79.

258 *See* proposed rule 203A-2(d); *supra* section II.A.5.c. of this Release.

259 *See supra* note 82.

260 *See* proposed rule 203A-1(d)(1).

261 *See supra* note 84.

state exemption standard. We also propose to eliminate the provision in the rule that permits advisers to remain registered until the number of states in which they must register falls below 25 states, and we are not proposing a similar cushion for the 15-state threshold.[262] We do not see any significant benefit of retaining the buffer and believe it is unnecessary as a result of our proposal to lower the number of states from 30 to 15 and because advisers elect to rely on the exemption.

Elimination of Safe Harbor

We are proposing to eliminate the safe harbor in rule 203A-4 from Commission registration for an investment adviser that is registered with a state securities authority of the state in which it has its principal office and place of business, based on a reasonable belief that it is prohibited from registering with the Commission because it does not have sufficient assets under management.[263] Advisers have not, in our experience, asserted the availability of this safe harbor as a defense, which protects only against enforcement actions by us and not any private actions, and we view it as unlikely that an adviser would be reasonably unaware that it has more than $100 million of regulatory assets under management when it is required to report its regulatory assets under management on Form ADV.[264] We do not believe that rescinding the safe harbor would generate any significant benefits, other than simplifying our rules in general and thereby marginally reducing costs of compliance, and we believe it would have little, if any, other effect on efficiency, competition or capital formation.

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[262] *See supra* note 85-86.

[263] Rule 203A-4. *See supra* section II.A.6. of this Release.

[264] *See supra* notes 91-92 and accompanying text.

Mid-Sized Advisers

The Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers registering with the Commission.[265] We propose to incorporate into Form ADV an explanation of how we construe these provisions.[266] Our instructions are intended to clarify the meaning of these provisions, which would benefit advisers by promoting efficiency and competition. For example, as a result of our proposal to identify to advisers filing on IARD the states that do not subject advisers to examination, a mid-sized adviser would not be required to determine whether it is subject to examination in a particular state. Simplifying the process for mid-sized advisers to determine whether they are required to register with us would decrease any competitive disadvantages compared to smaller advisers. Our proposed changes to IARD also would ensure that only mid-sized advisers with a principal office and place of business in those states (or mid-sized advisers that are not registered with the states where they maintain a principal office and place of business) will register with the Commission, which would also make the registration process more efficient.

2. Exempt Reporting Advisers: Sections 407 and 408

Congress gave us broad authority to require exempt reporting advisers to file reports as necessary or appropriate in the public interest or for the protection of investors.[267] We have sought information that we believe would be useful to us to be able to identify the advisers, their owners, and their business models and, in addition, whether they might present sufficient

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265 *See supra* note 94.

266 *See* proposed Form ADV: Instructions for Part 1A, instr. 2.b. *See also supra* section II.A.7. of this Release (discussing these instructions in detail).

267 *See* sections 407 and 408 of the Dodd-Frank Act.

concerns as to warrant our further attention in order to protect their clients and fulfill our regulatory responsibilities. We have also considered the broader public interest in making this information generally available and believe there may be benefits of providing information about their activities to the public. We acknowledge that there may be costs associated with providing this information to us, and that the adviser may provide some or all of this information to private fund investors or prospective investors, however, we believe these investors would benefit from the proposed reporting requirements.

To meet the Dodd-Frank Act's reporting provisions for "exempt reporting advisers," we are proposing a new rule, rule 204-4, to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.[268] We are also proposing amendments to Form ADV so that it could serve the dual purpose of both an SEC reporting form for exempt advisers and, as it is used today, a registration form for both state and SEC-registered firms.[269] In addition to requiring that exempt reporting advisers use Form ADV, proposed rule 204-4 would require these advisers to submit reports through the IARD and to pay a filing fee.[270]

We believe that using Form ADV and IARD for exempt reporting adviser reports would yield several benefits. For instance, using Form ADV and IARD would create efficiencies that benefit both us and filers by taking advantage of an established and proven adviser filing system, while avoiding the expense and delay of developing a new form and filing system. Additionally, the IARD contains many time-saving features, like the ability to pre-populate prior responses and drop-down boxes for common responses. In addition, because exempt reporting advisers may be required to register on Form ADV with one or more state securities authorities, use of the

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268 Proposed rule 204-4(a). *See supra* section II.B. of this Release.

269 *See supra* section II.B.1. of this Release.

270 Proposed rule 204-4(b), (d).

existing form and filing system (which is shared with the states) should reduce regulatory burdens for them because they can satisfy multiple filing obligations through a uniform form.[271] Similarly, regulatory burdens would be diminished for an exempt reporting adviser that later finds it can no longer rely on an exemption and would be required to register with us because the adviser would simply file an amendment to its current Form ADV to apply for Commission registration.[272] Finally, certain items in Form ADV Part 1 are also linked to Form BD, which would create efficiencies if the exempt reporting adviser ever applies for broker-dealer registration.

Requiring that exempt reporting advisers file their reports through the IARD would also benefit clients, prospective clients, and members of the public who could readily access the information, without cost, through the Commission's website on the Investment Adviser Public Disclosure (IAPD) system. Investors would have access to some information that may have been previously unavailable or not easily attainable, such as whether a prospective exempt reporting adviser has certain disciplinary events and whether its affiliates present conflicts of interest or broader access to other financial services. As a result, investors would be in a better position to make informed decisions. As a secondary benefit, the easy availability of information about these advisers and their advisory affiliates may discourage advisers from engaging in certain practices (such as maintaining client assets with a related person custodian) or hiring certain persons (such as those with disciplinary history). Investors' access to information may also facilitate greater competition among advisers, which may in turn benefit clients.

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271 *See supra* note 126-127 and accompanying text.

272 *See* proposed General Instruction 14 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser). *See also supra* note 128.

Electronic reporting by exempt reporting advisers of certain Items within Form ADV would give us better access to information about these advisers to administer our regulatory programs and to identify advisers whose activities suggest a need for closer scrutiny. We can easily use the IARD to generate reports on the industry, its characteristics and trends. These reports would help us anticipate regulatory problems, allocate and reallocate our resources, and more fully evaluate and anticipate the implications of various regulatory actions we may consider taking, which should increase both the efficiency and effectiveness of our programs and thus increase investor protection. In addition, requiring exempt reporting advisers to complete Section 7.B of Schedule D for each private fund they manage should result in many of the same benefits that this information produces with respect to registered advisers that we address in the discussion of the proposed amendments to Form ADV below.

We are also proposing to amend rule 204-1 under the Advisers Act, which addresses when and how advisers must amend their Form ADV, to require that exempt reporting advisers file updating amendments to reports filed on Form ADV.[273] Proposed rule 204-1(a) would require an exempt reporting adviser, like a registered adviser, to amend its reports on Form ADV: (i) at least annually, within 90 days of the end of the adviser's fiscal year; and (ii) more frequently, if required by the instructions to Form ADV. Consequently, we are proposing to amend General Instruction 4 to Form ADV to require an exempt reporting adviser to update Items 1 (identification information), 3 (Form of Organization), or 11 (disciplinary information) promptly if they become inaccurate in any way, and to update Item 10 (Control Persons) if it becomes materially inaccurate.[274]

273 Proposed rule 204-1. *See supra* section II.B.3. of this Release.

274 Registered advisers are subject to the same updating requirements with respect to these Items. *See* General Instruction 4 to Form ADV.

Requiring advisers to amend their reports on Form ADV at least annually, and more frequently if identification or disciplinary information becomes inaccurate in any way, would assure that we have access to updated information such as knowing when an exempt reporting adviser has added or no longer has a private fund client, which will provide us with the information necessary to assess whether they might present sufficient concerns to warrant our further inquiry. Updated information would also benefit clients, prospective clients, and other members of the public that could use this information in evaluating, for example, whether to make an investment in a venture capital fund managed by an exempt reporting adviser.

To accommodate their use by exempt reporting advisers, we also are proposing technical amendments to Form ADV-H, the form advisers use to request a hardship exemption from electronic filing,[275] and Form ADV-NR, used to appoint the Secretary of the Commission as an agent for service of process for certain non-resident advisers.[276] Proposed rule 204-4(e) and the proposed amendments to Form ADV-H would benefit exempt reporting advisers by allowing them to avoid non-compliance with reporting requirements based purely on unanticipated technical difficulties. The proposed amendments to Form ADV-NR would benefit investors by allowing us to obtain appropriate consent to permit the Commission and other parties to bring actions against non-resident partners or agents for violations of the federal securities laws.

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275 Proposed rule 204-4(e) would allow exempt reporting advisers having unanticipated technical difficulties that prevent submission of a filing to the IARD systems to request a temporary hardship exemption from electronic filing requirements.

276 *See* proposed amended Form ADV-H, proposed amended Form ADV-NR, and proposed General Instruction 18. The amendments to Form ADV-H and Form ADV-NR would reflect that exempt reporting advisers use the forms in the same way and for the same purpose as they are currently used by registered investment advisers.

3. Form ADV Amendments

As discussed above, we are proposing to require advisers to provide us on Form ADV additional information about (1) private funds they advise, (2) their advisory business and conflicts of interest, and (3) their non-advisory activities and financial industry affiliations.[277] We are also proposing certain additional changes intended to improve our ability to assess compliance risks and to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements.

Private Fund Reporting Requirements

The private fund reporting requirements we are proposing would provide us with information designed to help us better understand private fund investment activities and the scope and potential impact of those activities on investors and our markets. The information would assist us in identifying particular practices that may harm investors and would allow us to conduct targeted examinations of private fund advisers based on these practices or other criteria. In addition the proposed items are designed to improve our ability to assess risk, identify funds with service provider arrangements that raise a "red flag," identify firms for examination, and allow us to more efficiently conduct examinations. For instance, it would be relevant to us to know that a private fund is using a service provider that we are separately investigating for alleged misconduct. We propose to ask about both the number and the types of investors in the fund to get a better idea of the investors the fund is intended to serve and to get a sense of the extent to which investors may themselves be in a position to evaluate the adviser. We would ask about the size of the fund, including both its gross and net assets, to better understand the scope of its operations and the extent of leverage it employs. Responses to the service provider

[277] *See supra* section II.C. of this Release.

questions would, for example, allow us to identify those funds that do not make use of independent service providers, which may indicate a higher level of risk, and provide other key information regarding the identity and role of these private fund gatekeepers. Each particular item of information may not itself indicate an elevated risk of a compliance failure, but is designed to serve as an input to the risk metrics by which our staff identifies potential risk and allocates examination resources. The staff conducts similar analyses today, but with fewer inputs.

Form ADV information that private fund advisers would report to us also would benefit private fund investors in evaluating potential managers. As amended, Form ADV would require private fund advisers to disclose information about their business, affiliates and owners, gatekeepers, and disciplinary history. This would create a publicly accessible foundation of basic information that could aid investors, to the extent they were not otherwise timely given the information, in conducting due diligence and could further help investors and other industry participants protect against fraud. For example, using the IARD data, auditors would be able to compare their list of funds they audit with those whose advisers report them as auditor. Investors (and their consultants) would be able to compare representations made on Schedule D with those made in private offering documents or other material provided to prospective investors.

Private fund reporting would benefit investors and market participants by providing us and other policy makers with better data. Better data would enhance our ability to form and frame regulatory policies regarding the private fund industry and its advisers, and to evaluate the effect of our policies and programs on this sector, including for the protection of private fund investors. Today we frequently have to rely on data from other sources, when available. Private fund reporting would provide us with important information about this rapidly growing segment of the U.S. financial system.

Other Proposed Amendments to Form ADV

Other amendments we are proposing today to Form ADV would refine or expand existing questions, which would give us a more complete picture of an adviser's practices, help us better understand each adviser's operations, business and services, and provide us with more information to determine advisers' risk profiles and prepare for examinations. The amendments would provide us with critical information to identify practices that may harm clients, which would assist us in identifying candidates for risk-targeted examinations, detecting data or patterns that suggest further inquiry may be warranted about a particular issue, and distinguishing additional conflicts of interest that advisers may face. For example, the additional information we propose to require about related persons would allow us to link disparate pieces of information that we have access to concerning an adviser and its affiliates to identify whether those relationships present conflicts of interest that create higher risks for advisory clients. Another example is the proposed switch from ranges to approximate numbers of employees and assets by client type. Although these changes would refine data we already receive, it would provide significant benefits in developing risk-based profiles of advisers. Our proposal to expand the list of the types of advisory activities an adviser might engage in and to include a list of the types of investments about which they provide advice would help us better understand the operations of advisers. Additionally, our proposal to require advisers to report whether they have $1 billion or more in assets would help us to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements. Overall, the information proposed to be collected on Form ADV is designed to improve our risk-assessment capabilities and help us best allocate our examination resources.

Further, advisory clients and prospective clients would also benefit from these proposed amendments. The additional information that registered advisers would report to us would be publicly available, which would aid investors in evaluating potential managers and understanding their practices. For example, requiring an adviser to indicate whether it or any of its control persons is a public reporting company under the Exchange Act would provide a signal, not only to us, but to clients and to prospective clients, that additional public information is available about the adviser and/or its control persons. Requiring an adviser to report whether it has $1 billion or more of assets would help inform the adviser, its clients and the public whether or not the adviser is subject to section 956 of the Dodd-Frank Act and any rules or guidelines thereunder. The additional information about the adviser's related persons would assist clients to compare business practices, strategies, and conflicts of a number of advisers, which may help them to select the most appropriate adviser for them. Clients may also benefit indirectly because advisers may be incentivized to implement stronger controls and practices, particularly related to any conflicts of interest or business practices that may result in additional risks because of enhanced client awareness. Third parties would also be able to access the new information reported in filings of the amended form, which would allow academics, businesses, and others to access additional information about registered investment advisers and exempt reporting advisers, which they can use to study the industry.

We anticipate that the proposed amendments to the Form ADV instructions would assist investment advisers in determining their regulatory assets under management and whether they are eligible to register with us, which may result in cost savings for some advisers because they may more readily be able to make this determination.[278] Eliminating the choices we have given advisers in the Form ADV instructions for calculating assets under management would, for example, provide for a uniform method of determining assets under management for purposes of the form and the new exemptions from registration under the Advisers Act, which we expect would promote competition, would result in advisers' greater certainty in choosing to rely on an exemption from registration, and would result in consistent reporting across the industry.[279] Our proposed amendments to the instructions relating to calculation of assets under management would also clarify how an adviser would determine the amount of private fund assets it has under management, as there are currently no specific instructions on this point. We expect this may provide advisers with greater certainty in their calculation of regulatory assets under management and would provide greater certainty in determining their eligibility for the exemptions from registration available to certain private fund advisers.[280]

4. Amendments to Pay to Play Rule

We are proposing two amendments to rule 206(4)-5 that we believe are appropriate as a result of the enactment of the Dodd-Frank Act, and one minor amendment to clarify the rule.[281] First, we propose to amend the rule to make it continue to apply to all private advisers, including exempt reporting advisers and foreign private advisers.[282] We are proposing this amendment to prevent the narrowing of the application of the rule as a result of the amendments

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278 *See* section II.A.3.

279 *See id. See also* Exemptions Release at section II.C. (discussing exemption for foreign private advisers).

280 *See* Exemptions Release at sections II.B.2. and II.C.5.

281 *See supra* section II.D.1. of this Release.

282 Proposed rule 206(4)-5(a). *See supra* section II.B. of this Release (discussing the definitions of exempt reporting advisers and foreign private advisers).

to the Act made by the Dodd-Frank Act.[283] We do not believe that this amendment would create any benefits (or costs) beyond those created by the rule as originally adopted,[284] but rather would merely assure that the rule continues to apply to the same advisers as we intended when we adopted the rule.[285]

Second, we propose to amend the provision of rule 206(4)-5 that prohibits advisers from paying persons (*e.g.*, "solicitors" or "placement agents") to solicit government entities unless such persons are "regulated persons" (*i.e.*, registered investment advisers or broker-dealers subject to rules of a registered national securities association, such as FINRA, that restrict its members from engaging in pay to play activities).[286] Instead, the proposed amendments would permit an adviser to pay any "regulated municipal advisor" to solicit government entities on its behalf. A regulated municipal advisor under the proposed rule would be a municipal advisor that is registered under section 15B of the Exchange Act and subject to pay to play rules adopted by the MSRB.[287] We understand that the MSRB intends to consider subjecting municipal advisors to pay to play rules similar to its rules governing municipal securities dealers. Broker-dealers acting as placement agents or solicitors and investment advisers acting as solicitors of

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283 *See supra* section II.D.1. of this Release.

284 *See* section IV of the Pay to Play Release.

285 Rule 206(4)-5 currently applies to "private advisers" exempt from registration with the Commission under section 203(b)(3) of the Advisers Act. As discussed in section II.B. of this Release, the Dodd-Frank Act has eliminated the "private adviser" exemption from registration with the Commission in section 203(b)(3), but has created new exemptions for exempt reporting advisers and foreign private advisers. Advisers that qualify for these new exemptions generally are subsets of the advisers that qualify for the existing section 203(b)(3) "private adviser" exemption.

286 Rule 206(4)-5(a)(2)(i). FINRA is currently the only national securities association registered under section 19(a) of the Exchange Act (15 U.S.C. 78s(b)).

287 Proposed rule 206(4)-5(a)(2), (f)(9). These pay to play rules must prohibit municipal advisors from engaging in distribution or solicitation activities if certain political contributions have been made. In addition, the Commission must find that they both impose substantially equivalent or more stringent restrictions on municipal advisors than rule 206(4)-5 imposes on investment advisers and that they are consistent with the objectives of rule 206(4)-5.

government entities meet the statutory definition of a municipal advisor and thus would be subject to MSRB rules. Our proposed amendment would, like the current rule, permit advisers to pay persons to solicit government entities on their behalf only if such third parties are registered with us and subject to pay to play rules of their own.[288] Given the new regulatory regime applicable to municipal advisors, including solicitors of municipal entities that meet the definition of "regulated person" under rule 206(4)-5, broker-dealer solicitors are expected to be subject to MSRB's pay to play rules, rendering it unnecessary at this time for FINRA to adopt a pay to play rule that would satisfy rule 206(4)-5(f)(9)(ii). We are proposing, therefore, to replace references in rule 206(4)-5 to FINRA's pay to play rules with references to MSRB rules that we find are consistent with the objectives of rule 206(4)-5 and impose substantially equivalent or more stringent pay to play restrictions. To the extent that our proposed amendment would eliminate the need to subject certain solicitors to multiple pay to play rules, it would reduce the regulatory burdens on such placement agents.

In addition, due to the fact that the definition of a municipal advisor includes certain registered investment advisers and broker dealers—the two categories of regulated persons that an adviser may currently use as placement agents under rule 206(4)-5—our amendment may increase the number of placement agents that an adviser potentially could hire.[289] This could

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[288] Pay to Play Release at section II.B.2.(b).

[289] Our current "regulated person" definition does not include, for example, advisers prohibited from registering with the Commission under section 203A of the Advisers Act (15 U.S.C. 80b-3A), such as state-registered advisers, or advisers unregistered in reliance on an exemption other than section 203(b)(3) of the Act. (15 U.S.C. 80b-3(b)(3)). The definition of "municipal advisor" does not exclude these advisers. *See* section 975 of the Dodd-Frank Act.

We adopted the third party solicitor ban to prevent advisers from circumventing the rule through third parties. *See* section II.B.2.(b) of the Pay to Play Release. Given the Dodd-Frank Act's creation of the "municipal advisor" category, and given that it requires these persons to register with the Commission and subjects them to MSRB rulemaking authority, we believe that expanding the current "regulated person" exception to the third party solicitor ban to include registered municipal advisors subject to pay to play rules would not undermine the ban's purpose.

benefit advisers by increasing competition in the market for placement agent services and reducing the cost of such services. It could also benefit those placement agents that are not "regulated persons" under rule 206(4)-5, but may meet the municipal advisor definition, by allowing advisers to hire them.

Finally, we are proposing a minor amendment to rule 206(4)-5's definition of a "covered associate"[290] of an investment adviser to specify that a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser would meet the definition.[291] Because the minor amendment would not change the meaning of the rule, we do not believe that it would generate any additional benefits (or costs).

B. Costs

1. Eligibility to Register with the Commission: Section 410

Transition to State Registration

Proposed Rule 203A-5 would impose one-time costs on investment advisers registered with us by requiring them to file an amendment to Form ADV, and on advisers that are no longer eligible to remain registered with us by requiring them to file Form ADV-W to withdraw from Commission registration.[292] According to IARD data, approximately 11,850 investment advisers

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By potentially allowing advisers to choose from a broader set of potential third party solicitors, we believe our proposed amendments may promote efficiency and competition in the market for advisory services to the extent third party solicitors that are not regulated persons participate.

290 *See* rule 206(4)-5(f)(2) (defining a "covered associate" of an investment adviser as: "(i) Any general partner, managing member or executive officer, or other individual with a similar status or function; (ii) Any employee who solicits a government entity for the investment adviser and any person who supervises, directly or indirectly, such employee; and (iii) Any political action committee controlled by the investment adviser or by [any other covered associate].").

291 *See* proposed rule 206(4)-5(f)(2); *supra* section II.D.1. of this Release.

292 *See* proposed rule 203A-5; *supra* section II.A.1. of this Release.

are registered with us and would be required to file an amended Form ADV,[293] and we estimate that approximately 4,100 of those advisers will be required to withdraw their registration and register with one or more state securities authorities.[294] We believe that the proposed rule would have little impact on competition among advisers registered with us because they would all be subject to these requirements, but the rule could have a limited impact on competition between SEC-registered advisers who are subject to the rule and state-registered advisers who are not. We also believe that the rule would have little, if any, effect on capital formation.

For purposes of calculating the currently approved Paperwork Reduction Act ("PRA") burden for Form ADV, we estimated that an annual updating amendment would take each adviser approximately 6 hours per amendment,[295] and we estimate the one-time transition amendment would have similar burden. In addition, for purposes of the increased PRA burden for Form ADV, we estimate that the proposed amendments to Part 1A of Form ADV would take each adviser approximately 4.5 hours, on average, to complete.[296] As a result, we estimate a total average time burden of 10.5 hours for each respondent completing the amendment to Form ADV required by proposed rule 203A-5 (excluding private fund information which is addressed below).[297] We estimate that each adviser would incur average costs of approximately $2,646,[298]

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293. Based on IARD data as of September 1, 2010, 11,867 investment advisers are registered with the Commission. We have rounded this number to 11,850 for purposes of our analysis.

294. According to data from the IARD as of September 1, 2010, 4,136 Commission-registered advisers, which we are rounding to 4,100 for our analysis, either: (i) had assets under management between $25 million and $100 million and did not indicate on Form ADV Part 1A that they are relying on an exemption from the prohibition on Commission registration; or (ii) were permitted to register with us because they rely on the registration of an SEC-registered affiliate that has assets under management between $25 million and $100 million and are not relying on an exemption.

295. *See infra* section V.B.2.a.3. of this Release.

296. *See infra* sections V.B.1.a. and V.B.2.a.3. of this Release.

297. 6 hours (Form ADV amendment) + 4.5 hours (new Form ADV items) = 10.5 hours.

for a total aggregate of $31,355,100.[299] In addition, of these 11,850 registered advisers, we estimate that 3,500 advise one or more private funds and would have to complete the private fund reporting requirements we are proposing today.[300] We expect this would take 33,350 hours,[301] in the aggregate, for a total cost of $8,404,200.[302] As a result, the total estimated costs associated with filing amended Form ADV as required by proposed rule 203A-5 would be $39,759,300.[303]

For the estimated 4,100 advisers that will be required to withdraw their registrations, we estimate that the average burden for each respondent is 0.25 hours for filing a partial withdrawal on Form ADV-W.[304] An adviser would likely use compliance clerks to prepare the filings and

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298 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the Securities Industry Financial Markets Association's *Management & Professional Earnings in the Securities Industry 2009* ("SIFMA Management and Earnings Report"), modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for a senior compliance examiner and a compliance manager are $210 and $294 per hour, respectively. [5.25 hours x $210 = $1,102.50] + [5.25 hours x $294 = $1,543.50] = $2,646.

299 11,850 advisers x $2,646 = $31,355,100.

300 *See infra* note 400.

301 *See infra* note 403.

302 [16,675 hours x $210 = $3,501,750] + [16,675 hours x $294 = $4,902,450] = $8,404,200. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 298.

303 $31,355,100+ $8,404,200 = $39,759,300.

304 Form ADV-W is designed to accommodate the different types of withdrawals an investment advisers may file. An investment adviser ceasing operations would complete the entire form to withdraw from all jurisdictions in which it is registered (full withdrawal), while an adviser withdrawing from some, but not all, of the jurisdictions in which it is registered would omit certain items that we do not need from an adviser continuing in business as a state-registered adviser. We expect that advisers that would be required to file Form ADV-W if proposed rule 203A-5 is adopted would file only a partial withdrawal because switching to state registration only requires a partial withdrawal. Compliance with the requirement to complete Form ADV-W imposes an average burden of 0.25 hours for an adviser filing for partial withdrawal.

review the prepared Form ADV-W.[305] We estimate that each adviser would incur average costs of approximately $14.75[306] to comply with the Form ADV-W filing requirements, for a total one-time cost of $60,475.[307] As a result, proposed rule 203A-5 would result in a total one-time cost of $39,819,775.[308]

Switching Between State and Commission Registration

The proposed amendment to rule 203A-1 may impose costs on advisers by eliminating the $5 million buffer in current rule 203A-1(a), which permits but does not require an adviser to register with the Commission if the adviser has between $25 million and $30 million of assets under management.[309] Specifically, the proposed amendment may require advisers with between $25 million and $30 million in assets under management that are still eligible for registration with the Commission despite the Dodd-Frank Act's amendments to section 203A of the Advisers Act to switch their registration between the Commission and the states when they otherwise would not do so if the rule continued to include the buffer.[310] As of September 1, 2010,

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305 We have assumed for purposes of the current approved PRA burden for rule 203-2 and Form ADV-W that advisers would use clerical staff to file for a partial withdrawal. Data from the Securities Industry Financial Markets Association's *Office Salaries in the Securities Industry 2009* ("SIFMA Office Salaries Report") modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the hourly rate for a compliance clerk is $59.

306 0.25 hours x $59 (hourly wage for clerk) = $14.75 (total cost for Form ADV-W filing).

307 $14.75 x 4,100 = $60,475.

308 $39,759,300 (total cost for Form ADV filing) + $60,475 (total cost for Form ADV-W filing) = $39,819,775 (total cost for proposed rule 203A-5).

309 *See* proposed rule 203A-1; *supra* section II.A.4. of this Release.

310 *See supra* section II.A.4. of this Release. Under the Dodd-Frank Act, a mid-sized adviser is not prohibited from registering with the Commission if: (i) the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; (ii) if registered, the adviser would not be subject to examination as an investment adviser by that securities commissioner; or (iii) the adviser is required to register in 15 or more states. *See* section 410 of the Dodd-Frank Act; *supra* section II.A. of this Release.

approximately 530 advisers registered with the Commission had between \$25 million and \$30 million of assets under management.[311] Because the Dodd-Frank Act has amended section 203A to prohibit most of these advisers from registering with the Commission,[312] we believe that all of these advisers could see increased costs as a result of our proposed amendment.[313] These costs include those associated with withdrawing their registration with the Commission and registering with the states, including filing a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act. We have estimated for purposes of our current approved hour burden under the PRA for rule 203-2 and Form ADV that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser, and the filing (and costs associated with the filing) by these 530 advisers are included in our discussion above of the Form ADV-W filing requirement under rule 203A-5.[314] These advisers also would incur the costs of state registration and of compliance with state laws and regulations, which we expect would vary widely depending on the number of, and which, states with which each adviser is required to register. For example, individual state registration fees range from approximately \$60 to \$400

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311 Based on IARD data as of September 1, 2010.

312 *See supra* section II.A. of this Release (discussing new section 203A(a)(2) of the Advisers Act, which prohibits certain mid-sized advisers from registering with the Commission).

313 For purposes of this analysis, we assume that all of these advisers would not remain eligible to register with the Commission because they would be required to be registered and subject to examination by securities authorities in the states where they maintain their respective principal offices and places of business. *See* Section 203A(a)(2); *supra* section II.A.7.b. of this Release (discussing the fact that we are writing a letter to each state securities commissioner (or official with similar authority) to request that each advise us whether investment advisers registered in the state would be subject to examination as an investment adviser by that state's securities commissioner (or agency or office with similar authority)). *See also* NASAA Report at 7.

314 *See supra* notes 304-308 and accompanying text addressing the costs of filing Form ADV-W for advisers that will be required to withdraw their registrations.

annually and some states require advisers to submit documentation in addition to Form ADV.[315] We believe these amendments would have little, if any, effect on capital formation.

Exemptions from the Prohibition on Registration with the Commission

Amending the exemption from the prohibition on registration available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets from $50 million to $200 million[316] may impose costs on some of the approximately 350 advisers that currently rely on the exemption.[317] These costs, which include those associated with withdrawing their registration with the Commission and registering with the states, if required, would have a negative impact on competition for the advisers that no longer qualify for the exemption and potentially must register as an adviser with more than one state securities authority. We estimate that 50 of the 350 advisers relying on the exemption would have to file a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act and withdraw their

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315 *See, e.g.*, OHIO REV. CODE § 1707.17(B)(3) (2010) ($100 registration fee); ARK. CODE § 23-42-304(a)(3) (2010) ($300 registration fee); Colorado Division of Securities Fee Schedule ($60 registration fee), *available at* http://www.dora.state.co.us/securities/feeschedule.htm; Illinois Secretary of State, Securities Fees ($400 registration fee), *available at* http://www.sos.state.il.us/departments/securities/investment_advisers/fees.html; Texas State Securities Board, Check Sheet For a Sole Proprietor Corporation LLC or Partnership Applying For Registration as an Investment Adviser (requiring copies of adviser's organizational documents, balance sheet, fee schedule, advisory contract, and brochure or disclosure document delivered to clients), *available at* http://www.ssb.state.tx.us/Dealer_And_Investment_Adviser_Registration/Check_Sheet_For_a_Sole_Proprieter_Corporation_LLC_or_Partnership_Applying_For_Registration_as_an_Investment_Adviser.php; NASAA Report at 7 (among other things, states review registrants' disclosure history, financial status, business practices, and provisions in client contracts).

316 *See* proposed rule 203A-2(a). *See also supra* section II.A.5.b. of this Release.

317 Based on IARD data as of September 1, 2010, 353 SEC-registered advisers, which we rounded to 350, indicated that they rely on the exemption for pension consultants by marking Item 2.A.(6) on Form ADV Part 1A. These advisers do not report the amount of plan assets for which they provide investment advice, so we are unable to determine how many have between $50 million and $200 million of plan assets and may have to register with the state securities authorities as a result of the proposed amendment. It is also difficult to determine whether such advisers would be prohibited from registering with the Commission because they are required to register with and are subject to examination by the state securities authority where they maintain a principal office and place of business under the Dodd-Frank Act.

registration based on the proposed amendment.[318] We have estimated that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser.[319] Thus, we estimate that the proposed amendment to rule 203A-2(b) associated with filing Form ADV-W would generate a burden of 12.5 hours[320] at a cost of $738.[321] These advisers will incur the costs of state registration, which we expect will vary widely depending on the number of, and which, states with which an adviser is required to register.[322] We believe the amendment would have little, if any, effect on capital formation.

As discussed above, the proposed amendment to the multi-state adviser exemption in rule 203A-2(e) would reduce costs for advisers in the aggregate because more advisers would be permitted to register with one securities regulator—the Commission—rather than being required to register with multiple states.[323] Advisers relying on the exemption, however, would incur costs of complying with the Advisers Act and our rules, and would incur the costs associated with keeping records sufficient to demonstrate that they would be required to register with 15 or more states. We estimate that, in addition to the approximately 40 advisers that rely on the

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318 Based on IARD data as of September 1, 2010, approximately 225 pension consultants reported assets under management of less than $100 million, and 202 of those advisers reported assets under management of less than $25 million. We believe that most pension consultants relying on the exemption provide advice regarding a large amount of plan assets, so we expect the number of advisers affected by the proposed amendment to be one quarter of the advisers with less than $25 million of assets under management. We expect that advisers that would be required to file Form ADV-W if our proposed amendment to rule 203A-2(b) is adopted would file only a partial withdrawal because they would be registering with the states. *See supra* note 304. Compliance with the requirement to complete Form ADV-W imposes an average burden of approximately 0.25 hours for an adviser filing for partial withdrawal. *See id.*

319 *See supra* note 304.

320 50 responses on Form ADV-W x 0.25 hours = 12.5 hours.

321 12.5 hours x $59 = $738.

322 *See, e.g., supra* note 315.

323 *See* proposed rule 203A-2(d); *supra* section II.A.5.c. of this Release.

exemption currently, approximately 110 would rely on the exemption if amended as proposed.[324] For purposes of the PRA, we have estimated that these advisers would incur an average one-time initial burden of approximately 8 hours, and an average ongoing burden of approximately 8 hours per year, to keep records sufficient to demonstrate that they meet the 15-state threshold.[325] We further estimate that a senior operations manager would maintain the records at an hourly rate of $311, resulting in average initial and annual recordkeeping costs associated with our proposed amendments to rule 203A-2(e) of $2,488 per adviser,[326] and total increased costs of approximately $273,680 per year.[327] Advisers newly relying on the proposed amended exemption would also incur costs associated with completing and filing Form ADV for purposes of registration with the Commission. For purposes of the increase in our PRA burden for Form ADV, we have estimated that advisers newly registering with the Commission would incur a burden of approximately 13.58 hours per year,[328] resulting in costs of approximately $3,422 per

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324 Based on IARD data as of September 1, 2010, of the approximately 11,850 SEC-registered advisers, 40 checked Item 2.A.(9) of Part 1A of Form ADV to indicate their basis for SEC registration under the multi-state advisers rule. Of the advisers that have less than $100 million of assets under management, 94 currently file notice filings with 15 or more states. However, state notice filing requirements for SEC-registered advisers may differ from registration requirements because Form ADV does not distinguish between states where the registration is mandatory and where registration is voluntary. In addition, we estimate that 15 advisers currently registered with the states that are registered with 15 or more states could rely on the proposed exemption and register with us. Thus, we estimate that approximately 150 advisers will rely on the proposed exemption (40 currently relying on it + estimated 95 eligible based on IARD data + 15 advisers required to be registered in 15 or more states that are not registered with us today).

325 These estimates are based on an estimate that each year an investment adviser would spend approximately 0.5 hours creating a record of its determination whether it must register as an investment adviser with each of the 15 states required to rely on the exemption, and approximately 0.5 hours to maintain the record, for a total of 8 hours. *See infra* note 383 and accompanying text.

326 8 hours x $311 = $2,488. The $311 compensation rate used is the rate for a senior operations manager in the SIFMA Management and Earnings Report, 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.

327 110 new advisers relying on the exemption x $2,488 = $273,680.

328 *See infra* note 399 and accompanying text.

adviser[329] and total increased costs of approximately $376,420 per year.[330] Additionally, we estimate that 40 of the newly registering advisers would use outside legal services, and 50 would use outside compliance consulting services, to assist them in preparing their Part 2 brochures, for a total cost of $176,000, and $250,000, respectively, resulting in a total non-labor cost among the newly registering advisers of $426,000.[331] If adopted, the proposal could also impact competition between advisers who rely on the exemption and are subject to our full regulatory program, including examinations and our rules, and state-registered advisers who do not rely on the exemption. We believe these amendments would have little, if any, effect on capital formation.

Mid-Sized Advisers

As discussed above, the Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers registering with the Commission, and we propose to incorporate into Form ADV an explanation of how we construe these provisions.[332] We do not, however, believe that they would generate costs independent of any costs associated with Congress' enactment of section 203A(a)(2), and would have little, if any, effect on capital formation.

2. Exempt Reporting Advisers: Sections 407 and 408

While we believe that our proposed approach to implementing the Dodd-Frank Act's

329 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner at $210 per hour and a compliance manager at $294 per hour. *See infra* note 338. [6.79 hours x $210 = $1,425.90] + [6.79 hours x $294 = $1,996.26] = $3,422.

330 110 advisers relying on the exemption x $3,422 = $376,420.

331 The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants. *See infra* notes 420-421 and accompanying text.

332 *See supra* notes 265-266 and accompanying text.

reporting provisions applicable to exempt reporting advisers would minimize costs inherent in such reporting, we acknowledge that it would impose some costs on these advisers.[333] Although not significant, these costs would include paying a filing fee to FINRA to support the IARD. We anticipate that filing fees for exempt reporting advisers would be the same as those for registered investment advisers, which currently range from $40 to $200, based on the amount of assets an adviser has under management.[334] In order to estimate the costs associated with paying filing fees, we will assume for purposes of this cost-benefit analysis that exempt reporting advisers will pay a fee of $200 per report filed on Form ADV. We estimate that approximately 2,000 advisers would qualify as exempt reporting advisers pursuant to sections 407 and 408 of the Dodd-Frank Act and would have to file Form ADV on the IARD,[335] which would result in total annual costs consisting of filing fees of approximately $400,000.[336]

In addition to filing fees, our proposals would result in internal costs to exempt reporting advisers associated with collecting, reviewing, reporting, and updating a limited subset of Form ADV items in Part 1A, as we propose to amend it, including Items 1, 2.C., 3, 6, 7, 10, 11 and corresponding schedules, but exempt reporting advisers would not be required to complete the remainder of Part 1A or Part 2. The costs of completing these items would vary from one adviser to the next, depending in large part on the number of private funds these advisers

333 *See* proposed rules 204-1 and 204-4; proposed Form ADV, Part 1A; *supra* section II.B. of this Release.

334 *See supra* note 122 and accompanying text.

335 *See infra* note 422. While this is an estimate of the total number of advisers that may file reports rather than register with the Commission, a number of these advisers may choose to register with the Commission rather than file reports. We cannot determine *ex ante* the number of these advisers that will choose to register rather than report. Therefore, in order to avoid under-estimating the costs of our proposals, we are using the total number of potential exempt reporting advisers in our estimates.

336 2,000 exempt reporting advisers x $200 per year = $400,000. Advisers pay for initial Form ADV submissions and for annual amendments; there is no charge for an interim amendment.

manage. We believe the information required by these items should be readily available to any adviser, particularly the identifying data and control person information required by Items 1, 3, and 10. The check-the-box style of most of these items, as well as some of the features of the IARD system (such as drop-down boxes for common responses) should also keep the average completion time for these advisers to a minimum. For purposes of the PRA, we estimate that exempt reporting advisers, in the aggregate, would spend 14,000 hours to prepare and submit their initial reports on Form ADV.[337] Based on this estimate, we expect that exempt reporting advisers would incur costs of approximately $3,528,000 to prepare and submit their initial report on Form ADV.[338] Additionally, for PRA purposes, we estimate that exempt reporting advisers in the aggregate would spend 2,200 hours per year on amendments to their filings.[339] Based on this estimate, we expect that exempt reporting advisers would incur costs of approximately $554,400 to prepare and submit annual amendments to their reports on Form ADV.[340]

Completing and filing Form ADV-H and Form ADV-NR would also impose costs on exempt reporting advisers. For purposes of the PRA, we estimate that approximately 2 exempt reporting advisers would file Form ADV-H annually and that it would impose an average burden per response of 1 hour on exempt reporting advisers.[341] Thus, proposed rule 204-4 would result

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337 *See infra* note 425; *infra* section V. of this Release.

338 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager, or persons performing similar functions. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $210 and $294 per hour, respectively. [7,000 hours x $210 = $1,470,000] + [7,000 hours x $294 = 2,058,000] = $3,528,000. For an exempt reporting adviser that does not already have a senior compliance examiner or a compliance manager, we expect that a person performing a similar function would have similar hourly costs.

339 *See infra* note 430.

340 [1,100 hours x $210 = $231,000] + [1,100 hours x $294 = 323,400] = $554,400.

341 *See infra* section V.F. of this Release.

in an increase in the total hour burden associated with Form ADV-H of 2 hours.[342] We further estimate that for each hour required by the Form, professional staff time would comprise 0.625 hours, and clerical staff time would comprise 0.375 hours. The Commission staff estimates the hourly wage for compliance professionals to be $294 per hour,[343] and the hourly wage for general clerks to be $52 per hour.[344] Accordingly, we estimate the average cost per response imposed on exempt reporting advisers by proposed rule 204-4 and amended Form ADV-H would be $203,[345] for a total annual cost of $406.[346] With regard to Form ADV-NR, we estimate that exempt reporting advisers would file Form ADV-NR at the same annual rate (0.17 percent) as advisers registered with us.[347] Thus, we estimate that the amendments would increase the total annual hour burden associated with Form ADV-NR by 1 hour.[348] We further estimate that for each hour required by the Form, compliance clerk time comprises 0.75 hours and general clerk time comprises 0.25 hours.[349] Therefore, we estimate that the proposed amendments to Form ADV-NR would impose approximately $57 in total additional annual costs for advisers.[350]

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342 2 responses x 1 hour = 2 hours.

343 Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a Compliance Manager is approximately $294 per hour.

344 Data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a general clerk is approximately $52 per hour.

345 (0.625 hours x $294) + (0.375 hours x $52) = approximately $203.

346 $203 per response x 2 responses annually = $406.

347 *See infra* note 450.

348 0.17% (rate of filing) x (9,150 estimated registered investment advisers + 2,000 estimated exempt reporting advisers) x 1 hour per ADV-NR filing = 19.

349 Data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a general clerk is approximately $52 per hour and cost for a compliance clerk is approximately $59 per hour.

350 1 hour x ((0.75 hours x $59) + (0.25 hours x $52)) = approximately $57.

If adopted, our proposed reporting requirement would also result in other costs for exempt reporting advisers. For example, some of the information these advisers would report (and that we would make publicly available), such as the identification of owners of the adviser or disciplinary information, could impose costs on the advisers and, in some cases their supervised persons or owners, including the potential loss of business to competitors, as this information, today, is not typically made available to others. In addition, there may be other costs associated with the reporting requirements, including the possibility that the proposed disclosure requirements could influence business or other decisions by exempt reporting advisers, such as whether to form additional private funds or discourage entry into management of funds all together.

3. Form ADV Amendments

The costs of completing these new and amended items would vary among advisers. We believe that the information required by these items, however, should be readily available to any adviser. The check-the-box style of most of these items, as well as some of the features of the IARD system (such as drop-down boxes for common responses) should also keep costs down by reducing the average completion time.

One-time monetary costs we expect to be borne by current registrants to complete the proposed amendments to Form ADV in connection with the transition filing are discussed above, but that discussion does not take into account costs we expect to be borne by newly registering advisers.[351] For purposes of the PRA, we estimate that 650 advisers will register with us within the next year as a result of normal annual growth of our population of registered advisers[352] and would spend, on average, 4.5 hours to respond to the new and amended questions we are

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[351] *See supra* section IV.B.1. of this release.

[352] *See infra* note 376 and accompanying text.

proposing today, other than the private fund reporting requirements.[353] We expect the aggregate cost associated with this process would be $737,100.[354] In our PRA analysis, we also project that 750 new advisers would register with us as a result of the Dodd-Frank Act's elimination of the private adviser exemption, and this group of advisers would be required to complete and submit to us the entire form.[355] We expect these newly registering advisers would spend, in the aggregate, 30,555 hours to complete the form (Part 1 except for the private fund reporting requirements, and Part 2) as well as to periodically amend the form, prepare brochure supplements and deliver codes of ethics to clients,[356] for a total cost of $7,699,860.[357] In addition, of these 1,400 newly registering advisers,[358] we estimate that 950 advise one or more private funds and would have to complete the private fund reporting requirements we are proposing today.[359] We expect this would take 4,750 hours,[360] in the aggregate, for a total cost

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353 *See infra* section V.B.1.a. of this Release. We are calculating costs only of the increased burden because we have previously assessed the costs of the other items of Form ADV for registered advisers and for new advisers attributed to annual growth. The amendments we are proposing today would neither increase the burden associated with the other items on Form ADV, nor would they increase the external costs associated with certain Part 2 requirements.

354 We expect that the performance of this function would most likely be equally allocated between a Senior Compliance Examiner and a Compliance Manager. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $210 and $294 per hour, respectively. 650 advisers x 4.5 hours = 2,925 hours. [1,462.5 hours x $210 = $307,125] + [1,462.5 hours x $294 = $429,975] = $737,100.

355 *See infra* note 396.

356 750 advisers x 40.74 hours per adviser to complete entire form (except private fund reporting requirements) = 30,555 hours. *See infra* note 388.

357 [15,277.5 hours x $210 = $3,208,275] + [15,277.5 hours x $294 = $4,491,585] = $7,699,860. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

358 650 advisers expected to register with us within the next year + 750 advisers expected to register with us as a result of the elimination of the private adviser exemption = 1,400.

359 *See infra* text preceding note 405.

360 *See infra* notes 407 and 408.

of $1,197,000.[361] The total estimated costs associated with our amendments for newly registering advisers, therefore, are $9,633,960.[362]

Additionally, we estimate that a quarter (or 188) of the 750 new registered advisers no longer able to rely on the private adviser exemption would use outside legal services, and half (or 375) would use outside compliance consulting services, to assist them in preparing their Part 2 brochures, for a total cost of $827,200, and $1,875,000, respectively, resulting in a total non-labor cost among all newly registering advisers of $2,702,200.[363]

If adopted, our proposed amendments to Form ADV would also result in other costs. For instance, our proposed changes to the instructions on calculating regulatory assets under management, and proposed rule 203A-3(d), would result in some advisers reporting greater assets under management than they do today, and would preclude some advisers from excluding certain assets from their calculation in order to remain below the new asset threshold for registration with the Commission. The impact of these changes may result in a limited number of state-registered advisers that report assets under management of less than $30 million under the current Form ADV reporting requirements to register with us if under the proposed revised instructions they would report $100 million or more in assets under management.[364]

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361 [2,375 hours x $210 = $498,750] + [2,375 hours x $294 = $698,250] = $1,197,000. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

362 $737,100 + $7,699,860 + $1,197,000 = $9,633,960.

363 The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants, and it already accounts for a percentage of annual growth in our population of registered advisers. *See also infra* text following note 421.

364 A registered investment adviser that reports more than $30 million in assets under management under the current instructions to Item 5 of Form ADV would be required to register with the Commission. These advisers would not have additional costs associated with registration as they would already be incurring those costs.

We have also proposed to require advisers to private funds to use fair value of private fund assets for determining regulatory assets under management.[365] We understand that many, but not all, private funds value assets based on their fair value in accordance with U.S. generally accepted accounting principles (GAAP) or other international accounting standards.[366] The advisers to private funds that do not use fair value methodologies would likely incur costs to comply with this proposed requirement. These costs would vary based on factors such as the nature of the asset, the number of positions that do not have a market value, and whether the adviser has the ability to value such assets internally or would rely on a third party for valuation services. We do not believe, however, that these costs would be significant. We understand that private fund advisers, including those that may not use fair value methodologies for reporting purposes, perform administrative services, including valuing assets, internally as a matter of business practice.[367] Commission staff estimates that such an adviser would incur $1,224 in internal costs to conform its internal valuations to a fair value standard.[368] In the event a fund does not have an internal capability for valuing specific illiquid assets, we expect that it could obtain pricing or valuation services from an outside administrator or other service provider.

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365 *See* proposed Form ADV: Instructions for Part 1A, inst. 5.b.(4).

366 *See supra* note 56.

367 For example, a hedge fund adviser may value fund assets for purposes of allowing new investments in the fund or redemptions by existing investors, which may be permitted on a regular basis after an initial lock-up period. An adviser to private equity funds may obtain valuation of portfolio companies in which the fund invests in connection with financing obtained by those companies. Advisers to private funds also may value portfolio companies each time the fund makes (or considers making) a follow-on investment in the company. Private fund advisers could use these valuations as a basis for complying with the fair valuation requirement we propose with respect to private fund assets.

368 This estimate is based upon the following calculation: 8 hours x $153/hour = $1,224. The hourly wage is based on data for a fund senior accountant from the SIFMA Management and Earnings Report, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

Staff estimates that the cost of such a service would range from $250 to $75,000 annually.[369] We request comment on these estimates. Do advisers that do not use fair value methodologies for reporting purposes have the ability to fair value private fund assets internally? If not, what would be the costs to retain a third party valuation service? Are there certain types of advisers (*e.g.*, advisers to real estate private funds) that would experience special difficulties in performing fair value analyses? If so, why?

Requiring advisers to report whether they have $1 billion or more in assets also may have costs for advisers that are not publicly traded or otherwise do not publicly disclose the amount of their own assets as it would be easy to identify the very largest advisers in terms of assets. These proposals may provide limited efficiency improvements as a result of the uniformity in calculating and reporting managed assets, and there may also be, as discussed below, competitive effects of these changes and other proposed amendments to Form ADV. We believe these proposals would have little, if any, effect on capital formation.

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369 These estimates are based on conversations with providers of valuation services. We understand that the cost of valuation for illiquid fixed income securities generally ranges from $1.00 and $5.00 per security, depending on the difficulty of valuation, and is performed for clients on weekly or monthly basis. Appraisals of privately placed equity securities may cost from $3,000 to $5,000 (with updates to such values at much lower prices). As proposed, an adviser only has to calculate regulatory assets under management for purposes of reporting on Form ADV annually. For purposes of this cost benefit analysis, we are estimating the range of costs for (i) a private fund that holds 50 illiquid fixed income securities at a cost of $5.00 to price and (ii) a private fund that holds privately placed securities of 15 issuers that each cost $5,000 to value. We believe that costs for funds that hold both fixed-income and privately placed equity securities would fall within the maximum of our estimated range. We note that funds that have significant positions in illiquid securities are likely to have the in-house capacity to value those securities or already subscribe to a third party service to value them. We note that many private funds are likely to have many fewer fixed income illiquid securities in their portfolios, some or all of which may cost less than $5.00 to value. Finally, we note that obtaining valuation services for a small number of fixed income positions on an annual basis may result in a higher cost for each security or require a subscription to the valuation service for those that do not already purchase such services. The staff's estimate is based on the following calculations: (50 x $5.00 = $250; 15 x $5,000 = $75,000).

In addition, some of the proposed amendments also could impose costs including potential competitive effects with other advisers as certain information we are proposing to be disclosed may not typically be provided to others. This would be the case, for example, for advisers that currently disclose only to certain clients and prospective clients, or only upon request, such information as census data about the private funds and the amount of private fund assets that the adviser manages, information about the state registrations of the adviser's employees, the types of investments about which the adviser provides advice, and the service providers to each private fund that the adviser manages. This could create benefits as well as costs. While exempt reporting advisers may be subject to a lower regulatory burden, investors may have greater confidence in advisers that provide more fulsome disclosure and are subject to our oversight.

4. Amendments to Pay to Play Rule

Our proposal to permit an adviser to pay any municipal advisor that is registered with the Commission under section 15B of the Exchange Act[370] and subject to pay to play rules adopted by the MSRB to solicit government entities on its behalf may result in limited additional costs to comply with rule 206(4)-5.[371] Specifically, advisers that have created compliance programs in anticipation of rule 206(4)-5's compliance date may have to make adjustments to those programs to account for the fact that our proposed amendment would permit them to hire placement agents

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370 15 U.S.C. 78o-4.

371 *See* proposed rule 206(4)-5(a)(2), (f)(9). As discussed in section II.D.1. of this Release, we believe that our proposed amendment to rule 206(4)-5 to make it apply to exempt reporting advisers and foreign private advisers and our proposed technical amendment to the definition of "covered associate" would not generate new costs.

that are registered municipal advisors.[372] But, as explained above, our proposed amendments would allow them greater latitude in hiring placement agents.

C. Request for Comment

- The Commission requests comments on all aspects of the cost-benefit analysis, including the accuracy of the potential costs and benefits identified and assessed in this release, as well as any other costs or benefits that may result from the proposals.
- We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits.

V. PAPERWORK REDUCTION ACT ANALYSIS

Certain provisions of our proposal contain "collection of information" requirements within the meaning of the PRA, and we are submitting the proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The titles for the collections of information we are proposing or proposing to amend are: (i) "Form ADV"; (ii) "Rule 203-2 and Form ADV-W under the Investment Advisers Act of 1940;" (iii) "Rule 204-2 under the Investment Advisers Act of 1940;" (iv) "Exemption for Certain Multi-State Investment Advisers (Rule 203A-2(e));" (v) "Rule 203A-5;" (vi) "Form ADV-H;"[373] and (vii) "Rule 0-2 and Form ADV-NR under the Investment Advisers

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[372] *See* section III.B of the Pay to Play Release (requiring advisers to comply with the rule's prohibition on making payments to third parties to solicit government entities for investment advisory services on September 13, 2011).

[373] The current title for the collection of information on Form ADV-H is "Rule 203-3 and Form ADV-H under the Investment Advisers Act of 1940" because currently only registered advisers file Form ADV-H under rule 203-3. However, because we are proposing to amend Form ADV-H to allow exempt reporting advisers to apply for a temporary hardship exemption on Form ADV-H under rule 204-4, we are proposing to re-title the collection of information simply "Form ADV-H."

Act of 1940." . 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.

While our proposed rules and rule and form amendments would impose new collection of information burdens for certain advisers and change existing burdens on advisers under our rules, the Dodd-Frank Act also will impact our total burden estimates for certain of our rules, principally by changing the numbers of advisers subject to these rules. Specifically, we estimate the Dodd-Frank Act's amendments to section 203A to reallocate regulatory responsibility over numerous registered advisers to the states will result in about 4,100 registered advisers switching from Commission to state registration.[374] At the same time, we estimate that the Dodd-Frank Act's elimination of the private adviser exemption in section 203(b)(3) of the Advisers Act will result in approximately 750 additional private fund advisers registering with the Commission.[375] Based on IARD data as of September 1, 2010, we estimate that approximately 11,850 advisers are currently registered with the Commission. We further estimate that approximately 650 additional advisers register with the Commission each year.[376] Therefore, for purposes of calculating the burdens of our proposed rules and amendments under the PRA, we estimate that

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374 *See supra* section II.A. of this Release (discussing the Dodd-Frank Act's amendments to section 203A). Based on IARD data as of September 1, 2010, we estimate that approximately 4,050 will switch registration because they have assets under management of less than $100 million. We also estimate that approximately 50 additional advisers will switch to state registration because they are relying on the registration of an affiliated adviser with the same principal office and place of business that will be switching to state registration.

375 *See* Exemptions Release at section I. (discussing elimination of the private adviser exemption in section 203(b)(3)).

376 Over the past several years, approximately 1,000 new advisers have registered with us annually. Due to the Dodd-Frank Act's reallocation of regulatory responsibility for advisers with assets under management of less than $100 million, we estimate that about 650 new advisers will register with us annually based on reducing the current growth rates by the gross reduction in the number of advisers due to the Dodd-Frank Act. (4,100 (SEC advisers withdrawing) / 11,850 (total SEC advisers)) x 1000 (number of new advisers each year) = 0.35 x 1000 = 350 (number of additional new advisers registering with the states, not the SEC). 1000 - 350 = 650.

the number of advisers registering with the Commission after the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) become effective will be approximately 9,150.[377]

A. Rule 203A-2(e)

Rule 203A-2(e) exempts certain multi-state investment advisers from section 203A's prohibition on registration with the Commission. We are proposing to renumber and amend rule 203A-2(e) to permit investment advisers required to register as an investment adviser with 15 or more states, instead of 30 or more states under the current rule, to register with the Commission.[378] An investment adviser relying on this exemption would be required to maintain in an easily accessible place a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register.[379] We have submitted this collection of information to OMB for review.

Respondents to this collection of information would be investment advisers who are required to register in 15 or more states absent the exemption from the prohibition on Commission registration. This collection of information is mandatory for those advisers relying on the exemption provided by rule 203A-2(e) (proposed rule 203A-2(d)). The records kept by investment advisers in compliance with the rule would be necessary for the Commission staff to

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377. 11,850 (total SEC advisers) - 4,100 (SEC advisers withdrawing) + 750 (private advisers registering with the SEC) + 650 (new SEC advisers each year) = 9,150.

378. *See* proposed rule 203A-2(d). Under rule 203A-2(e) an adviser, once registered with the Commission, is not required to withdraw its registration as long as it would be required to register with at least 25 states.

379. *See* proposed rule 203A-2(d)(3). An investment adviser relying on this exemption also would continue to be required to: (i) include a representation on Schedule D of Form ADV that the investment adviser has reviewed applicable law and concluded that it must register as an investment adviser with 15 or more states; and (ii) undertake on Schedule D to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 states to register as an investment adviser with the state. *See* proposed rule 203A-2(d)(2). The proposed increase in the PRA burden for Form ADV reflects these requirements. *See infra* section V.B. of this Release.

use in its examination and oversight program, and the information in these records generally would be kept confidential.[380]

As of September 1, 2010, there were approximately 40 advisers relying on the exemption under rule 203A-2(e).[381] Although it is difficult to estimate the number of advisers that would rely on the exemption if amended as proposed because such reliance is entirely voluntary, we estimate that approximately 150 advisers would rely on the exemption.[382] These advisers would incur an average one-time initial burden of approximately 8 hours, and an average ongoing burden of approximately 8 hours per year, to keep records sufficient to demonstrate that they meet the 15-state threshold. These estimates are based on an estimate that each year an investment adviser would spend approximately 0.5 hours creating a record of its determination whether it must register as an investment adviser with each of the 15 states required to rely on the exemption, and approximately 0.5 hours to maintain these records.[383]

380 *See* section 210(b) of the Advisers Act.

381 Based on IARD data as of September 1, 2010, of the approximately 11,850 SEC-registered advisers, 40 checked Item 2.A.(9) of Part 1A of Form ADV to indicate their basis for SEC registration under the multi-state advisers rule.

382 Based on IARD data as of September 1, 2010, 94 of the advisers that have less than $100 million of assets under management currently file notice filings with 15 or more states. This number may overestimate the number of advisers required to be registered with 15 or more states, and therefore eligible for the proposed multi-state exemption, because notice filing requirements may differ from registration requirements. In addition, we are unable to determine the number of advisers currently registered with the states that are registered with 15 or more states that may rely on the proposed exemption and register with us. We expect this number to be small based on the scope of business of an adviser that has less than $25 million in assets under management and because section 222(d) of the Advisers Act provides a de minimis exemption for limited state operations without registration. For purposes of this analysis, we estimate the number is 15. As a result, we estimate that approximately 150 advisers would rely on the proposed exemption (40 currently relying on it + estimated 95 eligible based on IARD data + 15 advisers required to be registered in 15 or more states that are not registered with us today).

383 0.5 hours x 15 states = 7.5 hours + 0.5 hours = 8 hours.

B. Form ADV

Form ADV (OMB Control No. 3235-0049) is the two-part investment adviser registration form. Part 1 of Form ADV contains information designed for use by Commission staff, and Part 2 is the client brochure. We use the information to determine eligibility for registration with us and to manage our regulatory and examination programs. Clients use certain of the information to determine whether to hire or retain an adviser. Rule 203-1 requires every person applying for investment adviser registration with the Commission to file Form ADV. Rule 204-1 requires each registered adviser to file amendments to Form ADV at least annually, and requires advisers to submit electronic filings through the IARD. These collections of information are found at 17 CFR 275.203-1, 275.204-1, and 279.1 and are mandatory, although the paperwork burdens associated with rules 203-1 and 204-1 are included in the approved annual burden associated with Form ADV and thus do not entail separate collections of information. Responses are not kept confidential. The respondents to this information collection are investment advisers registered or applying for registration with us, and as discussed below, would include exempt reporting advisers.

The current total annual burden for all advisers completing, amending, and filing Form ADV (Part 1 and Part 2) with the Commission, approved recently in connection with amendments we adopted to Part 2,[384] is 268,457 hours.[385] This burden is based on an average

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[384] *See* section VI of Part 2 Release, *supra* note 46 at nn. 341 and 342 and accompanying text. This estimate includes the annual burden associated with advisers' obligations to deliver to clients copies of their codes of ethics upon request.

[385] The approved burden is comprised of 11,658 advisers preparing an initial filing of Form ADV at 36.24 hours, which is amortized over a three-year period (the estimated period that advisers are expected to use Form ADV) for an annual burden of 152,909 hours. The burden also includes two amendments to Form ADV annually, one annual amendment and one other than annual amendment, for an annual burden of 87,435 hours; an annual burden of 11,658 hours to account for new brochure supplements that advisers are required to prepare; and 16,455 hours attributable to the obligation to deliver to clients codes of ethics upon request.

total collection of information burden of 36.24 hours per adviser for the first year that an adviser completes Form ADV. The currently approved burden also includes a total annual cost burden of $22,775,400, which includes costs associated with outside legal assistance and outside consulting services that vary based on the size of the adviser.[386]

As discussed above, in order to give effect to provisions in Title IV of the Dodd-Frank Act, we are proposing amendments to Part 1A of Form ADV to reflect the new statutory threshold for registration with the Commission and to restructure it to accommodate filings by exempt reporting advisers. Additionally, to enhance our ability to oversee investment advisers, we are proposing amendments to Part 1A of Form ADV to require advisers to provide us additional information regarding: (i) private funds they advise; (ii) their advisory business and business practices that may present significant conflicts of interest; and (iii) advisers' non-advisory activities and their financial industry affiliations.[387] We are also proposing certain additional changes intended to improve our ability to assess compliance risks and to enable us to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements.

We expect that an increase in the information requested in Form ADV Part 1A as a result of these amendments would increase the currently approved collection of information associated with Form ADV. In addition, the annual burden also would increase as a result of an increase in the number of respondents attributable to new investment adviser registrations and the proposed

386 For outside legal services, ($4,400 x 535 medium advisers) + ($3,200 x 2,370 small advisers)) + ($10,400 x 36 large advisers) = $ 10,312,400. For compliance consulting services, ($3,000 x 2,371 small advisers) + ($5,000 x 1,070 medium advisers) = $12,463,000. $10,312,400+$12,463,000 = $22,775,400. *See* Part 2 Release, *supra* note 46, for a discussion of these estimates.

387 *See supra* section II.C of this Release. In addition, we are proposing several clarifying or minor amendments based on frequently asked questions we receive from advisers as well as in our experience administering the form.

use of the form for reporting by exempt reporting advisers. We discuss below, in three sub-sections, the estimated revised collection of information requirements for Form ADV: first, we address the change to the collection as a result of our proposed amendments to Part 1A of Form ADV excluding those related to private fund reporting for registered advisers; second, we discuss the proposed amendments related to private fund reporting for registered advisers; and third, we address the proposed amendments to Part 1A of Form ADV for its use as a reporting form by exempt reporting advisers.

1. Changes in Average Burden Estimates and New Burden Estimates

a. Estimated Change in Burden Related to Proposed Part 1A Amendments (Not Including Private Fund Reporting)

We are proposing amendments to many Items in Part 1A, some that are merely technical changes or very simple in-nature, and others that would require more of an adviser's time to respond. The paperwork burdens of filing an amended Form ADV, Part 1A would, however, vary among advisers, depending on factors such as the size of the adviser, the complexity of its operations, and the number or extent of its affiliations. Although burdens would vary among advisers, we believe that the proposed revisions to Part 1A would impose few additional burdens on advisers in collecting information as advisers should have ready access to all the information necessary to respond to the proposed items in their normal course of operations. We also are working with FINRA, as our IARD contractor, to implement measures intended to minimize the burden for advisers filing proposed amended Form ADV on IARD (*e.g.*, pre-populating fields and drop-down boxes for common responses). We anticipate, moreover, that the responses to many of the questions are unlikely to change from year to year, minimizing the ongoing reporting burden associated with these questions.

In large part, the amendments we propose to Form ADV, Part 1A, including those to account for the statutory changes in the threshold for SEC registration, primarily refine or expand existing questions or request information advisers already have for compliance purposes. For instance, some of the proposed changes to Item 5 would require advisers to provide numerical responses to certain questions about their employees. An adviser would likely already have this information in order to respond to those questions today by checking boxes that correspond to a range of numbers. Likewise, the proposed amendments to Item 8 require advisers to expand on information they provide in response to existing Item 8, such as whether the broker-dealers that advisers recommend or have discretion to select for client transactions are related persons of the adviser. Other questions expand upon existing requirements to elicit information advisers would already have available for compliance purposes, such as whether the soft dollar benefits they currently report receiving under Item 8 qualify for the safe harbor under section 28(e) of the Exchange Act for eligible research or brokerage services. As amended, Item 2 would require an adviser to report to us its basis for registration or reporting, as already determined for compliance purposes. Other proposed amendments to Items 5, 6 and 7 expand existing lists of information advisers already provide to us on Form ADV, such as types of advisory activities the advisers perform and other types of business engaged in by advisers and their related persons. We believe several of the new questions we propose would merely require advisers to provide readily available or easily accessible information, such as Chief Compliance Officer contact information and whether the adviser has $1 billion or more in assets in Item 1, form of organization in Item 3, or types of investments about which they provided advice during the fiscal year for which they are reporting in Item 5.

We anticipate other proposed questions may take longer for advisers to complete, even with readily available information, such as calculating regulatory assets under management according to our revised instruction. Other proposed new items may present greater burdens for some advisers, but not others, depending on the nature and complexity of their businesses, such as the proposed requirement to provide a list of the SEC file numbers of investment companies they advise, or providing expanded information about related person financial industry affiliates.

We estimate these proposed amendments to Part 1A of Form ADV would take each adviser approximately 4.5 hours, on average, to complete. We have based this estimate, in part, by comparing the relative complexity and availability of the information elicited by the proposed items and the nature of the response required (*i.e.*, checking a box as opposed to providing a narrative response) to the current form and its approved burden. As a result, we estimate the average total collection of information burden would increase to 40.74 hours per adviser for the first year that an adviser completes Form ADV (Part 1 and Part 2).[388]

b. New Estimated Burden Related to Proposed Private Fund Reporting Requirements

The amendments that we propose to Item 7.B. and Section 7.B. of Schedule D to collect new data on private funds managed by advisers would provide us with basic census data on private funds and would permit us to conduct a more robust risk assessment of private fund advisers for purposes of targeting our examinations. The information would include fund data such as basic organizational, operational, and investment characteristics of the fund; the amount of assets held by the fund; and the fund's service providers or gatekeepers. We believe much of the information we are proposing to be reported to us should be readily available to private fund advisers because, among other things, it is information that private fund investors commonly

388 Current approved per adviser total (36.24) + estimated per adviser increase (4.5) = 40.74.

seek in their due diligence questionnaires or it is information that would often be included in a private placement memorandum offering fund shares.

Although we understand that the information we are proposing to require for private funds typically would be readily available to advisers to these funds, we expect that these amendments could require advisers, particularly those with many private funds, to be subject to a significantly increased paperwork burden. We are proposing certain measures to minimize the increase in burden associated with this proposed reporting requirement. We propose to permit a sub-adviser to exclude private funds for which an adviser is reporting on another Schedule D, and would permit an adviser sponsoring a master-feeder arrangement to submit a single Schedule D for the master fund and all of the feeder funds that would otherwise be submitting substantially identical data.[389] We also propose to permit an adviser with a principal office and place of business outside the United States to omit a Schedule D for a private fund that is not organized in the United States and that does not have any investors who are "United States persons."[390] And as discussed above, we are working with FINRA to implement measures intended to minimize the burden for advisers filing proposed amended Form ADV, such as the ability to automatically populate private fund service provider information provided for other funds advised by the same adviser. Finally, we note that as proposed, Item 7.B. would no longer require advisers to report the funds that their related persons advise on Schedule D, which we expect would decrease the burden on private fund advisers. Taking into account, as discussed above, the scope of the information we propose to request and our understanding that much of the information is readily available, as well as the technology upgrades we expect to be incorporated into the IARD, we

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389 *See supra* notes 153-154 and accompanying text.

390 *See supra* note 155 and accompanying text.

estimate advisers to private funds would each spend, on average, one hour per private fund to complete these questions.

c. New Estimated Burden Related to Proposed Exempt Reporting Adviser Reporting Requirements

Exempt reporting advisers would be required to complete a limited number of items in Part 1A of Form ADV (consisting of Items 1, 2.C., 3, 6, 7, 10, 11 and corresponding schedules), and are not required to complete Part 2. We believe the information required by these items should be readily available to any adviser, particularly the identifying data and control person information required by Items 1, 3, and 10. The check-the-box style of most of these items, as well as some of the features of the IARD system (such as drop-down boxes for common responses) should also keep the average completion time for these advisers to a minimum. Moreover, in our staff's experience, the types of advisers that would meet the criteria for exempt reporting advisers are unlikely to have significantly large numbers of affiliations, nor do we expect them to have to report disciplinary events at a greater rate than currently registered advisers.[391] We estimate that these items, other than Item 7.B., would take each exempt reporting adviser approximately two hours to complete. We anticipate that, like registered advisers, exempt reporting advisers would each spend an additional hour per private fund to complete Item 7.B. and Schedule 7.B.

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[391] As of September 1, 2010, approximately 13% of SEC-registered investment advisers reported a disclosure in Item 11 of Form ADV.

2. Annual Burden Estimates

a. Estimated Annual Burden Applicable to All Registered Investment Advisers

i. Estimated Initial Hour Burden (Not Including Burden Applicable to Private Funds)

As a result of the transition filing discussed above,[392] we expect the total number of registered adviser respondents to this collection of information would be 9,150.[393] Approximately 11,850 investment advisers are currently registered with the Commission.[394] We expect 4,100 will withdraw from registration.[395] We expect about 750 advisers who currently rely on the private adviser exemption to apply for registration with us, and we estimate that approximately 650 new advisers will register with us each year beginning in 2011.[396]

The estimated total annual burden applicable to these advisers, including new registrants, but excluding private fund reporting requirements, is 372,771 hours.[397] We believe that most of the paperwork burden would be incurred in advisers' initial submission of the new and amended items of Form ADV Part 1A, and that over time this burden would decrease substantially because the paperwork burden will be limited to updating information. Amortizing this total burden imposed by Form ADV over a three-year period to reflect the anticipated period of time that advisers would use the revised Form would result in an average burden of an estimated

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392 *See supra* section IV.B.1. of this Release.

393 *See supra* note 377.

394 Based on IARD data as of September 1, 2010.

395 *See supra* section IV.B.1. of this Release.

396 (4,100 (SEC advisers expected to withdraw from registration) / 11,850 (total SEC advisers)) x 1000 (average number of new advisers registered with the Commission each year) = 0.35 x 1000 = 350 (number of additional new advisers registering with the states, not the SEC). 1000 - 350 = 650. *See also infra* note 422.

397 40.74 per-adviser burden x 9,150 = 372,771 hours.

124,257 hours per year,[398] or 13.58 hours per year for each new applicant[399] and for each adviser currently registered with the Commission that would re-file through the IARD.

ii. Estimated Initial Hour Burden Applicable to All Registered Advisers to Private Funds

The amount of time each of the registered advisers to private funds would incur to complete Item 7.B. and Section 7.B. of Schedule D would vary depending on the number of funds the advisers manage. Of the 9,150 advisers currently registered with us, approximately 3,500 indicate that they are advisers to private funds.[400] Due to the assets under management these advisers report on Form ADV,[401] and considering that today these advisers either do not qualify for the private adviser exemption or choose not to rely on it, we expect these advisers to remain registered with us. Based on Form ADV filings by these advisers, we estimate that 50% of these advisers, or 1,800, currently advise an average of 3 private funds each; 45%, or 1,550 advisers, currently advise an average of 10 private funds each, and the remaining 5%, or 150 advisers, manage an average of 83 private funds each.[402] As we discussed above, we estimate that private fund advisers would spend, on average, one hour per private fund to complete Item 7.B. and Section 7.B. of Schedule D. As a result, the private fund reporting requirements that

398 372,771 / 3 = 124,257.

399 124,257 / 9,150 = 13.58.

400 3,500 advisers indicate by reporting a fund in Schedule D, Section 7.B. that they, or a related person, advise private funds or investment related funds. Based on IARD data as of September 1, 2010.

401 Approximately 71% of the advisers to private funds or investment related funds report assets under management over $100 million.

402 Based on IARD data as of September 1, 2010. Form ADV currently asks for an adviser to report about investment-related partnerships and limited liability companies advised by the adviser *and* its related persons. As a result, the data we have obtained from IARD over-estimates the average number of funds as a result of reporting of the same fund multiple times by affiliated registered advisers.

would be applicable to registered investment advisers would add 33,350 hours to the overall annual burden applicable to registered advisers.[403]

In addition to the registered advisers that advise private funds today, we estimate that about 200 of the 650 new advisers that will register with us annually will manage private funds,[404] and an estimated 750 new private fund advisers will register with us that previously relied on the private adviser exemption. We believe that these 950 advisers that would be required to register will generally be similar to the 50% of our current registrants that advise, on average, 3 private funds, but believe that some portion of them may advise a greater number of funds, as the estimated 750 currently exempt private advisers rely on the private adviser exemption, which permits up to 14 private fund clients.[405] In addition, with respect to the 650 new registrants we estimate annually, the elimination of the private adviser exemption will require them, unless they are eligible for another exemption, to register even if they have only a single private fund client. To account for the addition of these two groups of advisers to the registrant pool, but taking into account the demographics of our current registrant pool (with 50% having on average 3 private fund clients), we estimate that each registered private fund adviser, on average, will advise five private funds.[406] Accordingly, private fund reporting requirements attributable to the estimated 750 new registrants because of the elimination of the

403 (1,800 advisers x 3 hours (3 funds x 1 hour per fund)) + (1,550 advisers x 10 hours (10 funds x 1 hour per fund)) + (150 advisers x 83 hours x 1 hour per fund)) = 5,400 + 15,500 + 12,450 = 33,350.

404 About 30% of current registrants report that they advise one or more private funds. (3,500 advisers to private funds / 11,850 registered advisers). Applying the same proportion to new registrants results in approximately 200 additional advisers to private funds each year. (650 x .30 = 195).

405 Section 203(b)(3).

406 Approximately 65% of advisers that reported a fund in Schedule D, Section 7.B. listed five or fewer funds and 72% of advisers that registered since September 1, 2009 and reported a fund reported five or fewer private funds. The average number of private funds reported is about five funds for the new registrants in the past year.

private adviser exemption would add 3,750 hours to the overall annual burden applicable to registered advisers.[407] We also estimate that private fund reporting requirements applicable to new registered investment advisers would add 1,000 hours to the overall annual burden applicable to registered advisers.[408]

The total annual burden related to private fund reporting that is applicable to registered advisers would be 38,100 hours.[409] We believe that most of the paperwork burden would be incurred in connection with advisers' initial submission of private fund data, and that over time this burden would decrease substantially because the paperwork burden will be limited to updating information. Amortizing this total burden imposed by Form ADV over a three-year period, as we did above with respect to the initial filing or re-filing of the rest of the form, would result in an average burden of an estimated 12,700 hours per year,[410] or 2.85 hours per year for each new private fund adviser[411] and for each private fund adviser currently registered with the Commission.

iii. Estimated Annual Burden Associated with Amendments, New Brochure Supplements and Delivery Obligations

The current approved collection of information burden for Form ADV has three additional elements: (1) the annual burden associated with annual and other amendments to Form ADV, (2) the annual burden associated with creating new Part 2 brochure supplements for advisory employees throughout the year, and (3) the annual burden associated with delivering codes of ethics to clients as a result of the offer of such codes contained in the brochure.

407 750 newly registering advisers x 5 private funds on average x 1 hour/private fund = 3,750.

408 200 new advisers x 5 private funds on average x 1 hour/private fund = 1,000.

409 33,350 for existing registered advisers + 3,750 for no longer exempt advisers + 1,000 for estimated new registrants due to growth = 38,100.

410 38,100 / 3 = 12,700.

411 12,700 / [3,500 + 200 + 750] = 2.85.

Although we do not anticipate that our proposed amendments to Form ADV would affect the per adviser burden imposed by these three elements, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) will change our estimates of the number of advisers subject to them, which will result in a change to the total annual burden associated with these elements of the collection of information for Form ADV.[412]

We continue to estimate that, on average, each adviser filing Form ADV through the IARD will likely amend its form two times during the year.[413] We estimate, based on IARD data, that advisers, on average, make one interim updating amendment (at an estimated 0.5 hours per amendment) and one annual updating amendment (at an estimated 6 hours per amendment) each year. We also expect advisers, on average, to continue to incur one hour annually to prepare new brochure supplements as required by Part 2 of the form,[414] and to continue to spend 1.3 hours annually to meet obligations to deliver codes of ethics to clients.[415] These obligations would add 80,520 hours annually to the collection of information. These 80,520 hours consist of 59,475 hours attributable to amendments,[416] 9,150 hours attributable to the creation of new brochure supplements,[417] and 11,895 hours for delivery of codes of ethics.[418]

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412 We anticipate that the clarification we are proposing to make to the brochure supplement (Part 2B) would not affect this cost burden estimate. *See* note 205 and accompanying text for a discussion of this proposed clarifying amendment.

413 Based on IARD system data regarding the number of filings of Form ADV amendments.

414 *See* section VI of Part 2 Release, *supra* note 46.

415 *Id.*

416 (9,150 advisers x .5 hours/other than annual amendment) + (9,150 advisers x 6 hours/annual amendment) = 59,475.

417 9,150 advisers x 1 hour = 9,150.

418 9,150 advisers x 1.3 hours = 11,895.

iv. Estimated Annual Cost Burden

The current approved collection of information burden for Form ADV has a one-time initial cost for outside legal and compliance consulting fees in connection with the initial preparation of Part 2 of Form ADV. Although we do not anticipate that our proposed amendments to Form ADV would affect the per adviser cost burden estimates, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) of the Adviser's Act will result in a significant change to our estimates of the number of advisers subject to these costs. The current approved collection is based on an estimate that 2,941 advisers will elect to obtain outside legal assistance and 3,441 advisers will elect to obtain outside consulting services, for a total cost among all respondents of $22,775,400 for a one-time initial cost to draft the new narrative brochure.

By the time the amendments to Form ADV that we are proposing today would become effective, substantially all SEC-registered advisers will have completed their initial filing of the narrative brochure required by our recent amendments to Part 2 of Form ADV and will have already incurred these estimated one-time costs.[419] As a result, the only respondents that we expect would incur legal and consulting costs for the initial drafting of Part 2 of Form ADV, subsequent to the effective date of the amendments to Part 2, would consist of the estimated 650 new advisers that we expect to register annually and the estimated 750 advisers that will have to register as a result of the elimination of the private adviser exemption.

The current approved burden estimates that the initial per adviser cost for legal services related to preparation of Part 2 of Form ADV would be $3,200 for small advisers, $4,400 for

419 *See* section V. of Part 2 Release, *supra* note 46.

medium-sized advisers, and $10,400 for larger advisers.[420] The current approved burden also contains an initial per adviser cost for compliance consulting services related to initial preparation of the amended Form ADV that ranges from $3,000 for smaller advisers to $5,000 for medium-sized advisers.[421] We estimate that the 750 new registered advisers no longer able to rely on the private adviser exemption will be medium-sized. The current approved burden anticipates that a quarter of medium-sized advisers would seek the help of outside legal services and half would seek the help of compliance consulting services. Accordingly, we estimate that 188 of these advisers would use outside legal services, for a total cost burden of $827,200, and 375 advisers would use outside compliance consulting services, for a total cost burden of $1,875,000, resulting in a total cost burden among all respondents of $2,702,000.

b. Estimated Annual Burden Applicable to Exempt Reporting Advisers

i. Estimated Initial Hour Burden

Based on publications, reports, and general information publicly available from trade organizations, financial research companies, and news organizations as well as safe harbor filings with the SEC, we expect approximately 2,000 investment advisers will qualify for an exemption from registration, but will be required to submit reports to us on Form ADV.[422] The paperwork burden applicable to these new exempt reporting advisers would consist of the burden

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420 For purposes of this estimate, we categorize small advisers as advisers with 10 or fewer employees, medium advisers as having between 11 and 1,000 employees, and large advisers as those with 1,000 or more employees. *See* Part 2 Release, *supra* note 46, at nn. 301 and 324.

421 *Id.* at n. 325.

422 This estimate was collectively derived from various sources including the National Venture Capital Association's Yearbook 2010 (http://www.nvca.org), First Research reports (http://www.firstresearch.com), Preqin reports (http://www.preqin.com), Bloomberg (http://www.bloomberg.com), the Managed Funds Association (http://www.managedfunds.org), PerTrac data (http://www.pertrac.com), and Form D data. Specific data relevant to the number or types of advisers that would be exempt reporting advisers was not available, but the information located did inform the staff to the probable number of exempt reporting advisers.

attributable to completing a limited number of items in Part 1A as well as the burden attributable to the private fund reporting requirements of Item 7.B. and Section 7.B. of Schedule D. We estimated the burden to complete the subset of items in Part 1A applicable to exempt reporting advisers, above, to be two hours, which would result in an annual burden of approximately 4,000 hours.

As discussed above, we estimate the private fund reporting requirements of the form to be one hour per private fund. We assume that each exempt reporting adviser currently relies on the private adviser exemption and, therefore, has 14 or fewer private fund clients. Based on reporting by registered advisers to private funds and industry publications and reports, we expect each of these advisers, on average, advises five private funds.[423] Accordingly, we would attribute an additional 10,000 burden hours to exempt reporting advisers' private fund reporting requirements.[424]

The estimated total annual hour burden applicable to exempt reporting advisers is 14,000 hours.[425] We believe that most of the paperwork burden would be incurred in advisers' initial submission of private fund data, and that over time this burden would decrease substantially because the paperwork burden would be limited to updating information. Amortizing this total burden imposed by Form ADV over a three-year period, as we did above with respect to the

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423 *Id.* Based upon the reported general number of private funds and the estimated number of advisers to these private funds, it is estimated that each adviser advises five private funds on average. (approximately 10,000 private funds / estimated 2,000 advisers = 5 private funds per adviser.

424 2,000 exempt reporting advisers x 5 private funds/adviser x 1 hour/private fund = 10,000. *See Id.* for 5 funds estimate.

425 4,000 + 10,000 = 14,000.

initial filing for registered advisers, would result in an average burden of an estimated 4,667 hours per year,[426] or 2.33 hours per year, on average, for each exempt reporting adviser.[427]

ii. Estimated Annual Burden Associated with Amendments

In addition to the burdens associated with initial completion and filing of the portion of the form that exempt reporting advisers would be required to prepare, we estimate that, on average, each exempt reporting adviser would prepare an annual updating amendment and 20% of these advisers would file an interim updating amendment.[428] With respect to an exempt reporting adviser's annual updating amendment of Form ADV, we expect that advisers would not have to spend a significant amount of time entering responses into the electronic version of the form to file their annual updating amendments because IARD will automatically pre-populate their prior responses. Based on this consideration, we estimate that the average exempt reporting adviser will spend 1 hour per year completing its annual updating amendment to Form ADV. This estimate is based on our estimate for registered advisers, but it is 85% shorter because exempt reporting advisers would be required to complete and update only a limited number of items in the form, not including Part 2. The other amendment that we estimate 20% of the exempt reporting advisers would file is an interim updating amendment to Items 1, 3, 10 or 11 of Form ADV,[429] and we estimate that this amendment would require 0.5 hours per amendment.

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426 14,000 / 3 = 4,667.

427 4,667 / 2,000 = 2.33.

428 Approximately 20% of advisers with a fiscal year end of December that filed an other-than-amendment changed Item 1 or 11 between April 1, 2009 and December 31, 2009 (period between annual amendment filing time).

429 *See* General Instruction 4 to Form ADV.

We therefore, estimate that the total paperwork burden on exempt reporting advisers of amendments to Form ADV would be 2,200 hours per year.[430]

3. Total Revised Burdens

The revised total annual collection of information burden for registered advisers to file and complete the revised Form ADV (Parts 1 and 2), including the initial burden for both existing and anticipated new registrants, including private fund advisers, plus the burden associated with amendments to the form, preparing brochure supplements and delivering codes of ethics to clients is estimated to be approximately 217,477 hours per year.[431] This burden represents an decrease of 50,980 hours from the current approved burden.[432] This decrease is attributable primarily to the 4,100 advisers that we expect to withdraw from SEC registration.

Registered investment advisers are also expected to incur an annual cost burden of $2,702,000, a reduction from the current approved cost burden of $22,775,400. The decrease in annual cost burden is attributed to the nature of the costs, which are one-time initial costs to draft the narrative brochure. As the transition to the narrative brochure will have substantially been completed, the on-going costs arise from new registrants.

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430 [(2,000 advisers x .20) x 0.5 hours] = 200 hours per year for interim amendments. 2,000 advisers x 1 hour = 2,000 hours per year for annual amendments. 200 + 2,000 = 2,200 hours. Exempt reporting advisers would not incur any burden to prepare new brochure supplements, however, as is required of registered advisers; nor would they be required to meet obligations to deliver codes of ethics to clients, as is also required of registered advisers. Similarly, we have not prepared an estimated annual cost burden to be incurred by exempt reporting advisers because the cost burden attributed to registered advisers is associated with Part 2 obligations to which exempt reporting advisers are not subject.

431 124,257 hours per year attributable to initial preparation of Form ADV + 12,700 hours per year attributable to initial private fund reporting requirements + 59,475 hours per year for amendments to Form ADV + 9,150 hours per year for brochure supplements for new employees + 11,895 hours per year to meet code of ethics delivery obligations = 217,477 hours.

432 Current approved burden of 268,457 hours - revised burden 217,477 hours = 50,980 decrease in hours.

The total annual collection of information burden for exempt reporting advisers to file and complete the required Items of Part 1A of Form ADV, including the burden associated with amendments to the form, would be 6,867 hours.[433]

We estimate that, if the amendments to Form ADV are adopted, the total annual hour burden for the form would decrease by 44,113 hours to 224,344.[434] The resulting blended average per adviser amortized burden for Form ADV would be 20.12 hours,[435] which would consist of an average annual amortized burden of 23.77 hours for the estimated 9,150 registered advisers and 3.43 hours for the estimated 2,000 exempt reporting advisers.[436]

C. Rule 203A-5

Proposed rule 203A-5 would require *each* investment adviser registered with us on July 21, 2011 to file an amendment to its Form ADV no later than August 20, 2011, and withdraw from Commission registration by October 19, 2011, if no longer eligible.[437] The amendment to Form ADV would, among other things, require each adviser to declare whether it remains eligible for Commission registration.[438] The likely respondents to this information collection are all investment advisers registered with the Commission on July 21, 2011, and the investment advisers that withdraw their registration. Compliance with this collection of information is mandatory, and the information collected on Form ADV and Form ADV-W is not kept confidential. We have submitted this collection of information to OMB for review.

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433 4,667 hours per year attributable to initial preparation of Form ADV + 2,200 hours per year for amendments = 6,867 hours.

434 217,477 + 6,867 = 224,344.

435 224,344 / 11,150 = 20.12.

436 Registered advisers (217,477 / 9,150 = 23.77), exempt reporting advisers (6,867/2,000 = 3.43).

437 Proposed rule 203A-5(a), (b). *See supra* section II.A.1. of this Release.

438 *See supra* section II.A.2. of this Release.

We estimate that there would be approximately 11,850 respondents to this collection of information filing an amendment to Form ADV[439] and 4,100 respondents filing Form ADV-W.[440] Each respondent would respond once. For purposes of the collection of information burden for Form ADV, we estimate that the amendment would take each adviser approximately 6 hours per amendment, on average,[441] and that the proposed amendments to Part 1A of Form ADV would take each adviser approximately 4.5 hours, on average, to complete.[442] We also estimate the average burden for each respondent to be 0.25 hours for filing Form ADV-W.[443]

We estimate that the burdens associated with the Form ADV amendment required by rule 203A-5 would be more like an annual amendment with respect to the burden to complete than an other-than-annual amendment, as a result of our proposed changes to Part 1A. Consequently, we estimate the total one-time burden for completing the Form ADV amendments to be 124,425 hours,[444] and for completing Form ADV-W to be 1,025 hours,[445] for a total one-time burden of 125,450 hours.[446]

D. Form ADV-NR

We are proposing minor amendments to Form ADV-NR (OMB Control No. 3235-0238), the form used to appoint the Secretary of the Commission as an agent for service of process for

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439 Based on IARD data as of September 1, 2010, 11,867 investment advisers are registered with the Commission. We have rounded this number to 11,850 for purposes of our analysis.

440 *See supra* note 294.

441 We anticipate that the hour burden for the refiling of Form ADV for purposes of rule 203A-5 would be the same as an adviser's annual amendment filing, which has an approved burden of 6 hours.

442 *See supra* sections V.B.1.a., V.B.2.a.3. of this Release.

443 *See supra* note 304.

444 [6 hours (annual amendment) + 4.5 hours (new items)] x 11,850 = 124,425.

445 0.25 hours x 4,100 = 1,025.

446 124,425 + 1,025 = 125,450.

certain non-resident advisers.[447] Non-resident general partners or managing agents of SEC-registered investment advisers must make a one-time filing of Form ADV-NR with the Commission. Form ADV-NR requires these non-resident general partners or managing agents to furnish us with a written irrevocable consent and power of attorney that designates the Commission as an agent for service of process, and that stipulates and agrees that any civil suit or action against such person may be commenced by service of process on the Commission. The amendments we are proposing reflect that exempt reporting advisers would be filing reports on IARD, and that they would use Form ADV-NR in the same way and for the same purpose as it is currently used by registered investment advisers. The collection of information is necessary for us to obtain appropriate consent to permit the Commission and other parties to bring actions against non-resident partners or agents for violations of the federal securities laws. This collection of information is found at 17 CFR 279.4. The collection of information is mandatory, and the information provided in response to the collection is not kept confidential. The currently approved collection of information in Form ADV-NR is 18 hours.

We estimate that approximately 9,150[448] investment advisers will be registered with the Commission and that approximately 2,000[449] exempt reporting advisers would file reports with the Commission, and that these advisers would file Form ADV-NR at the same annual rate (0.17 percent) as advisers registered with us.[450] Accordingly, we estimate that as a result of the amendments to Form ADV-NR and the change in the number of filers after the effectiveness of

447 *See* proposed amended Form ADV-NR; proposed General Instruction 18.

448 *See supra* note 377 and accompanying text.

449 *See supra* note 422 and accompanying text.

450 From September 1, 2009 through September 1, 2010, 20 Form ADV-NRs were filed with us for an annual rate for all SEC-registered advisers of 0.17%. (20 Form ADV-NR filings/11,850 advisers registered as of Sept. 1, 2010)

the Dodd-Frank Act the annual aggregate information collection burden for Form ADV-NR would be 19 hours, an increase of 1 hour over the currently approved burden.[451]

E. Rule 203-2 and Form ADV-W

We are proposing amendments to rule 203A-2(b), the exemption from the prohibition on registration for certain pension consultants. The proposed amendments would raise the amount of plan assets that an adviser must consult on from $50 to $200 million annually.[452] If we adopt the proposed amendment to rule 203A-2(b), an investment adviser would have to be a pension consultant with respect to assets of plans having an aggregate value of $200 million or more to be able to register with the Commission. Those pension consultants providing consulting services to plans of less than $200 million would be required to file a notice of withdrawal of their registration in accordance with rule 203-2 on Form ADV-W (OMB Control No. 3235-0313). The collection of information on Form ADV-W is mandatory and is not kept confidential. The currently approved collection of information for Form ADV-W is 500 hours for 1,000 responses.

Based on IARD data as of September 1, 2010, there are 353 advisers relying on the pension consultant exemption from registration. We estimate that approximately 15%, or 50, of the current advisers relying on this exemption from the prohibition on registration would no longer be eligible to rely on the exemption if adopted as proposed. This estimate is based on our understanding that a typical pension consultant would have plan assets far in excess of the proposed higher threshold, in light of the fact that most pension plans contain a significant amount of assets.

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451 0.17% (rate of filing) x (9,150 estimated registered investment advisers + 2,000 estimated exempt reporting advisers) x 1 hour per ADV-NR filing = 19.

452 *See* proposed rule 203A-2(a)(1).

The estimated 50 advisers no longer eligible to rely on the exemption, however, would have to file a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act and withdraw their registration based on the proposed amendment to rule 203A-2(b).[453] In addition, as noted above, we estimate that approximately 4,100 advisers also will have to withdraw their Commission registration as a result of the Dodd-Frank Act. Because these advisers are registered today, we further anticipate that these advisers will be switching from SEC to state registration, and as a result will be filing a "partial" Form ADV-W. We have estimated for purposes of our current approved burden under the PRA for rule 203-2 and Form ADV-W, that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser.[454] Thus, we estimate that the proposed amendment to rule 203A-2(b) associated with filing Form ADV-W would generate a burden of 1,038 additional hours[455] in addition to the approved burden of 500 hours for a total of 1,538 hours.

F. Form ADV-H

Proposed rule 204-4(e) would provide a temporary hardship exemption for an exempt reporting adviser having unanticipated technical difficulties that prevent submission of a filing to the IARD system.[456] Currently, rule 203-3(a) provides a similar temporary hardship exemption for registered advisers that file an application on Form ADV-H (OMB Control No. 3235-0538).[457] Like rule 203-3(a), proposed rule 204-4(e) would require advisers relying on the temporary hardship exemption to file an application on Form ADV-H in paper format no later

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453 *See supra* note 318 (discussing the fact that advisers filing Form ADV-W due to our proposed amendment to rule 203A-2(b) would likely file partial withdrawals).

454 *See supra* note 304.

455 (4,100 + 50) responses on Form ADV-W x 0.25 hours = 1,038 hours.

456 Proposed rule 204-4(e).

457 Rule 203-3(a); 17 CFR 279.3 (Form ADV-H). *See supra* note 125 and accompanying text.

than one business day after the filing that is the subject of the Form ADV-H was due, and submit the filing on Form ADV in electronic format with IARD no later than seven business days after the filing was due.[458] If rule 204-4 is adopted as proposed, respondents to the collection of information on Form ADV-H would be exempt reporting advisers, in addition to registered advisers, who are currently respondents to this collection of information. The collection of information on Form ADV-H is mandatory for registered advisers relying on a temporary hardship exemption and would be mandatory for exempt reporting advisers relying on a temporary hardship exemption if rule 204-4 is adopted as proposed. The information collected on Form ADV-H is not kept confidential.

To estimate the currently approved total burden associated with Form ADV-H, we estimated that registered advisers file approximately 11 responses to Form ADV-H per year, which, given the estimated 11,850 advisers currently registered with the Commission, means that approximately 1 response is filed per 1,000 advisers.[459] We further estimated that the average burden per response is approximately 1 hour. Therefore the total approved burden for Form ADV-H is approximately 11 hours per year.[460] Based on the proportion of annual responses to the number of registered advisers, we estimate that exempt reporting advisers would file approximately 2 responses to Form ADV-H annually if rule 204-4 is adopted.[461] We also estimate that Form ADV-H would impose the same average burden per response of 1 hour on

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458 Proposed rule 204-4(e).

459 11,850 registered advisers ÷ 11 responses = approximately 1 response per 1,000 registered advisers)

460 11 responses x 1 hour = 11 hours.

461 We estimate that approximately 2,000 exempt reporting advisers would file reports on Form ADV in accordance with proposed rule 204-4. Thus, we estimate 2 responses to Form ADV-H in accordance with proposed rule 204-4 (2,000 exempt reporting advisers x 1 response per 1000 advisers = 2 responses).

exempt reporting advisers. Thus, proposed rule 204-4 would result in an increase in the total hour burden associated with Form ADV-H of 2 hours.[462] However, as discussed above, the number of registered advisers will decrease due to the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) from 11,850 to 9,150.[463] Given the reduction in registered advisers, we estimate that Form ADV-H will receive 9 annual responses from registered advisers, for a total annual burden for registered advisers of 9 hours.[464] Thus, if rule 204-4 is adopted as proposed, the total burden associated with Form ADV-H would continue to be 11 hours.[465]

G. Rule 204-2

Rule 204-2 (OMB Control No. 3235-0278) requires investment advisers registered, or required to be registered under section 203 of the Act, to keep certain books and records relating to their advisory business.[466] The collection of information under rule 204-2 is necessary for the Commission staff to use in its examination and oversight program, and the information is generally kept confidential.[467] The collection of information is mandatory.

We are proposing to amend rule 204-2 to update the rule's "grandfathering provision" for investment advisers that are currently exempt from registration under the "private adviser" exemption, but will be required to register when the Dodd-Frank Act's elimination of the "private adviser" exemption becomes effective on July 21, 2011.[468] Under the proposed

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462 2 responses x 1 hour = 2 hours.

463 *See supra* note 377.

464 9,150 registered advisers x 1 response per 1,000 advisers = 9 responses. 9 responses x 1 hour = 9 hours.

465 9 hours for registered advisers + 2 hours for exempt reporting advisers = 11 hours.

466 Rule 204-2.

467 *See* section 210(b) of the Advisers Act.

468 *See* proposed rule 204-2(e)(3)(ii); *supra* section II.D.2.b of this Release. In addition, we are proposing to amend rule 204-2(e)(3)(ii) to cross-reference the new definition of "private fund" added to the Advisers Act by the Dodd-Frank Act where that term is used in rule 204-2.

amended grandfathering provision, an adviser that was exempt from registration under section 203(b)(3) of the Advisers Act prior to July 21, 2011 would not be required to maintain certain books and records concerning performance or rate of return of a private fund or other account for any period prior to July 21, 2011, provided the adviser was not registered with the Commission.[469] Most, if not all, advisers likely gather the records and documents necessary to support the calculation of performance or rate of return as those records or documents are produced or at the time a calculation is made. Thus, we do not believe that the proposed amendment to the grandfathering provision would reduce our current approved average annual hourly burden per adviser under rule 204-2.

Although we do not anticipate that our proposed amendments to rule 204-2 would affect the per adviser burden imposed by the rule, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) will change our estimates of the total annual burden associated with the rule.[470] The current approved burden for rule 204-2 is based an estimate of 11,607 registered advisers subject to rule 204-2 and an estimated average burden of 181.45 burden hours each year per

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However, this proposed amendment is technical, and would not increase or decrease the collection burden on advisers. We also intend to rescind rule 204-2(l) because that section was vacated by the federal appeals court in *Goldstein.*

469 Proposed rule 204-2(e)(3)(ii). Rule 204-2 requires registered advisers to make and keep books and records necessary to support the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons. Rule 204-2(a)(16). It requires that advisers maintain and preserve these records in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such records, the first two years in an appropriate office of the investment adviser. Rule 204-2(e)(1). Our proposed grandfathering provision would assure that advisers newly subject to the rule due to elimination of the "private adviser" exemption in existing section 203(b)(3) do not face a retroactively-imposed recordkeeping requirement. However, the proposed grandfathering provision would require these advisers to continue to preserve any books and records in their possession that pertain to the performance or rate of return of a private fund or other account for the two and five year periods.

470 Exempt reporting advisers are not subject to rule 204-2, and therefore there is no offsetting increase in the number of advisers subject to the rule.

adviser, for a total of 2,106,046 hours.[471] We estimate that the Dodd-Frank Act will reduce the number of registered advisers to 9,150.[472] Thus, we estimate that the total burden under rule 204-2 will be 1,660,268,[473] a reduction of 445,778 hours.[474]

The reduction in the number of advisers subject to the rule will also reduce the total non-labor cost burden of the rule. The current approved non-labor cost burden associated with rule 204-2 is $14,581,509, or an average of approximately $1,256 per adviser.[475] Due to the reduction in the number of advisers subject to rule 204-2, we estimate that the new total non-labor cost burden will be $11,492,400,[476] a reduction of $3,089,109.[477]

H. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed amendments to the collection of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

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471 In the Pay to Play Release, we estimated that the average burden for advisers imposed by rule 204-2 to be 181.45 hours. *See* section V.A. of the Pay to Play Release.

472 *See supra* note 377 and accompanying text.

473 9,150 registered advisers x 181.45 hours = approximately 1,660,268.

474 2,106,046 hours – 1,660,268 hours = 445,778 hours.

475 $14,581,509 ÷ 11,607 advisers = approximately $1,256.

476 9,150 x $1,256 = $11,492,400.

477 $14,581,509 - $11,492,400 = $3,089,109.

Persons desiring 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 10102, New Executive Office Building, Washington, DC 20503, and also should 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. S7-36-10. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-36-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this Release. A comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release.

VI. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") regarding our proposed rules and rule amendments to give effect to the Dodd-Frank Act's amendments to the Advisers Act in accordance with section 3(a) of the Regulatory Flexibility Act.[478] It relates to proposed new rules 203A-5 and 204-4, proposed amendments to rules 0-7, 203A-1, 203A-2, 203A-3, 203A-4, 204-1, 204-2, 206(4)-5, 222-1, 222-2, and proposed amendments to Form ADV, Form ADV-NR and Form ADV-H under the Advisers Act.

A. Need for the New Rules and Rule Amendments

The proposed new rules and rule amendments are necessary to give effect to provisions of the Dodd-Frank Act which, among other things, amend certain provisions of the Advisers Act,

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478 5 U.S.C. 603(a).

and to respond to a number of other changes to the Advisers Act made by the Dodd-Frank Act, including the Commission's pay to play rule. In addition, in light of our increased responsibility for oversight of private fund advisers, we are proposing to require advisers to those funds to provide us with additional information about the operation of those funds, which would permit us to provide better oversight of these advisers by focusing our examination and enforcement resources on those advisers to private funds that appear to present greater compliance risks. We also are proposing to require all registered advisers to provide us with additional information on their operations to allow us to more efficiently allocate our examination resources, to better prepare for on-site examinations, and to provide us with a better understanding of the investment advisory industry to assist our evaluation of the implications of policy choices we must make in administering the Advisers Act.

B. Objectives and Legal Basis

The primary objective of the proposed new rules and rule amendments is to give effect to provisions of Title IV of the Dodd-Frank Act that: (i) reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers; (ii) repeal the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act; and (iii) provide for reporting from advisers to certain types of private funds that are exempt from registration.[479] Proposed new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 are intended to provide us a means of identifying advisers that must transition to state regulation, clarify the application of the new statutory provisions under the Dodd-Frank Act, and extend certain of the exemptions we have adopted under section 203A of the Act to mid-sized advisers. Proposed new rule 204-4 and amendments to rule 204-1 are

[479] *See supra* section I of this Release.

intended to require exempt reporting advisers to submit, and to periodically update, reports to us by completing several items on Form ADV. The proposed amendments to rule 204-2 are intended to account for the Dodd-Frank Act's elimination of the "private adviser" exemption under section 203(b)(3) of the Advisers Act and its addition of a definition of "private fund" to the Advisers Act.[480] The proposed amendments to Form ADV would permit the form to serve as a reporting, as well as a registration, form and to specify the seven items exempt reporting advisers must complete. The proposed amendments to Form ADV would also provide additional information on the operations of registered investment advisers. The proposed amendments to Forms ADV-NR and ADV-H would revise the forms for use by exempt reporting advisers. Additionally, we are proposing amendments to the Advisers Act pay to play rule, rule 206(4)-5.[481]

The Commission is proposing new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 under the Advisers Act pursuant to the authority set forth in sections 203A(c), and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3A(c) and 80b-11(a)]; new rule 204-4 and amendments to rules 204-1 and 204-2 pursuant to the authority set forth in sections 204 and 211(a) of the Advisers Act [15 U.S.C. 80b-4 and 80b-11(a)]; amendments to rule 206(4)-5 pursuant to authority set forth in sections 206(4) and 211(a) of the Advisers Act [15 U.S.C. 80b-6(4) and 80b-11(a)]; amendments to rules 0-7, 222-1, and 222-2 pursuant to authority set forth in section 211(a) of the Advisers Act [15 U.S.C. 80b-11(a)]; and to amend Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)],

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480 *See supra* section II.D.2.b. We also intend to rescind section 204-2(l), which was vacated by the federal appeals court in *Goldstein*.

481 *See* proposed rule 206(4)-5; *supra* section II.D.1. of this Release.

section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; Form ADV-NR under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], section 23(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; and Form ADV-H pursuant to the authority set forth in sections 203(c)(1), 204, and 211(a) of the Advisers Act [15 U.S.C. 80b-3(c)(1), 80b-4, 80b-11(a)]. Section 203A(c) gives us authority to permit registration with the Commission of any person or class of persons to which the application of section 203A(a) would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A. Section 206(4) gives us authority to prescribe means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices. Section 211 gives us authority to classify, by rule, persons and matters within our jurisdiction and to prescribe different requirements for different classes of persons, as necessary or appropriate to the exercise of our authority under the Act. Section 204 gives us authority to prescribe, by rule, such records and reports that an adviser must make, keep for prescribed periods, or disseminate, as necessary or appropriate in the public interest or for the protection of investors.

C. Small Entities Subject to Rules and Rule Amendments

In developing these proposals, we have considered their potential impact on small entities that would be subject to the proposed rule and form amendments. The proposed rule and form amendments would affect all advisers registered with the Commission and exempt reporting advisers, including small entities. Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[482]

Our rule and form amendments would not affect most advisers that are small entities ("small advisers") because they are generally registered with one or more state securities authorities and not with us. Under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators.[483] We estimate that as of September 1, 2010, approximately 620 advisers that were small entities were registered with the Commission.[484] Because these advisers are registered, they would be subject to proposed new rule 203A-5 and amendments to rules 0-7, 204-2, 203A-1, 203A-2, 203A-3, and 203A-4, and Forms ADV and ADV-NR. In addition, we estimate that due to the Dodd-Frank Act's elimination of the "private adviser" exemption in section 203(b)(3), an additional 2 advisers that are small entities will become subject to these rules.[485] Further, as a result of our

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482 Rule 0-7(a) [17 CFR 275.0-7(a)].

483 *See supra* section II.A.7.a.

484 Based on IARD data as of September 1, 2010.

485 We believe that the only small entities that would become subject to registration as a result of the elimination of the private adviser exemption in section 203(b)(3) would be advisers to private funds that maintain their principal office and place of business in Wyoming. Based on IARD data as of September 1, 2010, we estimate that 36 SEC-registered small entity advisers are required to be registered with us because they have a principal office and place of business in Wyoming, which is 0.3% of all SEC-registered advisers (36 ÷ 11,850 SEC-registered advisers = approximately 0.3%). We estimate that a similar proportion of the approximately 750 advisers to private funds that will register with the Commission due to the elimination of the private adviser

proposed amendments to rule 203A-2, we estimate that 15 additional multi-state advisers would register with us and be subject to these rules,[486] and 21 pension consultants that are small entity advisers would be required to withdraw from registration with us and would no longer be subject to these rules.[487] We estimate that 6 exempt reporting advisers that are small entities would be subject to proposed rule 204-4, and the proposed amendments to rule 204-1, Form ADV, Form ADV-NR and Form ADV-H to give effect to the Dodd-Frank Act's reporting requirements by exempt reporting advisers.[488] We also estimate that 6 exempt reporting advisers that are small entities would be subject to the proposed amendments to rule 206(4)-5. Finally, all investment advisers, whether they are small entities or not, would be subject to the proposed technical

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exemption in section 203(b)(3) would be small Wyoming-based advisers. As a result, we estimate that approximately 2 small entity advisers to private funds will register with the Commission (750 private fund advisers x 0.3% = approximately 2).

486 *See supra* note 324.

487 Based on IARD data as of September 1, 2010, 142 of the advisers that would be considered small entities rely on the pension consultant exemption from registration. We estimate that approximately 15%, or 21, of these advisers would no longer be eligible to rely on the exemption if adopted as proposed. This ratio is consistent with our estimate for the PRA burden. *See supra* section V.E. of this Release.

488 The only small entity exempt reporting advisers that would be subject to the proposed rule and proposed amendments would be exempt reporting advisers that maintain their principal office and place of business in Wyoming. As discussed *supra* in note 98 and accompanying and preceding text, the current practical effect of section 203A(a)(1) is to prohibit U.S. advisers with less than $25 million in assets under management from registering with the Commission *unless* they maintain their principal office or place of business in Wyoming. Proposed new rule 204-4 requires an adviser relying on an exemption under new sections 203(l) or (m) of the Advisers Act to complete and file reports on Form ADV. *See* proposed rule 204-4; *supra* section II.B.1. of this Release. The exemptions from registration in sections 203(l) and (m) apply to advisers solely to venture capital funds and advisers solely to private funds with less than $150 million in assets under management, respectively. Small Wyoming-based advisers to venture capital funds or private funds may be required to register with the Commission but for the exemptions in section 203(l) or (m). Thus, these advisers would be subject to proposed rule 204-4 and the proposed amendments to rule 204-1, Form ADV, and Form ADV-H to give effect to the Dodd-Frank Act's mandate for reporting by exempt reporting advisers. Assuming that the proportion of registered Wyoming-based small advisers to registered advisers is similar to the proportion of small Wyoming-based exempt reporting advisers to exempt reporting advisers generally, we estimate that approximately 6 exempt reporting advisers that are small entities would be subject to proposed rule 204-4 and the proposed amendments to rule 204-1, Form ADV, and Form ADV-H (2,000 exempt reporting advisers x 0.3% = 6 small Wyoming-based exempt reporting advisers).

amendments to rules 222-1 and 222-2. The small entities subject to these amendments include approximately 6 exempt reporting advisers and approximately 14,700 state-registered advisers.[489]

D. Reporting, Recordkeeping and Other Compliance Requirements

The proposed rules and rule and form amendments would impose certain reporting, recordkeeping, and compliance requirements on advisers, including small advisers. The proposals would require all of the small advisers registered with us to file an amended Form ADV, would require some to file Form ADV-W, and would require some to file reports as exempt reporting advisers. The amendments also would cause the adviser to be subject to the existing recordkeeping and compliance requirements for SEC-registered advisers. These requirements and the burdens on small advisers are discussed below.[490]

Transition to State Registration

Proposed rule 203A-5 would impose costs on all investment advisers, including small advisers, by requiring *each* investment adviser registered with us to file an amendment to its Form ADV no later than August 20, 2011 (30 days after the July 21, 2011 effective date of the amendments to section 203A), and withdraw from Commission registration by October 19, 2011 (60 days after the required filing of Form ADV), if no longer eligible.[491] We estimate that all of

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489 Based on IARD data as of July 1, 2010, we estimate that there were approximately 14,700 state-registered advisers. Because section 203A currently precludes most advisers with less than $25 million in assets under management from registering with the Commission, we assume that nearly all of the 14,700 state-registered advisers are small entities. Therefore, 14,700 small entities (registered with the states as of July 1, 2010) + 21 small entities (registering with the states due to the proposed amendment to the pension consultant exemption in rule 203A-2(b)) – 2 small entities (registering due to elimination of the private adviser exemption in section 203(b)(3)) – 15 small entities (de-registering with the states and registering with the Commission due to the proposed amendment to the multi-state adviser exemption in rule 203A-2(e)) = approximately 14,704 state-registered advisers that are small entities.

490 *Supra* sections I through II of this Release, describe these requirements in more detail.

491 Proposed rule 203A-5(a); (b). *See supra* section II.A.1. of this Release.

the 620 small advisers currently registered with the Commission would file Form ADV, but none would withdraw registration because the Dodd-Frank Act does not change the eligibility requirements for small advisers registered with us because they rely on one or more of the exemptions from the prohibition on registration.[492]

Switching Between State and Commission Registration

The proposed amendments to rule 203A-1 would eliminate the $5 million buffer in current rule 203A-1(a), which permits but does not require an adviser to register with the Commission if the adviser has between $25 million and $30 million of assets under management.[493] By definition, a small adviser under the Advisers Act has less than $25 million in assets under management, so elimination of this rule should have no impact on small advisers.[494]

Exemptions from the Prohibition on Registration with the Commission

The amendments we are proposing to two of the three exemptions from the prohibition on registration in rule 203A-2 would cause small advisers to be subject to new reporting, recordkeeping, and other compliance requirements.[495] The proposed amendment to the exemption from the prohibition on registration available to pension consultants in rule 203A-2(b) would increase the minimum value of plan assets from $50 million to $200 million.[496] We

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492 *See* section 410 of the Dodd-Frank Act.

493 *See* proposed rule 203A-1; *supra* section II.A.4. of this Release.

494 *See* rule 0-7(a)(1).

495 *See* proposed rule 203A-2; *supra* section II.A.5. of this Release. The proposed elimination of the exemption from the prohibition on Commission registration for NRSROs in rule 203A-2(a) would not affect small advisers because based on IARD data as of September 1, 2010 only one NRSRO remains registered under the Act and it reports that it has more than $100 million of assets under management. Therefore, it would neither be a small adviser nor rely on the exemption.

496 We also propose to renumber the rule as rule 203A-2(a). *See* proposed rule 203A-2(a); *supra* section II.A.5.b. of this Release.

estimate that this may cause approximately 21 small adviser pension consultants to be required to withdraw from registration with us by filing Form ADV-W and thus no longer be subject to Commission rules.[497] These advisers would likely need to register with one or more states, and comply with the states' recordkeeping and other regulatory requirements. This would have a negative impact on competition for these advisers compared to pension consultants with more than $200 million of plan assets that would remain registered with the Commission.

The proposed amendment to the multi-state adviser exemption in rule 203A-2(e) would permit investment advisers required to register as an investment adviser with 15 or more states, instead of 30 or more states under the current rule, to register with the Commission.[498] An investment adviser relying on this exemption would continue to report certain information on Form ADV[499] and maintain a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register. This would promote efficiency and competition by making the standards for the multi-state exemption consistent for small and mid-sized advisers. We estimate that, in addition to the approximately 23 small advisers that rely on the exemption currently, approximately 15 would begin relying on the exemption if amended as proposed.[500] Advisers newly relying on the proposed amended exemption would incur costs associated with completing and filing Form ADV for purposes of registration with the Commission, and all of the advisers relying on the exemption will incur the costs associated with

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[497] *See supra* notes 318-321 and accompanying text; *supra* note 487 and accompanying text.

[498] We also propose to renumber the rule as rule 203A-2(d). *See* proposed rule 203A-2(d); *supra* section II.A.5.c. of this Release.

[499] Advisers would be required to: (i) include a representation on Schedule D of Form ADV that the investment adviser has concluded that it must register as an investment adviser with 15 or more states; and (ii) undertake to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 states to register as an investment adviser with those states. *See* proposed rule 203A-2(d)(2).

[500] *See supra* note 324.

keeping records sufficient to demonstrate that they would be required to register with 15 or more states.[501] In addition, these advisers will incur costs of complying with the Advisers Act and our rules, but they may see an absolute reduction in compliance costs by registering with the Commission instead of 15 or more states.[502]

Elimination of Safe Harbor

The proposed elimination of rule 203A-4, which provides a safe harbor from Commission registration for an investment adviser based on a reasonable belief that it is prohibited from registering with the Commission because it does not have at least $30 million of assets under management, would not create new requirements for small advisers.[503] These advisers would not have at least $30 million of assets under management, and advisers have not, in our experience, asserted the availability of this safe harbor.

Mid-Sized Advisers

Our proposal to incorporate into Form ADV an explanation of how we construe the determination of whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers from registering with the Commission would not create new reporting requirements for small advisers.[504] The mid-sized adviser requirements would only apply to advisers with assets under management between $25 million and $100 million and would therefore not apply to small advisers.

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[501] *See supra* notes 325-327 and accompanying text.

[502] *See supra* note 323 and accompanying text.

[503] Rule 203A-4. *See supra* section II.A.6. of this Release.

[504] *See* proposed Form ADV: Instructions for Part 1A, instr. 2.b.; *supra* section II.A.7. of this Release.

Exempt Reporting Advisers

Proposed rule 204-4 and the proposed amendments to rules 204-1, Form ADV, and Form ADV-H to require exempt reporting advisers to file reports with the Commission electronically on Form ADV would impose reporting requirements on an estimated 6 small advisers.[505] As discussed above, we estimate that completing and filing Form ADV will cost $1,764 for each exempt reporting adviser.[506] In addition, small exempt reporting advisers would be required to pay an estimated filing fee of $200 annually,[507] for a total of $1,200 for the estimated 6 small exempt reporting advisers.[508] Finally, under rule 204-4 exempt reporting advisers that seek a temporary hardship exemption from electronic filing would be required to complete and file Form ADV-H.[509] To the extent that either of the estimated two small exempt reporting advisers file Form ADV-H, we have estimated that it would require 1 burden hour at a total cost of $204.[510]

Amendments to Form ADV

Proposed amendments to Form ADV would require registered advisers to report different or additional information than what is currently required. Approximately 620 small advisers currently registered with us, and two advisers currently relying on the private adviser exemption that we expect will register with us, would be subject to these requirements.[511] We expect these 620 advisers would spend, on average, 4.5 hours to respond to the new and amended questions

505 *See supra* note 488.

506 *See supra* note 338 and accompanying text. $3,528,000/2,000 = $1,764.

507 *See supra* section IV.B.2. of this Release (discussing the potential filing fee).

508 $200 x 6 small exempt reporting advisers = $1,200.

509 Proposed rule 204-4(e).

510 *See supra* section IV.B.2. of this Release.

511 *See supra* notes 484-485 and accompanying text.

we are proposing today, other than the private fund reporting requirements.[512] We expect the aggregate cost associated with this process would be $703,080.[513] The two anticipated newly registering advisers would spend, in the aggregate, about 82 hours total to complete the form (Part 1 except for the private fund reporting requirements, and Part 2) as well as to amend the form periodically, to prepare brochure supplements, and to deliver codes of ethics to clients,[514] for a total cost of $20,664.[515] In addition, of these approximately 620 registered advisers, we estimate that 200 advise one or more private funds and would have to complete the private fund reporting requirements we are proposing today.[516] We expect this will take 600 hours,[517] in the aggregate, for a total cost of $151,200.[518] The total estimated labor costs associated with our amendments that we expect will be borne by small advisers, therefore, are $874,944.

512 *See supra* text preceding note 388. We are calculating costs only of the increased burden because we have previously assessed the costs of the other items of Form ADV for registered advisers and for new advisers attributed to annual growth. The amendments we are proposing today would increase neither the burden associated with these items on Form ADV, nor the external costs associated with certain Part 2 requirements.

513 We expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $210 and $294 per hour, respectively. 620 advisers x 4.5 hours = 2,790 hours. [1,395 hours x $210 = $292,950] + [1,395 hours x $294 = $410,130] = $703,080.

514 2 advisers x 40.74 hours per adviser to complete the entire form (except private fund reporting requirements) = 81.48 hours.

515 [41 hours x $210 = $8,610] + [41 hours x $294 = $12,054] = $20,664. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

516 *See supra* note 404.

517 We expect these advisers are likely to advise 3 funds each. *See* text accompanying note 405. We estimated above that private fund reporting would take an adviser approximately 1 hour per fund to complete. 200 advisers x 3 hours = 600 hours.

518 [300 hours x $210 = $63,000] + [300 hours x $294 = $88,200] = $151,200. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 354.

Additionally, we estimate that one of the newly registering advisers would use outside legal services to assist them in preparing their Part 2 brochure, for a total non-labor cost of $3,200.[519]

Amendments to Pay to Play Rule

Our proposed amendment to rule 206(4)-5 to make it apply to exempt reporting advisers and foreign private advisers would not create new reporting, recordkeeping, or other compliance requirements on these advisers.[520] Rather, we are proposing this amendment to ensure that the rule continues to apply to these advisers and to prevent the unintended narrowing of the rule.[521] Our proposed amendment to permit an adviser to pay any registered municipal advisor subject to a pay to play rule adopted by MSRB to solicit government entities on its behalf may create new recordkeeping and compliance requirements on investment advisers that are small entities subject to the rule to the extent that they have to verify and document that placement agents that they hire to solicit government entities are indeed registered municipal advisors.[522] Finally, our technical amendment to rule 206(4)-5's definition of a "covered associate"[523] of an investment adviser to clarify that a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser would meet the definition, would not create any new reporting, recordkeeping, or other compliance requirements.[524]

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519 The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants. The non-labor costs for Form ADV are based on an estimate that 50% of small advisers will retain either legal services (at $3,200) or compliance consulting services (at $3,000) to assist in the preparation of Form ADV. *See supra* note 420 and accompanying text.

520 *See supra* section II.D.1 of this Release (discussing these amendments).

521 *See id.*

522 *See id.*

523 *See id.*

524 *See id.*

Other Amendments

Our proposed amendments to rule 204-2's grandfathering provision are meant to ensure that private fund advisers that are required to register as a result of the Dodd-Frank Act's elimination of the private fund exemption in section 203(b)(3) would not face a retroactive recordkeeping requirement.[525] Our proposed technical amendment to rule 204-2(e)(3)(ii) would add a cross-reference to the new definition of a private fund in section 202(a)(29) of the Advisers Act.[526] These amendments would not create reporting, recordkeeping, and other compliance requirements for small entities independent of the reporting, recordkeeping, and other compliance requirements imposed by current rule 204-2.[527]

We do not believe that our proposed technical amendments to rules 0-7, 222-1, and 222-2 would impose reporting, recordkeeping, and other compliance requirements on small advisers.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that there are no proposed rules that duplicate, overlap, or conflict with the proposed rules and rule and form amendments.

F. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed rule amendments, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting

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525 *See supra* note 231 and accompanying text.

526 *See supra* section II.D.2.b of this Release.

527 The Dodd-Frank Act's removal of the private adviser exemption in section 203(b)(3) may require additional small advisers to register with the Commission. Therefore these small entities would become subject to rule 204-2 with its reporting, recordkeeping, and other compliance burdens. However, subjecting these entities to rule 204-2 is a function of the Dodd-Frank Act's removal of the private adviser exemption in section 203(b)(3), not our proposed amendments to rule 204-2.

requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for such small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rules, or any part thereof, for such small entities.

Regarding the first and fourth alternatives, we do not believe that differing compliance or reporting requirements or an exemption from coverage of the new rules or rule amendments, or any part thereof, for small entities, would be appropriate or consistent with investor protection or with Congress's mandate in the Dodd-Frank Act, to the extent the new rule or amendment is being proposed due to a Congressional mandate. Because the protections of the Advisers Act are intended to apply equally to clients of both large and small advisory firms, it would be inconsistent with the purposes of the Act to specify different requirements for small entities under the proposed rules and amendments unless expressly required to do so by Congress.

Regarding the second alternative, proposed rule 203A-5 would enable small advisers to easily and efficiently identify whether they are subject to our regulatory authority after the Dodd-Frank Act's amendment to section 203A becomes effective, and would also help minimize any potential uncertainty about the effects of the Dodd-Frank Act on their registration status by providing a simple, efficient means of determining their post-Dodd-Frank registration status as of a specific date. The proposed amendments to rule 203A-1 eliminate the $5 million buffer because it seems unnecessary in light of Congress's determination to require many (although not all) advisers having between $30 million and $100 million of assets under management to be registered with the states,[528] and makes the registration requirements for advisers with assets under management between $25 million and $30 million uniform with the requirements for

528 *See supra* note 67.

advisers with assets under management between $30 million and $100 million. Our proposal to amend the multi-state adviser exemption in rule 203A-2(e) also would consolidate and simplify compliance for small advisers by aligning the rule with the multi-state exemption Congress built into the mid-sized adviser provision under section 410 of the Dodd-Frank Act and by requiring one standard for advisers relying on the exemption.[529] This amendment also would reduce the compliance burdens on advisers required to be registered with at least 15 states, but less than 30, by allowing them to register with a single securities regulator—the Commission. Furthermore, our proposal to use an existing form, Form ADV, and an existing filing system, IARD, for reporting and registration purposes will clarify and simplify the processes of registering and/or reporting for small entities because: (i) all of the information collection requirements for both registration and reporting would be consolidated in a single form; (ii) a small exempt reporting adviser would be able to use the same form and filing system both for reporting and for purposes of registering with one or more state securities authorities; and (iii) a small exempt reporting adviser may find that it can no longer rely on an exemption from registration with the Commission and would be able to register simply by filing an amendment to its current Form ADV to apply for registration.[530]

Regarding the third alternative, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection or with Congress's mandate in the Dodd-Frank Act.

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529 *See* proposed rule 203A-2(d); *supra* section IV.A.1. of this Release. Under rule 203A-2(e), the prohibition on registration with the Commission does not apply to an investment adviser that is required to register with 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register with at least 25 states. We propose to amend rule 203A-2(e) to permit all investment advisers required to register as an investment adviser with 15 or more states to register with the Commission.

530 *See supra* section II.C. of this Release.

G. Solicitation of Comments

We encourage written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on:

- the number of small entities subject to the proposed rules and rule and form amendments; and
- whether the effect of the proposed rules and rule and form amendments on small entities would be economically significant.

Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect.

VII. EFFECTS ON COMPETITION, EFFICIENCY AND CAPITAL FORMATION

The Commission is proposing to adopt certain new rules and to amend others pursuant to its authority under section 204(a) of the Advisers Act,[531] and sections 23(a) and 28(e)(2) of the Exchange Act.[532] Section 204(a) of the Advisers Act and section 28(e)(2) of the Exchange Act require the Commission, when engaging in rulemaking under the authority provided in those sections, to consider whether the rule is "necessary or appropriate in the public interest or for the protection of investors."[533] Section 202(c) of the Advisers Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[534] Section 3(f) of the Exchange Act requires the Commission, when engaging in rulemaking that requires it to

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531 15 U.S.C. 80b-4(a).

532 15 U.S.C. 78w(a) and 78bb(e)(2).

533 15 U.S.C. 80b-4(a) and 78bb(e)(2).

534 15 U.S.C. 80b-2(c).

consider or determine whether an action is necessary or appropriate in the public interest to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[535] Section 23(a) of the Exchange Act requires the Commission, in adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition, and 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.[536]

The Commission is proposing to adopt rule 204-4 and to amend rules 204-1 and 204-2 and Forms ADV, ADV-NR, and ADV-H.[537] The proposed new rule and rule and form amendments are designed to give effect to provisions of Title IV of the Dodd-Frank Act.[538] We are proposing new rule 204-4 to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.[539] We are also proposing amendments to Form ADV to improve our risk-assessment capabilities and so that it can serve the dual purpose of both an SEC reporting form for exempt reporting advisers and, as it is used today, a registration form for both state and SEC-registered firms.[540] In addition to requiring that exempt reporting advisers use Form ADV, proposed rule 204-4 would require these advisers to submit reports through the

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535 15 U.S.C. 78c(f).

536 15 U.S.C. 78w(a)(2).

537 In contrast, we are proposing new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 pursuant to our authority set forth in sections 203A(c) and 211(a), amendments to rules 0-7, 222-1, and 222-2 pursuant to our authority set forth in section 211(a), and amendments to rule 206(4)-5 pursuant to our authority set forth in sections 206(4) and 211(a). For a discussion of the effects of this proposed new rule and rule amendments on competition, efficiency, and capital formation, see *supra* sections IV., V., and VI. of this Release.

538 For a discussion of the overall objectives of our proposals, see *supra* section I of this Release.

539 Proposed rule 204-4. *See supra* section II.B.1. of this Release.

540 *See supra* sections II.B. and II.C. of this Release.

IARD and to pay a filing fee.[541] We are also proposing to amend rule 204-1, which addresses when and how advisers must amend their Form ADV, to add a requirement that exempt reporting advisers file updating amendments to reports filed on Form ADV.[542]

A. Proposed Exempt Reporting Adviser Reporting Requirements

The Dodd-Frank Act provides that the Commission shall require reporting by exempt reporting advisers, but it does not indicate the information we should collect or the filing method by which it should be collected. Our choices, in proposing rule 204-4 to require these advisers to complete a sub-set of items contained in Form ADV and to file through the IARD, and in proposing to amend rule 204-1 to impose periodic updating requirements of those filings, would impose costs on exempt reporting advisers,[543] but would also create efficiencies that benefit both us and filers by taking advantage of an established and proven adviser filing system and avoiding the expense and delay of developing a new form and filing system. Additionally, we believe this proposal may create efficiencies to the extent exempt reporting advisers may be required to register on Form ADV with one or more state securities authorities because they would be using the existing form and filing system that is also used by the states, which should reduce regulatory burdens.[544] Similarly, regulatory burdens would be diminished for an exempt reporting adviser that later finds it can no longer rely on an exemption and would be required to register with us

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541 Proposed rule 204-4(b). Proposed rule 204-4(e) would also allow exempt reporting advisers having unanticipated technical difficulties that prevent submission of a filing to the IARD system to request a temporary hardship exemption from electronic filing requirements by filing Form ADV-H. We are also proposing technical amendments to Form ADV-H for this purpose.

542 *See* proposed rule 204-1; *supra* section II.B.3. of this Release.

543 For a discussion of the costs of the reporting obligations we are proposing to apply to exempt reporting advisers, see section IV.B.2, of this Release.

544 *See supra* section IV.A.2. of this Release.

because the adviser would simply file an amendment to its current Form ADV to apply for Commission registration.[545]

Using Form ADV and IARD would also enable investors to access information on our website that may have previously been unavailable or not easily attainable, such as whether a prospective exempt reporting adviser has reported disciplinary events and whether its relationships with affiliates present conflicts of interest or potential efficiencies. Public access to this information, which may previously have been undisclosed, may promote competition to the extent that it would allow private fund investors to make informed decisions about these advisers, avoiding the burdens and costs associated with selling private funds to switch advisers at a later date, and thereby potentially creating efficiency gains in the marketplace and improving allocation of client assets among investment advisers. The availability of disciplinary information, in particular, about these advisers and their supervised persons may also enhance competition if, for example, firms and personnel with better disciplinary records outcompete those with worse records. Alternatively, the choices that we have made about the information these advisers would report (and that we would make publicly available), such as the identification of owners of the adviser or disciplinary information, could impose costs on advisers, including the potential loss of business to competitors (who may or may not report to us or be registered with us), as this information may not typically be made available to others.

Access to the information we propose to require exempt reporting advisers to report may also increase clients' and prospective clients' trust in investment advisers, which may encourage them to seek professional investment advice and encourage them to invest their financial assets.

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545 *See* proposed General Instruction 14 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser). *See also supra* note 128 and accompanying text. Certain items in Form ADV Part 1 are also linked to Form B-D, which would create efficiencies if the exempt reporting adviser ever applies for broker-dealer registration.

This may enhance capital formation by making more funds available for investment and enhancing the allocation of capital generally. On the other hand, to the extent that the information we propose to collect and the filing method by which we propose to collect it imposes costs on exempt reporting advisers that are then passed on to clients, this may deter clients from seeking professional investment advice and investing their financial assets. This may result in inefficiencies in the market for advisory services and hinder capital formation.

B. Proposed Risk-Assessment Amendments to Form ADV

The amendments to Form ADV we are proposing today are designed to improve advisers' disclosure of their business practices (particularly, those relating to advising private funds), non-advisory activities and financial industry affiliations, and other conflicts of interest. Private fund reporting, in particular, would benefit private fund investors and other market participants and would provide us and other policy makers with better data. Better data would enhance our ability to form and frame regulatory policies regarding the private fund industry and fund advisers, and to evaluate the effect of our policies and programs on this sector. Private fund reporting would provide us with important information about this rapidly growing segment of the U.S. financial system. Additionally, data about which advisers have $1 billion or more of assets would enable us to identify the advisers that are covered by section 956 of the Dodd-Frank Act addressing certain incentive-based compensation arrangements.

As acknowledged above with respect to exempt reporting advisers, there may also be competitive impacts between registered investment advisers as a result of the collection of the proposed additional information on Form ADV. For instance, information regarding the amount of assets under management by specific types of clients could be used by competitors when marketing their own advisory services. Another example includes the information concerning private funds that we propose to require registered and exempt reporting advisers to submit on Form ADV, which could assist private fund investors in assessing investment choices or screen funds based on certain parameters such as the identification of certain fund service providers or gatekeepers. Similarly, this information could be used by other financial service providers (such as banks or broker-dealers) that do not provide similar information publicly. Increased competition among investment advisers (both exempt reporting and registered) and other financial service providers may result in capital being allocated more efficiently, benefiting clients and certain advisers.

Better disclosure may increase clients' and prospective clients' trust in investment advisers, which may encourage them to seek professional investment advice and encourage them to invest their financial assets. This also may enhance capital formation by making more funds available for investment and enhancing the allocation of capital generally. On the other hand, if the rule amendments increase costs for investment advisers and these cost increases are passed on to clients, this may deter clients from seeking professional investment advice and investing their financial assets. This may result in inefficiencies in the market for advisory services and hinder capital formation.

C. Other Proposed Amendments

Finally, we are proposing to amend rule 204-2 to cross-reference the new definition of private fund and add a grandfathering provision relieving firms that were exempt from registration prior to the effectiveness of the Dodd-Frank Act's elimination of the "private adviser" exemption from certain recordkeeping obligations applicable to registered advisers.[546] We also are amending Forms ADV-NR and Form ADV-H to provide for their use by exempt

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[546] *See* proposed rule 204-2; *supra* section II.D.2.b of this Release. We also intend to rescind rule 204-2(l) because that section was vacated by the federal appeals court in *Goldstein.*

reporting advisers. The proposed amendments to rule 204-2, Form ADV-NR, and Form ADV-H are technical in nature. We do not anticipate that they would have any bearing on efficiency, competition, or capital formation.

D. Request for Comment

The Commission requests comment whether the proposed rule and rule amendments would, if adopted, promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data to support their views.

VIII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[547] the Commission must advise OMB whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in: (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment, or innovation.

We request comment on the potential impact of the proposed new rule and proposed rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

IX. STATUTORY AUTHORITY

The Commission is proposing new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 under the Advisers Act pursuant to the authority set forth in sections 203A(c), and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3A(c) and 80b-11(a)]; new rule 204-4 and amendments to rules 204-1 and 204-2 pursuant to the authority set

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547 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. and 15 U.S.C., and as a note to 5 U.S.C. 601).

forth in sections 204 and 211(a) of the Advisers Act [15 U.S.C. 80b-4 and 80b-11(a)]; amendments to rule 206(4)-5 pursuant to authority set forth in sections 206(4) and 211(a) of the Advisers Act [15 U.S.C. 80b-6(4) and 80b-11(a)]; amendments to rules 0-7, 222-1, and 222-2 pursuant to authority set forth in section 211(a) of the Advisers Act [15 U.S.C. 80b-11(a)]; and to amend Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; Form ADV-NR under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], section 23(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; and Form ADV-H pursuant to the authority set forth in sections 203(c)(1), 204, and 211(a) of the Advisers Act [15 U.S.C. 80b-3(c)(1), 80b-4, 80b-11(a)].

List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements; Securities.

TEXT OF RULE AND FORM AMENDMENTS

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

PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

2. The authority citation for Part 275 is amended by adding authority for sections 275.203A-5, 275.204-1 and 275.204-4 to read as follows:

Section 275.203A-5 is also issued under 15 U.S.C. 80b-3a.

Section 275.204-1 is also issued under sec. 407 and 408, Pub. L. 111-203, 124 Stat. 1376.

Section 275.204-4 is also issued under sec. 407 and 408, Pub. L. 111-203, 124 Stat. 1376.

3. Section 275.0-7 is amended by revising the reference to "Section 203A(a)(2)" in paragraph (a)(1) to read "Section 203A(a)(3)."

4. Section 275.203A-1 is amended by revising the heading, paragraphs (a) and (b) to read as follows:

§ 275.203A-1 Switching to or from SEC registration.

(a) *State-registered advisers—switching to SEC registration.* If you are registered with a state securities authority, you must apply for registration with the Commission within 90 days of filing an annual updating amendment to your Form ADV reporting that you are eligible for SEC registration and are not relying on an exemption from registration under sections 203(l) or 203(m) of the Act (15 U.S.C. 80b-3(l), (m)).

(b) *SEC-registered advisers—switching to State registration.* If you are registered with the Commission and file an annual updating amendment to your Form ADV reporting that you are not eligible for SEC registration and are not relying on an exemption from registration under sections 203(l) or 203(m) of the Act (15 U.S.C. 80b-3(l), (m)), you must file Form ADV-W (17 CFR 279.2) to withdraw your SEC registration within 180 days of your fiscal year end (unless you then are eligible for SEC registration). During this period while you are registered with both the Commission and one or more state securities authorities, the Act and applicable State law will apply to your advisory activities.

5. Section 275.203A-2 is amended by:

a. Removing paragraph (a);

b. Redesignating paragraphs (b) through (f) as paragraphs (a) through (e);

c. Revising paragraph (a)(1);

d. Revising the reference to "paragraph (b) of this section" in paragraph (a)(2) to read "paragraph (a) of this section";

e. Revising paragraph (c)(1);

f. Revising the reference in paragraph (c)(3) to "§275.203A-1(b)(2)" to "§275.203A-1(b)";

g. Revising paragraph (d)(1);

h. Revising and redesignating paragraphs (d)(2) and (d)(3) as paragraphs (d)(2)(i) and (d)(2)(ii);

i. Redesignating paragraph (d)(4) as paragraph (d)(3);

j. Revising the reference to "paragraph (f) of this section" in paragraph (e)(1)(ii), (e)(1)(iii), and (e)(2) to read "paragraph (e) of this section";

k. Revising the reference to "paragraph (f)(1)(i) of this section" in paragraph (e)(1)(ii) to read "paragraph (e)(1)(i) of this section";

l. Revising the reference "paragraph (c) of this section" in paragraph (e)(1)(iii) to read "paragraph (b) of this section"; and

m. Revising the reference "§ 275.203(b)(3)-1" in paragraph (e)(3) to "§ 275.202(a)(30)-1".

The revisions read as follows:

§ 275.203A-2 Exemptions from prohibition on Commission registration.

* * *

(a) *Pension Consultants.* (1) An investment adviser that is a "pension consultant," as defined in this section, with respect to assets of plans having an aggregate value of at least $200,000,000.

(2) * * *

(c) * * *

(1) Immediately before it registers with the Commission, is not registered or required to be registered with the Commission or a state securities authority of any State and has a reasonable expectation that it would be eligible to register with the Commission within 120 days after the date the investment adviser's registration with the Commission becomes effective;

(2) * * *

(3) Notwithstanding §275.203A–1(b) of this chapter, files a completed Form ADV-W (17 CFR 279.2) withdrawing from registration with the Commission within 120 days after the date the investment adviser's registration with the Commission becomes effective.

(d) * * *

(1) Upon submission of its application for registration with the Commission, is required by the laws of 15 or more States to register as an investment adviser with the state securities authority in the respective States, and thereafter would, but for this section, be required by the

laws of at least 15 States to register as an investment adviser with the state securities authority in the respective States;

(2) Elects to rely on paragraph (d) of this section by:

(i) Indicating on Schedule D of its Form ADV that the investment adviser has reviewed the applicable State and federal laws and has concluded that, in the case of an application for registration with the Commission, it is required by the laws of 15 or more States to register as an investment adviser with the state securities authorities in the respective States or, in the case of an amendment to Form ADV, it would be required by the laws of at least 15 States to register as an investment adviser with the state securities authorities in the respective States, within 90 days prior to the date of filing Form ADV; and

(ii) Undertaking on Schedule D of its Form ADV to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 States to register as an investment adviser with the state securities authority in the respective States, and that the investment adviser would be prohibited by section 203A(a) of the Act (15 U.S.C. 80b–3a(a)) from registering with the Commission, by filing a completed Form ADV-W within 180 days of the adviser's fiscal year end (unless the adviser then has at least $100 million of assets under management or is otherwise eligible for SEC registration); and

(3) * * *

(e) * * *

(ii) Maintains, in an easily accessible place, for a period of not less than five years from the filing of a Form ADV that includes a representation that the adviser is eligible to register with the Commission under paragraph (e) of this section, a record demonstrating that it provides investment advice to its clients exclusively through an interactive website in accordance with the limits in paragraph (e)(1)(i) of this section; and

(iii) Does not control, is not controlled by, and is not under common control with, another investment adviser that registers with the Commission under paragraph (b) of this section solely in reliance on the adviser registered under paragraph (e) of this section as its *registered adviser.*

(2) For purposes of paragraph (e) of this section, *interactive website* means a website in which computer software-based models or applications provide investment advice to clients based on personal information each client supplies through the website.

(3) An investment adviser may rely on the definition of *client* in §275.202(a)(30)–1 in determining whether it provides investment advice to fewer than 15 clients under paragraph (e)(1)(i) of this section.

6. Section 275.203A-3 is amended by revising paragraph (a)(4) and adding paragraphs (d) and (e) to read as follows:

§ 275.203A-3 Definitions.

* * * * *

(a) * * *

(4) Supervised persons may rely on the definition of "client" in §275.202(a)(30)–1 to identify clients for purposes of paragraph (a)(1) of this section, except that supervised persons need not count clients that are not residents of the United States.

(b) * * *

(d) *Assets under management.* Determine "assets under management" by calculating the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services as reported on the investment adviser's Form ADV (17 CFR 279.1).

(e) *State securities authority.* "State securities authority" means the securities commissioner or commission (or any agency, office or officer performing like functions) of any State.

7. Section 275.203A-4 is removed and reserved.

8. Section 275.203A-5 is added to read as follows:

§ 275.203A-5 Transition rules.

(a) Every investment adviser registered with the Commission on July 21, 2011 shall file an other-than-annual amendment to Form ADV (17 CFR 279.1) no later than August 20, 2011 and shall determine its assets under management based on the current market value of the assets as determined within 30 days prior to the date of filing the Form ADV.

(b) If an investment adviser registered with the Commission on July 21, 2011 would be prohibited from registering with the Commission under section 203A(a)(2) of the Act (15 U.S.C. 80b-3a(a)(2)), and is not otherwise exempted by § 275.203A-2 from such prohibition, such investment adviser shall withdraw from registration with the Commission by filing Form ADV-W (17 CFR 279.2) no later than October 19, 2011. During this period while an investment adviser is registered with both the Commission and one or more state securities authorities, the Act and applicable State law will apply to the investment adviser's advisory activities.

(c) If, prior to the effective date of the withdrawal from registration of an investment adviser on Form ADV-W, the Commission has instituted a proceeding pursuant to section 203(e) of the Act (15 U.S.C. 80b-3(e)) to suspend or revoke registration, or pursuant to section 203(h) of the Act (15 U.S.C. 80b-3(h)) to impose terms or conditions upon withdrawal, the withdrawal from registration shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

9. Section 275.204-1 is amended by revising the heading, paragraphs (b) and (c) to read as follows:

§ 275.204-1 Amendments to Form ADV.

* * * * *

(b) Electronic filing of amendments.

(1) Subject to paragraph (c), you must file all amendments to Part 1A of Form ADV and Part 2A of Form ADV electronically with the IARD, unless you have received a continuing hardship exemption under §275.203-3. You are not required to file with the Commission amendments to brochure supplements if required by Part 2B of Form ADV.

(2) If you have received a continuing hardship exemption under §275.203-3, you must, when you are required to amend your Form ADV, file a completed Part 1A and Part 2A of Form ADV on paper with the SEC by mailing it to FINRA.

Note to paragraphs (a) and (b): Information on how to file with the IARD is available on our website at www.sec.gov/iard. For the annual updating amendment: (i) summaries of material changes that are not included in the adviser's brochure must be filed with the Commission as an exhibit to Part 2A in the same electronic file; and (ii) if you are not required to prepare a brochure, a summary of material changes, or an annual updating amendment to your brochure, you are not required to file them with the Commission. See the instructions for Part 2A of Form ADV.

(c) Transition to electronic filing. If you are required to file a brochure and your fiscal year ends on or after December 31, 2010, you must amend your Form ADV by electronically filing with the IARD one or more brochures that satisfy the requirements of Part 2A of Form ADV (as amended effective October 12, 2010) as part of the next annual updating amendment that you are required to file.

* * * * *

10. Section 275.204-2 is amended by removing paragraph (l), and revising paragraph (e)(3)(ii) to read as follows:

§ 275.204-2 Books and records to be maintained by investment advisers.

* * * * *

(e) * * *

(3) * * *

(ii) Transition rule. If you are an investment adviser that was, prior to July 21, 2011, exempt from registration under section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)), as in effect on July 20, 2011, paragraph (e)(3)(i) of this section does not require you to maintain or preserve books and records that would otherwise be required to be maintained or preserved under the provisions of paragraph (a)(16) of this section to the extent those books and records pertain to the performance or rate of return of such private fund (as defined in section 202(a)(29) of the Act (15 U.S.C. 80b-2(a)(29)), or other account you advise for any period ended prior to July 21, 2011, provided that you were not registered with the Commission as an investment adviser during such period, and provided further that you continue to preserve any books and records in your possession that pertain to the performance or rate of return of such private fund or other account for such period.

*   *   *   *   *

11. Section 275.204-4 is added to read as follows:

§ 275.204-4 Reporting by exempt reporting advisers.

(a) Exempt Reporting Advisers. If you are an investment adviser relying on the exemption from registering with the Commission under section 203(l) or (m) of the Act (15 U.S.C. 80b-3(l) or 80b-3(m)), you must complete and file reports on Form ADV (17 CFR 279.1) by following the instructions in the Form, which specify the information that an exempt reporting adviser must provide.

(b) Electronic Filing. You must file Form ADV electronically with the Investment Adviser Registration Depository (IARD) unless you have received a hardship exemption under paragraph (e) of this section.

Note to paragraph (b): Information on how to file with the IARD is available on the Commission's website at http://www.sec.gov/iard.

(c) When filed. Each Form ADV is considered filed with the Commission upon acceptance by the IARD.

(d) Filing fees. You must pay FINRA (the operator of the IARD) a filing fee. The Commission has approved the amount of the filing fee. No portion of the filing fee is refundable. Your completed Form ADV will not be accepted by FINRA, and thus will not be considered filed with the Commission, until you have paid the filing fee.

(e) Temporary hardship exemption.

(1) Eligibility for exemption. If you have unanticipated technical difficulties that prevent submission of a filing to the IARD system, you may request a temporary hardship exemption from the requirements of this chapter to file electronically.

(2) Application procedures. To request a temporary hardship exemption, you must:

(i) File Form ADV-H (17 CFR 279.3) in paper format no later than one business day after the filing that is the subject of the ADV-H was due; and

(ii) Submit the filing that is the subject of the Form ADV-H in electronic format with the IARD no later than seven business days after the filing was due.

(3) Effective date – upon filing. The temporary hardship exemption will be granted when you file a completed Form ADV-H.

(f) Final Report. You must file a final report in accordance with instructions in Form ADV when:

(1) You cease operation as an investment adviser;

(2) You no longer meet the definition of exempt reporting adviser under paragraph (a); or

(3) You apply for registration with the Commission.

Note to paragraph (f): You do not have to pay a filing fee to file a final report on Form ADV through the IARD.

12. Section 275.206(4)-5 is amended by:

a. In paragraph (f)(2)(i), replacing the term "individual" with the term "person"; and

b. Revising paragraphs (a), (d), and (f)(9) to read as follows:

§ 275.206(4)-5 Political contributions by certain investment advisers.

(a) * * *

(1) For any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, as defined in

section 275.204-4(a), to provide investment advisory services for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser (including a person who becomes a covered associate within two years after the contribution is made); and

(2) For any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, or any of the investment adviser's covered associates:

(i) To provide or agree to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of such investment adviser unless such person is:

(A) a regulated municipal advisor; or

(B) an executive officer, general partner, managing member (or, in each case, a person with a similar status or function), or employee of the investment adviser; and

(ii) * * *

* * * * *

(d) <u>Further prohibition</u>. As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts, practices, or courses of business within the meaning of section 206(4) of Advisers Act (15 U.S.C. 80b-6(4)), it shall be unlawful for any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, or any of the investment adviser's covered associates to do anything indirectly which, if done directly, would result in a violation of this section.

* * * * *

(f) * * *

(9) Regulated municipal advisor means a municipal advisor registered with the Commission under section 15B of that Act and subject to rules of the Municipal Securities Rulemaking Board that:

(i) Prohibit municipal advisors from engaging in distribution or solicitation activities if certain political contributions have been made; and

(ii) The Commission, by order, finds:

(A) Impose substantially equivalent or more stringent restrictions on municipal advisors than this section imposes on investment advisers; and

(B) Are consistent with the objectives of this section.

* * * * *

13. Section 275.222-1 is amended by revising the phrase "principal place of business" in paragraph (b) to read "principal office and place of business."

14. Section 275.222-2 is amended to read as follows:

§ 275.222-2 Definition of "client" for purposes of the national de minimis standard.

For purposes of section 222(d)(2) of the Act (15 U.S.C. 80b-18a(d)(2)), an investment adviser may rely upon the definition of "client" provided by section 275.202(a)(30)-1, without giving regard to paragraph (b)(4) of that section, provided that an investment adviser is not required to count as a client any person for whom the investment adviser provides advisory services without compensation.

PART 279 -- FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

15. The authority citation for Part 279 continues to read in part as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, et seq.

16. Form ADV [referenced in § 279.1] is amended by:

a. In the instructions to the form, revising the section entitled "Form ADV: General Instructions." The revised version of Form ADV: General Instructions is attached as Appendix A;

b. In the instructions to the form, revising the section entitled "Form ADV: Instructions for Part 1A." The revised version of Form ADV: Instructions for Part 1A is attached as Appendix B;

c. In the instructions to the form, revising the section entitled "Form ADV: Glossary of Terms." The revised version of Form ADV: Glossary of Terms is attached as Appendix C;

d. In the form, revising Part 1A. The revised version of Form ADV, Part 1A is attached as Appendix D;

e. In the form, revising the reference to "proceeding" in Item 3.D. of Part 2B to read "hearing or formal adjudication"; and

f. In the form, revising the section entitled "Form ADV: Domestic Investment Adviser Execution Page." The revised version of Form ADV: Domestic Investment Adviser Execution Page is attached as Appendix E.

The revisions read as follows:

Note: The text of Form ADV does not and the amendments will not appear in the Code of Federal Regulations.

* * * * *

Form ADV: Part 2B

* * *

Item 3. * * *

D. Any other hearing or formal adjudication in which a professional attainment, designation, or license of the supervised person was revoked or suspended because of a violation of rules relating to professional conduct. If the supervised person resigned (or otherwise relinquished the attainment, designation, or license) in anticipation of such a hearing or formal adjudication (and the adviser knows, or should have known, of such resignation or relinquishment), disclose the event.

* * * * *

17. Form ADV-H [referenced in § 279.3] is amended by revising the form. The revised version of Form ADV-H is attached as Appendix F.

Note: The text of Form ADV-H does not and the amendments will not appear in the Code of Federal Regulations.

18. Form ADV-NR [referenced in § 279.4] is amended by revising the form. The revised version of Form ADV-NR is attached as Appendix G.

Note: The text of Form ADV-NR does not and the amendments will not appear in the Code of Federal Regulations.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

November 19, 2010

FORM ADV (Paper Version)

- UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND
- REPORT FORM BY EXEMPT REPORTING ADVISERS

Form ADV: General Instructions

Read these instructions carefully before filing Form ADV. Failure to follow these instructions, properly complete the form, or pay all required fees may result in your application or report being delayed or rejected.

In these instructions and in Form ADV, "you" means the investment adviser (*i.e.*, the advisory firm). If you are a "separately identifiable department or division" (SID) of a bank, "you" means the SID, rather than your bank, unless the instructions or the form provide otherwise. Terms that appear in *italics* are defined in the Glossary of Terms to Form ADV.

Special One-time Dodd-Frank Transition Filing for SEC-Registered Advisers:

- Form ADV Amendment: If you are registered or have an application for registration pending with the SEC on July 21, 2011, you must file an amendment to Form ADV no later than August 20, 2011. You must update your responses to all items and corresponding sections of Schedules A, B, C and D, including the reporting of your assets under management determined within 30 days of the filing. See SEC rule 203A-5(a). If you are no longer eligible for Commission registration, you must mark Item 2.A.(13) of Form ADV, Part 1A. You should amend your *brochure* if any information has become materially inaccurate. See Form ADV, Part 2A, Instructions 4 and 6.

- Form ADV-W Filing: If you are no longer eligible for Commission registration, you must withdraw your Commission registration by filing Form ADV-W no later than October 19, 2011. See SEC rule 203A-5(b). You should consult state law or the *state securities authority* for the states in which you are doing business as soon as possible to determine if you are required to register in these states and to begin the registration process. See General Instruction 1. Until you file your Form ADV-W with the SEC, you will remain subject to SEC regulation, and you also will be subject to regulation in any states where you register. See SEC rule 203A-1(b).

Failure to amend your Form ADV or file Form ADV-W, as required by this instruction, is a violation of SEC rules and could lead to your registration being revoked.

1. Where can I get more information on Form ADV, electronic filing, and the IARD?

The SEC provides information about its rules and the Advisers Act on its website: <http://www.sec.gov/iard>.

NASAA provides information about state investment adviser laws and state rules, and how to contact a *state securities authority*, on its website: <http://www.nasaa.org>.

FINRA provides information about the IARD and electronic filing on the IARD website: <http://www.iard.com>.

2. What is Form ADV used for?

Investment advisers use Form ADV to:

- Register with the Securities and Exchange Commission
- Register with one or more *state securities authorities*
- Amend those registrations;

- Report to the SEC as an *exempt reporting adviser*
- Report to one or more *state securities authorities* as an *exempt reporting adviser*
- Amend those reports; and
- Submit a final report as an *exempt reporting adviser*

3. How is Form ADV organized?

Form ADV contains four parts:

- Part 1A asks a number of questions about you, your business practices, the *persons* who own and *control* you, and the *persons* who provide investment advice on your behalf.
  - All advisers registering with the SEC or any of the *state securities authorities* must complete Part 1A.
  - *Exempt reporting advisers* (that are not also registering with any *state securities authority*) must complete only the following items of Part 1A: 1, 2, 3, 6, 7, 10, and 11, as well as corresponding schedules. *Exempt reporting advisers* that are registering with any *state securities authority* must complete all of Form ADV.

  Part 1A also contains several supplemental schedules. The items of Part 1A let you know which schedules you must complete.

  - Schedule A asks for information about your direct owners and executive officers.
  - Schedule B asks for information about your indirect owners.
  - Schedule C is used by paper filers to update the information required by Schedules A and B (see Instruction 16).
  - Schedule D asks for additional information for certain items in Part 1A.
  - Disclosure Reporting Pages (or DRPs) are schedules that ask for details about disciplinary events involving you or your *advisory affiliates*.

- Part 1B asks additional questions required by *state securities authorities*. Part 1B contains three additional DRPs. If you are applying for SEC registration or are registered only with the SEC, you do not have to complete Part 1B. (If you are filing electronically and you do not have to complete Part 1B, you will not see Part 1B.)

- Part 2A requires advisers to create narrative *brochures* containing information about the advisory firm. The requirements in Part 2A apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.

- Part 2B requires advisers to create *brochure supplements* containing information about certain *supervised persons*. The requirements in Part 2B apply to all investment advisers registered with or applying for registration with the SEC , but do not apply to *exempt reporting advisers*.

4. When am I required to update my Form ADV?

- SEC- and State-Registered Advisers:

  - Annual Updating Amendments: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all items, including corresponding sections of Schedules A, B, C and D. You must submit your summary of material changes required by Item 2 of Part 2A either in the *brochure* (cover page or the page immediately thereafter) or as an exhibit to your *brochure*.

  - Other-than-Annual Amendments: In addition to your *annual updating amendment*, if you are registered with the SEC or a *state securities authority*, you must amend your Form ADV by filing additional amendments (other-than-annual amendments) promptly if:

    - information you provided in response to Items 1, 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B becomes inaccurate in any way;
    - information you provided in response to Items 4, 8, or 10 of Part 1A or Item 2.G. of Part 1B becomes materially inaccurate; or
    - information you provided in your *brochure* becomes materially inaccurate (see note below for exceptions)

  Notes: Part 1: If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., 9.F., or 12 of Part 1A or Items 2.H. or 2.J. of Part 1B even if your responses to those items have become inaccurate.

Part 2: You must amend your *brochure supplements* (see Form ADV, Part 2B) promptly if any information in them becomes materially inaccurate. If you are submitting an other-than-annual amendment to your *brochure*, you are not required to update your summary of material changes as required by Item 2. You are not required to update your *brochure* between annual amendments solely because the amount of *client* assets you manage has changed or because your fee schedule has changed. However, if you are updating your *brochure* for a separate reason in between annual amendments, and the amount of *client* assets you manage listed in response to Item 4.E or your fee schedule listed in response to Item 5.A has become materially inaccurate, you should update that item(s) as part of the interim amendment.

- If you are an SEC-registered adviser, you are required to file your *brochure* amendments electronically through IARD. You are not required to file amendments to your *brochure supplements* with the SEC, but you must maintain a copy of them in your files.
- If you are a state-registered adviser, you are required to file your *brochure* amendments and *brochure supplement* amendments with the appropriate *state securities authorities* through IARD.

- Exempt reporting advisers:
  - Annual Updating Amendments: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all required items, including corresponding sections of Schedules A, B, C and D.
  - Other-than-Annual Amendments: In addition to your *annual updating amendment*, you must amend your Form ADV by filing additional amendments (other-than-annual amendments) promptly if:
    - information you provided in response to Items 1, 3, or 11 becomes inaccurate in any way; or
    - information you provided in response to Item 10 becomes materially inaccurate.

Failure to update your Form ADV, as required by this instruction, is a violation of SEC rules or similar state rules and could lead to your registration being revoked.

5. Part 2 of Form ADV was amended recently. When do I have to comply with the new requirements?

If you are applying for registration with the SEC: As of January 1, 2011, every application for registration must include a narrative *brochure* prepared in accordance with the requirements of (amended) Part 2A of Form ADV. See SEC rule 203-1. The SEC will no longer accept any application that does not include a *brochure*(s) that satisfies the requirements of (amended) Part 2 of Form ADV.

If you already are registered with the SEC: Until you file your first *annual updating amendment* for your fiscal year that ended on or after December 31, 2010, you may (but are not required to) submit a narrative *brochure* that meets the requirements of (amended) Part 2A of Form ADV. If you do not do this, you must continue to comply with the requirements for preparing, delivering, and offering "old" Part II of Form ADV. Your first *annual updating amendment* must contain a narrative *brochure* that meets the requirements of (amended) Part 2A of Form ADV.

Note: Until you are required to meet the requirements of (amended) Part 2, you can satisfy the requirements related to "old" Part II by updating the information in your "old" Part II whenever it becomes materially inaccurate. You must deliver "old" Part II or a *brochure* containing at least the information contained in "old" Part II to prospective *clients* and annually offer it to current *clients*. You are not required to file "old" Part II with the SEC, but you must keep a copy in your files, and provide it to the SEC staff upon request.

If you are applying for registration or are registered with one or more *state securities authorities*, contact the appropriate *state securities authorities* or check <http://www.nasaa.org> for more information about the implementation deadline for the amended Part 2.

6. Where do I sign my Form ADV application or amendment?

You must sign the appropriate Execution Page. There are three Execution Pages at the end of the form. Your initial application, your initial report (in the case of an *exempt reporting adviser*), and all amendments to Form ADV must include at least one Execution Page.

- If you are applying for or are amending your SEC registration, or if you are reporting as an *exempt reporting adviser* or amending your report, you must sign and submit either a:
  - Domestic Investment Adviser Execution Page, if you (the advisory firm) are a resident of the United States; or
  - *Non-Resident* Investment Adviser Execution Page, if you (the advisory firm) are not a resident of the United States.
- If you are applying for or are amending your registration with a *state securities authority*, you must sign and submit the State-Registered Investment Adviser Execution Page.

7. Who must sign my Form ADV or amendment?

The individual who signs the form depends upon your form of organization:

- For a sole proprietorship, the sole proprietor.
- For a partnership, a general partner.
- For a corporation, an authorized principal officer.
- For a "separately identifiable department or division" (SID) of a bank, a principal officer of your bank who is directly engaged in the management, direction, or supervision of your investment advisory activities.
- For all others, an authorized individual who participates in managing or directing your affairs.

The signature does not have to be notarized, and in the case of an electronic filing, should be a typed name.

8. How do I file my Form ADV?

Complete Form ADV electronically using the Investment Adviser Registration Depository (IARD) if:

- You are filing with the SEC (and submitting *notice filings* to any of the *state securities authorities*), or

- You are filing with a *state securities authority* that requires or permits advisers to submit Form ADV through the IARD.

  Note: SEC rules require advisers that are registered or applying for registration with the SEC, or that are reporting to the SEC as an *exempt reporting adviser* to file electronically through the IARD system. See SEC rules 203-1 and 204-4.

To file electronically, go to the IARD website (<www.iard.com>), which contains detailed instructions for advisers to follow when filing through the IARD.

Complete Form ADV (Paper Version) on paper if:

- You are filing with the SEC or a *state securities authority* that requires electronic filing, but you have been granted a continuing hardship exemption. Hardship exemptions are described in Instruction 16.

- You are filing with a *state securities authority* that permits (but does not require) electronic filing and you do not file electronically.

9. How do I get started filing electronically?

- First, get a copy of the IARD Entitlement Package from the following web site: <http://www.iard.com/GetStarted.asp>. Second, request access to the IARD system for your firm by completing and submitting the IARD Entitlement Package. The IARD Entitlement Package must be submitted on paper. Mail the forms to: FINRA Entitlement Group, P.O. Box 9495, Gaithersburg, MD 20898-9495.

- When FINRA receives your Entitlement Package, they will assign a *CRD* number (identification number for your firm) and a user I.D. code and password (identification number and system password for the individual(s) who will submit Form ADV filings for your firm). Your firm may request an I.D. code and password for more than one individual. FINRA also will create a financial account for you from which the IARD will deduct filing fees and any state fees you are required to pay. If you already have a *CRD* account with FINRA, it will also serve as your IARD account; a separate account will not be established.

- Once you receive your *CRD* number, user I.D. code and password, and you have funded your account, you are ready to file electronically.

- Questions regarding the Entitlement Process should be addressed to FINRA at 240.386.4848.

10. If I am applying for registration with the SEC, or amending my SEC registration, how do I make *notice filings* with the *state securities authorities*?

If you are applying for registration with the SEC or are amending your SEC registration, one or more *state securities authorities* may require you to provide them with copies of your SEC filings. We call these filings "*notice filings*." Your *notice filings* will be sent electronically to the states that you check on Item 2.B. of Part 1A. The *state securities authorities* to which you send *notice filings* may charge fees, which will be deducted from the account you establish with FINRA. To determine which *state securities authorities* require SEC-registered advisers to submit *notice filings* and to pay fees, consult the relevant state investment adviser law or *state securities authority*. See General Instruction 1.

If you are granted a continuing hardship exemption to file Form ADV on paper, FINRA will enter your filing into the IARD and your *notice filings* will be sent electronically to the *state securities authorities* that you check on Item 2.B. of Part 1A.

11. I am registered with a state. When must I switch to SEC registration?

If at the time of your *annual updating amendment* you meet at least one of the requirements for SEC registration in Item 2.A.(1) to (12) of Part 1A, you must register with the SEC within 90 days after you file the *annual updating amendment*. Once you register with the SEC, you are subject to SEC regulation, regardless of whether you remain registered with one or more states. See SEC rule 203A-1(b). Each of your *investment adviser representatives*, however, may be subject to registration in those states in which the representative has a place of business. See Advisers Act section 203A(b)(1); SEC rule 203A-3(a). For additional information, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

12. I am registered with the SEC. When must I switch to registration with a *state securities authority*?

If you check box 13 in Item 2.A. of Part 1A to report on your *annual updating amendment* that you are no longer eligible to register with the SEC, you must withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. See SEC rule 203A-1(b). You should consult state law or the *state securities authority* for the states in which you are doing business to determine if you are required to register in these states. See General Instruction 1. Until you file your Form ADV-W with the SEC, you will remain subject to SEC regulation, and you also will be subject to regulation in any states where you register. See SEC rule 203A-1(b).

13. I am an *exempt reporting adviser*. Is it possible that I might be required to also register with or submit a report to a *state securities authority*?

Yes, you may be required to register with or submit a report to one or more *state securities authorities*. If you are required to register with one or more *state securities authorities*, you must complete all of Form ADV. See General Instruction 3. If you are required to submit a report to one or more *state securities authorities*, check the box(es) in Item 2.B. of Part 1A next to the state(s) you would like to receive the report. Each of your *investment adviser representatives* may also be subject to registration requirements. For additional information about the requirements that may apply to you, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

14. What do I do if I no longer meet the definition of an "*exempt reporting adviser*"?

An investment adviser may no longer be an *exempt reporting adviser*. For example, it may (i) cease to do business or become eligible for an exemption from registration that does not require reporting, or (ii) be required to register as an investment adviser with the Commission. In either case, you must submit an amendment to your Form ADV by checking the box at the start of the filing that you are submitting a final report as an *exempt reporting adviser*. In order to also register with the Commission, you must also check the box that you are applying for registration with the Commission. You will be deemed in compliance with the Form ADV filing and reporting requirements for 45 days from filing your application or until your application is approved or denied by the Commission. If your application is approved, you will be able to continue business as a registered adviser.

Note: If you are an *exempt reporting adviser* and were relying on Section 203(m) of the Advisers Act because you solely advised *private funds* of less than $150 million, under SEC rule 203(m)-1(d), you have three months from the end of the quarter in which you no longer qualified for the exemption because your *private fund* assets are $150 million or more to file your final report and your application for registration. You must file your amendment to Form ADV indicating that you are submitting a final report as an *exempt reporting adviser* and, if you intend to register with the Commission, apply for registration no later than the end of that three month period.

To determine state registration or *notice filing* requirements, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

15. Are there filing fees?

Yes. These fees go to support and maintain the IARD. The IARD filing fees are in addition to any registration or other fee that may be required by state law. You must pay an IARD filing fee for your initial application, your initial report, and each *annual updating amendment*. There is no filing fee for an other-than-annual amendment, a final report as an *exempt reporting adviser*, or Form ADV-W. The IARD filing fee schedule is published at <http://www.sec.gov/iard>; <http://www.nasaa.org>; and <http://www.iard.com>.

If you are submitting a paper filing under a continuing hardship exemption (see Instruction 16), you are required to pay an additional fee. The amount of the additional fee depends on whether you are filing Form ADV or Form ADV-W. (There is no additional fee for filings made on Form ADV-W.) The hardship filing fee schedule is available by contacting FINRA at 240.386.4848.

16. What if I am not able to file electronically?

If you are required to file electronically but cannot do so, you may be eligible for one of two types of hardship exemptions from the electronic filing requirements.

- A **temporary hardship exemption** is available if you file electronically, but you encounter unexpected difficulties that prevent you from making a timely filing with the IARD, such as a computer malfunction or electrical outage. This exemption does not permit you to file on paper; instead, it extends the deadline for an electronic filing for seven business days. See SEC rules 203-3(a) and 204-4(e).

- A **continuing hardship exemption** may be granted if you are a small business and you can demonstrate that filing electronically would impose an undue hardship. You are a small business, and may be eligible for a continuing hardship exemption, if you are required to answer Item 12 of Part 1A (because you have assets under management of less than $25 million) <u>and</u> you are able to respond "no" to each question in Item 12. See SEC rule 0-7.

If you have been granted a continuing hardship exemption, you must complete and submit the paper version of Form ADV to FINRA. FINRA will enter your responses into the IARD. As discussed in General Instruction 15, FINRA will charge you a fee to reimburse it for the expense of data entry.

17. I am eligible to file on paper. How do I make a paper filing?

When filing on paper, you must:

- Type all of your responses.
- Include your name (the same name you provide in response to Item 1.A. of Part 1A) and the date on every page.
- If you are amending your Form ADV:
    - complete page 1 and circle the number of any item for which you are changing your response.
    - include your SEC 801-number (if you have one), or your 802-number (if you have one), and your *CRD* number (if you have one) on every page.
    - complete the amended item in full and circle the number of the item for which you are changing your response.
    - to amend Schedule A or Schedule B, complete and submit Schedule C.

Where you submit your paper filing depends on why you are eligible to file on paper:

- If you are filing on paper because you have been granted a continuing hardship exemption, submit one manually signed Form ADV and one copy to: IARD Document Processing, FINRA, P.O. Box 9495, Gaithersburg, MD 20898-9495.

  If you complete Form ADV on paper and submit it to FINRA but you do not have a continuing hardship exemption, the submission will be returned to you.

- If you are filing on paper because a state in which you are registered or in which you are applying for registration allows you to submit paper instead of electronic filings, submit one manually signed Form ADV and one copy to the appropriate *state securities authorities*.

18. Who is required to file Form ADV-NR?

Every *non-resident* general partner and *managing agent* of <u>all</u> SEC-registered advisers and *exempt reporting advisers*, whether or not the adviser is resident in the United States, must file Form ADV-NR in connection with the adviser's initial application or report. A general partner or *managing agent* of an SEC-registered adviser or *exempt reporting adviser* who becomes a *non-resident* after the adviser's initial application or report has been submitted must file Form ADV-NR within 30 days. Form ADV-NR must be filed on paper (it cannot be filed electronically).

Submit Form ADV-NR to the SEC at the following address:

> Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549; Attn: Branch of Registrations and Examinations.

Failure to file Form ADV-NR promptly may delay SEC consideration of your initial application.

Federal Information Law and Requirements

Sections 203 and 204 of the Advisers Act [15 U.S.C. §§ 80b-3(c) and 80b-4] authorize the SEC to collect the information required by Form ADV. The SEC collects the information for regulatory purposes, such as deciding whether to grant registration. Filing Form ADV is mandatory for advisers who are required to register with the SEC and for *exempt reporting advisers*. The SEC maintains the information submitted on this form and makes it publicly available. The SEC may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17.

SEC's 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 control number. The Advisers Act authorizes the SEC to collect the information on Form ADV from investment *advisers*. See 15 U.S.C. §§ 80b-3 and 80b-4. Filing the form is mandatory.

The form enables the SEC to register investment advisers and to obtain information from and about *exempt reporting advisers*. Every applicant for registration with the SEC as an adviser, and every *exempt reporting adviser*, must file the form. See 17 C.F.R. § 275.203-1 and 204-4. By accepting a form, however, the SEC does not make a finding that it has been completed or submitted correctly. The form is filed annually by every adviser, no later than 90 days after the end of its fiscal year, to amend its registration or its report. It is also filed promptly during the year to reflect material changes. See 17 C.F.R. § 275.204-1. The SEC maintains the information on the form and makes it publicly available through the IARD.

Anyone may send the SEC comments on the accuracy of the burden estimate on page 1 of the form, as well as suggestions for reducing the burden. The Office of Management and Budget has reviewed this collection of information under 44 U.S.C. § 3507.

The information contained in the form is part of a system of records subject to the Privacy Act of 1974, as amended. The SEC has published in the Federal Register the Privacy Act System of Records Notice for these records.

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT BY EXEMPT REPORTING ADVISERS**

Form ADV: Instructions for Part 1A

These instructions explain how to complete certain items in Part 1A of Form ADV.

1. Item 1: Identifying Information

a. **Separately Identifiable Department or Division of a Bank.** If you are a "separately identifiable department or division" (SID) of a bank, answer Item 1.A. with the full legal name of your bank, and answer Item 1.B. with your own name (the name of the department or division) and all names under which you conduct your advisory business. In addition, your *principal office and place of business* in Item 1.F. should be the principal office at which you conduct your advisory business. In response to Item 1.I., the website addresses you list on Schedule D should be sites that provide information about your own activities, rather than general information about your bank.

b. **Item 1.O.: Assets.** For purposes of Item 1.O. only, "assets" refers to your total assets, rather than the assets you manage on behalf of clients. Determine your total assets using the total assets shown on the balance sheet for your most recent fiscal year end.

2. Item 2: SEC Registration and SEC Report by *Exempt Reporting Advisers*

If you are registered or applying for registration with the SEC, you must indicate in Item 2.A. why you are eligible to register with the SEC by checking at least one of the boxes.

a. **Item 2.A.(1): Adviser with Regulatory Assets Under Management of $100 Million or More.** You may check box 1 only if your response to Item 5.F(2)(c) is $100 million or more. You must register with the SEC if your regulatory assets under management are $100 million or more. If you are a state-registered adviser and you report on your *annual updating amendment* that your regulatory assets under management increased to $100 million or more, you must register with the SEC within 90 days after you file that *annual updating amendment*. See SEC rule 203A-1(a) and Form ADV General Instruction 11. Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

b. **Item 2.A.(2): Mid-Sized Adviser.** You may check box 2 only if your response to Item 5.F(2)(c) is $25 million or more but less than $100 million, and you satisfy one of the requirements below. Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

You must register with the SEC if you meet at least one of the following requirements:

- You are not required to be registered as an investment adviser with the *state securities authority* of the state where you maintain your *principal office and place of business* pursuant to that state's investment adviser laws. If you are exempt from registration with that state or are excluded from the definition of investment adviser in that state, you <u>must</u> register with the SEC. You should consult the investment adviser laws or the *state securities authority* for the particular state in which you maintain your *principal office and place of business* to determine if you are required to register in that state. See General Instruction 1.

- You are not subject to examination by the *state securities authority* of the state where you maintain your *principal office and place of business*. To determine whether such *state securities authority* does not conduct such examinations, see: [insert SEC.gov website address TBD].

See section 203A(a)(2) of the Advisers Act.

c. **Item 2.A.(5): Adviser to an Investment Company.** You may check box 5 <u>only</u> if you currently provide advisory services under an investment advisory contract to an investment company registered under the Investment Company Act of 1940 and the investment company is operational (i.e., has assets and shareholders, other than just the organizing shareholders). See sections 203A(a)(1)(B) and 203A(a)(2)(A) of the Advisers Act. Advising investors about the merits of investing in mutual funds or recommending particular mutual funds does not make you eligible to check this box.

d. **Item 2.A.(6): Adviser to a Business Development Company.** You may check box 6 <u>only</u> if your response to Item 5.F(2)(c) is $25 million or more of regulatory assets under management, and you currently provide advisory services under an investment advisory contract to a company that has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940, that has not withdrawn the election, and that is operational (i.e., has assets and shareholders, other than just the organizing shareholders). See section 203A(a)(2)(A) of the Advisers Act. Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

e. **Item 2.A.(7): Pension Consultant.** You may check box 7 <u>only</u> if you are eligible for the pension consultant exemption from the prohibition on SEC registration.

  - You are eligible for this exemption if you provided investment advice to employee benefit plans, governmental plans, or church plans with respect to assets having an aggregate value of $200 million or more during the 12-month period that ended within 90 days of filing this Form ADV. You are <u>not</u> eligible for this exemption if you only advise plan participants on allocating their investments within their pension plans. See SEC rule 203A-2(a).

  - To calculate the value of assets for purposes of this exemption, aggregate the assets of the plans for which you provided advisory services at the end of the 12-month period. If you provided advisory services to other plans during the 12-month period, but your employment or contract terminated before the end of the 12-month period, you also may include the value of those assets.

f. **Item 2.A.(8): Related Adviser.** You may check box 8 only if you are eligible for the related adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(b). You are eligible for this exemption if you *control*, are *controlled by*, or *are under common control with* an investment adviser that is registered with the SEC, and you have the same *principal office and place of business* as that other investment adviser. Note that you may not rely on the SEC registration of an Internet investment adviser under rule 203A-2(e) in establishing eligibility for this exemption. See SEC rule 203A-2(e)(iii). If you check box 8, you also must complete Section 2.A.(8) of Schedule D.

g. **Item 2.A.(9): Newly-Formed Adviser.** You may check box 9 only if you are eligible for the newly-formed-adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(c). You are eligible for this exemption if:

- immediately before you file your application for registration with the SEC, you were not registered or required to be registered with the SEC or a *state securities authority;* and

- at the time of your formation, you have a reasonable expectation that within 120 days of registration you will be eligible for SEC registration.

If you check box 9, you also must complete Section 2.A.(9) of Schedule D.

You must file an amendment to Part 1A of your Form ADV that updates your response to Item 2.A. within 120 days after the SEC declares your registration effective. You may not check box 9 on your amendment; since this exemption is available only if you are not registered, you may not "re-rely" on this exemption. If you indicate on that amendment (by checking box 13) that you are not eligible to register with the SEC, you also must file a Form ADV-W to withdraw your SEC registration no later than 120 days after your registration was declared effective. You should contact the appropriate *state securities authority* to determine how long it may take to become state-registered sufficiently in advance of when you are required to file Form ADV-W to withdraw from SEC registration.

h. **Item 2.A.(10): Multi-State Adviser.** You may check box 10 only if you are eligible for the multi-state adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(d). You are eligible for this exemption if you are required to register as an investment adviser with the *state securities authorities* of 15 or more states. If you check box 10, you must complete Section 2.A.(10) of Schedule D. You must complete Section 2.A.(10) of Schedule D in each *annual updating amendment* you submit.

If you check box 10, you also must:

- create and maintain a list of the *states* in which, but for this exemption, you would be required to register;
- update this list each time you submit an *annual updating amendment* in which you continue to represent that you are eligible for this exemption; and

- maintain the list in an easily accessible place for a period of not less than five years from each date on which you indicate that you are eligible for the exemption.

If, at the time you file your *annual updating amendment*, you are required to register in less than 15 *states* and you are not otherwise eligible to register with the SEC, you must check box 13 in Item 2.A. You also must file a Form ADV-W to withdraw your SEC registration. See Part 1A Instruction 2.j.

i. **Item 2.A.(11): Internet Investment Adviser.** You may check box 11 only if you are eligible for the Internet adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(e). You are eligible for this exemption if:

- you provide investment advice to your *clients* through an interactive website. An interactive website means a website in which computer software-based models or applications provide investment advice based on personal information each *client* submits through the website. Other forms of online or Internet investment advice do not qualify for this exemption;

- you provide investment advice to all of your *clients* exclusively through the interactive website, except that you may provide investment advice to fewer than 15 *clients* through other means during the previous 12 months; and

- you maintain a record demonstrating that you provide investment advice to your *clients* exclusively through an interactive website in accordance with these limits.

j. **Item 2.A.(13): Adviser No Longer Eligible to Remain Registered with the SEC.** You must check box 13 if:

- you are registered with the SEC;
- you are filing an *annual updating amendment* to Form ADV in which you indicate in response to Item 5.F(2)(c) that you have regulatory assets under management of less than $100 million; and
- you are not eligible to check any other box (other than box 13) in Item 2.A. (and are therefore no longer eligible to remain registered with the SEC).

You must withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. Until you file your Form ADV-W, you will remain subject to SEC regulation, and you also will be subject to regulation in the *states* in which you register. See SEC rule 203A-1.

k. **Item 2.C.: Reporting by Exempt Reporting Advisers.** You may check box 2.C.(1) only if you qualify for the exemption from SEC registration as an adviser solely to one or more venture capital funds. See SEC rule 203(l)-1. You may check box 2.C.(2) only if you qualify for the exemption from SEC registration because you act solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million. See SEC rule 203(m)-1. If you check box 2.C.(2), you also must complete Section 2.C. of Schedule D. You may check both boxes to indicate that you qualify for both exemptions.

3. **Item 3: Form of Organization**

If you are a "separately identifiable department or division" (SID) of a bank, answer Item 3.A. by checking "other." In the space provided, specify that you are a "SID of" and indicate the form of organization of your bank. Answer Items 3.B. and 3.C. with information about your bank.

4. **Item 4: Successions**

a. **Succession of an SEC-Registered Adviser.** If you (1) have taken over the business of an investment adviser <u>or</u> (2) have changed your structure or legal status (e.g., form of organization or state of incorporation), a new organization has been created, which has registration obligations under the Advisers Act. There are different ways to fulfill these obligations. You may rely on the registration provisions discussed in the General Instructions, or you may be able to rely on special registration provisions for "successors" to SEC-registered advisers, which may ease the transition to the successor adviser's registration.

To determine if you may rely on these provisions, review "Registration of Successors to Broker-Dealers and Investment Advisers," Investment Advisers Act Release No. 1357 (Dec. 28, 1992). If you have taken over an adviser, follow Part 1A Instruction 4.a(1), Succession by Application. If you have changed your structure or legal status, follow Part 1A Instruction 4.a(2), Succession by Amendment. If either (1) you are a "separately identifiable department or division" (SID) of a bank that is currently registered as an investment adviser, and you are taking over your bank's advisory business; or (2) you are a SID currently registered as an investment adviser, and your bank is taking over your advisory business, then follow Part 1A Instruction 4.a(1), Succession by Application.

(1) **Succession by Application.** If you are not registered with the SEC as an adviser, and you are acquiring or assuming substantially all of the assets and liabilities of the advisory business of an SEC-registered adviser, file a new application for registration on Form ADV. You will receive new registration numbers. You must file the new application within 30 days after the succession. On the application, make sure you check "yes" to Item 4.A., enter the date of the succession in Item 4.B., and complete Section 4 of Schedule D.

Until the SEC declares your new registration effective, you may rely on the registration of the adviser you are acquiring, but only if the adviser you are acquiring is no longer conducting advisory activities. Once your new registration is effective, a Form ADV-W must be filed with the SEC to withdraw the registration of the acquired adviser.

(2) **Succession by Amendment.** If you are a new investment adviser formed solely as a result of a change in form of organization, a reorganization, or a change in the composition of a partnership, and there has been no practical change in *control* or

management, you may amend the registration of the registered investment adviser to reflect these changes rather than file a new application. You will keep the same registration numbers, and you should not file a Form ADV-W. On the amendment, make sure you check "yes" to Item 4.A., enter the date of the succession in Item 4.B., and complete Section 4 of Schedule D. You <u>must</u> submit the amendment within 30 days after the change or reorganization.

b. **Succession of a State-Registered Adviser.** If you (1) have taken over the business of an investment adviser <u>or</u> (2) have changed your structure or legal status (e.g., form of organization or state of incorporation), a new organization has been created, which has registration obligations under state investment adviser laws. There may be different ways to fulfill these obligations. You should contact each state in which you are registered to determine that state's requirements for successor registration. See Form ADV General Instruction 1.

5. **Item 5: Information About Your Advisory Business**

a. **Newly-Formed Advisers:** Several questions in Item 5 that ask about your advisory business assume that you have been operating your advisory business for some time. Your response to these questions should reflect your current advisory business (i.e., at the time you file your Form ADV), with the following exceptions:

- base your response to Item 5.E. on the types of compensation you expect to accept;
- base your response to Item 5.G. and Item 5.J. on the types of advisory services you expect to provide during the next year; and
- skip Item 5.H.

b. **Item 5.F: Calculating Your Regulatory Assets Under Management.** In determining the amount of your regulatory assets under management, include the securities portfolios for which you provide continuous and regular supervisory or management services as of the date of filing this Form ADV.

(1) **Securities Portfolios.** An account is a securities portfolio if at least 50% of the total value of the account consists of securities. For purposes of this 50% test, you may treat cash and cash equivalents (i.e., bank deposits, certificates of deposit, bankers acceptances, and similar bank instruments) as securities. You must include securities portfolios that are:

(a) your family or proprietary accounts;

(b) accounts for which you receive no compensation for your services; and

(c) accounts of *clients* who are not *United States persons*.

For purposes of this definition, treat all of the assets of a *private fund* as a securities portfolio, regardless of the nature of such assets. For accounts of *private funds*, moreover, include in the securities portfolio any uncalled commitment pursuant to which a *person* is obligated to acquire an interest in, or make a capital contribution to, the *private fund*.

(2) **Value of Portfolio**. Include the entire value of each securities portfolio for which you provide continuous and regular supervisory or management services. If you provide continuous and regular supervisory or management services for only a portion of a securities portfolio, include as regulatory assets under management only that portion of the securities portfolio for which you provide such services. Exclude, for example, the portion of an account:

(a) under management by another *person*; or

(b) that consists of real estate or businesses whose operations you "manage" on behalf of a *client* but not as an investment.

Do not deduct any outstanding indebtedness or other accrued but unpaid liabilities.

(3) **Continuous and Regular Supervisory or Management Services.**

General Criteria. You provide continuous and regular supervisory or management services with respect to an account if:

(a) you have *discretionary authority* over and provide ongoing supervisory or management services with respect to the account; or

(b) you do not have *discretionary authority* over the account, but you have ongoing responsibility to select or make recommendations, based upon the needs of the *client*, as to specific securities or other investments the account may purchase or sell and, if such recommendations are accepted by the *client*, you are responsible for arranging or effecting the purchase or sale.

Factors. You should consider the following factors in evaluating whether you provide continuous and regular supervisory or management services to an account.

(a) **Terms of the advisory contract.** If you agree in an advisory contract to provide ongoing management services, this suggests that you provide these services for the account. Other provisions in the contract, or your actual management practices, however, may suggest otherwise.

(b) **Form of compensation.** If you are compensated based on the average value of the *client's* assets you manage over a specified period of time, that suggests that you provide continuous and regular supervisory or management services for the account. If you receive compensation in a manner similar to either of the following, that suggests you do not provide continuous and regular supervisory or management services for the account --

(i) you are compensated based upon the time spent with a *client* during a *client* visit; or

(ii) you are paid a retainer based on a percentage of assets covered by a financial plan.

(c) **Management practices.** The extent to which you actively manage assets or provide advice bears on whether the services you provide are continuous and regular supervisory or management services. The fact that you make infrequent trades (e.g., based on a "buy and hold" strategy) does not mean your services are not "continuous and regular."

Examples. You may provide continuous and regular supervisory or management services for an account if you:

(a) have *discretionary authority* to allocate *client* assets among various mutual funds;

(b) do not have *discretionary authority*, but provide the same allocation services, and satisfy the criteria set forth in Instruction 5.b(3);

(c) allocate assets among other managers (a "manager of managers"), but only if you have *discretionary authority* to hire and fire managers and reallocate assets among them; or

(d) you are a broker-dealer and treat the account as a brokerage account, but only if you have *discretionary authority* over the account.

You do not provide continuous and regular supervisory or management services for an account if you:

(a) provide market timing recommendations (i.e., to buy or sell), but have no ongoing management responsibilities;

(b) provide only *impersonal investment advice* (e.g., market newsletters);

(c) make an initial asset allocation, without continuous and regular monitoring and reallocation; or

(d) provide advice on an intermittent or periodic basis (such as upon *client* request, in response to a market event, or on a specific date (e.g., the account is reviewed and adjusted quarterly)).

(4) **Value of Regulatory Assets Under Management.** Determine your regulatory assets under management based on the current market value of the assets as determined within 90 days prior to the date of filing this Form ADV. Determine market value using the same method you used to report account values to *clients* or to calculate fees for investment advisory services.

In the case of a *private fund*, determine the current market value (or fair value) of the *private fund*'s assets and the contractual amount of any uncalled commitment pursuant to which a person is obligated to acquire an interest in, or make a capital contribution to, the *private fund*.

(5) **Example.** This is an example of the method of determining whether an account of a *client* other than a *private fund* may be included as regulatory assets under management.

The *client's* portfolio consists of the following:

$ 6,000,000	stocks and bonds
$ 1,000,000	cash and cash equivalents
$ 3,000,000	non-securities (collectibles, commodities, real estate, etc.)
$10,000,000	Total Assets

First, is the account a securities portfolio? The account is a securities portfolio because securities as well as cash and cash equivalents (which you have chosen to include as securities) ($6,000,000 + $1,000,000 = $7,000,000) comprise at least 50% of the value of the account (here, 70%). (See Instruction 5.b(1)).

Second, does the account receive continuous and regular supervisory or management services? The entire account is managed on a *discretionary* basis and is provided ongoing supervisory and management services, and therefore receives continuous and regular supervisory or management services. (See Instruction 5.b(3)).

Third, what is the entire value of the account? The entire value of the account ($10,000,000) is included in the calculation of the adviser's total regulatory assets under management.

6. Item 7: Financial Industry Affiliations and Private Fund Reporting

Item 7.B. and Section 7.B. of Schedule D ask questions about the *private funds* that you advise. You are required to complete a Section 7.B.1. of Schedule D for each *private fund* that you advise, except in certain circumstances described under Item 7.B. and below.

a. If your *principal office and place of business* is outside the United States, for purposes of Item 7 and Section 7.B. of Schedule D you may disregard any *private fund* that during your last fiscal year was neither a *United States person* nor offered to, or beneficially owned by, any *United States person*.

b. When filing Section 7.B.1 of Schedule D for a *private fund*, you must acquire an identification number for the fund. You must continue to use the same identification number whenever you amend Section 7.B.1 for that fund. If you file a Section 7.B.1 for a *private fund* for which an identification number has already been acquired by another adviser, you must not acquire a new identification number, but must instead utilize the existing number. If you choose to complete a single Section 7.B.1 for a master-feeder arrangement under instruction 6.d. below, you must acquire an identification number also for each feeder fund.

c. If any *private fund* has issued two or more series (or classes) of equity interests whose values are determined with respect to separate portfolios of securities and other assets, then each such series (or class) should be regarded as a separate *private fund*. In Section 7.B.1 and 7.B.2 of Schedule D, next to the name of the *private fund*, list the name and identification number of the specific series (or class) for which you are filing the sections. This only applies with respect to series (or classes) that you manage as if they were separate funds and not a fund's side pockets or similar arrangements.

d. In the case of a master-feeder arrangement (*see* questions 6-7 of Section 7.B.1 of Schedule D), instead of completing a Section 7.B.1 for each of the master fund and each feeder fund, you may complete a single Section 7.B.1 for the master-feeder arrangement under the name of the master fund, if the answers to questions 8, 10, 23, 25, 26, 27, 28, 29 are the same for all of the feeder funds (and also if the feeder funds do not use a prime broker or custodian). If you choose to complete a single Section 7.B.1, you should disregard the feeder funds, except for the following:

(1) Question 11: State the gross and net assets for the master-feeder arrangement as a whole.

(2) Question 13: List the lowest minimum investment commitment applicable to any of the master fund and the feeder funds.

(3) Questions 14-18: Answer by aggregating all investors in the master-feeder arrangement.

(4) Questions 21-22: For purposes of these questions, the *private fund* means any of the master fund or the feeder funds. In answering the questions, moreover, disregard the feeder funds' investment in the master fund.

(5) Question 24: List all of the Form D SEC file numbers of any of the master fund and feeder funds.

e. Additional Instructions:

(1) **Question 9: Investment in Registered Investment Companies:** For purposes of this question, disregard any open-end management investment company regulated as a money market fund under rule 2a-7 under the Investment Company Act, if the *private fund* invests in such a company in reliance on rule 12d1-1 under the same Act.

(2) **Question 10: Type of Private Fund:** For purposes of this question the following definitions apply:

"Hedge fund" means any *private fund* that:

a. Has a performance fee or allocation calculated by taking into account unrealized gains;

b. May borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or

c. May sell securities or other assets short.

A commodity pool is categorized as a hedge fund solely for purposes of this question. For purposes of this definition, do not net long and short positions. Include any borrowings or notional exposure of another person that are guaranteed by the *private fund* or that the *private fund* may otherwise be obligated to satisfy.

"Liquidity fund" means any *private fund* that seeks to generate income by investing in a portfolio of short term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors.

"Private equity fund" means any *private fund* that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund, or venture capital fund and does not provide investors with redemption rights in the ordinary course.

"Real estate fund" means any *private fund* that is not a hedge fund, that does not provide investors with redemption rights in the ordinary course and that invests primarily in real estate and real estate related assets.

"Securitized asset fund" means any *private fund* that is not a hedge fund and that issues asset backed securities and whose investors are primarily debt-holders.

"Venture capital fund" means any *private fund* meeting the definition of venture capital fund in rule 203(l)-1 under the Advisers Act.

"Other *private fund*" means any *private fund* that is not a hedge fund, liquidity fund, private equity fund, real estate fund, securitized asset fund, or venture capital fund.

(3) **Question 11(a): Gross Assets.** Report the assets of the *private fund* that you would include in calculating your regulatory assets under management according to instruction 5.b above.

(4) **Question 11(b): Net Assets.** The *private fund*'s net assets are equal to the gross assets reported in response to Question 11(a) minus any outstanding indebtedness or other accrued but unpaid liabilities.

(5) **Questions 21-22: Other clients' investments.** For purposes of these questions, disregard any feeder fund's investment in its master fund. (*See* questions 6-7 for the definition of "master fund" and "feeder fund.")

9. Item 10: ***Control Persons***

If you are a "separately identifiable department or division" (SID) of a bank, identify on Schedule A your bank's executive officers who are directly engaged in managing, directing, or supervising your investment advisory activities, and list any other *persons* designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities, including supervising *employees* performing investment advisory activities.

10. Additional Information.

If you believe your response to an item in Form ADV Part 1A requires further explanation, or if you wish to provide additional information, you may do so on Schedule D, in the Miscellaneous section. Completion of this section is optional.

APPENDIX C

GLOSSARY OF TERMS

1. **Advisory Affiliate:** Your advisory affiliates are (1) all of your officers, partners, or directors (or any ***person*** performing similar functions); (2) all ***persons*** directly or indirectly ***controlling*** or ***controlled*** by you; and (3) all of your current ***employees*** (other than ***employees*** performing only clerical, administrative, support or similar functions).

   If you are a "separately identifiable department or division" (SID) of a bank, your ***advisory affiliates*** are: (1) all of your bank's ***employees*** who perform your investment advisory activities (other than clerical or administrative ***employees***); (2) all ***persons*** designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities (including supervising the ***employees*** who perform investment advisory activities); (3) all ***persons*** who directly or indirectly ***control*** your bank, and all ***persons*** whom you ***control*** in connection with your investment advisory activities; and (4) all other ***persons*** who directly manage any of your investment advisory activities (including directing, supervising or performing your advisory activities), all ***persons*** who directly or indirectly ***control*** those management functions, and all ***persons*** whom you ***control*** in connection with those management functions. *[Used in: Part 1A, Items 7, 11, DRPs; Part 1B, Item 2]*

2. **Annual Updating Amendment:** Within 90 days after your firm's fiscal year end, your firm must file an "annual updating amendment," which is an amendment to your firm's Form ADV that reaffirms the eligibility information contained in Item 2 of Part 1A and updates the responses to any other item for which the information is no longer accurate. *[Used in: General Instructions; Part 1A Instructions, Introductory Text, Item 2; Part 2A, Instructions, Appendix 1 Instructions; Part 2B, Instructions]*

3. **Brochure:** A written disclosure statement that you must provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2A. *[Used in: General Instructions; Used throughout Part 2]*

4. **Brochure Supplement:** A written disclosure statement containing information about certain of your ***supervised persons*** that your firm is required by Part 2B of Form ADV to provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2B. *[Used in: General Instructions; Used throughout Part 2]*

5. **Charged:** Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs]*

6. **Client:** Any of your firm's investment advisory clients. This term includes clients from which your firm receives no compensation, such as members of your family. If your firm also provides other services (e.g., accounting services), this term does not include clients that are not investment advisory clients. *[Used throughout Form ADV and Form ADV-W]*

9. **Discretionary Authority or Discretionary Basis:** Your firm has discretionary authority or manages assets on a discretionary basis if it has the authority to decide which securities to purchase and sell for the ***client***. Your firm also has discretionary authority if it has the authority to decide which investment advisers to retain on behalf of the ***client***. *[Used in: Part 1A, Instructions, Item 8; Part 1B, Instructions; Part 2A, Items 4, 16, 18; Part 2B, Instructions]*

10. **Employee:** This term includes an independent contractor who performs advisory functions on your behalf. *[Used in: Part 1A, Instructions, Items 1, 5, 11; Part 2B, Instructions]*

11. **Enjoined:** This term includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining ***order***. *[Used in: Part 1A, Item 11; DRPs]*

12. **Exempt Reporting Adviser:** An investment adviser that qualifies for the exemption from registration under section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under rule 203(m) of the Advisers Act because it is an adviser solely to ***private funds*** and has assets under management in the United States of less than $150 million. *[Used in: Throughout Part 1A; General Instructions; Form ADV-H; Form ADV-NR]*

13. **Felony:** For jurisdictions that do not differentiate between a felony and a ***misdemeanor***, a felony is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

14. **FINRA CRD** or **CRD:** The Web Central Registration Depository ("CRD") system operated by FINRA for the registration of broker-dealers and broker-dealer representatives. *[Used in: General Instructions, Part 1A, Item 1, Schedules A, B, C, D, DRPs; Form ADV-W, Item 1]*

15. **Foreign Financial Regulatory Authority:** This term includes (1) a foreign securities authority; (2) another governmental body or foreign equivalent of a ***self-regulatory organization*** empowered by a foreign government to administer or enforce its laws relating to the regulation of ***investment-related*** activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above. *[Used in: Part 1A, Items 1, 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

16. **Found:** This term includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters. *[Used in: Part 1A, Item 11; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

23. **Investment-Related:** Activities that pertain to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with an investment adviser, broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, futures sponsor, bank, or savings association). *[Used in: Part 1A, Items, 7, 11, DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3, 4 and 7]*

24. **Involved:** Engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act. *[Used in: Part 1A, Item 11; Part 2A, Items 9 and 19; Part 2B, Items 3 and 7]*

25. **Management Persons:** Anyone with the power to exercise, directly or indirectly, a ***controlling*** influence over your firm's management or policies, or to determine the general investment advice given to the ***clients*** of your firm.

    Generally, all of the following are management persons:

    - Your firm's principal executive officers, such as your chief executive officer, chief financial officer, chief operations officer, chief legal officer, and chief compliance officer; your directors, general partners, or trustees; and other individuals with similar status or performing similar functions;

    - The members of your firm's investment committee or group that determines general investment advice to be given to ***clients***; and

    - If your firm does not have an investment committee or group, the individuals who determine general investment advice provided to ***clients*** (if there are more than five people, you may limit your firm's response to their supervisors).

    [Used in: Part 1B, Item 2; Part 2A, Items 9, 10 and 19]

26. **Managing Agent:** A managing agent of an investment adviser is any ***person***, including a trustee, who directs or manages (or who participates in directing or managing) the affairs of any unincorporated organization or association that is not a partnership. *[Used in: General Instructions; Form ADV-NR; Form ADV-W, Item 8]*

27. **Minor Rule Violation:** A violation of a ***self-regulatory organization*** rule that has been designated as "minor" pursuant to a plan approved by the SEC. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less, and if the sanctioned ***person*** does not contest the fine. (Check with the appropriate ***self-regulatory organization*** to determine if a particular rule violation has been designated as "minor" for these purposes.) *[Used in: Part 1A, Item 11]*

criminal indictment or information (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

37. **Related Person:** Any ***advisory affiliate*** and any ***person*** that is under common ***control*** with your firm. *[Used in: Part 1A, Items 7, 8, 9; Schedule D; Form ADV-W, Item 3; Part 2A, Items 10, 11, 12, 14; Part 2A, Appendix 1, Item 6]*

38. **Self-Regulatory Organization** or **SRO:** Any national securities or commodities exchange, registered securities association, or registered clearing agency. For example, the Chicago Board of Trade ("CBOT"), FINRA and New York Stock Exchange ("NYSE") are self-regulatory organizations. *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3 and 7]*

39. **Sponsor:** A sponsor of a ***wrap fee program*** sponsors, organizes, or administers the program or selects, or provides advice to ***clients*** regarding the selection of, other investment advisers in the program. *[Used in: Part 1A, Item 5; Schedule D; Part 2A, Instructions, Appendix 1 Instructions]*

40. **State Securities Authority:** The securities commissioner or commission (or any agency, office or officer performing like functions) of any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. *[Used throughout Form ADV]*

41. **Supervised Person:** Any of your officers, partners, directors (or other ***persons*** occupying a similar status or performing similar functions), or ***employees***, or any other ***person*** who provides investment advice on your behalf and is subject to your supervision or ***control***. *[Used throughout Part 2]*

42. **United States person:** This term has the same meaning as in rule 203(m)-1 under the Advisers Act, which includes any natural person that is resident in the United States. *[Used in: Part 1A, Instructions; Item 5; Schedule D]*

43. **Wrap Brochure** or **Wrap Fee Program Brochure:** The written disclosure statement that ***sponsors*** of ***wrap fee programs*** must provide to each of their ***wrap fee program clients***. *[Used in: Part 2, General Instructions; Used throughout Part 2A, Appendix 1]*

44. **Wrap Fee Program:** Any advisory program under which a specified fee or fees not based directly upon transactions in a ***client's*** account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of ***client*** transactions. *[Used in: Part 1, Item 5; Schedule D; Part 2A, Instructions, Item 4, used throughout Appendix 1; Part 2B, Instructions]*

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION**
  AND
- **REPORT BY EXEMPT REPORTING ADVISERS**

PART 1A

WARNING: Complete this form truthfully. False statements or omissions may result in denial of your application, revocation of your registration, or criminal prosecution. You must keep this form updated by filing periodic amendments. See Form ADV General Instruction 4.

Check the box that indicates what you would like to do (check all that apply):

SEC or State Registration:
- ☐ Submit an initial application to register as an investment adviser with the SEC.
- ☐ Submit an initial application to register as an investment adviser with one or more states.
- ☐ Submit an *annual updating amendment* to your registration for your fiscal year ended ________.
- ☐ Submit an other-than-annual amendment to your registration.

SEC Report by *Exempt Reporting Advisers*:
- ☐ Submit an initial report to the SEC.
- ☐ Submit an *annual updating amendment* to your report for your fiscal year ended ________.
- ☐ Submit an other-than-annual amendment to your report.
- ☐ Submit a final report.

State Report by *Exempt Reporting Advisers*:
- ☐ Submit a report to one or more *state securities authorities* for an *exempt reporting adviser*.

Item 1 Identifying Information

Responses to this Item tell us who you are, where you are doing business, and how we can contact you.

A. Your full legal name (if you are a sole proprietor, your last, first, and middle names):

____

B. Name under which you primarily conduct your advisory business, if different from Item 1.A.

____

List on Section 1.B. of Schedule D any additional names under which you conduct your advisory business.

C. If this filing is reporting a change in your legal name (Item 1.A.) or primary business name (Item 1.B.), enter the new name and specify whether the name change is of ☐ your legal name or ☐ your primary business name:

____

D. (1) If you are registered with the SEC as an investment adviser, your SEC file number: 801-__________

(2) If you report to the SEC as an *exempt reporting adviser*, your SEC file number: 802-__________

E. If you have a number ("*CRD* Number") assigned by the *FINRA's CRD* system or by the IARD system, your *CRD* number:

____

If your firm does not have a CRD number, skip this Item 1.E. Do not provide the CRD number of one of your officers, employees, or affiliates.

F. *Principal Office and Place of Business*

(1) Address (do not use a P.O. Box):

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

List on Section 1.F. of Schedule D any office, other than your principal office and place of business, at which you conduct investment advisory business. If you are applying for registration, or are registered, with one or more state securities authorities, you must list all of your offices in the state or states to which you are applying for registration or with whom you are registered. If you are applying for SEC registration, if you are registered only with the SEC, or if you are reporting to the SEC as an exempt reporting adviser, list the largest five offices in terms of numbers of employees.

(2) Days of week that you normally conduct business at your *principal office and place of business*:

☐ Monday - Friday ☐ Other: ______________________

Normal business hours at this location: ______________________

(3) Telephone number at this location: ______________________
(area code) (telephone number)

(4) Facsimile number at this location: ______________________
(area code) (telephone number)

G. Mailing address, if different from your *principal office and place of business* address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

H. If you are a sole proprietor, state your full residence address, if different from your *principal office and place of business* address in Item 1.F.:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

I. Do you have one or more websites? Yes ☐ No ☐

If "yes," list all website addresses on Section 1.I. of Schedule D. If a website address serves as a portal through which to access other information you have published on the web, you may list the portal without listing addresses for all of the other information. Some advisers may need to list more than one portal address. Do not provide individual electronic mail (e-mail) addresses in response to this Item.

J. Provide the name and contact information of your Chief Compliance Officer: If you are an *exempt reporting adviser*, you must provide the contact information for your Chief Compliance Officer, if you have one. If not, you must complete Item 1.K. below.

(name)

(other titles, if any)

(area code) (telephone number) (area code) (facsimile number)

(number and street)

(city) (state/country) (zip+4/postal code)

(electronic mail (e-mail) address, if Chief Compliance Officer has one)

K. Additional Regulatory Contact Person: If a person other than the Chief Compliance Officer is authorized to receive information and respond to questions about this Form ADV, you may provide that information here.

(name)

(titles)

(area code) (telephone number) (area code) (facsimile number)

(number and street)

(city) (state/country) (zip+4/postal code)

(electronic mail (e-mail) address, if contact person has one)

L. Do you maintain some or all of the books and records you are required to keep under Section 204 of the Advisers Act, or similar state law, somewhere other than your *principal office and place of business*?

Yes ☐ No ☐

If "yes," complete Section 1.L. of Schedule D.

M. Are you registered with a *foreign financial regulatory authority*? Yes ☐ No ☐

Answer "no" if you are not registered with a foreign financial regulatory authority, even if you have an affiliate that is registered with a foreign financial regulatory authority. If "yes," complete Section 1.M. of Schedule D.

N. Are you a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934?

Yes ☐ No ☐

If "yes," provide your CIK number (Central Index Key number that the SEC assigns to each public reporting company): ____________

O. Did you have $1 billion or more in assets on the last day of your most recent fiscal year?

Yes ☐ No ☐

Item 2

SEC Registration

Responses to this Item help us (and you) determine whether you are eligible to register with the SEC. Complete this Item 2.A. only if you are applying for SEC registration or submitting an *annual updating amendment* to your SEC registration.

A. To register (or remain registered) with the SEC, you must check at least one of the Items 2.A.(1) through 2.A.(12), below. If you are submitting an *annual updating amendment* to your SEC registration and you are no longer eligible to register with the SEC, check Item 2.A.(13). Part 1A Instruction 2 provides information to help you determine whether you may affirmatively respond to each of these items.

You (the adviser):

☐ (1) are a large advisory firm that has regulatory assets under management of $100 million (in U.S. dollars) or more;

☐ (2) are a mid-sized advisory firm that has regulatory assets under management of $25 million (in U.S. dollars) or more but less than $100 million (in U.S. dollars) and you are either:

(a) not required to be registered as an adviser with the *state securities authority* of the state where you maintain your *principal office and place of business*, or

(b) not subject to examination by the *state securities authority* of the state where you maintain your *principal office and place of business*;

Click HERE for a list of states in which an investment adviser, if registered, would not be subject to examination by the state securities authority.

☐ (3) have your *principal office and place of business* in Wyoming (which does not regulate advisers);

☐ (4) have your *principal office and place of business* outside the United States;

☐ (5) are an investment adviser (or sub-adviser) to an investment company registered under the Investment Company Act of 1940;

☐ (6) are an investment adviser to a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940 and has not withdrawn the election, and you have at least $25 million of regulatory assets under management;

☐ (7) are a pension consultant with respect to assets of plans having an aggregate value of at least $200,000,000 that qualifies for the exemption in rule 203A-2(a);

☐ (8) are a related adviser under rule 203A-2(b) that *controls*, is *controlled* by, or is under common *control* with, an investment adviser that is registered with the SEC, and your *principal office and place of business* is the same as the registered adviser;

If you check this box, complete Section 2.A.(8) of Schedule D.

☐ (9) are a newly formed adviser relying on rule 203A-2(c) because you expect to be eligible for SEC registration within 120 days;

If you check this box, complete Section 2.A.(9) of Schedule D.

☐ (10) are a multi-state adviser that is required to register in 15 or more states and is relying on rule 203A-2(d);

If you check this box, complete Section 2.A.(10) of Schedule D.

☐ (11) are an Internet adviser relying on rule 203A-2(e);

☐ (12) have received an SEC order exempting you from the prohibition against registration with the SEC;

If you check this box, complete Section 2.A.(12) of Schedule D.

☐ (13) are no longer eligible to remain registered with the SEC.

State Securities Authority Notice Filings and State Reporting by *Exempt Reporting Advisers*

B. Under state laws, SEC-registered advisers may be required to provide to *state securities authorities* a copy of the Form ADV and any amendments they file with the SEC. These are called *notice filings*. In addition, *exempt reporting advisers* may be required to provide *state securities authorities* with a copy of reports and any amendments they file with the SEC. If this is an initial application or report, check the box(es) next to the state(s) that you would like to receive notice of this and all subsequent filings or reports you submit to the SEC. If this is an amendment to direct your *notice filings* or reports to additional state(s), check the box(es) next to the state(s) that you would like to receive notice of this and all subsequent filings or reports you submit to the SEC. If this is an amendment to your registration to stop your *notice filings* or reports from going to state(s) that currently receive them, uncheck the box(es) next to those state(s).

☐ AL	☐ CT	☐ HI	☐ KY	☐ MN	☐ NH	☐ OH	☐ SC	☐ VI
☐ AK	☐ DE	☐ ID	☐ LA	☐ MS	☐ NJ	☐ OK	☐ SD	☐ VA
☐ AZ	☐ DC	☐ IL	☐ ME	☐ MO	☐ NM	☐ OR	☐ TN	☐ WA
☐ AR	☐ FL	☐ IN	☐ MD	☐ MT	☐ NY	☐ PA	☐ TX	☐ WV
☐ CA	☐ GA	☐ IA	☐ MA	☐ NE	☐ NC	☐ PR	☐ UT	☐ WI
☐ CO	☐ GU	☐ KS	☐ MI	☐ NV	☐ ND	☐ RI	☐ VT	

If you are amending your registration to stop your notice filings or reports from going to a state that currently receives them and you do not want to pay that state's notice filing or report filing fee for the coming year, your amendment must be filed before the end of the year (December 31).

SEC Reporting by *Exempt Reporting Advisers*

C. Complete this Item 2.C. only if you are reporting to the SEC as an *exempt reporting adviser*. Check all that apply. You:

☐ (1) qualify for the exemption from registration as an adviser solely to one or more venture capital funds;

☐ (2) qualify for the exemption from registration because you act solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million.

If you check this box (2), complete Section 2.C. of Schedule D.

Item 3 Form of Organization

A. How are you organized?

☐ Corporation ☐ Sole Proprietorship ☐ Limited Liability Partnership (LLP)
☐ Partnership ☐ Limited Liability Company (LLC) ☐ Limited Partnership (LP)
☐ Other (specify): ____

If you are changing your response to this Item, see Part 1A Instruction 4.

B. In what month does your fiscal year end each year? ________________

C. Under the laws of what state or country are you organized? __________________

If you are a partnership, provide the name of the state or country under whose laws your partnership was formed. If you are a sole proprietor, provide the name of the state or country where you reside.

If you are changing your response to this Item, see Part 1A Instruction 4.

Item 4 Successions

A. Are you, at the time of this filing, succeeding to the business of a registered investment adviser?

☐ Yes ☐ No

If "yes," complete Item 4.B. and Section 4 of Schedule D.

B. Date of Succession: ______________
(mm/dd/yyyy)

If you have already reported this succession on a previous Form ADV filing, do not report the succession again. Instead, check "No." See Part 1A Instruction 4.

Item 5 Information About Your Advisory Business

Responses to this Item help us understand your business, assist us in preparing for on-site examinations, and provide us with data we use when making regulatory policy. Part 1A Instruction 5.a. provides additional guidance to newly formed advisers for completing this Item 5.

Employees

If you are organized as a sole proprietorship, include yourself as an employee in your responses to Item 5.A and Items 5.B(1), (2), (3), (4) and (5). If an employee performs more than one function, you should count that employee in each of your responses to Items 5.B(1), (2), (3), (4) and (5).

A. Approximately how many *employees* do you have? Include full- and part-time *employees* but do not include any clerical workers.

____

B.

(1) Approximately how many of the *employees* reported in 5.A. perform investment advisory functions (including research)?

____

(2) Approximately how many of the *employees* reported in 5.A. are registered representatives of a broker-dealer?

____

(3) Approximately how many of the *employees* reported in 5.A. are registered with one or more *state securities authorities* as *investment adviser representatives*?

____

(4) Approximately how many of the *employees* reported in 5.A. are registered with one or more *state securities authorities* as *investment adviser representatives* for an investment adviser other than you?

____

(5) Approximately how many of the *employees* reported in 5.A. are licensed agents of an insurance company or agency?

____

(6) Approximately how many firms or other *persons* solicit advisory *clients* on your behalf?

____

In your response to Item 5.B(6), do not count any of your employees and count a firm only once – do not count each of the firm's employees that solicit on your behalf.

FORM ADV Part 1A Page 8 of 20	Your Name ______________ Date ______________	*CRD* Number ______________ SEC 801- or 802- Number ______________

Clients

In your responses to Items 5.C. and 5.D. do not include as "clients" the investors in a private fund you advise, unless you have a separate advisory relationship with those investors.

C. (1) To approximately how many *clients* did you provide investment advisory services during your most recently completed fiscal year?

☐ 0 ☐ 1-10 ☐ 11-25 ☐ 26-100

If more than 100, how many? ______ (round to the nearest 100)

(2) Approximately what percentage of your *clients* are non-*United States persons*? ______%

D. What types of *clients* do you have? Indicate the approximate percentage that each type of *client* comprises of your total number of *clients*. Also indicate the approximate amount of your regulatory assets under management (reported in Item 5.F. below) attributable to each type of *client*.

	None	Up to 10%	11-25%	26-50%	51-75%	76-99%	100%	Amount of AUM
(1) Individuals (other than *high net worth individuals*)	☐	☐	☐	☐	☐	☐	☐	______
(2) *High net worth individuals*	☐	☐	☐	☐	☐	☐	☐	______
(3) Banking or thrift institutions	☐	☐	☐	☐	☐	☐	☐	______
(4) Investment companies	☐	☐	☐	☐	☐	☐	☐	______
(5) Business development companies	☐	☐	☐	☐	☐	☐	☐	______
(6) Pooled investment vehicles	☐	☐	☐	☐	☐	☐	☐	______
(7) (a) Pension and profit sharing plans subject to ERISA (but not the plan participants)	☐	☐	☐	☐	☐	☐	☐	______
(b) Other pension and profit sharing plans (but not the plan participants)	☐	☐	☐	☐	☐	☐	☐	______
(8) Charitable organizations	☐	☐	☐	☐	☐	☐	☐	______
(9) Corporations or other businesses not listed above	☐	☐	☐	☐	☐	☐	☐	______
(10) State or municipal *government entities*	☐	☐	☐	☐	☐	☐	☐	______
(11) Other investment advisers	☐	☐	☐	☐	☐	☐	☐	______
(12) Insurance companies	☐	☐	☐	☐	☐	☐	☐	______
(13) Other: ______________	☐	☐	☐	☐	☐	☐	☐	______

The category "individuals" includes trusts, estates, 401(k) plans and IRAs of individuals and their family members, but does not include businesses organized as sole proprietorships.

The category "business development companies" consists of companies that have made an election pursuant to section 54 of the Investment Company Act of 1940.

Unless you provide advisory services pursuant to an investment advisory contract to an investment company registered under the Investment Company Act of 1940, check "None" in response to Item 5.D(4).

Compensation Arrangements

E. You are compensated for your investment advisory services by (check all that apply):

- ☐ (1) A percentage of assets under your management
- ☐ (2) Hourly charges
- ☐ (3) Subscription fees (for a newsletter or periodical)
- ☐ (4) Fixed fees (other than subscription fees)
- ☐ (5) Commissions
- ☐ (6) *Performance-based fees*
- ☐ (7) Other (specify): ______________________________

Regulatory Assets Under Management

F. (1) Do you provide continuous and regular supervisory or management services to securities portfolios? ☐ Yes ☐ No

(2) If yes, what is the amount of your regulatory assets under management and total number of accounts?

	U.S. Dollar Amount	Total Number of Accounts
Discretionary:	(a) $____________.00	(d) ____________
Non-Discretionary:	(b) $____________.00	(e) ____________
Total:	(c) $____________.00	(f) ____________

Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management. You must follow these instructions carefully when completing this Item.

Advisory Activities

G. What type(s) of advisory services do you provide? Check all that apply.

- ☐ (1) Financial planning services
- ☐ (2) Portfolio management for individuals and/or small businesses
- ☐ (3) Portfolio management for investment companies
- ☐ (4) Portfolio management for pooled investment vehicles
- ☐ (5) Portfolio management for businesses or institutional *clients* (other than pooled investment vehicles and registered investment companies)
- ☐ (6) Pension consulting services
- ☐ (7) Selection of other advisers
- ☐ (8) Publication of periodicals or newsletters
- ☐ (9) Security ratings or pricing services
- ☐ (10) Market timing services
- ☐ (11) Educational seminars/workshops
- ☐ (12) Other (specify): ______________________________

Do not check Item 5.G(3) unless you provide advisory services pursuant to an investment advisory contract to an investment company registered under the Investment Company Act of 1940. If you check Item 5.G(3), report the 811 number of the investment company or investment companies to which you provide advice in Section 5.G. of Schedule D.

H. If you provide financial planning services, to how many *clients* did you provide these services during your last fiscal year?

☐ 0 ☐ 1-10 ☐ 11-25 ☐ 26-50 ☐ 51-100 ☐ 101-250 ☐ 251 – 500
☐ More than 500 If more than 500, how many? ______ (round to the nearest 500)

In your responses to this Item 5.H., do not include as "clients" the investors in a private fund you advise, unless you have a separate advisory relationship with those investors.

I. If you participate in a *wrap fee program*, do you (check all that apply):

☐ (1) *sponsor* the *wrap fee program*?
☐ (2) act as a portfolio manager for the *wrap fee program*?

If you are a portfolio manager for a wrap fee program, list the names of the programs and their sponsors in Section 5.I(2) of Schedule D.

If your involvement in a wrap fee program is limited to recommending wrap fee programs to your clients, or you advise a mutual fund that is offered through a wrap fee program, do not check either Item 5.I(1) or 5.I(2).

J. During the previous fiscal year, about what type(s) of investments did you provide advice? Check all that apply.

☐ (1) equity securities
 ☐ (a) domestic issuers
 ☐ (b) foreign issuers
 ☐ (c) preferred stock
 ☐ (d) private investment in public equities (PIPEs)
☐ (2) warrants
☐ (3) securitized products
 ☐ (a) ABS (asset-backed securities)
 ☐ (b) CLOs (collateralized loan obligations)
 ☐ (c) CDOs (collateralized debt obligations)
 ☐ (d) CMOs (collateralized mortgage obligations)
 ☐ (e) CBOs (collateralized bond obligations)
☐ (4) swaps
 ☐ (a) single name CDS (credit default swaps)
 ☐ (b) other CDS (*e.g.*, basket, index, funded, loan only, etc.)
 ☐ (c) security-based swaps
 ☐ (d) commodity-based swaps
 ☐ (e) swaptions
☐ (5) commercial paper
☐ (6) bank loan participations
☐ (7) corporate debt securities (other than commercial paper)
 ☐ (a) investment grade
 ☐ (b) high-yield
☐ (8) certificates of deposit
☐ (9) repurchase agreements

- ☐ (10) registered investment company securities
  - ☐ (a) variable life insurance
  - ☐ (b) variable annuities
  - ☐ (c) open-end funds (other than exchange-traded funds)
  - ☐ (d) closed-end funds
  - ☐ (e) ETFs (exchange-traded funds)
- ☐ (11) business development company securities
- ☐ (12) pooled investment vehicle securities
- ☐ (13) municipal securities
- ☐ (14) US government securities
- ☐ (15) option contracts
  - ☐ (a) securities-based
  - ☐ (b) commodities-based
- ☐ (16) futures contracts
  - ☐ (a) securities-based
  - ☐ (b) commodities-based
- ☐ (17) forward contracts
- ☐ (18) interests in entities that primarily invest in
  - ☐ (a) real estate
  - ☐ (b) oil and gas interest
  - ☐ (c) other commodities
- ☐ (19) real estate
- ☐ (20) any other type of investment that constitutes more than 10% of your total regulatory assets under management (calculated in response to Item 5.F.(2)(c))
  (please explain) ____________________

Item 6 Other Business Activities

In this Item, we request information about your other business activities.

A. You are actively engaged in business as a (check all that apply):

- ☐ (1) Broker-dealer
- ☐ (2) Registered representative of a broker-dealer
- ☐ (3) Commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
- ☐ (4) Futures commission merchant
- ☐ (5) Real estate broker, dealer, or agent
- ☐ (6) Insurance broker or agent
- ☐ (7) Bank (including a separately identifiable department or division of a bank)
- ☐ (8) Trust company
- ☐ (9) Registered municipal advisor
- ☐ (10) Registered security-based swap dealer
- ☐ (11) Major security-based swap participant
- ☐ (12) Other financial product salesperson (specify): ____________________
- ☐ (13) Accountant or accounting firm
- ☐ (14) Lawyer or law firm

If you engage in other business using a name that is different from the names reported in Items 1.A. or 1.B, complete Section 6.A. of Schedule D.

B. (1) Are you actively engaged in any other business not listed in Item 6.A. (other than giving investment advice)? ☐ Yes ☐ No

(2) If yes, is this other business your primary business? ☐ Yes ☐ No

If "yes," describe this other business on Section 6.B. of Schedule D and if you engage in this business under a different name, provide that name.

C. Do you sell products or provide services other than investment advice to your advisory *clients*?
☐ Yes ☐ No

Item 7 Financial Industry Affiliations and *Private Fund* Reporting

In this Item, we request information about your financial industry affiliations and activities. This information identifies areas in which conflicts of interest may occur between you and your *clients*.

Item 7 requires you to provide information about you and your *related persons*, including foreign affiliates. Your *related persons* are all of your *advisory affiliates* and any *person* that is under common *control* with you.

A. You have a *related person* that is a (check all that apply):

☐ (1) broker-dealer, municipal securities dealer, or government securities broker or dealer
☐ (2) other investment adviser (including financial planners)
☐ (3) registered municipal advisor
☐ (4) registered security-based swap dealer
☐ (5) major security-based swap participant
☐ (6) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
☐ (7) futures commission merchant
☐ (8) banking or thrift institution
☐ (9) trust company
☐ (10) accountant or accounting firm
☐ (11) lawyer or law firm
☐ (12) insurance company or agency
☐ (13) pension consultant
☐ (14) real estate broker or dealer
☐ (15) sponsor or syndicator of limited partnerships (or equivalent), excluding pooled investment vehicles
☐ (16) sponsor, general partner, managing member (or equivalent) of pooled investment vehicles

For each related person, including foreign affiliates, complete Section 7.A. of Schedule D.

B. (1) Are you an adviser to any *private fund*? ☐ Yes ☐ No

If "yes," for each private fund, complete Section 7.B.1. of Schedule D. If another adviser reports this information with respect to any such private fund in Section 7.B.1. of Schedule D of its Form ADV (e.g., if you are a subadviser), do not complete Section 7.B.1. of Schedule D with respect to that private fund. You must, instead, complete Section 7.B.2. of Schedule D.

In either case, if you seek to preserve the anonymity of a private fund client by maintaining its identity in your books and records in numerical or alphabetical code, or similar designation, pursuant to rule 204-2(d), you may identify the private fund in section 7.B.1. or 7.B.2. of Schedule D using the same code or designation.

Item 8 Participation or Interest in *Client* Transactions

In this Item, we request information about your participation and interest in your *clients'* transactions. This information identifies additional areas in which conflicts of interest may occur between you and your *clients*.

Like Item 7, Item 8 requires you to provide information about you and your *related persons*, including foreign affiliates.

Proprietary Interest in *Client* Transactions

A. Do you or any *related person*:	Yes	No
(1) buy securities for yourself from advisory *clients*, or sell securities you own to advisory *clients* (principal transactions)?	☐	☐
(2) buy or sell for yourself securities (other than shares of mutual funds) that you also recommend to advisory *clients*?	☐	☐
(3) recommend securities (or other investment products) to advisory *clients* in which you or any *related person* has some other proprietary (ownership) interest (other than those mentioned in Items 8.A.(1) or (2))?	☐	☐

Sales Interest in *Client* Transactions

B. Do you or any *related person*:	Yes	No
(1) as a broker-dealer or registered representative of a broker-dealer, execute securities trades for brokerage customers in which advisory *client* securities are sold to or bought from the brokerage customer (agency cross transactions)?	☐	☐
(2) recommend purchase of securities to advisory *clients* for which you or any *related person* serves as underwriter, general or managing partner, or purchaser representative?	☐	☐
(3) recommend purchase or sale of securities to advisory *clients* for which you or any *related person* has any other sales interest (other than the receipt of sales commissions as a broker or registered representative of a broker-dealer)?	☐	☐

Investment or Brokerage Discretion

C. Do you or any *related person* have *discretionary authority* to determine the:	Yes	No
(1) securities to be bought or sold for a *client's* account?	☐	☐
(2) amount of securities to be bought or sold for a *client's* account?	☐	☐
(3) broker or dealer to be used for a purchase or sale of securities for a *client's* account?	☐	☐
(4) commission rates to be paid to a broker or dealer for a *client's* securities transactions?	☐	☐

		Yes	No
D.	If you answer "yes" to C.(3) above, are any of the brokers or dealers *related persons*?	☐	☐
E.	Do you or any *related person* recommend brokers or dealers to *clients*?	☐	☐
F.	If you answer "yes" to E above, are any of the brokers or dealers *related persons*?	☐	☐
G.	(1) Do you or any *related person* receive research or other products or services other than execution from a broker-dealer or a third party ("soft dollar benefits") in connection with *client* securities transactions?	☐	☐
	(2) If "yes" to G.(1) above, are all the "soft dollar benefits" you or any *related persons* receive eligible "research or brokerage services" under section 28(e) of the Securities Exchange Act of 1934?	☐	☐
H.	Do you or any *related person*, directly or indirectly, compensate any *person* for *client* referrals?	☐	☐
I.	Do you or any *related person*, directly or indirectly, receive compensation from any *person* for *client* referrals?	☐	☐

In responding to Items 8.H and 8.I., consider all cash and non-cash compensation that you or a related person gave to (in answering Item 8.H) or received from (in answering Item 8.I) any person in exchange for client referrals, including any bonus that is based, at least in part, on the number or amount of client referrals.

Item 9 Custody

In this Item, we ask you whether you or a *related person* has *custody* of *client* assets and about your custodial practices.

		Yes	No
A. (1)	Do you have *custody* of any advisory *clients*':		
	(a) cash or bank accounts?	☐	☐
	(b) securities?	☐	☐

If you are registering or registered with the SEC, answer "No" to Item 9.A.(1)(a) and (b) if you have custody solely because (i) you deduct your advisory fees directly from your clients' accounts, or (ii) a related person maintains client funds or securities as a qualified custodian but you have overcome the presumption that you are not operationally independent (pursuant to Advisers Act rule 206(4)(2)-(d)(5)) from the related person.

(2) If you checked "yes" to Item 9.A.(1)(a) or (b), what is the amount of *client* funds and securities and total number of *clients* for which you have *custody*:

U.S. Dollar Amount — Total Number of *Clients*

(a) $______________ (b) ______________

If your related person serves as qualified custodian of client assets, do not include the amount of those assets and the number of those clients in your response to Item 9.A.(2). Instead, include that information in your response to Item 9.B.(2).

B. (1) Do any of your *related persons* have *custody* of any of your advisory *clients'*:

	Yes	No
(a) cash or bank accounts?	☐	☐
(b) securities?	☐	☐

You are required to answer this item regardless of how you answered Item 9.A.(1)(a) or (b).

(2) If you checked "yes" to Item 9.B.(1)(a) or (b), what is the amount of *client* funds and securities and total number of *clients* for which your *related persons* have *custody*:

U.S. Dollar Amount — Total Number of *Clients*

(a) $______________ (b) ______________

C. If you or your *related persons* have *custody* of *client* funds or securities, check all the following that apply:

☐ (1) A qualified custodian(s) sends account statements at least quarterly to the investors in the pooled investment vehicle(s) you manage.

☐ (2) An *independent public accountant* audits annually the pooled investment vehicle(s) that you manage and the audited financial statements are distributed to the investors in the pools.

☐ (3) An *independent public accountant* conducts an annual surprise examination of *client* funds and securities.

☐ (4) An *independent public accountant* prepares an internal control report with respect to custodial services when you or your *related persons* are qualified custodians for *client* funds and securities.

If you checked Item 9.C.(2), C.(3) or C.(4), list in Section 9.C. of Schedule D the accountants that are engaged to perform the audit or examination or prepare an internal control report. (If you checked Item 9.C.(2), you do not have to list auditor information in Section 9.C. of Schedule D if you already provided this information with respect to the private funds you advise in Section 7.B.1 of Schedule D).

D. Do you or your *related persons* act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*?

	Yes	No
(1) you act as a qualified custodian	☐	☐
(2) your *related persons* act as qualified custodians.	☐	☐

If you checked "yes" to Item 9.D.(2), list in Section 9.D. of Schedule D all your related persons that are foreign financial institutions that act as qualified custodians for your clients in connection with advisory services you provide to clients. (You do not need to provide this information about private fund custodians in Section 9.D. of Schedule D if you already provided it in Section 7.B.1 of Schedule D. Related person broker-dealers, futures commission merchants and banks that act as qualified custodians should be identified in Section 7.A. of Schedule D.).

E. If you are filing your *annual updating amendment* and you were subject to a surprise examination by an *independent public accountant* during your last fiscal year, provide the date (MM/YYYY) the examination commenced: ______

F. How many persons, including, but not limited to, you and your *related persons*, act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*? ______

Item 10 Control Persons

In this Item, we ask you to identify every *person* that, directly or indirectly, *controls* you.

If you are submitting an initial application or report, you must complete Schedule A and Schedule B. Schedule A asks for information about your direct owners and executive officers. Schedule B asks for information about your indirect owners. If this is an amendment and you are updating information you reported on either Schedule A or Schedule B (or both) that you filed with your initial application or report, you must complete Schedule C.

A. Does any *person* not named in Item 1.A. or Schedules A, B, or C, directly or indirectly, *control* your management or policies? ☐ Yes ☐ No

If yes, complete Section 10.A. of Schedule D.

B. If any *person* named in Schedules A, B, or C or in Section 10. A. of Schedule D is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934, please complete Section 10.B. of Schedule D.

Item 11 Disclosure Information

In this Item, we ask for information about your disciplinary history and the disciplinary history of all your *advisory affiliates*. We use this information to determine whether to grant your application for registration, to decide whether to revoke your registration or to place limitations on your activities as an investment adviser, and to identify potential problem areas to focus on during our on-site examinations. One event may result in "yes" answers to more than one of the questions below.

Your *advisory affiliates* are: (1) all of your current *employees* (other than *employees* performing only clerical, administrative, support or similar functions); (2) all of your officers, partners, or directors (or any *person* performing similar functions); and (3) all *persons* directly or indirectly *controlling* you or *controlled* by you. If you are a "separately identifiable department or division" (SID) of a bank, see the Glossary of Terms to determine who your *advisory affiliates* are.

If you are registered or registering with the SEC or if you are an exempt reporting adviser, you may limit your disclosure of any event listed in Item 11 to ten years following the date of the event. If you are registered or registering with a state, you must respond to the questions as posed; you may, therefore, limit your disclosure to ten years following the date of an event only in responding to Items 11.A(1), 11.A(2), 11.B(1), 11.B(2), 11.D(4), and 11.H(1)(a). For purposes of calculating this ten-year period, the date of an event is the date the final order, judgment, or decree was entered, or the date any rights of appeal from preliminary orders, judgments, or decrees lapsed.

You must complete the appropriate Disclosure Reporting Page ("DRP") for "yes" answers to the questions in this Item 11.

	Yes	No
Do any of the events below involve you or any of your *supervised persons?*	☐	☐

For "yes" answers to the following questions, complete a Criminal Action DRP:

	Yes	No
A. In the past ten years, have you or any *advisory affiliate*:		
(1) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to any *felony*?	☐	☐
(2) been *charged* with any *felony*?	☐	☐

If you are registered or registering with the SEC, or if you are reporting as an exempt reporting adviser, you may limit your response to Item 11.A(2) to charges that are currently pending.

	Yes	No
B. In the past ten years, have you or any *advisory affiliate*:		
(1) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to a *misdemeanor* involving: investments or an *investment-related* business, or any fraud, false statements, or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?	☐	☐
(2) been *charged* with a *misdemeanor* listed in Item 11.B(1)?	☐	☐

If you are registered or registering with the SEC, or if you are reporting as an exempt reporting adviser, you may limit your response to Item 11.B(2) to charges that are currently pending.

For "yes" answers to the following questions, complete a Regulatory Action DRP:

	Yes	No
C. Has the SEC or the Commodity Futures Trading Commission (CFTC) ever:		
(1) *found* you or any *advisory affiliate* to have made a false statement or omission?	☐	☐
(2) *found* you or any *advisory affiliate* to have been *involved* in a violation of SEC or CFTC regulations or statutes?	☐	☐

(3) *found* you or any *advisory affiliate* to have been a cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted? ☐ ☐

(4) entered an *order* against you or any *advisory affiliate* in connection with *investment-related* activity? ☐ ☐

(5) imposed a civil money penalty on you or any *advisory affiliate*, or *ordered* you or any *advisory affiliate* to cease and desist from any activity? ☐ ☐

D. Has any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority*:

(1) ever *found* you or any *advisory affiliate* to have made a false statement or omission, or been dishonest, unfair, or unethical? ☐ ☐

(2) ever *found* you or any *advisory affiliate* to have been *involved* in a violation of *investment-related* regulations or statutes? ☐ ☐

Yes No

(3) ever *found* you or any *advisory affiliate* to have been a cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted? ☐ ☐

(4) in the past ten years, entered an *order* against you or any *advisory affiliate* in connection with an *investment-related* activity? ☐ ☐

(5) ever denied, suspended, or revoked your or any *advisory affiliate's* registration or license, or otherwise prevented you or any *advisory affiliate*, by *order*, from associating with an *investment-related* business or restricted your or any *advisory affiliate's* activity? ☐ ☐

E. Has any *self-regulatory organization* or commodities exchange ever:

(1) *found* you or any *advisory affiliate* to have made a false statement or omission? ☐ ☐

(2) *found* you or any *advisory affiliate* to have been *involved* in a violation of its rules (other than a violation designated as a "*minor rule violation*" under a plan approved by the SEC)? ☐ ☐

(3) *found* you or any *advisory affiliate* to have been the cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted? ☐ ☐

(4) disciplined you or any *advisory affiliate* by expelling or suspending you or the *advisory affiliate* from membership, barring or suspending you or the *advisory affiliate* from association with other members, or otherwise restricting your or the *advisory affiliate's* activities? ☐ ☐

F. Has an authorization to act as an attorney, accountant, or federal contractor granted to you or any *advisory affiliate* ever been revoked or suspended? ☐ ☐

G. Are you or any *advisory affiliate* now the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of Item 11.C., 11.D., or 11.E.? ☐ ☐

For "yes" answers to the following questions, complete a Civil Judicial Action DRP:

	Yes	No
H. (1) Has any domestic or foreign court:		
(a) in the past ten years, *enjoined* you or any *advisory affiliate* in connection with any *investment-related* activity?	☐	☐
(b) ever *found* that you or any *advisory affiliate* were *involved* in a violation of *investment-related* statutes or regulations?	☐	☐
(c) ever dismissed, pursuant to a settlement agreement, an *investment-related* civil action brought against you or any *advisory affiliate* by a state or *foreign financial regulatory authority*?	☐	☐
(2) Are you or any *advisory affiliate* now the subject of any civil *proceeding* that could result in a "yes" answer to any part of Item 11.H(1)?	☐	☐

Item 12 Small Businesses

The SEC is required by the Regulatory Flexibility Act to consider the effect of its regulations on small entities. In order to do this, we need to determine whether you meet the definition of "small business" or "small organization" under rule 0-7.

Answer this Item 12 only if you are registered or registering with the SEC and you indicated in response to Item 5.F.(2)(c) that you have regulatory assets under management of less than $25 million. You are not required to answer this Item 12 if you are filing for initial registration as a state adviser, amending a current state registration, or switching from SEC to state registration.

For purposes of this Item 12 only:

- Total Assets refers to the total assets of a firm, rather than the assets managed on behalf of *clients*. In determining your or another *person's* total assets, you may use the total assets shown on a current balance sheet (but use total assets reported on a consolidated balance sheet with subsidiaries included, if that amount is larger).

- *Control* means the power to direct or cause the direction of the management or policies of a *person*, whether through ownership of securities, by contract, or otherwise. Any *person* that directly or indirectly has the right to vote 25 percent or more of the voting securities, or is entitled to 25 percent or more of the profits, of another *person* is presumed to *control* the other *person*.

	Yes	No
A. Did you have total assets of $5 million or more on the last day of your most recent fiscal year?	☐	☐

If "yes," you do not need to answer Items 12.B. and 12.C.

B. Do you:

(1) *control* another investment adviser that had regulatory assets under management (calculated in response to Item 5.F.(2)(c) of Form ADV) $25 million or more on the last day of its most recent fiscal year? ☐ ☐

(2) *control* another *person* (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year? ☐ ☐

C. Are you:

(1) *controlled* by or under common *control* with another investment adviser that had regulatory assets under management (calculated in response to Item 5.F.(2)(c) of Form ADV) of $25 million or more on the last day of its most recent fiscal year? ☐ ☐

(2) *controlled* by or under common *control* with another *person* (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year? ☐ ☐

FORM ADV Schedule A	Your Name: ____________________	SEC File No.: ____________
	Date: ____________________	*CRD* No.: ____________

Direct Owners and Executive Officers

1. Complete Schedule A only if you are submitting an initial application or report. Schedule A asks for information about your direct owners and executive officers. Use Schedule C to amend this information.

2. Direct Owners and Executive Officers. List below the names of:

   (a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer (Chief Compliance Officer is required if you are registered or applying for registration and cannot be more than one individual), director and any other individuals with similar status or functions;

   (b) if you are organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of your voting securities, unless you are a public reporting company (a company subject to Section 12 or 15(d) of the Exchange Act);

   Direct owners include any *person* that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 5% or more of a class of your voting securities. For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (c) if you are organized as a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of your capital;

   (d) in the case of a trust that directly owns 5% or more of a class of your voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of your capital, the trust and each trustee; and

   (e) if you are organized as a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of your capital, and (ii) if managed by elected managers, all elected managers.

3. Do you have any indirect owners to be reported on Schedule B? ☐ Yes ☐ No

In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner or executive officer is an individual.

5. Complete the Title or Status column by entering board/management titles; status as partner, trustee, sole proprietor, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

6. Ownership codes are:

NA - less than 5%	B - 10% but less than 25%	D - 50% but less than 75%
A - 5% but less than 10%	C - 25% but less than 50%	E - 75% or more

7. (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.
   (b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.
   (c) Complete each column.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Title or Status	Date Title or Status Acquired		Owner-ship Code	*Control Person*		*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No., or Employer ID No.
			MM	YYYY			PR	

FORM ADV
Schedule B

Your Name: ______________________ SEC File No.: ______________

Date: ______________________ *CRD* No.: ______________

Indirect Owners

1. Complete Schedule B only if you are submitting an initial application or report. Schedule B asks for information about your indirect owners; you must first complete Schedule A, which asks for information about your direct owners. Use Schedule C to amend this information.

2. Indirect Owners. With respect to each owner listed on Schedule A (except individual owners), list below:

   (a) in the case of an owner that is a corporation, each of its shareholders that beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 25% or more of a class of a voting security of that corporation;

   For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (b) in the case of an owner that is a partnership, all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 25% or more of the partnership's capital;

   (c) in the case of an owner that is a trust, the trust and each trustee; and

   (d) in the case of an owner that is a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 25% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.

3. Continue up the chain of ownership listing all 25% owners at each level. Once a public reporting company (a company subject to Sections 12 or 15(d) of the Exchange Act) is reached, no further ownership information need be given.

4. In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner is an individual.

5. Complete the Status column by entering the owner's status as partner, trustee, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

6. Ownership codes are: C - 25% but less than 50% D - 50% but less than 75% E - 75% or more F - Other (general partner, trustee, or elected manager)

7. (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.
   (b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.
   (c) Complete each column.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Entity in Which Interest is Owned	Status	Date Status Acquired		Ownership Code		*Control Person*	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.
				MM	YYYY		PR		

FORM ADV
Schedule C

Your Name: ______________ SEC File No.: ______________
Date: ______________ *CRD* No.: ______________

Amendments to Schedules A and B

1. Use Schedule C only to amend information requested on either Schedule A or Schedule B. Refer to Schedule A and Schedule B for specific instructions for completing this Schedule C. Complete each column.

2. In the Type of Amendment column, indicate "A" (addition), "D" (deletion), or "C" (change in information about the same *person*).

3. Ownership codes are: NA - less than 5%; A - 5% but less than 10%; B - 10% but less than 25%; C - 25% but less than 50%; D - 50% but less than 75%; E - 75% or more; G - Other (general partner, trustee, or elected member)

4. List below all changes to Schedule A (Direct Owners and Executive Officers):

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Type of Amendment	Title or Status	Date Title or Status Acquired		Ownership Code	*Control Person*		*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.
				MM	YYYY			PR	

5. List below all changes to Schedule B (Indirect Owners):

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Type of Amendment	Entity in Which Interest is Owned	Status	Date Status Acquired		Ownership Code	*Control Person*		*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No., or Employer ID No.
					MM	YYYY			PR	

FORM ADV Your Name ______________ *CRD* Number ______
Schedule D Date ______________ SEC 801- or 802- Number ______

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 1.B. Other Business Names

List your other business names and the jurisdictions in which you use them. You must complete a separate Schedule D Section 1.B. for each business name.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name ______________ Jurisdictions ______________

SECTION 1.F. Other Offices

Complete the following information for each office, other than your *principal office and place of business*, at which you conduct investment advisory business. You must complete a separate Schedule D Section 1.F. for each location. If you are applying for SEC registration, if you are registered only with the SEC, or if you are an *exempt reporting adviser*, list only the largest five offices (in terms of numbers of *employees*).

Check only one box: ☐ Add ☐ Delete

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

______________ ______________
(area code) (telephone number) (area code) (facsimile number)

SECTION 1.I. Website Addresses

List your website addresses. You must complete a separate Schedule D Section 1.I. for each website address.

Check only one box: ☐ Add ☐ Delete

Website Address: ______________

SECTION 1.L. Location of Books and Records

Complete the following information for each location at which you keep your books and records, other than your *principal office and place of business*. You must complete a separate Schedule D Section 1.L. for each location.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of entity where books and records are kept: ______________

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

______________ ______________
(area code) (telephone number) (area code) (facsimile number)

This is (check one): ☐ one of your branch offices or affiliates.
☐ a third-party unaffiliated recordkeeper.
☐ other.

Briefly describe the books and records kept at this location. ______________

____

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 1.M. Registration with *Foreign Financial Regulatory Authorities*

List the name and country, in English, of each *foreign financial regulatory authority* with which you are registered. You must complete a separate Schedule D Section 1.M. for each *foreign financial regulatory authority* with whom you are registered.

Check only one box: ☐ Add ☐ Delete

Name of *Foreign Financial Regulatory Authority* ______
Name of Country ______

SECTION 2.A.(8) Related Adviser

If you are relying on the exemption in rule 203A-2(b) from the prohibition on registration because you *control*, are *controlled* by, or are under common *control* with an investment adviser that is registered with the SEC and your *principal office and place of business* is the same as that of the registered adviser, provide the following information:

Name of Registered Investment Adviser ______
CRD Number of Registered Investment Adviser ______
SEC Number of Registered Investment Adviser 801-______

SECTION 2.A.(9) Newly Formed Adviser

If you are relying on rule 203A-2(c), the newly formed adviser exemption from the prohibition on registration, you are required to make certain representations about your eligibility for SEC registration. By checking the appropriate boxes, you will be deemed to have made the required representations. You must make both of these representations:

☐ I am not registered or required to be registered with the SEC or a *state securities authority* and I have a reasonable expectation that I will be eligible to register with the SEC within 120 days after the date my registration with the SEC becomes effective.

☐ I undertake to withdraw from SEC registration if, on the 120th day after my registration with the SEC becomes effective, I would be prohibited by Section 203A(a) of the Advisers Act from registering with the SEC.

SECTION 2.A.(10) Multi-State Adviser

If you are relying on rule 203A-2(d), the multi-state adviser exemption from the prohibition on registration, you are required to make certain representations about your eligibility for SEC registration. By checking the appropriate boxes, you will be deemed to have made the required representations.

If you are applying for registration as an investment adviser with the SEC, you must make both of these representations:

☐ I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of 15 or more states to register as an investment adviser with the *state securities authorities* in those states.

☐ I undertake to withdraw from SEC registration if I file an amendment to this registration indicating that I would be required by the laws of fewer than 15 states to register as an investment adviser with the *state securities authorities* of those states.

If you are submitting your *annual updating amendment*, you must make this representation:

☐ Within 90 days prior to the date of filing this amendment, I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of at least 15 states to register as an investment adviser with the *state securities authorities* in those states.

FORM ADV Your Name ______________________ *CRD* Number ____________
Schedule D Date ______________________ SEC 801- or 802- Number ____________
Page 3 of 13

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 2.A.(12) SEC Exemptive *Order*

If you are relying upon an SEC *order* exempting you from the prohibition on registration, provide the following information:

Application Number: 803-____________ Date of *order*: ______________
(mm/dd/yyyy)

SECTION 2.C. *Private Fund* Assets

If you check Item 2.C.(2), what is the amount of the *private fund* assets that you manage? ____________.

NOTE: "*Private fund* assets" has the same meaning here as it has under rule 203(m)-1. If you are an investment adviser with its *principal office and place of business* outside of the United States only include *private fund* assets that you manage from a place of business in the United States.

SECTION 4 Successions

Complete the following information if you are succeeding to the business of a currently registered investment adviser. If you acquired more than one firm in the succession you are reporting on this Form ADV, you must complete a separate Schedule D Section 4 for each acquired firm. See Part 1A Instruction 4.

Name of Acquired Firm ______________________________________

Acquired Firm's SEC File No. (if any) 801- ______________ Acquired Firm's *CRD* Number (if any) ______________

SECTION 5.G.(3) Advisers to Registered Investment Companies

If you check Item 5.G (3), what is the SEC file number (811 number) of each of the registered investment companies to which you act as an adviser pursuant to an advisory contract? You must complete a separate Schedule D Section 5.G.(3) for each registered investment company to which you act as an adviser.

Check only one box: ☐ Add ☐ Delete

SEC File Number 811- ____________

SECTION 5.I.(2) *Wrap Fee Programs*

If you are a portfolio manager for one or more *wrap fee programs*, list the name of each program and its *sponsor*. You must complete a separate Schedule D Section 5.I.(2) for each *wrap fee program* for which you are a portfolio manager.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of *Wrap Fee Program* ______________________________________

Name of *Sponsor* ______________________________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 6.A. Other Business Names

If you are actively engaged in other business using a different name, provide that name and the other line(s) of business.

Other Business Name: ______________________________

Other line(s) of business in which you engage using this name: (check all that apply)

- ☐ (1) Broker-dealer
- ☐ (2) Registered representative of a broker-dealer
- ☐ (3) Commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
- ☐ (4) Futures commission merchant
- ☐ (5) Real estate broker, dealer, or agent
- ☐ (6) Insurance broker or agent
- ☐ (7) Bank (including a separately identifiable department or division of a bank)
- ☐ (8) Trust company
- ☐ (9) Registered municipal advisor
- ☐ (10) Registered swap dealer
- ☐ (11) Other financial product salesperson (specify): ______________________
- ☐ (12) Accountant or accounting firm
- ☐ (13) Lawyer or law firm

SECTION 6.B. Description of Primary Business

Describe your primary business (not your investment advisory business), and if you engage in that business under a different name, provide that name: ______________________________

SECTION 7.A. Financial Industry Affiliations

Complete a separate Schedule D Section 7.A. for each *related person* listed in Item 7.A.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Legal Name of *Related Person*: ______________________________

Primary Business Name of *Related Person*: ______________________________

Related Person's SEC File Number (if any) (*e.g.*, 801-, 8-, 866-, 802-) ______________

Related Person's CRD Number (if any): __________

Related Person is: (check all that apply)

- ☐ (1) broker-dealer, municipal securities dealer, or government securities broker or dealer
- ☐ (2) other investment adviser (including financial planners)
- ☐ (3) registered municipal advisor
- ☐ (4) registered swap dealer
- ☐ (5) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
- ☐ (6) futures commission merchant
- ☐ (7) banking or thrift institution
- ☐ (8) trust company
- ☐ (9) accountant or accounting firm

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This is an ☐ INITIAL or ☐ AMENDED Schedule D

- ☐ (10) lawyer or law firm
- ☐ (11) insurance company or agency
- ☐ (12) pension consultant
- ☐ (13) real estate broker or dealer
- ☐ (14) sponsor or syndicator of limited partnerships
- ☐ (15) sponsor, general partner, managing member (or equivalent) of pooled investment vehicles

1. Do you *control* or are you *controlled* by the *related person*? ☐ Yes ☐ No
2. Are you and the *related person* under common *control*? ☐ Yes ☐ No
3. (a) If the *related person* is a broker-dealer, bank, or futures commission merchant, is it a qualified custodian for your *clients* in connection with advisory services you provide to *clients*? ☐ Yes ☐ No
   (b) If you are registering or registered with the SEC and you have answered "yes," have you overcome the presumption that you are not operationally independent (pursuant to rule 206(4)(2)-(d)(5)) from the *related person* broker-dealer, bank, or futures commission merchant and thus are not required to obtain a surprise examination for your *clients'* funds or securities that are maintained at the *related person*? ☐ Yes ☐ No
4. (a) If the *related person* is an investment adviser, is it exempt from registration? ☐ Yes ☐ No
   (b) If the answer is yes, under what exemption? ______
5. (a) Is the *related person* registered with a *foreign financial regulatory authority?* ☐ Yes ☐ No
   (b) If the answer is yes, list the name and country, in English, of each *foreign financial regulatory authority* with which the *related person* is registered. ______________
6. Do you and the *related person* share any personnel that is your, or the *related person*'s, "access person" under the definition of rule 204A-1(c)(1) under the Advisers Act, or any information the access to which would render your, or the *related person*'s, *supervised persons* such an "access person"? ☐ Yes ☐ No

SECTION 7.B.1 *Private Fund* Reporting

Check only one box: ☐ Add ☐ Delete ☐ Amend

A. PRIVATE FUND

Information About the *Private Fund*

1. (a) Name of the *private fund*: ______________
   (b) *Private fund* identification number: ______________
2. Under the laws of what state or country is the *private fund* organized: ______________
3. Name of General Partner, Manager, Trustee, or Directors (or persons serving in a similar capacity): ______________
4. The *private fund* (check all that apply):
   - ☐ (1) qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940
   - ☐ (2) qualifies for the exclusion from the definition of investment company under section 3(c)(7) of the Investment Company Act of 1940

FORM ADV Schedule D Page 6 of 13	Your Name ______________ Date ______________	*CRD* Number ________ SEC 801- or 802- Number ________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

5. List the name and country, in English, of each *foreign financial regulatory authority* with which the *private fund* is registered.

   Check only one box: ☐ Add ☐ Delete

   English Name of *Foreign Financial Regulatory Authority* ________ Name of Country ________

6. (a) Is this a "master fund" in a master-feeder arrangement? ☐ Yes ☐ No

   (b) If yes, what is the name and *private fund* identification number (if any) of the feeder funds investing in this *private fund*? ________

   (c) Is this a "feeder fund" in a master-feeder arrangement? ☐ Yes ☐ No

   (d) If yes, what is the name and *private fund* identification number (if any) of the master fund in which this *private fund* invests?

   ________ ________

7. If you are filing a single Schedule D, Section 7.B.1 for a master-feeder arrangement according to the instructions to this Section 7.B.1, for each of the feeder funds answer the following questions:

   (a) Name of the *private fund*: ________

   (b) *Private fund* identification number: ________

   (c) Under the laws of what state or country is the *private fund* organized: ________

   (d) Name of General Partner, Manager, Trustee, or Directors (or persons serving in a similar capacity): ________

   (e) The *private fund* (check all that apply):

   ☐ qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940

   ☐ qualifies for the exclusion from the definition of investment company under section 3(c)(7) of the Investment Company Act of 1940

   (f) List the name and country, in English, of each *foreign financial regulatory authority* with which the *private fund* is registered.

   Check only one box: ☐ Add ☐ Delete

   English Name of *Foreign Financial Regulatory Authority* ________ Name of Country ________

For purposes of questions 6 and 7, in a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). A fund would also be a "feeder fund" investing in a "master fund" for purposes of this question if it issued multiple classes (or series) of shares or interests, and each class (or series) invests substantially all of its assets a single master fund.

8. (a) Is this *private fund* a "fund of funds"? ☐ Yes ☐ No

   (b) If yes, does the *private fund* invest in funds managed by you or by a *related person?* ☐ Yes ☐ No

   NOTE: For purposes of this question only, answer "yes" if the fund invests 10 percent or more of its total assets in other pooled investment vehicles, whether or not they are also *private funds*, or registered investment companies.

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9. During the last fiscal year, did the *private fund* invest in securities issued by investment companies registered under the Investment Company Act of 1940? ☐ Yes ☐ No

10. What type of fund best describes the *private fund*?

☐ hedge fund ☐ liquidity fund ☐ private equity fund ☐ real estate fund ☐ securitized asset fund ☐ venture capital fund

☐Other *private fund*: ____________

NOTE: For funds of funds, refer to the funds in which the *private fund* invests.

11. (a) Current gross asset value of the *private fund*: $_____

(b) Current net asset value of the *private fund*: $_____

12. Provide a summary of the current value of the *private fund*'s investments broken down by asset and liability class and categorized in the fair value hierarchy established under U.S. generally accepted accounting principles ("GAAP") (*i.e.*, Level 1, 2 or 3 measurements)

Asset Class	Level 1	Level 2	Level 3
________________	$___	$___	$___
Liability Class			
________________	$___	$___	$___

Ownership

13. Minimum investment commitment required of an investor in the *private fund*: $______________

14. Number of the *private fund*'s beneficial owners ____

15. What is the approximate percentage of the *private fund* beneficially owned by you and your *related persons*:

_____ %

16. What is the approximate percentage of the *private fund* beneficially owned (in the aggregate) by funds of funds:

_____ %

17. What is the approximate percentage of the *private fund* beneficially owned by the following groups of investors:

Individuals (including their trusts)	_____ %
Broker-Dealers	_____ %
Insurance Companies	_____ %
Registered Investment Companies	_____ %
Private Funds	_____ %
Non-profits	_____ %
Pension plans (excluding state or governmental plans)	_____ %
Banking or thrift institutions (proprietary)	_____ %
State or municipal *government entities* including governmental pension plans	_____ %
Other	_____ %

18. What is the approximate percentage of the *private fund* beneficially owned by *non-United States persons*:

_____ %

FORM ADV Your Name ______________ *CRD* Number ______________
Schedule D Date ______________ SEC 801- or 802- Number ______________
Page 8 of 13

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D.

Your Advisory Services

19. (a) Are you a subadviser to this *private fund*? ☐ Yes ☐ No

(b) If the answer to question 19(a) is "yes," provide the name and SEC file number, if any, of the adviser of the *private fund*. If the answer to question 19(a) is "no," leave this question blank. ______________

20. (a) Do any other investment advisers advise the *private fund*? ☐ Yes ☐ No

(b) If the answer to question 20(a) is "yes," provide the name and SEC file number, if any, of the other advisers to the *private fund*. If the answer to question 20(a) is "no," leave this question blank. ______________ ______________

21. Are your *clients* solicited to invest in the *private fund*? ☐ Yes ☐ No

22. Approximately what percentage of your *clients* has invested in the *private fund*? ______%

Private Offering

23. Does the *private fund* rely on an exemption from registration of its securities under Regulation D of the Securities Act of 1933?
☐ Yes ☐ No

24. If yes, *private fund*'s Form D file number (if any): 021-____

B. SERVICE PROVIDERS

☐ Check this box if you are filing this Form ADV through the IARD system and want the IARD system to create a new Schedule D, Section 7.B.1. with the same service provider information you have given here in Questions 25 - 29 for a new *private fund* for which you are required to complete Section 7.B.1. If you check the box, the system will pre-fill those fields for you, but you will be able to manually edit the information after it is pre-filled and before you submit your filing.

Auditors

25. (a) (1) Are the *private fund*'s financial statements subject to an annual audit? ☐ Yes ☐ No

(2) Are the financial statements prepared in accordance with U.S. GAAP? ☐ Yes ☐ No

If the answer to 25(a)(1) is "yes," respond to questions (b) – (g) below. You must complete a separate Schedule D Section 7.B.1. for each auditor.

(b) Name of the auditing firm: ______________

(c) The location of the auditing firm's office responsible for the *private fund's* audit (city and country): ______________

(d) Is the auditing firm an *independent public accountant*?
☐ Yes ☐ No

(e) Is the auditing firm registered with the Public Company Accounting Oversight Board? ☐ Yes ☐ No

(f) If yes to (e) above, is the auditing firm subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? ☐ Yes ☐ No

(g) Are the *private fund*'s audited financial statements distributed to the *private fund*'s investors? ☐ Yes ☐ No

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This is an ☐ INITIAL or ☐ AMENDED Schedule D

Prime Broker

26. (a) Does the *private fund* use one or more prime brokers? ☐ Yes ☐ No

If the answer to 26(a) is "yes," respond to questions (b) through (e) below for each prime broker the *private fund* uses. You must complete a separate Schedule D Section 7.B.1. for each prime broker.

(b) Name of the prime broker: ______________________

(c) If the prime broker is registered with the SEC, its registration number: 8-____________

(d) Location of prime broker's office used principally by the *private fund* (city and country): ______________________

(e) Does this prime broker act as custodian for some or all of the *private fund*'s assets? ☐ Yes ☐ No

Custodian

27. (a) Does the *private fund* use any custodians (including the prime brokers listed above) to hold some or all of its assets? ☐ Yes ☐ No

If the answer to 27(a) is "yes," respond to questions (b) through (f) below for each custodian the *private fund* uses. You must complete a separate Schedule D Section 7.B.1. for each custodian.

(b) Legal name of custodian: ______________________

(c) Primary business name of custodian: ______________________

(d) The location of the custodian's office responsible for *custody* of the *private fund*'s assets (city and country): ____________

(e) Is the custodian your *related person*? ☐ Yes ☐ No

(f) If the custodian is a broker-dealer, provide its SEC registration number (if any) 8-____________

Administrator

28. (a) Does the *private fund* use an administrator other than your firm?

If the answer to 28(a) is "yes," respond to questions (b) – (f) below. You must complete a separate Schedule D Section 7.B.1. for each administrator.

(b) Name of administrator: ______________________

(c) Location of administrator (city and country): ______________________

(d) Is the administrator a *related person* of your firm? ☐ Yes ☐ No

(e) Does the administrator prepare and send investor account statements to the *private fund*'s investors?

☐ Yes (provided to all investors) ☐ Some (provided to some but not all investors) ☐ No (provided to no investors)

If the answer to 28(e) is "no" or "some," who sends the investor account statements to the (rest of the) *private fund*'s investors? ______________________

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(f) (1) What percentage of the *private fund*'s assets are valued by a *person*, such as an administrator, which is not your *related person*?

________________%

Include only those assets where the *person* is responsible for the valuation used for purposes of investor subscriptions, redemptions or distributions, and fee calculations (including allocations).

(2) Name of the *person* ________________

(3) Location of the *person* (city and country): ________________

Marketers

29. (a) Does the *private fund* use the services of someone other than you or your *employees* for marketing purposes? ☐ Yes ☐ No

You must answer "yes" whether the person acts as a placement agent, consultant, finder, introducer, municipal advisor or other solicitor, or similar person. If the answer to 29(a) is "yes", respond to questions (b) through (f) below for each such marketer the *private fund* uses. You must complete a separate Schedule D Section 7.B.1. for each marketer.

(b) Is the marketer a *related person* of your firm? ☐ Yes ☐ No

(c) Name of the marketer: ________________

(d) If the marketer is registered with the SEC, its file number (*e.g.*, 801-, 8-, or 866-): ________ and *CRD* Number (if any) ________

(e) Location of the marketer's office used principally by the *private fund*: (city and country): ________________

(f) Does the marketer market the *private fund* through one or more websites? ☐ Yes ☐ No

If yes, list the website address(es): ________

SECTION 7.B.2. *Private Fund* Reporting

(1) Name of the *private fund* ________________

(2) *Private fund* identification number ________

(3) Name and SEC File number of adviser that provides information about this *private fund* in Section 7.B.1. of Schedule D of its Form ADV filing ________________; 801- ________ or 802-________

(4) Are your *clients* solicited to invest in this *private fund*? ☐ Yes ☐ No

In answering this question, disregard feeder funds' investment in a master fund. For purposes of this question, in a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). A fund would also be a "feeder fund" investing in a "master fund" for purposes of this question if it issued multiple classes (or series) of shares or interests, and each class (or series) invests substantially all of its assets a single master fund.

FORM ADV Your Name ______________ *CRD* Number ______________
Schedule D Date ______________ SEC 801- or 802- Number ______________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 9.C. *Independent Public Accountant*

You must complete the following information for each *independent public accountant* engaged to perform a surprise examination, perform an audit of a pooled investment vehicle that you manage, or prepare an internal control report. You must complete a separate Schedule D Section 9.C. for each *independent public accountant.*

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Name of the *independent public accountant*: ______________

(2) The location of the *independent public accountant*'s office responsible for the services provided:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

(3) Is the *independent public accountant* registered with the Public Company Accounting Oversight Board? ☐ Yes ☐ No

(4) If yes to (3) above, is the *independent public accountant* subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? ☐ Yes ☐ No

(5) The *independent public accountant* is engaged to:

A. ☐ audit a pooled investment vehicle
B. ☐ perform a surprise examination of *clients'* assets
C. ☐ prepare an internal control report

(6) Does the report prepared by the *independent public accountant* that audited the pooled investment vehicle or that examined internal controls contain an unqualified opinion? ☐ Yes ☐ No

SECTION 9.D. Foreign Financial Institution *Related Person* Qualified Custodian

You must complete the following information for each of your foreign financial institution *related persons* that acts as a qualified custodian for your *clients* in connection with advisory services you provide to *clients*. You must complete a separate Schedule D for each listed *related person*.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Legal Name of Foreign Financial Institution *Related Person*: ______________

(2) Primary Business Name of Foreign Financial Institution *Related Person*: ______________

(3) The location of the *related person's* office responsible for *custody* of your *clients'* assets:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

(4) If you are registering or registered with the SEC, have you overcome the presumption that you are not operationally independent (pursuant to Advisers Act rule 206(4)(2)-(d)(5)) from the *related person* qualified custodian, and thus are not required to obtain a surprise examination for your *clients'* funds or securities that are maintained at the *related person*?
☐ Yes ☐ No

FORM ADV Your Name ______ *CRD* Number ______
Schedule D Date ______ SEC 801- or 802- Number ______

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 10.A. *Control Persons*

A. You must complete a separate Schedule D Section 10.A. for each *control person* not named in Item 1.A. or Schedules A, B, or C that directly or indirectly *controls* your management or policies.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Firm or Organization Name

______

(2) *CRD* Number (if any) ______ Effective Date ______ mm/dd/yyyy Termination Date ______ mm/dd/yyyy

(3) Business Address:

______
(number and street)

______
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(4) Individual Name (if applicable) (Last, First, Middle)

______

(5) *CRD* Number (if any) ______ Effective Date ______ mm/dd/yyyy Termination Date ______ mm/dd/yyyy

(6) Business Address:

______
(number and street)

______
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(7) Briefly describe the nature of the *control*:

______

SECTION 10.B. *Control Person* Public Reporting Companies

B. If any person named in Schedules A, B, or C, or in Section 10 A. of Schedule D is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934 , please provide the following information (you must complete a separate Schedule D Section 10.B. for each public reporting company):

(1) Full legal name of the public reporting company: ______

(2) The public reporting company's CIK number (Central Index Key number that the SEC assigns to each reporting company):

______

FORM ADV Your Name ________________ *CRD* Number ________

Schedule D Date ________________ SEC 801- or 802- Number ________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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Miscellaneous

You may use the space below to explain a response to an Item or to provide any other information.

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL *OR* ☐ AMENDED response used to report details for affirmative responses to Items 11.A. or 11.B. of Form ADV.

Check item(s) being responded to: ☐ 11.A(1) ☐ 11.A(2) ☐ 11.B(1) ☐ 11.B(2)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

Multiple counts of the same charge arising out of the same event(s) should be reported on the same DRP. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. Use this DRP to report all charges arising out of the same event. One event may result in more than one affirmative answer to the items listed above.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
- ☐ You (the advisory firm)
- ☐ You and one or more of your *advisory affiliates*
- ☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number	This *advisory affiliate* is	☐a firm ☐an individual
	Registered:	☐Yes ☐No

Name (For individuals, Last, First, Middle)

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC and the event was resolved in the adviser's or *advisory affiliate's* favor.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.

☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)
(continuation)

PART II

1. If charge(s) were brought against an organization over which you or an *advisory affiliate* exercise(d) *control*: Enter organization name, whether or not the organization was an *investment-related* business and your or the *advisory affiliate's* position, title, or relationship.

2. Formal Charge(s) were brought in: (include name of Federal, Military, State or Foreign Court, Location of Court - City or County and State or Country, Docket/Case number).

3. Event Disclosure Detail (Use this for both organizational and individual charges.)

   A. Date First *Charged* (MM/DD/YYYY): ☐ Exact ☐ Explanation

   If not exact, provide explanation:

   B. Event Disclosure Detail (include Charge(s)/Charge Description(s), and for each charge provide: (1) number of counts, (2) *felony* or *misdemeanor*, (3) plea for each charge, and (4) product type if charge is *investment-related*).

   C. Did any of the Charge(s) within the Event involve a *felony*? ☐ Yes ☐ No

   D. Current status of the Event? ☐ Pending ☐ On Appeal ☐ Final

   E. Event Status Date (complete unless status is Pending) (MM/DD/YYYY):

   ☐ Exact ☐ Explanation

   If not exact, provide explanation:

4. Disposition Disclosure Detail: Include for each charge (a) Disposition Type (e.g., convicted, acquitted, dismissed, pretrial, etc.), (b) Date, (c) Sentence/Penalty, (d) Duration (if sentence-suspension, probation, etc.), (e) Start Date of Penalty, (f) Penalty/Fine Amount, and (g) Date Paid.

(continued)

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)
(continuation)

5. Provide a brief summary of circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct which was the subject of the charge(s) occurred. (Your response must fit within the space provided.)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL *OR* ☐ AMENDED response used to report details for affirmative responses to Items 11.C., 11.D., 11.E., 11.F. or 11.G. of Form ADV.

Check item(s) being responded to: ☐ 11.C(1) ☐ 11.C(2) ☐ 11.C(3) ☐ 11.C(4) ☐ 11.C(5)
☐ 11.D(1) ☐ 11.D(2) ☐ 11.D(3) ☐ 11.D(4) ☐ 11.D(5)
☐ 11.E(1) ☐ 11.E(2) ☐ 11.E(3) ☐ 11.E(4)
☐ 11.F. ☐ 11.G.

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 11.C., 11.D., 11.E., 11.F. or 11.G. Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
☐ You (the advisory firm)
☐ You and one or more of your *advisory affiliates*
☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number	This *advisory affiliate* is ☐ a firm ☐ an individual Registered: ☐ Yes ☐ No
Name (For individuals, Last, First, Middle)	

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC and the event was resolved in the adviser's or *advisory affiliate's* favor.

If you are registered or registering with a *state securities authority*, you may remove a DRP for an event you reported only in response to Item 11.D(4), and only if that event occurred more than ten years ago. If you are registered or registering with the SEC, you may remove a DRP for any event listed in Item 11 that occurred more than ten years ago.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)

(continuation)

PART II

1. Regulatory Action initiated by:
   ☐ SEC ☐ Other Federal ☐ State ☐ *SRO* ☐ Foreign

(Full name of regulator, *foreign financial regulatory authority*, federal, state or *SRO*)

____

2. Principal Sanction (check appropriate item):

☐ Civil and Administrative Penalty(ies)/Fine(s)	☐ Disgorgement	☐ Restitution
☐ Bar	☐ Expulsion	☐ Revocation
☐ Cease and Desist	☐ Injunction	☐ Suspension
☐ Censure	☐ Prohibition	☐ Undertaking
☐ Denial	☐ Reprimand	☐ Other ___________

Other Sanctions:

____
____
____

3. Date Initiated (MM/DD/YYYY): [ ] ☐ Exact ☐ Explanation

If not exact, provide explanation: ____

4. Docket/Case Number:

5. *Advisory Affiliate* Employing Firm when activity occurred which led to the regulatory action (if applicable):

6. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed	☐ Derivative(s)	☐ Investment Contract(s)
☐ Annuity(ies) - Variable	☐ Direct Investment(s) - DPP & LP Interest(s)	☐ Money Market Fund(s)
☐ CD(s)	☐ Equity - OTC	☐ Mutual Fund(s)
☐ Commodity Option(s)	☐ Equity Listed (Common & Preferred Stock)	☐ No Product
☐ Debt - Asset Backed	☐ Futures - Commodity	☐ Options
☐ Debt - Corporate	☐ Futures - Financial	☐ Penny Stock(s)
☐ Debt - Government	☐ Index Option(s)	☐ Unit Investment Trust(s)
☐ Debt - Municipal	☐ Insurance	☐ Other ___________

Other Product Types:

____
____
____

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

7. Describe the allegations related to this regulatory action (your response must fit within the space provided):

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, regulatory action appealed to (SEC, *SRO*, Federal or State Court) and Date Appeal Filed:

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

10. How was matter resolved (check appropriate item):

☐ Acceptance, Waiver & Consent (AWC)
☐ Consent
☐ Decision
☐ Decision & *Order* of Offer of Settlement
☐ Dismissed
☐ *Order*
☐ Settled
☐ Stipulation and Consent
☐ Vacated
☐ Withdrawn
☐ Other ____________

11. Resolution Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____________

12. Resolution Detail:

A. Were any of the following Sanctions *Ordered* (check all appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution

Amount: $ ☐ Censure ☐ Cease and Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions *Ordered*:

Sanction detail: if suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against you or an *advisory affiliate*, date paid and if any portion of penalty was waived:

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)

(continuation)

13. Provide a brief summary of details related to the action status and (or) disposition and include relevant terms, conditions and dates (your response must fit within the space provided).

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL *OR* ☐ AMENDED response used to report details for affirmative responses to Item 11.H. of Part 1A and Item 2.F. of Part 1B of Form ADV.

Check Part 1A item(s) being responded to: ☐ 11.H(1)(a) ☐ 11.H(1)(b) ☐ 11.H(1)(c) ☐ 11.H(2)
Check Part 1B item(s) being responded to: ☐ 2.F(1) ☐ 2.F(2) ☐ 2.F(3) ☐ 2.F(4) ☐ 2.F(5)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 11.H. of Part 1A or Item 2.F. of Part 1B. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
- ☐ You (the advisory firm)
- ☐ You and one or more of your *advisory affiliates*
- ☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number

This *advisory affiliate* is ☐ a firm ☐ an individual
Registered: ☐ Yes ☐ No

Name (For individuals, Last, First, Middle)

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC and the event was resolved in the adviser's or advisory affiliate's favor.

If you are registered or registering with a *state securities authority*, you may remove a DRP for an event you reported only in response to Item 11.H(1)(a), and only if that event occurred more than ten years ago. If you are registered or registering with the SEC, you may remove a DRP for any event listed in Item 11 that occurred more than ten years ago.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

____

____

____

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)

(continuation)

PART II

1. Court Action initiated by: (Name of regulator, *foreign financial regulatory authority, SRO*, commodities exchange, agency, firm, private plaintiff, etc.)

2. Principal Relief Sought (check appropriate item):

☐ Cease and Desist
☐ Civil Penalty(ies)/Fine(s)
☐ Disgorgement
☐ Injunction
☐ Money Damages (Private/Civil Complaint)
☐ Restitution
☐ Restraining Order
☐ Other ________

Other Relief Sought:

3. Filing Date of Court Action (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation:

4. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed
☐ Annuity(ies) - Variable
☐ CD(s)
☐ Commodity Option(s)
☐ Debt - Asset Backed
☐ Debt - Corporate
☐ Debt - Government
☐ Debt - Municipal
☐ Derivative(s)
☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Equity - OTC
☐ Equity Listed (Common & Preferred Stock)
☐ Futures - Commodity
☐ Futures - Financial
☐ Index Option(s)
☐ Insurance
☐ Investment Contract(s)
☐ Money Market Fund(s)
☐ Mutual Fund(s)
☐ No Product
☐ Options
☐ Penny Stock(s)
☐ Unit Investment Trust(s)
☐ Other ____________

Other Product Types:

5. Formal Action was brought in (include name of Federal, State or Foreign Court, Location of Court - City or County <u>and</u> State or Country, Docket/Case Number):

6. *Advisory Affiliate* Employing Firm when activity occurred which led to the civil judicial action (if applicable):

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)

(continuation)

7. Describe the allegations related to this civil action (your response must fit within the space provided):

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, action appealed to (provide name of court) and Date Appeal Filed (MM/DD/YYYY):

10. If pending, date notice/process was served (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.

11. How was matter resolved (check appropriate item):

☐ Consent ☐ Judgment Rendered ☐ Settled
☐ Dismissed ☐ Opinion ☐ Withdrawn ☐ Other ____

12. Resolution Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____

13. Resolution Detail:

A. Were any of the following Sanctions Ordered or Relief Granted (check appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution

Amount: $ ☐ Censure ☐ Cease and Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions:

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)

(continuation)

C. Sanction detail: if suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against you or an *advisory affiliate*, date paid and if any portion of penalty was waived:

14. Provide a brief summary of circumstances related to the action(s), allegation(s), disposition(s) and/or finding(s) disclosed above (your response must fit within the space provided).

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION**
  AND
- **REPORT BY EXEMPT REPORTING ADVISERS**

DOMESTIC INVESTMENT ADVISER EXECUTION PAGE

You must complete the following Execution Page to Form ADV. This execution page must be signed and attached to your initial submission of Form ADV to the SEC and all amendments.

Appointment of Agent for Service of Process

By signing this Form ADV Execution Page, you, the undersigned adviser, irrevocably appoint the Secretary of State or other legally designated officer, of the state in which you maintain your *principal office and place of business* and any other state in which you are submitting a *notice filing*, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration (a) arises out of any activity in connection with your investment advisory business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of the state in which you maintain your *principal office and place of business* or of any state in which you are submitting a *notice filing*.

Signature

I, the undersigned, sign this Form ADV on behalf of, and with the authority of, the investment adviser. The investment adviser and I both certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this ADV, including exhibits and any other information submitted, are true and correct, and that I am signing this Form ADV Execution Page as a free and voluntary act.

I certify that the adviser's books and records will be preserved and available for inspection as required by law. Finally, I authorize any *person* having *custody* or possession of these books and records to make them available to federal and state regulatory representatives.

Signature: ______________________ Date: ____________________

Printed Name: ______________________ Title: ____________________

Adviser *CRD* Number: __________________

FORM ADV (Paper Version)

- UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION
  AND
- REPORT BY EXEMPT REPORTING ADVISERS

STATE-REGISTERED INVESTMENT ADVISER EXECUTION PAGE

You must complete the following Execution Page to Form ADV. This execution page must be signed and attached to your initial application for state registration and all amendments to registration.

1. Appointment of Agent for Service of Process

By signing this Form ADV Execution Page, you, the undersigned adviser, irrevocably appoint the legally designated officers and their successors, of the state in which you maintain your *principal office and place of business* and any other state in which you are applying for registration or amending your registration, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration (a) arises out of any activity in connection with your investment advisory business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of the state in which you maintain your *principal office and place of business* or of any state in which you are applying for registration, or amending your registration.

2. State-Registered Investment Adviser Affidavit

If you are subject to state regulation, by signing this Form ADV, you represent that, you are in compliance with the registration requirements of the state in which you maintain your *principal place of business* and are in compliance with the bonding, capital, and recordkeeping requirements of that state.

Signature

I, the undersigned, sign this Form ADV on behalf of, and with the authority of, the investment adviser. The investment adviser and I both certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this ADV, including exhibits and any other information submitted, are true and correct, and that I am signing this Form ADV Execution Page as a free and voluntary act.

I certify that the adviser's books and records will be preserved and available for inspection as required by law. Finally, I authorize any *person* having custody or possession of these books and records to make them available to federal and state regulatory representatives.

Signature: ______________________ Date: ______________________

Printed Name: ______________________ Title: ______________________

Adviser *CRD* Number: ______________________

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION**
  AND
- **REPORT BY EXEMPT REPORTING ADVISERS**

NON-RESIDENT INVESTMENT ADVISER EXECUTION	PAGE 1

You must complete the following Execution Page to Form ADV. This execution page must be signed and attached to your initial submission of Form ADV to the SEC and all amendments.

1. Appointment of Agent for Service of Process

By signing this Form ADV Execution Page, you, the undersigned adviser, irrevocably appoint each of the Secretary of the SEC, and the Secretary of State or other legally designated officer, of any other state in which you are submitting a *notice filing*, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration (a) arises out of any activity in connection with your investment advisory business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of any state in which you are submitting a *notice filing*.

2. Appointment and Consent: Effect on Partnerships

If you are organized as a partnership, this irrevocable power of attorney and consent to service of process will continue in effect if any partner withdraws from or is admitted to the partnership, provided that the admission or withdrawal does not create a new partnership. If the partnership dissolves, this irrevocable power of attorney and consent shall be in effect for any action brought against you or any of your former partners.

3. *Non-Resident* Investment Adviser Undertaking Regarding Books and Records

By signing this Form ADV, you also agree to provide, at your own expense, to the U.S. Securities and Exchange Commission at its principal office in Washington D.C., at any Regional or District Office of the Commission, or at any one of its offices in the United States, as specified by the Commission, correct, current, and complete copies of any or all records that you are required to maintain under Rule 204-2 under the Investment Advisers Act of 1940. This undertaking shall be binding upon you, your heirs, successors and assigns, and any *person* subject to your written irrevocable consents or powers of attorney or any of your general partners and *managing agents*.

Signature

I, the undersigned, sign this Form ADV on behalf of, and with the authority of, the *non-resident* investment adviser. The investment adviser and I both certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this ADV, including exhibits and any other information submitted, are true and correct, and that I am signing this Form ADV Execution Page as a free and voluntary act.

I certify that the adviser's books and records will be preserved and available for inspection as required by law. Finally, I authorize any *person* having custody or possession of these books and records to make them available to federal and state regulatory representatives.

Signature: ____________________ Date: ____________________

Printed Name: ____________________ Title: ____________________

Adviser *CRD* Number: ____________________

APPENDIX F

OMB APPROVAL
OMB Number: 3235-0538 Expires: March 31, 2011 Estimated average burden hours per response . . .1.00

Form ADV-H
APPLICATION FOR A TEMPORARY OR CONTINUING HARDSHIP EXEMPTION

Item 1 Type of Exemption

You are (check one):

- ☐ Requesting a Temporary Hardship Exemption; or
- ☐ Applying for a Continuing Hardship Exemption

A. If you are requesting a temporary hardship exemption, this Form ADV-H is for your (check one)

- ☐ Initial SEC Application
- ☐ *Annual updating amendment* to SEC Registration
- ☐ Other-than-annual amendment to SEC Registration
- ☐ Initial report to the SEC as an *exempt reporting adviser*
- ☐ *Annual updating amendment* to your report as an *exempt reporting adviser*
- ☐ Submit an other-than-annual amendment to your report as an *exempt reporting adviser*
- ☐ Submit a final report an *exempt reporting adviser*

B. If you are applying for a continuing hardship exemption, this Form ADV-H is for all filings between the date you file this form and ______________________.
MM / DD / YYYY

Only an adviser that is a "small business" (as defined by SEC rule 0-7) is eligible for a continuing hardship exemption. To determine whether you are eligible for a continuing hardship exemption, review Item 12 of the Form ADV that you filed most recently with the SEC to answer the following questions:

Were you required to answer Item 12 of Part 1A of Form ADV? Yes ☐ No ☐

Did you check "yes" to any question on Item 12 of Part 1A of Form ADV? Yes ☐ No ☐

If you were not required to answer Item 12 or checked "yes" to any question on Item 12, you are not eligible for a continuing hardship exemption and must submit electronic filings to the IARD system.

Item 2 Identifying Information

SEC File number: 801 - ____________ or 802 - ____________

CRD Number (if you have one) __________

A. Your full legal name (if you are a sole proprietor, state your last, first, and middle names):

____

B. *Principal Office and Place of Business*
Address (do not use a P.O. Box):

____
(number and street)

____
(city) (state) (country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

C. Name and telephone number of the individual filing this Form ADV-H:

____
(name) (title) (area code) (telephone number)

Item 3 Information Relating to the Hardship

A. If you are filing to request a temporary hardship exemption, attach a separate page that:

1. Describes the nature and extent of the temporary technical difficulties when you attempt to submit the filing in electronic format.
2. Describes the extent to which you previously have submitted documents in electronic format with the same hardware and software that you are unable to use to submit this filing.
3. Describes the burden and expense of employing alternative means (*e.g.* public library, service provider) to submit the filing in electronic format in a timely manner.
4. Provides any other reasons why a temporary hardship exemption is warranted.

B. If you are applying for a continuing hardship exemption, your application will be granted or denied based on the following items. You should attach a separate page to this Form ADV-H that:

1. Explains the reason(s) that the necessary hardware and software are not available without unreasonable burden and expense.
2. Describes the burden and expense of employing alternative means (*e.g.* public library, service provider) to submit your filings in electronic format in a timely manner.
3. Justifies the time period requested in Item 1 of this Form ADV-H.
4. Provides any other reasons why a continuing hardship exemption is warranted.

Item 4 How to Submit Your Form ADV-H

Sign this Form ADV-H. You must preserve in your records a copy of the Form ADV-H that you file. Mail one manually signed Form ADV-H and one copy to U.S. Securities and Exchange Commission, Branch of Regulations and Examinations, Mail Stop 0-25, 100 F Street, NE, Washington, DC 20549.

Item 5 Execution

I, the undersigned, have signed this Form ADV-H on behalf of, and with the authority of, the adviser requesting a temporary hardship exemption or applying for a continuing hardship exemption. The undersigned and the adviser represent that the information and statements made in this ADV-H, including any other information submitted, are true. The undersigned and the adviser further agree to waive any claim against the administrator of the IARD for errors made in good faith that may occur when converting to electronic format this Form ADV-H or any paper filing made in reliance of a continuing hardship exemption.

Signature: ______________________ Date: ______________

Printed Name: ______________________ Title: ______________

PRIVACY ACT STATEMENT. Section 203(c)(1) of the Advisers Act [15 U.S.C. § 80b-3(c)(1)] authorizes the Commission to collect the information required by Form ADV-H. The Commission collects this information for regulatory purposes, such as processing requests for temporary hardship exemptions and determining whether to grant a continuing hardship exemption. Filing Form ADV-H is mandatory for investment advisers requesting a temporary or continuing hardship exemption. The Commission maintains the information submitted on Form ADV-H and makes it publicly available. The Commission may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17. The information contained in Form ADV-H is part of a system of records subject to the Privacy Act of 1974, as amended. The Commission has published in the Federal Register the Privacy Act System of Records Notice for these records.

SEC'S 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 control number. Section 203(c)(1) of the Advisers Act authorizes the Commission to collect the information on this Form from applicants. *See* 15 U.S.C. § 80b-3(c)(1). Filing of this Form is mandatory for an investment adviser to request an exemption from the electronic filing requirements. The principal purpose of this collection of information is to enable the Commission to process requests for temporary hardship exemptions and to determine whether to grant a continuing hardship exemption. By accepting a form, however, the Commission does not make a finding that it has been completed or submitted correctly. The Commission will maintain files of the information on Form ADV-H and will make the information publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on page one of Form ADV-H, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. §3507.

APPENDIX G

OMB APPROVAL	
OMB Number:	3235-0240
Expires:	February 28, 2011
Estimated average burden hours per response	1.00

Form ADV-NR

APPOINTMENT OF AGENT FOR SERVICE OF PROCESS BY NON-RESIDENT GENERAL PARTNER AND NON-RESIDENT MANAGING AGENT OF AN INVESTMENT ADVISER

You must submit this Form ADV-NR if you are a *non-resident* general partner or a *non-resident managing agent* of any investment adviser (domestic or *non-resident*). Form ADV-NR must be signed and submitted in connection with the adviser's initial Form ADV submission. If the mailing address you list below changes, you must file an amended Form ADV-NR to provide the current address. If you become a *non-resident* general partner or a *non-resident managing agent* after the date the adviser files its initial Form ADV, you must file Form ADV-NR with the Commission within 30 days of the date that you became a *non-resident* general partner or a *non-resident managing agent*. If you serve as a general partner or *managing agent* for multiple advisers, you must submit a separate Form ADV-NR for each adviser.

1. Appointment of Agent for Service of Process

By signing this Form ADV-NR, you, the undersigned *non-resident* general partner or *non-resident managing agent*, irrevocably appoint each of the Secretary of the SEC, and the Secretary of State, or equivalent officer, of the state in which the adviser referred to in this form maintains its *principal office and place of business*, if applicable, and any other state in which the adviser is applying for registration, amending its registration, or submitting a *notice filing*, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration: (a) arises out of any activity in connection with the investment adviser's business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of the state in which the adviser referred to in this Form maintains its *principal office and place of business*, if applicable, or of any state in which the adviser is applying for registration, amending its registration, or submitting a *notice filing*.

2. Appointment and Consent: Effect on Partnerships

If you are organized as a partnership, this irrevocable power of attorney and consent to service of process will continue in effect if any partner withdraws from or is admitted to the partnership, provided that the admission or withdrawal does not create a new partnership. If the partnership dissolves, this irrevocable power of attorney and consent shall be in effect for any action brought against you or any of your former partners.

Signature

I, the undersigned *non-resident* general partner or *non-resident managing agent,* certify, under penalty of perjury under the laws of the United States of America, that the information contained in this Form ADV-NR is true and correct and that I am signing this Form ADV-NR as a free and voluntary act.

Signature of Partner or Agent:

____________________ Date: ________________

Printed Name: ________________ Title: ________________

Mailing Address of Partner or Agent (no P.O. Boxes):

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Signature of Investment Adviser:

____________________ Date: ________________

Printed Name: ________________ Title: ________________

Adviser SEC File Number: 801-________ or 802-________

Adviser *CRD* Number: ____________

Adviser Name: ____________________________

PRIVACY ACT STATEMENT. Section 211(a) of the Advisers Act [15 U.S.C. § 80b-11(a)] authorizes the Commission to collect the information required by Form ADV-NR. The Commission collects this information to ensure that a non-resident general partner or managing agent of an investment adviser appoints an agent for service of process in the United States. Filing Form ADV-NR is mandatory for non-resident general partners and non-resident managing agents of investment advisers. The Commission maintains the information submitted on Form ADV-NR and makes it publicly available. The Commission may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17. The information contained in Form ADV-NR is part of a system of records subject to the Privacy Act of 1974, as amended. The Commission has published in the Federal Register the Privacy Act System of Records Notice for these records.

SEC'S 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 control number. Section 211(a) of the Advisers Act authorizes the Commission to collect the information on this Form from applicants. *See* 15 U.S.C. § 80b-11(a). Filing of this Form is mandatory for non-resident general partners or managing agents of investment advisers. The principal purpose of this collection of information is to ensure that a non-resident general partner or managing agent of an investment adviser appoints an agent for service of process in the United States. The Commission will maintain files of the information on Form ADV-NR and will make the information publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on page one of Form ADV-NR, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. § 3507.

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 240 and 249

[Release No. 34-63347; File No. S7-35-10]

RIN 3235-AK79

Security-Based Swap Data Repository Registration, Duties, and Core Principles

AGENCY: Securities and Exchange Commission

ACTION: Proposed rule.

SUMMARY: In accordance with Section 763(i) of Title VII ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Securities and Exchange Commission ("Commission") is proposing new rules under the Securities Exchange Act of 1934 ("Exchange Act") governing the security-based swap data repository ("SDR") registration process, duties, and core principles.

DATES: Comments should be submitted on or before [45 days after the 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 S7-53-10 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, D.C. 20549.

All submissions should refer to File Number S7-53-10. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: John Ramsay, Deputy Director; Jo Anne Swindler, Assistant Director; Richard Vorosmarti, Special Counsel; Angie Le, Special Counsel; Miles Treakle, Staff Attorney; or Bradley Gude, Special Counsel, Division of Trading and Markets, at (202) 551-5777, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission is proposing Rules 13n-1 to 13n-11 under the Exchange Act governing SDRs. The Commission is soliciting comment on all aspects of the proposed rules and will carefully consider any comments received.

I. Introduction

On July 21, 2010, President Barack Obama signed the Dodd-Frank Act into law.[1] The Dodd-Frank Act was enacted to, among other things, promote the financial stability of the United States by improving accountability and transparency in the financial system.[2] Specifically, Title VII of the Dodd-Frank Act provides the Commission and the Commodity Futures Trading Commission ("CFTC") with the authority to regulate over-the-counter ("OTC") derivatives in light of the recent financial crisis, which demonstrated the need for enhanced regulation of the OTC derivatives market. The Dodd-Frank Act is intended to strengthen the existing regulatory structure and to provide the Commission and the CFTC with effective regulatory tools to oversee the OTC derivatives market, which has grown exponentially in recent years and is capable of affecting significant sectors of the U.S. economy.

The Dodd-Frank Act provides the CFTC with authority to regulate "swaps," the Commission with authority to regulate "security-based swaps" ("SBSs"), and both the CFTC and the Commission with authority to regulate "mixed swaps."[3] The Dodd-Frank Act amends the

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1 The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

2 See Pub. L. No. 111-203, Preamble.

3 Section 712(d) of the Dodd-Frank Act provides that the Commission and the CFTC, in consultation with the Board of Governors of the Federal Reserve System ("Federal Reserve"), shall jointly further define the terms "swap," "security-based swap," "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," "eligible contract participant," and "security-based swap agreement." These terms are defined in Sections 721 and 761 of the Dodd-Frank Act and, with respect to the term "eligible contract participant," in Section 1a(18) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 1a(18), as re-designated and amended by Section 721 of the Dodd-Frank Act. Further, Section 721(c) of the Dodd-Frank Act requires the CFTC to adopt a rule to further define the terms "swap," "swap dealer," "major swap participant," and "eligible contract participant," and Section 761(b) of the Dodd-Frank Act permits the Commission to adopt a rule to further define the terms "security-based swap," "security-based swap dealer," "major security-based swap participant," and "eligible contract participant," with regard to SBSs, for the purpose of including transactions and entities

Exchange Act to require the following with respect to transactions in SBSs regulated by the Commission: (1) transactions in SBSs must be cleared through a clearing agency if they are of a type that the Commission determines must be cleared, unless an exemption applies;[4] (2) if an SBS is subject to the clearing requirement, then it must be traded on a registered trading platform, i.e., a security-based swap execution facility ("SB SEF") or SBS exchange, unless no facility makes such SBS available for trading;[5] and (3) transactions in SBSs (whether cleared or uncleared) must be reported to a registered SDR or the Commission.[6]

The Dodd-Frank Act provides the Commission with broad authority to adopt rules governing SDRs and to develop additional duties applicable to SDRs.[7] Today, the Commission is proposing in this release new Rules 13n-1 to 13n-11 under the Exchange Act governing SDR registration process, duties, and core principles, including duties related to data maintenance and

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that have been structured to evade Title VII. Finally, Section 712(a) of the Dodd-Frank Act provides that the Commission and CFTC, after consultation with the Federal Reserve, shall jointly prescribe regulations regarding "mixed swaps," as may be necessary to carry out the purposes of Title VII. To assist the Commission and CFTC in further defining the terms specified above, and to prescribe regulations regarding "mixed swaps" as may be necessary to carry out the purposes of Title VII, the Commission and the CFTC are currently seeking comments from interested parties. See Exchange Act Release No. 62717 (Aug. 13, 2010), 75 FR 51429 (Aug. 20, 2010) (File No. S7-16-10) (advance joint notice of proposed rulemaking regarding definitions contained in Title VII).

4 See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C).

5 See Pub. L. No. 111-203, § 763(c) (adding Exchange Act Section 3D).

6 See Pub. L. No. 111-203, §§ 763(i) and 766(a) (adding Exchange Act Sections 13(m)(1)(G) and 13A(A)(1), respectively). The Dodd-Frank Act amends the CEA to provide for a similar regulatory framework with respect to transactions in swaps regulated by the CFTC.

7 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Sections 13(n)(7)(D)(i) and 13(n)(9)).

access by relevant authorities and those seeking to use the SDR's repository services.[8] Pursuant to the legislation, SDRs are required to collect and maintain accurate SBS transaction data so that relevant authorities can access and analyze the data from secure, central locations to better monitor for systemic risk and potential market abuse.

A separate release issued by the Commission today proposes Regulation SBSR, which, among other things, implements the provisions of the Dodd-Frank Act for reporting SBS transactions to SDRs, including standards for the data elements that must be provided.[9] In addition, the Dodd-Frank Act requires the Commission to engage in rulemaking for the public dissemination of SBS transaction, volume, and pricing data,[10] and provides the Commission with discretion to determine an appropriate approach to implement this important function. In Regulation SBSR, the Commission proposes to require SDRs to undertake this role.[11]

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8 Section 712(a)(2) of the Dodd-Frank Act provides that, before commencing any rulemaking regarding SBSs, security-based swap dealers ("SBS dealers"), major security-based swap participants ("major SBS participants"), SDRs, SBS clearing agencies, persons associated with an SBS dealer or major SBS participant, eligible contract participants with regard to SBSs, or SB SEFs pursuant to Subtitle B of Title VII, the Commission must consult and coordinate with the CFTC and other prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible. See Pub. L. No. 111-203, § 712(a)(2). Any person that is required to be registered as an SDR under Exchange Act Section 13(n) must register with the Commission, regardless of whether that person is also registered under the CEA as a swap data repository. Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(8)). The Commission preliminarily believes that an entity that registers with the Commission as an SDR is likely to register also with the CFTC as a swap data repository. As a result, the Commission staff and the CFTC staff have consulted and coordinated with one another regarding their respective Commissions' proposed rules regarding SDRs and swap data repositories as mandated by Sections 763 and 728 of the Dodd-Frank Act, respectively. The Commission staff has also consulted and coordinated with other prudential regulators.

9 See Exchange Act Release No. 63346 (Nov. 19, 2010) ("Regulation SBSR Release").

10 Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(m)(1)).

11 See Regulation SBSR Release, supra note 9.

Taken together, the rules that the Commission proposes today seek to provide improved transparency to regulators and the markets through comprehensive regulations for SBS transaction data and SDRs. The proposed rules would require SBS transaction information to be (1) provided to SDRs in accordance with uniform data standards; (2) verified and maintained by SDRs, which serve as secure, centralized recordkeeping facilities that are accessible by relevant authorities; and (3) publicly disseminated in a timely fashion by SDRs. In combination, these proposed rules represent a significant step forward in providing a regulatory framework that promotes transparency and efficiency in the OTC derivatives markets and creates important infrastructure to assist relevant authorities in performing their market oversight functions.

In preparation for the rulemakings related to SDRs, Commission and CFTC staff held a joint public roundtable (the "Data Roundtable") on September 14, 2010 to gain further insight into many of the issues addressed in this proposal.[12] The rules proposed today take into account the views expressed at the Data Roundtable, as well as the comments received.

This proposed rulemaking is among the first that the Commission has considered in connection with its mandates under the Dodd-Frank Act, and the Commission is mindful of the considerations raised by this timing. The Commission notes that the SBS market is in a nascent stage of regulatory development compared to the markets for equity securities and listed options and that the SBS market could develop further as the Dodd-Frank Act is fully implemented and

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12 The Commission and the CFTC solicited comments on the Data Roundtable. See Exchange Act Release No. 62863 (Sept. 8, 2010), 75 FR 55575 (Sept. 13, 2010). Comments received by the Commission are available at http://www.sec.gov/cgi-bin/ruling-comments?ruling=df-title-vii-swap-data-repositories&rule_path=/comments/df-title-vii/swap-data-repositories&file_num=DF%20Title%20VII%20-%20Swap%20Data%20Repositories&action=Show_Form&title=Swap%20Data%20Repositories%20-%20Title%20VII%20Provisions%20of%20the%20Dodd-Frank%20Wall%20Street%20Reform%20and%20Consumer%20Protection%20Act.

these transactions move to central clearing and trading on organized markets. Accordingly, the Commission urges all interested parties to comment on all aspects of this proposed rulemaking, including whether this proposal, taken as a whole, appropriately advances the objectives of the Dodd-Frank Act in a manner that adequately takes into account the characteristics of the relevant markets.

II. Role, Regulation, and Business Models of SDRs

Under the Dodd-Frank Act, SDRs are intended to play a key role in enhancing transparency in the SBS market by retaining complete records of SBS transactions, maintaining the integrity of those records, and providing effective access to those records to relevant authorities and the public in line with their respective information needs. The enhanced transparency provided by an SDR is important to help regulators and others monitor the build-up and concentration of risk exposures in the SBS market. Without an SDR, data on SBS transactions is dispersed and not readily available to regulators and others. SDRs may be especially critical during times of market turmoil, both by giving relevant authorities information to help limit systemic risk and by promoting stability through enhanced transparency. By enhancing stability in the SBS market, SDRs may also indirectly enhance stability across markets, including equities and bond markets.[13]

In addition, SDRs have the potential to reduce operational risk and enhance operational efficiency in the SBS market. By maintaining transaction records that are accessible by both counterparties to an SBS, SDRs will provide a mechanism for counterparties to ensure that their

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13 See Darrell Duffie, Ada Li, and Theo Lubke, Policy Perspectives of OTC Derivatives Market Infrastructure, Federal Reserve Bank of New York Staff Report No. 424, dated January 2010, as revised March 2010 ("Transparency can have a calming influence on trading patterns at the onset of a potential financial crisis, and thus act as a source of market stability to a wider range of markets, including those for equities and bonds.").

records reconcile on all of the key economic details, which may decrease the likelihood of disputes. The Dodd-Frank Act's requirement of having all SBSs reported to an SDR encourages standardization of data elements, which promotes operational and market efficiency.

The data maintained by an SDR may also assist regulators in (i) preventing market manipulation, fraud, and other market abuses; (ii) performing market surveillance, prudential supervision, and macroprudential (systemic risk) supervision; and (iii) resolving issues and positions after an institution fails.[14]

SDRs themselves are, however, subject to certain operational risks. The inability of an SDR to protect the accuracy and integrity of the data that it maintains or the inability of an SDR to make such data available to regulators, market participants, and others in a timely manner could have a significant negative impact on the SBS market. Failure to maintain privacy of such data could lead to market abuse and subsequent loss of liquidity. Therefore, it is important that SDRs are well-run and effectively regulated.

The Commission is cognizant that the proposed rules discussed herein, as well as other proposals that the Commission may consider in the coming months to implement the Dodd-Frank Act, if adopted, could significantly affect – and be significantly affected by – the nature and scope of the SBS market in a number of ways. For example, the Commission recognizes that if the measures that are adopted are too onerous for new entrants, they could discourage competition and formation of SDRs. On the other hand, if the Commission adopts rules that are

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14 See Letter from DTCC to Chairmen Mary Schapiro and Gary Gensler (Nov. 15, 2010) (available at http://www.sec.gov/comments/df-title-vii/swap-data-repositories/swapdatarepositories-13.pdf) ("A registered SDR should be able to provide (i) enforcement agents with necessary information on trading activity; (ii) regulatory agencies with counterparty-specific information about systemic risk based on trading activity; (iii) aggregate trade information for publication on market-wide activity; and (iv) a framework for real-time reporting from swap execution facilities and derivatives clearinghouses.")

too permissive, SDRs might be prone to deficiencies such as limited access to their services or potential lack of data integrity. The Commission is also mindful that further development of the SBS market may alter the calculus for future regulation of SDRs. As commenters review this release, they are urged to consider generally the role that regulation may play in fostering or limiting development of the SBS market (or, vice versa, the role that market developments may play in changing the nature and implications of regulation) and to focus specifically on this issue with respect to the proposals regarding SDRs that are discussed below.

The Commission is also aware that the regulatory framework for SDRs being developed by the Commission must take into account the commercial viability of SDRs, because realizing the benefits of SDRs requires that entities seek to engage in the business of being an SDR. In this regard, the Commission, which has limited experience with data repositories, seeks to understand the potential revenue streams and operating costs for SDRs. Based on our understanding of existing data repositories and discussions with industry representatives, it appears that SDRs might operate under any one of a number of business models. For example, an SDR could provide basic services and access to data on an at-cost utility model basis. Alternatively, an SDR might seek to earn a profit from fees charged to participants for reporting SBS transaction data to the SDR or for providing raw data to participants or others. In either of these two models, the SDR could also offer to participants additional or ancilliary services related to the SBS data that is reported to the SDR, such as calculating quarterly coupon and other payments (e.g., upfront fees or credit event payments) due between counterparties of an SBS; providing bilateral netting calculations; and providing automated life cycle processing for successor events such as reorganizations and renaming of corporate entities, and credit events such as bankruptcies, restructurings, and insolvencies. Further, an entity that already offers post-trade processing or matching and confirmation services might seek to expand its business to include acting as a data repository. Finally, any of these models could involve the sale of enhanced data or tools derived from the use and analysis of data reported to the repository.

The SDR regulatory regime set forth in the Dodd-Frank Act and any rules that the Commission may adopt to implement the Act will likely affect an entity's decision over which business model to adopt. An entity likely will remain in or enter into the SBS market as a registered SDR based upon the interplay between the business model that it selects and the regulatory requirements that the Commission imposes under the Dodd-Frank Act.

The Commission recognizes the importance of promoting the development of SDRs to collect, maintain, and make available accurate SBS data to relevant authorities and the public. The rules that the Commission proposes in this release today reflect its preliminary views on potentially appropriate regulatory requirements to implement the Dodd-Frank Act with respect to SDRs. In this regard, the Commission has considered its experience in regulating the securities market and has sought to propose rules that take into account the obligations the Commission has imposed on other registrants.[15] At the same time, the Commission is interested in gathering

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15 For example, proposed Rule 13n-6 would require SDRs to comply with obligations related to their automated systems' capacity, resiliency, and security that are comparable to the standards applicable to self-regulatory organizations, including clearing agencies, and other registrants pursuant to the Commission's Automation Review Policy standards. And, the requirement in proposed Rule 13n-4 for an SDR to ensure that any dues, fees, or any other charges imposed by, and any discounts or rebates offered by, an SDR be fair and reasonable and not unreasonably discriminatory is similar to obligations imposed by the Exchange Act on other registrants. See, e.g., Exchange Act Section 6(b)(4) ("The rules of the exchange [shall] provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities"); Exchange Act Section 17A(b)(3)((D) ("The rules of the clearing agency [shall] provide for the equitable allocation of reasonable dues, fees and other charges among its participants"); see also Exchange Act Sections 11A(c)(1)(C) and (D) (providing that the Commission may prescribe rules to assure that all securities information processors ("SIPs") may, "for purposes of distribution and publication, obtain on fair and reasonable

additional information regarding the business models that the industry may utilize to operate registered SDRs, views on the potential areas of competition among SDRs, and the interplay between the commercial viability of various SDR business models and any rules implemented under the Dodd-Frank Act. The Commission does not intend by the requirements imposed on an SDR to mandate any particular business model, and it solicits comment on the effect of the proposed rules on business models that SDRs would adopt, and the consequences for market integrity, transparency, and efficiency.

<u>Request for Comment</u>

The Commission also requests comment on the following specific issues:

- Are there business models other than those described above that an SDR may want to adopt? What are the business models, and what are their benefits and drawbacks for SDRs and for the integrity, transparency, and efficiency of the SBS market?
- Do the Commission's proposed rules favor or discourage one business model over another? If so, identify which rule(s) and explain.
- Should the Commission's rules favor or discourage one business model over another? If so, which models should be favored or discouraged and why?
- What factors determine whether an entity decides to operate as an SDR?
- Who are the likely investors in or sources of capital for new SDRs? What are the key sources of risk or uncertainty facing such persons? How would the rules being proposed by the Commission, taken as a whole or individually, facilitate or discourage the investment of capital in SDRs?

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terms such information" and to assure that "all other persons may obtain on terms which are not unreasonably discriminatory" the transaction information published or distributed by SIPs).

- What are the revenue sources available to SDRs? How would the rules proposed or that may be adopted affect potential revenue sources for SDRs, and their commercial viability? Could repositories be commercially viable if the only permissible sources of revenue derived from receiving and generating and providing aggregated data? Which revenue sources are expected to be most important from the standpoint of commercial viability?
- Would there be advantages or disadvantages to the market if SDRs were required to provide basic services on an at-cost or utility model basis?
- Do the rules proposed by the Commission in this release, taken as a whole, reflect an appropriate regulatory burden on SDRs, considering the statutory mandates and policy goals of the Dodd-Frank Act? Should the Commission impose additional or fewer requirements on SDRs? Which requirements should be added or removed and why? Which requirements, if any, in combination or alone, would be unduly burdensome on SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in these rules? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement these proposed rules?
- How many SDRs are likely to register with the Commission? Will there likely be more than one SDR for each asset class of SBSs? If there will likely be only one SDR for each asset class, will that be due to the inherent nature of the market and of the SDR business model; will that be due to the rules proposed by the Commission;

or will that be due to other factors? Should the Commission impose additional regulatory requirements to mitigate any potential detrimental impact on the SBS market related to a single, dominant SDR for each asset class? Or should the Commission instead seek to encourage more competition among SDRs by modifying or eliminating certain aspects of its proposed rules to facilitate new entrants into the market?

- Exchange Act Section 13(n)(5) requires an SDR to "provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity)." Under this provision, should the Commission designate one SDR as the recipient of the information of other SDRs, through direct electronic access to the SBS data at the other SDRs, in order to provide the Commission and relevant authorities with a consolidated location for SBS data? If so, should the consolidation of data from SDRs be by asset class of SBSs or across all asset classes? What would be the costs and benefits of requiring SDRs to report transaction data to another registered SDR that would consolidate the information? If the Commission were to designate one SDR to be the consolidator of SBS data in an asset class or for all SBS data, are there requirements that should be imposed on such an entity that are different than those imposed on other SDRs? Are there specific criteria that the Commission should consider in selecting an SDR to be a consolidator of SBS data?

III. Discussion of Proposed Rules Governing SDRs

Exchange Act Section 3(a)(75), enacted in Section 761 of the Dodd-Frank Act, defines a "security-based swap data repository" to mean "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps."[16] Exchange Act Section 13(n), enacted in Section 763(i) of the Dodd-Frank Act, makes it "unlawful for any person, unless registered with the Commission, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a security-based swap data repository."[17] To be registered and maintain such registration, each SDR is required to comply with the requirements and core principles described in Exchange Act Section 13(n), as well as with any requirements that the Commission adopts by rule or regulation.[18] The Dodd-Frank Act also requires each SDR to appoint a chief compliance officer ("CCO") and specifies the CCO's duties.[19] In addition, the Dodd-Frank Act grants the Commission authority to inspect and examine any registered SDR and to prescribe data standards for SDRs.[20]

A. Proposed Rule Regarding Registration of SDRs[21]

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16 Pub. L. No. 111-203, § 761 (adding Exchange Act Section 3(a)(75)).

17 Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(1)). Any person that is required to be registered as an SDR under Exchange Act Section 13(n) must register with the Commission, regardless of whether that person is also registered under the CEA as a swap data repository. Id. (adding Exchange Act Section 13(n)(8)). Under the legislation, a clearing agency may register as an SDR. Id. (adding Exchange Act Section 13(m)(1)(H)). In addition, any person that is required to register as an SDR pursuant to this section must register with the Commission regardless of whether that person is also registered as an SB SEF.

18 See id. (adding Exchange Act Section 13(n)(3)).

19 See id. (adding Exchange Act Section 13(n)(6)).

20 See id. (adding Exchange Act Sections 13(n)(2) and 13(n)(4)). In a separate proposal, the Commission is proposing rules prescribing the data elements that an SDR is required to accept for each SBS in association with requirements under Section 763(i), adding Exchange Act Section 13(n)(4)(A) relating to standard setting and data identification. See Regulation SBSR Release (proposed Rule 901), supra note 9. Any comments regarding the data elements should be submitted in connection with that proposal.

21 In separate proposals, the Commission is proposing rules requiring each SDR to register as a SIP, as defined in Exchange Act Section 3(a)(22), on Form SIP based on additional

The Commission is proposing Rule 13n-1, which establishes the procedures by which an SDR may apply to the Commission for registration. The proposed rule would provide that an application for the registration of an SDR must be filed electronically in a tagged[22] data format on proposed new Form SDR with the Commission in accordance with the instructions contained in the form.[23] The Commission anticipates developing an online filing system through which an SDR would be able to file and update Form SDR.[24] The information filed would be available on the Commission's website.[25] The Commission preliminarily believes that filing Form SDR in an electronic format would be less burdensome and more efficient for both the SDRs and the Commission.

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requirements proposed in those rules and to register as a clearing agency, depending on an SDR's services. See, e.g., Regulation SBSR Release (proposed Rule 909), supra note 9. Any comments regarding such registrations should be submitted in connection with these proposals.

22 The term "tag" (including the term "tagged") would be defined as an identifier that highlights specific information submitted to the Commission that is in the format required by the Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR") Filer Manual, as described in Rule 301 of Regulation S-T. See proposed Rule 13n-1(a)(3); see also 17 CFR 232.301. The term "EDGAR Filer Manual" would have the same meaning as set forth in Rule 11 of Regulation S-T (defining "EDGAR Filer Manual" as "the current version of the manual prepared by the Commission setting out the technical format requirements for an electronic submission"). See Proposed Rule 13n-1(a)(1); see also 17 CFR 232.11.

23 See proposed Rule 13n-1(b).

24 The Commission anticipates that SDR filings will be submitted through EDGAR, in which case the electronic filing requirements of Regulation S-T would apply. See generally 17 CFR 232 (governing the electronic submission of documents filed with the Commission).

25 If the Commission adopts the rule as proposed, it is possible that SDRs might be required to file Form SDR in paper until such time as an electronic filing system is operational and capable of receiving the form. SDRs would be notified as soon as the electronic system can accept filing of Form SDR. At such time, the Commission may require each SDR to promptly re-file electronically Form SDR and any amendments to the form.

As part of the Commission's longstanding efforts to increase transparency and the usefulness of information, the Commission has been implementing data-tagging of information contained in electronic filings to improve the accuracy of financial information and facilitate its analysis.[26] Data becomes machine-readable when it is labeled, or tagged, using a computer markup language that can be processed by software programs for analysis. Such computer markup languages use standard sets of definitions, or "taxonomies," that translate text-based information in Commission filings into structured data that can be retrieved, searched, and analyzed through automated means. Requiring the information to be tagged in a machine-readable format using a data standard that is freely available, consistent, and compatible with the tagged data formats already in use for Commission filings would enable the Commission to review and analyze effectively Form SDR submissions.

1. Proposed New Form SDR

Proposed Form SDR includes a set of instructions for its proper completion and submission. These instructions are attached to this release, together with proposed Form SDR. The instructions would require an SDR to indicate the purpose for which it is submitting the form (i.e., application for registration, or amendment to an application or to an effective registration) and then to provide information in seven categories: (1) general information, (2) business organization, (3) financial information, (4) operational capability, (5) access to services and data, (6) other policies and procedures, and (7) legal opinion. As part of the application

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26 See Regulation S-T, 17 CFR 232. See also Securities Act Release No. 8891 (Feb. 6, 2008), 73 FR 10592 (Feb. 27, 2008); Securities Act Release No. 9002 (Jan. 30, 2009), 74 FR 6776 (Feb. 10, 2009); Securities Act Release No. 9006 (Feb. 11, 2009), 74 FR 7748 (Feb. 19, 2009); Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009); Investment Company Release No. 29132 (Feb. 23, 2010), 75 FR 10060 (Mar. 4, 2010).

process, each SDR would be required to provide additional information to the Commission upon request.[27]

The Commission preliminarily believes that permitting an SDR to provide information in narrative form would allow the SDR greater flexibility and opportunity for meaningful disclosure of relevant information. The Commission also preliminarily believes that it is necessary to obtain the requested information in proposed Form SDR to enable the Commission to determine whether to grant or deny an application for registration. Specifically, the information would assist the Commission in understanding the basis for registration as well as an SDR's overall business structure, financial condition, track record in providing access to its services and data, technological reliability, and policies and procedures to comply with its statutory obligations. The information would also be useful to the Commission in tailoring any requests for additional information that it may ask an SDR to provide. Furthermore, the required information would assist the Commission in the preparation of its inspection and examination of an SDR.

General Information. Proposed Form SDR would require an SDR to provide contact information, information concerning successor entities (if applicable), a list of asset classes of SBSs for which the SDR is collecting and maintaining data or for which it proposes to collect and maintain data, and a description of the functions that it performs or proposes to perform. This information would assist the Commission and its staff in evaluating the applications and overseeing registered SDRs.

An SDR would be required to consent that any notice or service of process, pleadings, or other documents in connection with any action or proceeding against the SDR may be effectuated by certified mail to an officer or person specified by the SDR at a given U.S. address.

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27 See proposed Rule 13n-1(b).

The Commission preliminarily believes that this consent is important to minimize any logistical obstacles (e.g., locating defendants or respondents abroad) that the Commission may encounter when attempting to provide notice to an SDR or to effect service, including service overseas.

Form SDR must be signed by a person who is duly authorized to act on behalf of the SDR. The signer would be required to certify that all information contained in the application, including the required items and exhibits, is true, current, and complete. This certification is consistent with the certification provisions in the registration forms for SIPs, investment advisers, and broker-dealers (i.e., Forms SIP, ADV, and BD).[28]

If an applicant is a non-resident SDR, then the signer of Form SDR would also be required to certify that the SDR can, as a matter of law, provide the Commission with prompt access to the SDR's books and records and that the SDR can, as a matter of law, submit to onsite inspection and examination by the Commission.[29] For purposes of the certification, the term "non-resident security-based swap data repository" would mean (i) in the case of an individual, one who resides in or has his principal place of business in any place not in the United States; (ii) in the case of a corporation, one incorporated in or having its principal place of business in any place not in the United States; or (iii) in the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not in the United States.[30] Certain foreign jurisdictions may have laws that complicate the ability of

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28 See 17 CFR 249.1001 (Form SIP, for application for registration as a securities information processor or to amend such an application or registration); Form ADV (available at http://www.sec.gov/about/forms/formadv.pdf); and Form BD (available at http://www.sec.gov/about/forms/formbd.pdf).

29 Under Exchange Act Section 13(n)(2), an SDR is subject to inspection and examination by the Commission. See Pub. L. No. 111-203, § 763(i).

30 See also proposed Rule 13n-1(a)(2). This definition is substantially similar to the definition of "non-resident broker or dealer" in Exchange Act Rule 17a-7(d)(3). See 17 CFR 240.17a-7(d)(3).

financial institutions such as SDRs located in their jurisdictions from sharing and/or transferring certain information, including personal financial data of individuals that the financial institutions come to possess from third persons (e.g., personal data relating to the identity of market participants or their customers). The Commission preliminarily believes that the non-resident SDR certification is important to confirm that each SDR located overseas has taken the necessary steps to be in the position to provide the Commission with prompt access to its books and records and to be subject to onsite inspection and examination by the Commission. Failure to make this certification may be a basis for the Commission to deny an application for registration. If a registered non-resident SDR becomes unable to comply with this certification, then this may be a basis for the Commission to revoke the SDR's registration.

Business Organization. Proposed Form SDR would require each SDR to provide information regarding its business organization, including information about (1) any person who owns 10 percent or more of the SDR's stock or who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the SDR's management or policies, (2) the business experience, qualifications, and disciplinary history of its designated CCOs, officers, directors, governors, and persons performing functions similar to any of the foregoing, and the members of all standing committees,[31] (3) its governance arrangements, (4)

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[31] More specifically, proposed Form SDR would require an SDR to disclose the following information regarding its designated CCOs, officers, directors, governors, and persons performing functions similar to any of the foregoing, and the members of all standing committees: (a) name, (b) title, (c) date of commencement and, if appropriate, termination of present term of position, (d) length of time such person has held the same position, (e) brief account of the business experience of such person over the last five years, (f) any other business affiliations in the securities industry or OTC derivatives industry, and (g) a description of: (1) any order of the Commission with respect to such person pursuant to Exchange Act Sections 15(b)(4), 15(b)(6), 19(h)(2), or 19(h)(3); (2) any conviction or injunction of a type described in Exchange Act Sections 15(b)(4)(B) or (C) within the past ten years; (3) any action of a self-regulatory organization with respect

the SDR's constitution, articles of incorporation or association with all amendments to them, existing by-laws, rules, procedures, and instruments corresponding to them, (5) the SDR's organizational structure, (6) its affiliates,[32] (7) any material pending legal proceedings to which the SDR or its affiliate is a party or to which any of its property is the subject, (8) the SDR's material contracts with any SB SEF, clearing agency, central counterparty, and third party service provider, and (9) the SDR's policies and procedures to minimize conflicts of interest in its decision-making process and to resolve any such conflicts of interest. Obtaining this information would assist the Commission in understanding an SDR's overall business structure, governance arrangements, and operations, all of which would assist the Commission in its inspection and examination of the SDR.

Financial Information. Each SDR would be required to disclose as exhibits to proposed Form SDR certain financial and related information, including (1) its balance sheet, statement of income and expenses, statement of sources and application of revenues, and all notes or

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to such person imposing a final disciplinary sanction pursuant to Exchange Act Sections 6(b)(6), 15A(b)(7), or 17A(b)(3)(G); (4) any final action by a self-regulatory organization with respect to such person constituting a denial, bar, prohibition, or limitation of membership, participation, or association with a member, or of access to services offered by, such organization of a member thereof; and (5) any final action by another federal regulatory agency, including the CFTC, any state regulatory agency, or any foreign financial regulatory authority resulting in: (i) a finding that such person has made a false statement or omission, or has been dishonest, unfair, or unethical; (ii) a finding that such person has been involved in a violation of any securities-related regulations or statutes; (iii) a finding that such person has been a cause of a business having its authorization to do business denied, suspended, revoked, or restricted; (iv) an order entered, in the past ten years, against such person in connection with a securities-related activity; or (v) any disciplinary sanction, including a denial, suspension, or revocation of such person's registration or license or otherwise, by order, a prevention from associating with a securities-related business or a restriction of such person's activities.

32 For purposes of proposed Form SDR, an "affiliate" of an SDR would be defined as a person that, directly or indirectly, controls, is controlled by, or is under common control with the SDR. See also proposed Rule 13n-4(a)(1). This proposed definition of "affiliate" is designed to allow the Commission to collect comprehensive identifying information relating to an SDR.

schedules thereto, as of the most recent fiscal year of the SDR, or, alternatively, a financial report, as discussed further in Section III.K.3 of this release, (2) a balance sheet and statement of income and expense for each affiliate of the SDR as of the end of the most recent fiscal year of each such affiliate, or, alternatively, identification of the most recently filed annual report on Form 10-K of the SDR's affiliate, if available, (3) the SDR's schedule of dues, fees, and other charges imposed, or to be imposed, for its services as well as any discounts and rebates offered, or to be offered, and (4) a description of any differentiations in such dues, fees, other charges, discounts, and rebates.

Operational Capability. Proposed Form SDR would also require each SDR to provide information on its operational capability, including (1) its functions and services, (2) the computer hardware that it uses to perform its functions, (3) personnel qualifications for each category of professional, non-professional, and supervisory employees employed by the SDR or the division, subdivision, or other segregable entity within the SDR, (4) the SDR's measures or procedures to provide for the security of any system employed to perform its functions, including any physical and operational safeguards designed to prevent unauthorized access to the system, (5) any circumstances within the past year in which such security measures or safeguards failed to prevent any such unauthorized access to the system and any measures taken to prevent a reoccurrence, (6) any measures used to satisfy itself that the information received or disseminated by the system is accurate, (7) the SDR's backup systems or subsystems that are designed to prevent interruptions in the performance of any SDR functions, (8) limitations on the SDR's capacity to receive (or collect), process, store, or display its data and factors that account for such limitations, and (9) the priorities of assignment of capacity between functions of the SDR and any other uses and methods used to divert capacity between such functions and other uses. Obtaining this information would assist the Commission in determining, among other things, whether an SDR is able to comply with proposed Rule 13n-6, as discussed further in Section III.F of this release.

Access to Services and Data. Proposed Form SDR would further require an SDR to provide information regarding access to its services and data, including (1) the number of persons who presently subscribe, or who have notified the SDR of their intention to subscribe, to its services, (2) instances in which the SDR has prohibited or limited any person with respect to access to services offered or data maintained by the SDR,[33] (3) the storage media of any service furnished in machine-readable form and the data elements of such service, (4) copies of the contracts governing the terms by which persons may subscribe to the SDR's services, including ancillary services, (5) any specifications, qualifications, and criteria that limit, are interpreted to limit, or have the effect of limiting access to or use of any services offered or data maintained by the SDR, (6) any specifications, qualifications, or other criteria required of persons who supply SBS information to the SDR for collection and maintenance or of persons who seek to connect to or link with the SDR, (7) any specifications, qualifications, or other criteria required of any person who requests access to data maintained by the SDR, and (8) the SDR's policies and procedures to review any prohibition or limitation of any person with respect to access to services offered or data maintained by the SDR and to determine whether any person who has been denied access has been discriminated against unfairly. Obtaining this information would assist the Commission in determining, among other things, whether an SDR can comply with proposed Rule 13n-4(c)(1), as discussed further in Section III.D.2.a in this release.

33 If the Commission adopts proposed Rule 909 of Regulation SBSR, which would require each SDR to register as a SIP, then Exchange Act Section 11A(b)(5) would govern denials of access to all SDRs' services. See Regulation SBSR Release (proposed Rule 909), supra note 9.

Other Policies and Procedures. Proposed Form SDR would require each SDR to submit as exhibits: (1) the SDR's policies and procedures to protect the privacy of any and all SBS transaction information that the SDR receives from a market participant or any registered entity, (2) a description of the SDR's safeguards, policies, and procedures to prevent the misappropriation or misuse of (a) any confidential information received by the SDR, including, but not limited to, trade data, position data, and any nonpublic personal information about a market participant or any of its customers; (b) material, nonpublic information; and/or (c) intellectual property by the SDR or any person associated with the SDR for their personal benefit or for the benefit of others, (3) the SDR's policies and procedures regarding its use of the SBS transaction information that it receives from a market participant, any registered entity, or any other person for non-commercial and/or commercial purposes, (4) the SDR's procedures and a description of its facilities for resolving disputes over the accuracy of the transaction data and positions that are recorded in the SDR, (5) the SDR's policies and procedures relating to its calculation of positions, (6) the SDR's policies and procedures to prevent any provision in a valid SBS from being invalidated or modified through the procedures or operations of the SDR, and (7) a plan to ensure that the transaction data and position data that are recorded in the SDR continue to be maintained after the SDR withdraws from registration, which shall include procedures for transferring transaction data and position data to the Commission or its designee (including another registered SDR). As discussed further below, the Commission is proposing to require each SDR to establish, maintain, and enforce these seven policies and procedures. In addition, an SDR would be required to submit as exhibits to Form SDR all of the policies and procedures set forth in Regulation SBSR.[34]

[34] See Regulation SBSR Release, supra note 9.

Legal Opinion. Finally, Form SDR would require each non-resident SDR to provide an opinion of counsel that the SDR can, as a matter of law, provide the Commission with prompt access to the books and records of such SDR and that the SDR can, as a matter of law, submit to onsite inspection and examination by the Commission. Each jurisdiction may have a different legal framework with respect to its laws (e.g., privacy laws) that may limit or restrict the Commission's ability to receive information from an SDR. Providing an opinion of counsel that an SDR can provide prompt access to books and records and can be subject to onsite inspection and examination will allow the Commission to better evaluate an SDR's ability to meet the requirements of registration and ongoing supervision. Failure to provide an opinion of counsel may be a basis for the Commission to deny an application for registration.

Request for Comment

The Commission requests comment on the following specific issues:

- Are the instructions in proposed Form SDR sufficiently clear? If not, identify any instructions that should be clarified and, if possible, offer alternatives.
- Are the Commission's proposed definitions of "affiliate," "non-resident security-based swap data repository," and "tag" appropriate and sufficiently clear? If not, why not and how should they be defined?
- Should the Commission implement an electronic filing system for receipt of Form SDR, and, if so, what particular features should be incorporated into the system?
- Do SDRs anticipate any burdens of filing Form SDR electronically that the Commission should consider?
- In the event that there is a delay in the full implementation of the Commission's electronic filing system for receiving Form SDR, should the Commission require each

SDR to promptly re-file electronically Form SDR and any amendments to the form after the system is operational? If so, what would be a reasonable timeframe to allow such re-filing (e.g., 30 days, 60 days)? Would the re-filing be unduly burdensome for SDRs?

- Which information in Form SDR, including exhibits, should be subject to the proposed data tagging requirements?
- Regarding the format of tagged data, as discussed in Section III.K.3 of this release, the Commission is proposing that an SDR's financial reports be submitted in eXtensible Business Reporting Language ("XBRL") format. Should the Commission require a specific format for tagging other information in proposed Form SDR (e.g., financial information that is not a financial report as described in proposed Rule 13n-11(f), operational capability, access to services and data, and other policies and procedures)? If so, which format (e.g., XML, XBRL) would be best suited to such information?
- Would it be useful for the Commission to provide any additional instructions or define any additional terms in proposed Form SDR? If so, what are they?
- Is the consent relating to notice and service of process on proposed Form SDR appropriate and sufficiently clear? If not, why not and what would be a better alternative to obtaining such consent?
- Are there other factors that the Commission should consider, in addition to an opinion of counsel, that address whether the Commission can legally, under applicable foreign law, obtain prompt access to an SDR's books and records and conduct onsite inspection or examination of the SDR?

- Are the representations that would be required to be made by the person who signs Form SDR appropriate and sufficiently clear? Should the Commission require any additional or alternative representations?
- Should the Commission require SDRs to provide information on persons who own ten percent or more of the SDR's stock or who may control or direct the management or policies of the SDR? Would a different ownership or control threshold be more appropriate? If so, why?
- Are the suggested timeframes of the business experience, qualifications, and disciplinary history of an SDR's designated CCOs, officers, directors, governors, and persons performing functions similar to any of the foregoing, and members of all standing committees appropriate? If not, what should the timeframes be?
- Should the suggested timeframe relating to any conviction or injunction of a type described in Exchange Act Sections 15(b)(4)(B) or (C) be ten years as proposed? If not, should it be longer, shorter, or indefinite? Should it be consistent with other forms (e.g., Form BD) or with Section 15(b)(4)(B) itself?
- Is the financial information that the Commission is requesting on proposed Form SDR appropriate? If not, identify any items that are not appropriate, explain why, and, if possible, offer alternatives. For example, should the Commission request financial information of all affiliates of an SDR or only specific affiliates (e.g., an SDR's parent company, an SDR's wholly-owned subsidiaries, entities in which an SDR has at least a 25% interest, entities that have at least a 25% interest in the SDR)?

- Is the information relating to an SDR's operational capability that the Commission is requesting on proposed Form SDR appropriate? If not, identify any items that are not appropriate, explain why, and, if possible, offer alternatives.
- Should the Commission require on Form SDR a narrative description of any interruption in an SDR's functions performed by automated facilities or systems that has lasted for more than thirty minutes within the preceding six months of filing Form SDR, including the date of each interruption, the cause and duration of each interruption, and the total number of interruptions that have lasted thirty minutes or less? If not, why not? Should the timeframes be longer or shorter? Would this request be necessary in light of the Commission's proposed Rule 13n-6(b)(3)'s requirement that an SDR notify the Commission in writing of material systems outages, as discussed further in Section III.F.1.c. of this release?
- Is the information relating to access to an SDR's services and data that the Commission is requesting on proposed Form SDR appropriate? If not, identify any items that are not appropriate, explain why, and, if possible, offer alternatives.
- Is the Commission's request for information on the specified policies and procedures of an SDR appropriate? If not, explain.
- Would any of the requested information on proposed Form SDR be difficult for an SDR to supply? If so, explain.
- Should the Commission require any additional information on proposed Form SDR? If so, what information and why?
- Are there any items on proposed Form SDR that the Commission should not request? If so, which items and why?

- Under proposed Regulation SBSR, an SDR would be required to register with the Commission as a SIP on Form SIP.[35] Should the Commission combine Form SDR and Form SIP such that an SDR would register as an SDR and SIP using only one form? For example, should the Commission add item 28c from Form SIP to Form SDR? Are there other items from Form SIP that should be added to Form SDR that would help facilitate the registration process?
- Should the policies and procedures required under proposed Regulation SBSR be filed with the Commission as exhibits to Form SDR or attachments to a separate schedule to Form SDR?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?

2. Factors for Approval of Registration and Procedural Process for Review

Proposed Rule 13n-1(c) would provide that within 90 days of the date of the filing of Form SDR (or within such longer period as to which the SDR consents), the Commission shall either grant the registration by order or institute proceedings to determine whether registration should be denied. The 90-day period would not begin to run until a complete Form SDR has been filed by an SDR with the Commission. Proceedings instituted pursuant to this proposed rule shall include notice of the grounds for denial under consideration and opportunity for hearing on the record and shall be concluded not later than 180 days after the date on which the application for registration is filed with the Commission under proposed Rule 13n-1(b).[36] At the conclusion of such proceedings, the Commission, by order, shall grant or deny such

35 See Regulation SBSR Release (proposed Rule 909), supra note 9.

36 Proposed Rule 13n-1(c).

registration.[37] The Commission may extend the time for conclusion of such proceedings for up to 90 days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the SDR consents.[38]

The proposed rule would further provide that the Commission shall grant the registration of an SDR if the Commission finds that such SDR is so organized, and has the capacity, to be able to assure the prompt, accurate, and reliable performance of its functions as an SDR, comply with any applicable provision of the federal securities laws and the rules and regulations thereunder, and carry out its functions in a manner consistent with the purposes of Exchange Act Section 13(n) and the rules and regulations thereunder.[39] The Commission shall deny the registration of an SDR if the Commission does not make any such finding.[40]

The Commission preliminarily believes that its proposed timeframes for reviewing applications for registration as an SDR are appropriate to allow the Commission staff sufficient time to ask questions and, as needed, to require amendments or changes to address legal or regulatory concerns before the Commission approves an application for registration. In addition, the registration provides a mechanism for an SDR to demonstrate that it can comply with the federal securities laws and the rules and regulations thereunder. The proposed procedural process for reviewing applications for registration as an SDR is consistent with the procedural process for reviewing applications of other registrants by the Commission (e.g., SIPs, broker-

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37 Id.

38 Id.

39 Proposed Rule 13n-1(c)(3).

40 Id.

dealers, nationally recognized statistical ratings organizations, national securities exchanges, registered securities associations, clearing agencies) although the timeframes for review vary.[41]

In order to form a more complete and informed basis on which to determine whether to grant, deny, or revoke an SDR's registration, the Commission is considering whether to adopt a requirement that an SDR file with the Commission, as a condition of registration or continued registration, a review relating to the SDR's operational capacity and ability to meet its regulatory obligations. The Commission could require such a review to be in the form of a report conducted by the SDR, an independent third party, or both. This review could be required as an exhibit to Form SDR at the time of registration or as an amendment to Form SDR at a later date (e.g., one year after the registration becomes effective) to allow the review to evaluate the SDR's capabilities after some operational experience following registration.

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed registration process appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Are the timeframes in the proposed registration process appropriate? If not, why not and what would be more appropriate timeframes?
- Are the proposed factors in determining whether the Commission should grant or deny an application for registration appropriate and sufficiently clear? If not, why not? Should the Commission take into consideration any other factors in determining whether to grant or deny an SDR's application for registration?

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41 See 15 U.S.C. 78k-1(b)(3), 78o(b), 78o-7(2), and 78s(a).

- If a non-resident SDR is registered as an SDR in a foreign jurisdiction, should the registration process for the non-resident SDR be any different than the Commission's proposed registration process? For example, should the registration process be more streamlined for such non-resident SDR? Should the process instead require more information from a non-resident SDR? What would be the reasons to provide for a different registration process or, on the other hand, to require a uniform process?
- Should the Commission consider any other factors relating to a non-resident SDR with respect to the Commission's registration rules or in general?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- Should the Commission require an SDR to conduct or obtain a review relating to the SDR's operational capacity and ability to meet its regulatory obligations? If not, why not? If so, how should the Commission define the nature and scope of this review? Should the Commission identify a specific framework for SDRs or independent third parties to follow when conducting a review? If so, what would the critical components of the framework include? Are existing frameworks available that are suitable for this purpose and, if so, which ones would be considered appropriate? Should the review resemble a report, audit, or something else?
- Should the Commission require the SDR, an independent third party, or some other entity to conduct the review? What are examples of such a review? Should the Commission require a review on a case-by-case basis or for all SDRs? Should the Commission require that the review be filed with the Commission? If not, why not? If so, should it be required to be filed with the Commission as a condition of

registration pursuant to proposed Rule 13n-1? If not, why not? When should the Commission require the filing of any review? Would conducting or obtaining a review, or filing such review with the Commission, impose impracticable burdens and costs on SDRs? Please explain the burdens and quantify the costs of such a review.

- If the Commission were to adopt a rule requiring a review by an independent third party, should the rule specify some minimum standard of review or the types of review that should be performed? If so, what should the standards be? Should there be minimum qualification standards for the independent third party? Are there any particular types of third party service providers that should not be permitted to conduct a review of an SDR?
- Should the Commission also require that an SDR certify the accuracy of the review and provide disclosure regarding the nature of the review, findings, and conclusions? To what extent should an SDR be permitted to rely on a third party that it hired to perform the review? Should the Commission condition the ability of an SDR to rely on a third party's review?
- Would a review by an independent third party be necessary in light of the CCO's annual compliance report or proposed Rule 13n-6, as discussed further below?

3. <u>Temporary Registration</u>

Proposed Rule 13n-1(d) would provide a method for SDRs to register temporarily with the Commission. Specifically, the Commission, upon the request of an SDR, may grant temporary registration of the SDR that shall expire on the earlier of: (1) the date that the Commission grants or denies registration of the SDR, or (2) the date that the Commission rescinds the temporary registration of the SDR.[42] The reasons that the Commission may rescind such temporary registration would be the same as those set forth in proposed Rule 13n-2(c), discussed below, for revoking or cancelling a registration of an SDR – e.g., if the Commission finds that an SDR has made any false and misleading statements with respect to any material fact on its Form SDR, is no longer in existence, has ceased to do business in the capacity specified in its application for registration, or has violated or failed to comply with any provision of the federal securities laws or the rules or regulations thereunder. In addition, the Commission would expect that SDRs registered on a temporary registration basis demonstrate that they have the capacity and resources to comply with their regulatory obligations on an ongoing basis as their business evolves.

The proposed temporary registration would enable an SDR to comply with the Dodd-Frank Act upon its effective date (i.e., the later of 360 days after the date of its enactment or 60 days after publication of the final rule implementing Exchange Act Section 13(n))[43] regardless of any unexpected contingencies that may arise in connection with the filing of Form SDR. The temporary registration would also allow the Commission to implement the registration requirements of the Dodd-Frank Act for SDRs while still giving the Commission sufficient time to review fully the application of an SDR after it becomes operational, but before granting a registration that is not limited in duration. An SDR that is temporarily registered with the Commission would be subject to Exchange Act Section 13(n) and the rules and regulations thereunder during the period in which the Commission is reviewing the SDR's application of registration.

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42 Proposed Rule 13n-1(d).

43 See Pub. L. No. 111-203, § 774.

Notwithstanding the potential for temporary registration, the Commission encourages each SDR to apply for registration as soon as possible, following the Commission's adoption of final Rules 13n-1 through 13n-11, to permit sufficient time for an SDR to answer any questions that the Commission staff may have and to provide additional information or documentation, if necessary. The Commission will review applications in the order in which they are received. Applications received close to the effective date of the SDR registration requirement may not be reviewed and approved by the effective date.

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed rule regarding temporary registration appropriate? If not, why not? For example, should the temporary registration be time-limited (e.g., eighteen months from the date the registration is made effective)?
- Is the Commission's proposed rule for temporary registration sufficiently clear? If not, how can it be clarified?
- What conditions should apply to the granting of a temporary registration? For example, should a temporary registration be granted provided that an SDR's completed Form SDR suggests that it can comply with Exchange Act Section 13(n) and the rules and regulations thereunder?
- Is it feasible for an SDR to comply with Exchange Act Section 13(n) and the rules thereunder upon the effective date of the final rules applicable to SDRs? If not, which requirement(s) would be difficult for an SDR to comply with upon the effective date? Should such requirement(s) be imposed on an incremental, phased-in

approach? If so, what would be an appropriate timeframe for such requirement(s) to be met?

- Are there specific requirements that the Commission should consider not requiring an SDR to comply with during the temporary registration period for reasons other than feasibility? If so, what requirements and for what reasons?
- Are there any other reasons not specified in this release upon which a temporary registration should be denied or rescinded?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?

4. Amendment on Form SDR

Under proposed Rule 13n-1(e), if any information reported in items 1 through 16, 25, and 44 of Form SDR or in any amendment thereto is or becomes inaccurate for any reason, whether before or after the registration has been granted, an SDR shall promptly file an amendment on Form SDR updating such information ("interim amendment"). Generally, an SDR would be required to file an amendment within 30 days from the time such information becomes inaccurate.

For example, a non-resident SDR should file an amendment promptly after any changes in the legal or regulatory framework that would impact its ability or the manner in which it provides the Commission with prompt access to its books and records or impacts the Commission's ability to inspect and examine the SDR onsite. The amendment should include a revised opinion of counsel describing how, as a matter of law, the SDR will continue to meet its obligations to provide the Commission with prompt access to the SDR's books and records and to be subject to the Commission's onsite inspection and examination under the new regulatory regime. As noted in Section III.A.1.a of this release, if a registered non-resident SDR becomes unable to comply with this requirement, because of legal or regulatory changes, or otherwise, then this may be a basis for the Commission to revoke the SDR's registration.

In addition to the proposed interim amendments, an SDR would be required to file an annual amendment on Form SDR, including all items subject to interim amendments, within 60 days after the end of its fiscal year.[44] Proposed Rule 13n-1(e) is consistent with the Commission's requirements for other registrants (e.g., national securities exchanges, SIPs, broker-dealers) to file updated and annual amendments with the Commission.[45] The Commission believes that such amendments are important to obtain updated information on each SDR, which would assist the Commission in determining whether each SDR continues to be in compliance with the federal securities laws and the rules and regulations thereunder. Obtaining updated information would also assist the Commission in its inspection and examination of an SDR.

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed rule for interim amendments on Form SDR appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Is the proposed timeframe to file an amendment on Form SDR appropriate? If not, should the timeframe be shorter or longer?
- Should an SDR be required to file an interim amendment for any other items on Form SDR other than items 1 through 16, 25, and 44? If so, which item(s) and why?

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44 Proposed Rule 13n-1(e).

45 See Exchange Act Rules 6a-2 and 15b3-1, 17 CFR 240.6a-2 and 240.15b3-1, respectively. See also 17 CFR 249.1001, supra note 28.

- Should any of the items 1 through 16, 25, and 44 not be required to be amended in the interim? If so, which item(s) and why?
- Should interim amendments be required under any other circumstances not specified?
- Is the Commission's proposed rule requiring SDRs to file annual amendments on Form SDR appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Is an annual filing requirement redundant, in light of the requirement to update promptly the form, or should the annual filing be sufficient to obviate the need for prompt updates?
- Is the proposed timeframe to file an annual amendment on Form SDR appropriate? If not, should the timeframe be shorter or longer? Should the Commission permit the SDR to request an extension to file an annual amendment on Form SDR (e.g., due to substantial, undue hardship)?

5. Service of Process and Non-Resident SDRs

The Commission is proposing Rule 13n-1(f) to require each SDR to designate and authorize on Form SDR an agent in the United States, other than a Commission member, official, or employee, to accept any notice or service of process, pleadings, or other documents in any action or proceedings against the SDR to enforce the federal securities laws and the rules and regulations thereunder. If an SDR appoints another agent to accept such notice or service of process, then the SDR would be required to file promptly an amendment on Form SDR updating this information.[46] Proposed Rule 13n-1(f) is intended to conserve the Commission's resources and to minimize any logistical obstacles (e.g., locating defendants or respondents abroad) that the

46 See proposed Rule 13n-1(e).

Commission may encounter when attempting to effect service. For instance, by prohibiting an SDR from designating a Commission member, official, or employee as its agent for service of process, the proposed rule would reduce a significant resource burden on the Commission, including resources to locate agents of registrants overseas and keep track of their whereabouts.

Proposed Rule 13n-1(g) would further require any non-resident SDR applying for registration pursuant to this rule to certify on Form SDR and provide an opinion of counsel that the SDR can, as a matter of law, provide the Commission with prompt access to the books and records of such SDR and that the SDR can, as a matter of law, submit to onsite inspection and examination by the Commission. For the reasons stated in Section III.A.1.a above, the Commission preliminarily believes that before granting registration to a non-resident SDR, it is appropriate to obtain assurance and an opinion of counsel that such person has taken the necessary steps to be in the position to provide legally the Commission with prompt access to the SDR's books and records and to be subject to onsite inspection and examination by the Commission.

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed rule regarding service of process appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Should the Commission impose any minimum requirements on the agent whom a non-resident SDR designates to accept any notice or request for service of process?
- Are there any factors or alternatives that the Commission should take into consideration to ensure that there could be effective service of process on a non-resident SDR applying for registration as an SDR?

- Are there any factors that the Commission should take into consideration to ensure that a non-resident SDR seeking to register as an SDR can, in compliance with applicable foreign laws, provide the Commission with access to the SDR's books and records that are required pursuant to proposed Rule 13n-7(b), as discussed below, and submit to onsite inspection and examination by the Commission?
- Are any other documents or information necessary to establish a non-resident SDR's ability to comply with the federal securities laws and the rules and regulations thereunder?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?

6. Definition of "Report"

Proposed Rule 13n-1(h) would provide that "[a]n application for registration or any amendment thereto that is filed pursuant to this [rule] shall be considered a 'report' filed with the Commission for purposes of Sections 18(a) and 32(a) of the [Exchange] Act and the rules and regulations thereunder and other applicable provisions of the United States Code and the rules and regulations thereunder." Exchange Act Sections 18(a) and 32(a) set forth the potential liability for a person who makes, or causes to be made, any false or misleading statement in any "report" filed with the Commission (e.g., Form SDR).[47]

[47] Exchange Act Section 18(a) provides, in part, that "[a]ny person who shall make or cause to be made any statement in any . . . report . . . which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading." 15 U.S.C. 78r(a). Exchange Act Section 32(a) provides, in part, that "[a]ny person who willfully and knowingly

B. <u>Proposed Rule Regarding Withdrawal From Registration</u>

Proposed Rule 13n-2(b) would permit a registered SDR to withdraw from registration by filing a notice of withdrawal with the Commission. An SDR would be required to designate on its notice of withdrawal a person associated with the SDR[48] to serve as the custodian of the SDR's books and records.[49] The purpose of this requirement is to ensure that the books and records of an SDR are maintained and available to the Commission and other regulators after the SDR withdraws from registration, and to assist the Commission in enforcing proposed Rules 13n-5(b)(7) and 13n-7(c), as discussed below.

Prior to filing a notice of withdrawal, an SDR would be required to file an amended Form SDR to update any inaccurate information.[50] If there is no inaccurate information to update, then an SDR should include a confirmation to that effect in its notice of withdrawal. The

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makes, or causes to be made, any statement in any . . . report . . . which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $25,000,000 may be imposed." 15 U.S.C. 78ff(a).

48 The term "person associated with a security-based swap data repository" would be defined as (i) any partner, officer, or director of such SDR (or any person occupying a similar status or performing similar functions), (ii) any person directly or indirectly controlling, controlled by, or under common control with such SDR, or (iii) any employee of such SDR. Proposed Rule 13n-2(a)(2). The term "control" (including the terms "controlled by" and "under common control with") would be defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. Under the proposed rules, a person is presumed to control another person if the person: (i) is a director, general partner, or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25 percent of more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital. Proposed Rule 13n-2(a)(1).

49 Proposed Rule 13n-2(b).

50 <u>Id.</u>

Commission anticipates developing an online filing system through which an SDR can file its notice of withdrawal. The information filed would be available on the Commission's website. The Commission preliminarily believes that filing a notice of withdrawal in an electronic format would be less burdensome and more efficient for both the SDRs and the Commission.

Proposed Rule 13n-2(c) would provide that a notice of withdrawal from registration filed by an SDR shall become effective for all matters (except as provided in Rule 13n-2(c)) on the 60th day after the filing thereof with the Commission, within such longer period of time as to which such SDR consents or which the Commission, by order, may determine as necessary or appropriate in the public interest or for the protection of investors, or within such shorter period of time as the Commission may determine. Proposed Rule 13n-2(d) would provide that a notice of withdrawal that is filed pursuant to this rule shall be considered a "report" filed with the Commission for purposes of Exchange Act Sections 18(a) and 32(a) and the rules and regulations thereunder and other applicable provisions of the United States Code and the rules and regulations thereunder.

Under proposed Rule 13n-2(e), if the Commission finds, on the record after notice and opportunity for hearing, that any registered SDR has obtained its registration by making any false and misleading statements with respect to any material fact or has violated or failed to comply with any provision of the federal securities laws and the rules and regulations thereunder, the Commission, by order, may revoke the registration. The proposed rule would further provide that pending final determination of whether any registration shall be revoked, the Commission, by order, may suspend such registration, if such suspension appears to the Commission, after notice and opportunity for hearing on the record, to be necessary or appropriate in the public interest or for the protection of investors.[51]

Finally, proposed Rule 13n-2(f) would provide that if the Commission finds that a registered SDR is no longer in existence or has ceased to do business in the capacity specified in its application for registration, the Commission, by order, may cancel the registration.

This proposed rule is similar to Exchange Act Rule 15b6-1, which relates to withdrawal from registration as a broker-dealer. The Commission believes that implicit in its authority to register an SDR is its authority to revoke or cancel such registration.

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed rule regarding withdrawal from registration appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Are the proposed definitions of "person associated with a security-based swap data repository" and "control" appropriate and sufficiently clear? If not, why not and how should they be defined?
- Should the Commission require an SDR to designate on its notice of withdrawal a custodian of the SDR's books and records? If not, why not and what would be a better alternative?
- Are there any other instances not specified in this proposed rule in which the Commission should have the authority to revoke or cancel an SDR's registration?

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51 Proposed Rule 13n-2(e).

- Is the proposed effective date of 60 days from the filing of the notice of withdrawal with the Commission appropriate? If not, would an earlier or later date be more appropriate?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?

C. Proposed Rule Regarding Registration of Successor to Registered SDR

1. Succession by Application

Proposed Rule 13n-3 would govern the registration of a successor to a registered SDR. Because this proposed rule is substantially similar to Exchange Act Rule 15b1-3, which governs the registration of a successor to a registered broker-dealer, the Commission is proposing to incorporate the concepts that the Commission explained when it adopted amendments to Rule 15b1-3.[52]

Specifically, proposed Rule 13n-3(a) would provide that in the event that an SDR succeeds to and continues the business of an SDR registered pursuant to Exchange Act Section 13(n), the registration of the predecessor shall be deemed to remain effective as the registration of the successor if, within 30 days after such succession, the successor files an application for registration on Form SDR, and the predecessor files a notice of withdrawal from registration with the Commission. A successor would not be permitted to "lock in" the 30-day window period by submitting an application that is incomplete in material respects.

The proposed rule would further provide that the registration of the predecessor SDR shall cease to be effective 90 days after the application for registration on Form SDR is filed by

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[52] See Registration of Successors to Broker-Dealers and Investment Advisers, Exchange Act Release No. 31661 (Dec. 28, 1992), 58 FR 7 (Jan. 4, 1993).

the successor SDR.[53] In other words, the 90-day period would not begin to run until a complete Form SDR has been filed by the successor with the Commission. This 90-day period is consistent with proposed Rule 13n-1, pursuant to which the Commission would have 90 days to grant a registration or institute proceedings to determine if a registration should be denied.

The following are examples of the types of successions that would be required to be completed by filing an application: (1) an acquisition, through which an unregistered entity purchases or assumes substantially all of the assets and liabilities of the SDR and then operates the business of the SDR, (2) a consolidation of two or more registered entities, resulting in their conducting business through a new unregistered entity, which assumes substantially all of the assets and liabilities of the predecessor entities, and (3) dual successions, through which one registered entity subdivides its business into two or more new unregistered entities.

2. Succession by Amendment

Proposed Rule 13n-3(b) would further provide that notwithstanding Rule 13n-3(a), if an SDR succeeds to and continues the business of a registered predecessor SDR, and the succession is based solely on a change in the predecessor's date or state of incorporation, form of organization, or composition of a partnership, the successor may, within 30 days after the succession, amend the registration of the predecessor SDR on Form SDR to reflect these changes. Such amendment shall be deemed an application for registration filed by the predecessor and adopted by the successor. In all three types of successions, the predecessor must cease operating as an SDR. The Commission preliminarily believes that it is appropriate to allow a successor to file an amendment to the predecessor's Form SDR in these types of successions.

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53 Proposed Rule 13n-3(a).

3. Scope and Applicability of Proposed Rule 13n-3

The purpose of proposed Rule 13n-3 is to enable a successor SDR to operate without an interruption of business by relying for a limited period of time on the registration of the predecessor SDR until the successor's own registration becomes effective. The proposed rule is intended to facilitate the legitimate transfer of business between two or more SDRs and to be used only where there is a direct and substantial business nexus between the predecessor and the successor SDR. The proposed rule would not allow a registered SDR to sell its registration, eliminate substantial liabilities, spin off personnel, or facilitate the transfer of the registration of a "shell" organization that does not conduct any business. No entity would be permitted to rely on proposed Rule 13n-3 unless it is acquiring or assuming substantially all of the assets and liabilities of the predecessor's SDR business.

Proposed Rule 13n-3 would not apply to reorganizations that involve only registered SDRs. In those situations, the registered SDRs need not use the rule because they can continue to rely on their existing registrations. The proposed rule would also not apply to situations in which the predecessor intends to continue to engage in SDR activities. Otherwise, confusion may result as to the identities and registration statuses of the parties.

Request for Comment

The Commission requests comment on the following specific issues:

- Is there a sufficient likelihood of successors to registered SDRs to warrant a successor rule?
- Is the Commission's proposed successor rule appropriate and sufficiently clear? If not, why not and what would be a better alternative?

- Are the 30-day and 90-day timeframes in the proposed successor rule appropriate? If not, what would be more appropriate timeframes and why?
- Are there any other instances not specified in the proposed rule in which a successor should be permitted to file an amendment to the predecessor's Form SDR for registration?
- Are there any reasons not to allow a successor to rely on its predecessor's registration by filing an amendment to the predecessor's Form SDR in the specified circumstances?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- Are there any factors not specified that the Commission should consider with respect to this proposed successor rule?

D. Proposed Rule Regarding Duties and Core Principles of SDRs

Section 763(i) of the Dodd-Frank Act requires an SDR to comply with the requirements and core principles described in Exchange Act Section 13(n) as well as any requirement that the Commission prescribes by rule or regulation in order to be registered and maintain registration as an SDR with the Commission.[54] The Commission is proposing Rule 13n-4, which would implement the enumerated duties and core principles and establish additional requirements by rule.

In May 2010, the Committee on Payment and Settlement Systems ("CPSS") and the Technical Committee of the International Organization of Securities Commissions ("IOSCO") issued a consultative report that presented a set of factors for trade repositories in the OTC

[54] See Pub. L. No. 111-203, § 763(i). The legislation also authorizes the Commission to establish additional requirements for SDRs by rule or regulation.

derivatives markets to consider in designing and operating their services ("CPSS-IOSCO consultative report").[55] The OTC Derivatives Regulators' Forum[56] ("ODRF") has also made general recommendations relating to the functionality of trade repositories. The Commission's proposed rules draw from recommendations made by CPSS-IOSCO and the ODRF.

1. Enumerated Duties

Under Exchange Act Sections 13(n)(2), 13(n)(5), and 13(n)(6), each SDR is required to:

(1) subject itself to inspection and examination by the Commission;

(2) accept data as prescribed by the Commission for each SBS;[57]

(3) confirm with both counterparties to the SBS the accuracy of the data that was submitted, as discussed further in Section III.E.2.a of this release;

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55 See Considerations for Trade Repositories in OTC Derivatives Markets, CPSS-IOSCO (May 2010) (available at http://www.bis.org/press/p100512.htm). CPSS is a forum for central banks to monitor and analyze developments in payment and settlement arrangements as well as in cross-border and multicurrency settlement schemes. See Press Release, CPSS-IOSCO, CPSS and IOSCO Consult on Policy Guidance for Central Counterparties and Trade Repositories in the OTC Derivatives Market (May 12, 2010) (available at http://www.bis.org/press/p100512.htm). IOSCO is an international policy forum for securities regulators. The objective of the Technical Committee, a specialized working group established by IOSCO's Executive Committee, is to review major regulatory issues related to international securities and futures transactions and to coordinate practical responses to these concerns. See id.

56 The OTC Derivatives Regulators' Forum is comprised of international financial regulators, including central banks, banking supervisors, and market regulators, resolution authorities, and other governmental authorities that either have direct authority over OTC derivatives market infrastructure providers or major OTC derivatives market participants or that consider OTC derivative market matters more broadly. See OTC Derivatives Regulators' Forum Overview, http://www.otcdrf.org/.

57 In a separate proposal, the Commission is proposing rules prescribing the data elements that an SDR is required to accept for each SBS in association with requirements under Section 763(i) of the Dodd-Frank Act (adding Exchange Act Section 13(n)(4)(A) relating to standard setting and data identification). See Regulation SBSR Release (proposed Rule 901), supra note 9. Any comments regarding the data elements should be submitted in connection with that proposal.

(4) maintain the data in such form, in such manner, and for such period as prescribed by the Commission, as discussed further in Section III.E.2 of this release;

(5) provide direct electronic access to the Commission (or any designee of the Commission), including another registered entity;

(6) provide such information in such form and at such frequency as the Commission may require to comply with requirements set forth in Exchange Act Section 13(m) and the rules and regulations thereunder;[58]

(7) at such time and in such manner as may be directed by the Commission, establish automated systems for monitoring, screening, and analyzing data;

(8) maintain the privacy of any and all SBS transaction information that the SDR receives from an SBS dealer,[59] counterparty, or any registered entity, as discussed further in Section III.I of this release;

(9) on a confidential basis pursuant to Exchange Act Section 24 and the rules and regulations thereunder, upon request, and after notifying the Commission of the

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58 Exchange Act Section 13(m) pertains to the public availability of SBS data. See Pub. L. No. 111-203, § 763(i). In a separate proposal relating to implementation of Section 763(i) of the Dodd-Frank Act (adding Exchange Act Section 13(m)), the Commission is proposing rules that would impose various duties on SDRs in connection with the reporting and real-time public dissemination of SBS transaction information. See Regulation SBSR Release, supra note 9. Any comments regarding Exchange Act Section 13(m) should be submitted in connection with that proposal.

59 Section 761 of the Dodd-Frank Act codified the term "security-based swap dealer" at Exchange Act Section 3(a)(71) to generally mean any person that holds itself out as a dealer in SBSs, makes a market in SBSs, regularly enters into SBSs with counterparties as an ordinary course of business for its own account, or engages in any activity causing it to be commonly known in the trade as a dealer or market maker in SBSs. See Pub. L. No. 111-203, § 761; see also Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Release No. 62717 (Aug. 13, 2010), 75 FR 51429 (Aug. 20, 2010).

request, make available all data obtained by the SDR, including individual counterparty trade and position data, to the following:

(i) each appropriate prudential regulator;[60]

(ii) the Financial Stability Oversight Council;

(iii) the CFTC;

(iv) the Department of Justice; and

(v) the FDIC[61] and any other person that the Commission determines to be appropriate, including, but not limited to –

  (i) foreign financial supervisors (including foreign futures authorities);

  (ii) foreign central banks; and

  (iii) foreign ministries.

(10) before sharing information with any entity described in Exchange Act Section 13(n)(5)(G), obtain a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in Exchange Act Section 24 and the rules and regulations thereunder relating to the information on SBS transactions that is provided, and each entity shall agree to indemnify the SDR and the Commission for any expenses arising from litigation relating to the information

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60 "Prudential regulator" is defined in Exchange Act Section 3(a)(74) to have the same meaning as in the CEA. See Pub. L. No. 111-203, § 761. The CEA identifies the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation ("FDIC"), the Farm Credit Administration, and the Federal Housing Finance Agency as prudential regulators. See Pub. L. No. 111-203, § 721(a)(17) (adding Section 1a(39) of the CEA, 7 U.S.C. 1a(39)).

61 Subject to the statutory requirements of Sections 13(n)(5)(G) and (H), the FDIC, for example, would have access to all data maintained by an SDR, including in connection with its resolution authority under Title II of the Dodd-Frank Act or the Federal Deposit Insurance Act and with respect to SBS data in the SDR related to all counterparties to SBS transactions.

provided under Exchange Act Section 24 and the rules and regulations thereunder ("indemnification provision"); and

(11) designate a CCO who must comply with the duties set forth in Exchange Act Section 13(n)(6).

With respect to the SDR's duty to provide direct electronic access to the Commission or any designee of the Commission, the Commission is proposing to define "direct electronic access" to mean access, which shall be acceptable to the Commission, to data stored by an SDR in an electronic format and updated at the same time as the SDR's data is updated so as to provide the Commission or any of its designees with the ability to query or analyze the data in the same manner that the SDR can query or analyze the data.[62] The Commission may specify the form and manner in which an SDR provides direct electronic access. The Commission is considering different – and possibly multiple – ways in which an SDR may be required or permitted to provide direct electronic access, including, but not limited to, (1) a direct streaming of the data maintained by the SDR to the Commission or any of its designees, (2) a user interface that provides the Commission or any of its designees with direct access to the data maintained by the SDR and that provides the Commission or any of its designees with the ability to query or analyze the data in the same manner that is available to the SDR, or (3) another mechanism that provides a mirror copy of the data maintained by the SDR, which is in an electronic form that is downloadable by the Commission or any of its designees and is in a format that provides the ability to query or analyze the data in the same manner that is available to the SDR.

The Commission is not proposing in this release that an SDR establish automated systems for monitoring, screening, and analyzing SBS data. The Commission believes that a

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62 See proposed Rule 13n-4(a)(5).

measured approach to addressing this provision of the Dodd-Frank Act is appropriate. The market infrastructure of the SBS market is in its infancy. The Dodd-Frank Act and the rules and regulations that the Commission will promulgate over the next year will direct further development and refinement of this market. As the infrastructure for the SBS market continues to develop and the Commission gains experience in regulating this market, the Commission will consider further steps to implement this statutory provision.[63]

With respect to an SDR's duty to notify the Commission when any entity described in Exchange Act Section 13(n)(5)(G) requests directly from the SDR access to data obtained by the SDR, the SDR must keep such notifications and any related requests confidential.[64] Failure by an SDR to treat such notifications and requests confidential could render ineffective or could have adverse effects on the underlying basis for the requests. If, for example, a regulatory use of the data is improperly disclosed, such disclosure could possibly signal a pending investigation or enforcement action, which could have detrimental effects.

With respect to the indemnification provision, the Commission understands that regulators may be legally prohibited or otherwise restricted from agreeing to indemnify third parties, including SDRs as well as the Commission. The indemnification provision could chill requests for access to data obtained by SDRs, thereby hindering the ability of others to fulfill their regulatory mandates and responsibilities. The Commission preliminarily believes that by having access to such data, however, regulators would be in a better position to, among other

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63 In a separate proposal relating to implementation of Section 763(i) of the Dodd-Frank Act (adding Exchange Act Section 13(n)(5)(E)), the Commission is considering proposing rules that would require SDRs to collect data related to monitoring the compliance and frequency of end-user clearing exemption claims. Any comments regarding the end-user clearing exemption proposed rules should be submitted in connection with that proposal.

64 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(5)(G)).

things, monitor risk exposures of individual counterparties to swap and SBS transactions, monitor concentrations of risk exposures, and evaluate systemic risks.[65] As such, the Commission expects that an SDR would not go beyond the minimum requirements of the statute so as not to preclude entities described in Exchange Act Section 13(n)(5)(G) from obtaining the data maintained by an SDR.

The Commission notes that, pursuant to Exchange Act Section 24 and Rule 24c-1 thereunder, the Commission may share nonpublic information[66] in its possession with, among others, "federal, state, local, or foreign government, or any political subdivision, authority, agency or instrumentality of such government . . . . [or] a foreign financial regulatory authority." Pursuant to Exchange Act Section 21(a), the Commission also may assist a foreign securities authority in investigating whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the requesting authority administers or enforces.[67]

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65 See Duffie et al., supra note 13 (Regulators can "explore the sizes and depths of the markets, as well as the nature of the products being traded. With this information, regulators are better able to identify and control risky market practices, and are better positioned to anticipate large market movements.").

66 Under Rule 24c-1, the term "nonpublic information" means "records, as defined in Section 24(a) of the [Exchange] Act, and other information in the Commission's possession, which are not available for public inspection and copying." 17 CFR 240.24c-1.

67 Exchange Act Section 21(a)(2) provides: "On request from a foreign securities authority, the Commission may provide assistance in accordance with this paragraph if the requesting authority states that the requesting authority is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the requesting authority administers or enforces. The Commission may, in its discretion, conduct such investigation as the Commission deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether (A) the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission; and (B) compliance with the request would prejudice the public interest of the United States." 15 U.S.C. 78u(a)(2). Exchange Act

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed rule incorporating the enumerated duties appropriate and sufficiently clear? If not, what would be a better alternative?
- Under Exchange Act Section 13(n)(2), an SDR shall be subject to inspection and examination by any representative of the Commission. Should the Commission specify in its rule or clarify when the Commission anticipates inspecting prospective or newly registered SDRs?
- Is the Commission's proposed definition of "direct electronic access" appropriate and sufficiently clear? If not, how can the Commission clarify this definition?
- What are the advantages and disadvantages of requiring SDRs to provide a direct streaming of data to the Commission or its designee? Should the Commission require periodic electronic transfer of data as an alternative? If so, how often should such transfer occur (e.g., hourly, a few times a day, every few days, once a week)?
- What are the advantages and disadvantages of requiring SDRs to provide a user interface that provides the Commission or any of its designees access to the data maintained by the SDR and that provides the Commission or its designee with the ability to query or analyze the data in the same manner that is available to the SDR?
- What are the advantages and disadvantages of requiring SDRs to provide a mirror copy of its data, which is in an electronic form that is downloadable and is in a format

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Section 3(a)(50) defines "foreign securities authority" to mean "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matter." 15 U.S.C. 78c(a)(50).

that provides the ability to query or analyze the data in the same manner that is available to the SDR?

- What would be the most feasible and cost-effective method for an SDR to provide direct electronic access to the Commission or its designee?
- Are there other methods of providing direct electronic access to the Commission or its designee that the Commission should consider?
- Are there any other factors that the Commission should take into consideration when requiring SDRs to provide the Commission or its designee with direct electronic access?
- What would be the advantages and disadvantages of the Commission appointing as its designee for direct electronic access another registered SDR, to which SDRs would grant direct electronic access and which would consolidate the data that would then be provided to the Commission?
- Are there specific reports or sets of data that the Commission should consider obtaining from SDRs to monitor risk exposures of individual counterparties to SBS transactions, to monitor concentrations of risk exposures, or for other purposes that would help encourage the transparency and open trading of SBSs?
- In addition to the data already subject to the Commission's request,[68] are there additional reports or sets of data that the Commission should consider obtaining from SDRs to evaluate systemic risk or that could be used for prudential supervision?
- Are there any other reports or sets of data that the Commission should consider obtaining from SDRs?

[68] See Regulation SBSR Release, supra note 9.

- Should the Commission require SDRs to establish automated systems for monitoring, screening, and analyzing SBS data or provide the data for the Commission to perform these functions? Should the Commission require SDRs to monitor, screen, and analyze all SBS data in their possession in such a manner as the Commission may require, including in connection with ad hoc requests by the Commission?
- Besides the FDIC, should the Commission specify in its rules any other appropriate person to have access to all data maintained by an SDR (e.g., the Federal Reserve Bank of New York)?
- Are there alternative ways that the Commission could address the indemnification provision while being consistent with Exchange Act Section 13(n)(5)(H)?
- Should the Commission provide in its rules specific indemnification language that an SDR would be required to use when requesting indemnification from entities described in Exchange Act Section 13(n)(5)(G)? If so, what indemnification language would address the requirements of the statute and the needs of information users?
- Alternatively, should the Commission explicitly require that the indemnification agreement be fair and not unreasonably discriminatory so as not to preclude entities described in Exchange Act Section 13(n)(5)(G) from obtaining the data maintained by an SDR?
- Should the Commission limit the amount of indemnification to an SDR and the Commission? If so, what should the limit be? For example, should it be limited to only reasonable litigation expenses (and not any damages) in order to facilitate the

ability of entities described in Exchange Act Section 13(n)(5)(G) to obtain data maintained by an SDR?

- Should the Commission impose any additional duties on SDRs? For example, should SDRs be required to provide downstream processing services or ancillary services (e.g., managing life cycle events and asset servicing)?
- Should any additional duties imposed on SDRs depend on the asset class of SBSs that the SDR is collecting and maintaining? If so, clarify.
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- How might the evolution of the SBS market over time affect SDRs or impact the Commission's proposed rule?

2. Implementation of Core Principles

Each SDR is required, under Exchange Act Section 13(n)(7), to comply with core principles relating to (1) market access to services and data, (2) governance arrangements, and (3) conflicts of interest. Specifically, unless necessary or appropriate to achieve the purposes of the Exchange Act and the rules and regulations thereunder, an SDR[69] is prohibited from adopting

[69] Although Exchange Act Section 13(n)(7)(A) refers to "swap data repository," the Commission believes that the Congress intended it to refer to "security-based swap data repository."

any policies and procedures or taking any action that results in any unreasonable restraint of trade or imposing any material anticompetitive burden on the trading, clearing, or reporting of transactions. In addition, each SDR must establish governance arrangements that are transparent to fulfill the public interest requirements under the Exchange Act and the rules and regulations thereunder; to carry out functions consistent with the Exchange Act, the rules and regulations thereunder, and the purposes of the Exchange Act; and to support the objectives of the federal government, owners of the SDR, and market participants. Moreover, each SDR must establish and enforce written policies and procedures reasonably designed to minimize conflicts of interest in the SDR's decision-making process and to establish a process for resolving any such conflicts of interest. Proposed Rule 13n-4(c) incorporates and implements these three core principles.

a. First Core Principle: Market Access to Services and Data[70]

In implementing the first core principle, the Commission is proposing rules that are intended to protect investors and to maintain a fair, orderly, and efficient SBS market. These proposed rules would protect investors by, for example, fostering transparency in the services that an SDR provides and its pricing for such services as well as promoting competition in the SBS market. As discussed more fully below, when administering these rules, the Commission would generally expect to apply the principles and procedures it has developed in other areas in which it monitors analogous services, such as clearing agencies.

First, proposed Rule 13n-4(c)(1)(i) would require each SDR to ensure that any dues, fees, or other charges it imposes, and any discounts or rebates it offers, are fair and reasonable and

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70 The Dodd-Frank Act refers to the first core principle as "antitrust considerations," which the Commission believes include market access to services offered by and data maintained by SDRs. See Pub. L. No. 111-203, § 763(i).

not unreasonably discriminatory.[71] Such dues, fees, other charges, discounts, or rebates shall be applied consistently across all similarly-situated users of the SDR's services, including, but not limited to, market participants,[72] market infrastructures (including central counterparties), venues from which data can be submitted to the SDR (including exchanges, SB SEFs, electronic trading venues, and matching and confirmation platforms), and third party service providers.

The terms "fair" and "reasonable" often need standards to guide their application in practice. One factor commonly taken into consideration to evaluate the fairness and reasonableness of fees, particularly those of a monopolistic provider of a service, is the cost incurred to provide the service.[73] The Commission does not, however, intend to establish fees or rates, or to dictate formulas by which fees or rates are determined. Based on our experience with other registrants, the Commission would need to take a flexible approach and evaluate the fairness and reasonableness of an SDR's charges on a case-by-case basis. The Commission recognizes that there may be instances in which an SDR would charge different users different prices for the same or similar services. Such differences, however, cannot be unreasonably

[71] The Exchange Act applies a similar standard for other registrants. See, e.g., Exchange Act Section 6(b)(4) ("The rules of the exchange [shall] provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities"); Exchange Act Section 17A(b)(3)(D) ("The rules of the clearing agency [shall] provide for the equitable allocation of reasonable dues, fees and other charges among its participants"); see also Exchange Act Sections 11A(c)(1)(C) and (D) (providing that the Commission may prescribe rules to assure that all SIPs may, "for purposes of distribution and publication, obtain on fair and reasonable terms such information" and to assure that "all other persons may obtain on terms which are not unreasonably discriminatory" the transaction information published or distributed by SIPs).

[72] The term "market participant" would be defined as any person participating in the SBS market, including, but not limited to, SBS dealers, major SBS participants, and any other counterparties to an SBS transaction. Proposed Rule 13n-4(a)(7).

[73] See Regulation of Market Information Fees and Revenues, Exchange Act Release No. 42208 (Dec. 17, 1999).

discriminatory. For example, if an SDR's policies and procedures provide that it may accept an electronic confirmation as reasonable documentation that the data submitted by both counterparties to an SBS is accurate, then an SDR may charge a smaller fee to a market participant that is expected to send a large volume of data that is all electronically confirmed. If, on the other hand, an SDR requires greater resources to contact a counterparty to reasonably satisfy itself that the data that was submitted to the SDR is accurate, then higher fees may be appropriate. The Commission preliminarily believes that an SDR should make reasonable accommodations, including consideration of any cost burdens, on a non-reporting counterparty of an SBS transaction in connection with any follow-up by the SDR regarding the accuracy of the SBS transaction data.

Second, proposed Rule 13n-4(c)(1)(ii) would require each SDR to permit market participants to access specific services offered by the SDR separately. Although an SDR would be allowed to bundle its services, including any ancillary services, this proposed rule would require the SDR to also provide market participants with the option of using its services separately.[74] For instance, if an SDR or its affiliate provides an ancillary matching and confirmation service, then the SDR would be prohibited from requiring a market participant to use and pay for that matching and confirmation service as a condition of using the SDR's data collection service. In evaluating the fairness and reasonableness of fees that an SDR charges for bundled and unbundled services, the Commission would take into consideration the cost to the SDR of making those services available on a bundled or unbundled basis, as the case may be.

[74] See also CPSS-IOSCO, supra note 55 ("To the extent a [trade repository] provides complementary post-trade processing services, these should be available independently from its record keeping function so that users can selectively utilise the services they require from the suite of services a [trade repository] may offer.").

Third, proposed Rule 13n-4(c)(1)(iii) would require each SDR to establish, monitor on an ongoing basis, and enforce clearly stated objective criteria that would permit fair, open, and not unreasonably discriminatory access to services offered and data maintained by the SDR as well as fair, open, and not unreasonably discriminatory participation by market participants, market infrastructures, venues from which data can be submitted to the SDR, and third party service providers that seek to connect to or link with the SDR. The Commission is concerned, among other things, that an SDR, controlled or influenced by a market participant, may limit the level of access to the services offered or data maintained by the SDR as a means to impede competition from other market participants or third party service providers. To satisfy the requirements of this proposed rule, an SDR should seek to ensure that its practices and procedures do not stifle innovation and competition in the provision of post-trade processing services. The Commission concurs with the CPSS-IOSCO consultative report's recommendation that "[r]equirements that limit access and participation on grounds other than risks should be avoided" and that "[d]enials of access should only be based on risk-related criteria"[75] (e.g., risks related to the security or functioning of the SDR). Moreover, "[m]arket infrastructures and service providers that may or may not offer potentially competing services should not be subject to anti-competitive practices such as product tying, contracts with non-compete and/or exclusivity clauses, overly restrictive terms of use and anti-competitive price discrimination."[76]

Finally, proposed Rule 13n-4(c)(1)(iv) would require each SDR to establish, maintain, and enforce written policies and procedures reasonably designed to review any prohibition or limitation of any person with respect to access to services offered, directly or indirectly, or data maintained by the SDR and to grant such person access to such services or data if such person

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[75] See CPSS-IOSCO, supra note 55.

[76] Id.

has been discriminated against unfairly. The Commission preliminarily believes that for any such policies and procedures to be reasonable, at a minimum, those involved in the decision-making process of prohibiting or limiting a person from access to an SDR's services or data cannot be involved in the review of whether the prohibition or limitation was appropriate. Otherwise, the purpose of the review process would be undermined. An SDR should consider whether its internal review process is best delegated to the SDR's board of directors, a body performing a function similar to the board of directors (collectively, "board"), or an executive committee.

Request for Comment

The Commission requests comment on the following specific issues:

- Are the Commission's proposed rules implementing the first core principle appropriate and sufficiently clear? If not, why not and what would be better alternatives?
- Is the Commission's proposed definition of "market participant" appropriate? If not, is it over-inclusive or under-inclusive and how should it be defined?
- Would the proposed rules relating to fees provide sufficient flexibility to SDRs such that they can operate in a commercially viable manner?
- Besides an SDR's costs of providing its services, what other factors should the Commission consider in determining whether the SDR's fees, dues, other charges, rebates, or discounts for such services are fair and reasonable?
- Are there circumstances in which it would be fair or reasonable for an SDR to charge a reporting or non-reporting counterparty to an SBS a fee or require that a counterparty invest in certain technologies to satisfy the SDR that the SBS data

submitted to the SDR is accurate? Under what circumstances and for what purposes might allowing SDRs to charge higher fees or require counterparties to invest in certain technologies be appropriate?

- Is the Commission's proposed rule requiring an SDR's fees to be fair, reasonable, and non-discriminatory appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Are there circumstances in which it would be fair and reasonable for an SDR to charge a counterparty to an SBS a fee to satisfy itself that the SBS data submitted to the SDR by the other counterparty to the SBS is accurate?
- In what instances would an SDR differentiate among its users with respect to fees, dues, other charges, discounts, and rebates? Should any of those instances be explicitly prohibited or restricted?
- Are there any other requirements that the Commission should impose on an SDR that would promote competition?
- Is the Commission's proposed rule requiring an SDR to permit market participants to access specific SDR services separately appropriate and sufficiently clear? If not, why not?
- Are there instances in which permitting an SDR to offer bundled services that are not provided separately would be better for market participants or the SBS market as a whole? For example, would bundling certain services improve data quality or promote efficiency? If so, what services should be permitted to be bundled?
- Are there any other factors not mentioned that the Commission should take into consideration with respect to requiring the unbundling of services and fees?

- Should the Commission require an SDR to notify the Commission about the outcome of the SDR's internal review of any prohibition or limitation of access to its services or data? If so, should the Commission specify a timeframe in which an SDR must notify the Commission? What should the timeframe be?
- Are the Commission's proposed rules regarding an SDR's criteria relating to access to services and data and participation appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Should the Commission prescribe specific criteria for fair, open, and not unreasonably discriminatory access and participation? If so, what should the criteria be?
- In what instances (besides risk-related reasons) would it be reasonable for an SDR to deny access to its services and data?
- Is the Commission's proposed rule requiring an SDR to review its denials of access appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Are there any measures that the Commission can require that would result in a more meaningful internal review process? For example, should the Commission explicitly require that the board review all denials of access? If so, within what timeframe should the review be completed?
- Should the Commission require an SDR to promptly file notice with the Commission if the SDR, in its capacity as an SDR rather than a SIP, prohibits or limits any person's access to services offered or data maintained by the SDR? If not, why not and what would be a better approach?

- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- How might the evolution of the SBS market over time affect SDRs or impact the Commission's proposed rule?
- What is the likely impact of the Commission's proposed rule on the development and use of different technologies for reporting SBS transaction information to SDRs and for accessing the services offered and data maintained by SDRs?

b. Second Core Principle: Governance Arrangements

To implement the second core principle, proposed Rule 13n-4(c)(2) would require each SDR to establish governance arrangements that are well defined and include a clear organizational structure with effective internal controls. The proposed rule would also require an SDR's governance arrangements to provide for fair representation of market participants.[77] This requirement is similar to requirements imposed on exchanges.[78] Additionally, an SDR would be

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77 Proposed Rule 13n-4(c)(2)(ii).

78 Exchange Act Section 6(b)(3) requires that the rules of an exchange assure a fair representation of its members in the selection of its directors and administration of its affairs, and must provide that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer. See 15 U.S.C. 78f(b)(3).

required to provide representatives of market participants, including end-users,[79] who are on the board with the opportunity to participate in the process for nominating directors and with the right to petition for alternative candidates.[80] The Commission notes that directors of an SDR owe a fiduciary duty to the SDR and all of its shareholders, and that the board as a whole is ultimately responsible for overseeing the SDR's compliance with the SDR's statutory obligations.

The proposed rule would further require each SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the SDR's senior management and each member of the board or committee that has the authority to act on behalf of the board possess requisite skills and expertise to fulfill their responsibilities in the management and governance of the SDR, to have a clear understanding of their responsibilities, and to exercise sound judgment about the SDR's affairs.[81] This proposed requirement is based on a recommendation in the CPSS-IOSCO consultative report.[82] Given an SDR's unique role in an SBS market, the Commission preliminarily believes that it is particularly important that those who are managing and overseeing an SDR's activities are qualified to do so. An SDR's failure to comply with its statutory obligations, for example, could impact the SBS market as a whole.

As part of its consideration of governance issues as they pertain to SDRs, the Commission is considering whether potential conflicts between commercial incentives of owners of an SDR and statutory objectives would warrant prescriptive rules relating to governance,

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79 The term "end-user" would be defined as any counterparty that is described in Exchange Act Section 3C(g)(1) and the rules and regulations thereunder. Proposed Rule 13n-4(a)(6).

80 Proposed Rule 13n-4(c)(2)(iii).

81 Proposed Rule 13-4(c)(2)(iv).

82 See CPSS-IOSCO, supra note 55.

particularly in light of the Commission's general oversight authority and the other specific rules proposed in this release intended to minimize conflicts and ensure that SDRs meet core principles.[83] As discussed further below, the owners of an SDR may have an interest in maximizing the potential commercial value of the information reported to the SDR, which depends on the extent to which the SDR and its affiliates are permitted to use such information for commercial purposes. The Commission is not at this time proposing to preclude an SDR or its affiliates from making commercial use of the transaction data, e.g., by developing analytical reports or tools that are derived from aggregate transaction reports. This commercial interest may conflict with the statutory objective of protecting data privacy and providing for fair and open access to the data maintained by the SDR. For example, an SDR might attempt to restrict access to parties who would seek to use the data for their own commercial purposes.

In order to address this issue, the Commission could choose to prescribe minimum requirements pertaining to board composition or impose ownership restrictions. For example, the Commission could require each SDR to establish a governance arrangement with a certain percentage of independent directors[84] (e.g., majority of independent directors, 35% independent

83 See, e.g., proposed Rule 13n-4(c)(1) (implementing core principle relating to market access to SDRs' services and data), supra Section III.D.2.a; proposed Rule 13n-4(c)(3) (implementing core principle relating to conflicts of interest), infra Section III.D.2.c; and proposed Rule 13n-5 (requiring an SDR to accept all SBSs in a given asset class if it accepts any SBS in that asset class), infra Section III.E.2.a. See also Item 32 of proposed Form SDR (requiring disclosure of instances in which an SDR has prohibited or limited a person with respect to access to the SDR's services or data).

84 The term "independent director" may generally be defined as a director who has no material relationship with the SDR, any affiliate of the SDR, an SDR participant, or any affiliate of an SDR participant. The term "material relationship" may be defined as a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director. The term "participant" when used with respect to an SDR may be defined as any person who uses an SDR's services. Such term would not include a person whose only use of an SDR is through another person who is a participant.

directors) on its board and any committee that has the delegated authority to act on behalf of the board so as not to undermine the effect of the former requirement. The Commission could also require each SDR to establish a nominating committee that is composed of a certain percentage of independent directors (e.g., majority or solely composed of independent directors). Additionally, the Commission could require each SDR to establish governance arrangements that would restrict any SDR participant and its related persons or any person and its related persons[85] from (1) beneficially owning,[86] directly or indirectly, any interest in the SDR that exceeds a certain percentage (e.g., 20 percent for any SDR participant and its related persons, 40 percent for any person and its related persons) of any class of securities, or other ownership interest, entitled to vote of such SDR, or (2) directly or indirectly voting, causing the voting of, or giving any consent or proxy with respect to the voting of, any interest in the SDR that exceeds a certain percentage (e.g., 20 percent) of the voting power of any class of securities or other ownership

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85 The term "related person" may be defined as (i) any affiliate of an SDR participant; (ii) any person associated with an SDR participant; (iii) any immediate family member of an SDR participant who is a natural person, or any immediate family member of the spouse of such person, who, in each case, has the same home as the SDR participant, or who is a director or officer of the SDR, or any of its parents or subsidiaries; or (iv) any immediate family member of a person associated with an SDR participant who is a natural person, or any immediate family member of the spouse of such person, who, in each case, has the same home as the person associated with the SDR participant or who is a director or officer of the SDR, or any of its parents or subsidiaries. The term "immediate family member" may be defined as a person's spouse, parents, children, and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's home.

86 The term "beneficial ownership" (including the terms "beneficially owns" or any variation thereof) may have the same meaning, with respect to any security or other ownership interest, as set forth in Exchange Act Rule 13d-3(a), as if such security or other ownership interest were a voting equity security registered under Exchange Act Section 12; provided that to the extent any person is a member of a group within the meaning of Exchange Act Section 13(d)(3), such person shall not be deemed to beneficially own such security or other ownership interest for purposes of this section, unless such person has the power to direct the vote of such security or other ownership interest.

interest of such SDR. The Commission recently has proposed similar requirements for SBS clearing agencies and SB SEFs, which pose a different set of competing interests.[87]

Request for Comment

- Should the Commission's proposed rule regarding fair representation of market participants include fair representation of others (e.g., public representation)? What are the advantages and disadvantages of including others?
- What requirements, if any, should be in place with respect to the duties owed by the board to mitigate tensions between commercial interests and statutory goals? What types of tensions might exist and how do they compare in severity and consequences to those that exist in clearing agencies or exchanges?
- Is the proposed definition of "end-user" appropriate and sufficiently clear? If not, why not and how should it be defined?
- Should end-users or any other group be given guaranteed rights of participation in an SDR's governance? Alternatively, should the Commission require an SDR to establish governance arrangements whereby certain market participants, including end-users, may consult with the board on matters of concern?
- Is requiring an SDR's management to meet certain minimum standards appropriate? If not, what would be a better alternative?
- Is requiring the members of an SDR's board or committee(s) to meet certain minimum standards appropriate? Does the answer depend upon whether the Commission requires that a certain percentage of the SDR's board be independent? If

87 See Exchange Act Release No. 63107 (Oct. 14, 2010), 75 FR 65882 (Oct. 26, 2010).

so, in what way? Would minimum standards have a significant effect on the experience and efficiency of an SDR's board?

- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule encourage or impede competition and the establishment of a greater number of SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare with the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- How might the evolution of the SBS market over time affect SDRs or impact the Commission's proposed rule?
- Should the Commission require an SDR to have independent directors on its board and board committees? If not, why not and what would be a better alternative to improve governance and mitigate any tensions between commercial interests and statutory goals? If so, what should be the required composition of the board and each board committee? How should the terms "independent director" and "related person" be defined? Should the Commission rely on definitions from existing rules (e.g., Exchange Act Rule 10A-3(b)(1)(ii)(A) or Instruction 1 to Item 404(a) of Regulation S-K)?
- Would requiring the board and each board committee to be composed of at least 35% independent directors improve governance of the SDR or effectively address concerns pertaining to conflicting interests of SDR owners? What potential benefits or

drawbacks might result from requiring at least 35% of an SDR's board and each board committee to be independent directors? Would 35% be sufficient to give independent directors a meaningful voice within the board and board committees? If not, would a higher or lower level be appropriate?

- Should the Commission require that a majority of an SDR's board and each board committee be independent directors? What potential benefits or drawbacks might result from such a requirement? Would a majority independent board be likely to enhance an SDR's management of any tensions between commercial interests and statutory goals or to enhance its compliance with the proposed rules? Would a majority independent board be necessary to ensure that an SDR appropriately manages any tensions between commercial interests and statutory goals?
- Should there be a minimum requirement on the number of independent directors on the board or each board committee? If so, what should the minimum requirement be and why? For example, would a minimum requirement of two independent directors be sufficient?
- How are independent directors likely to affect the activities of the SDR? What are their incentives to assure open and fair access to the services offered and data maintained by the SDR? Do independent directors have any conflicts of interest that would affect their ability to facilitate this objective?
- Would participant owners of an SDR be able to exercise undue influence over an SDR even if at least 35% of the board consists of independent directors? Would the requirement of at least 35% independent board effectively insulate an SDR from undue influence by its participant owners?

- Would participant owners of an SDR be able to exercise undue influence over an SDR even if the majority of the board consists of independent directors? Would the requirement of a majority independent board effectively insulate an SDR from undue influence by its participant owners?
- Should the Commission require each SDR to establish a nominating committee? If not, why not and what would be a better approach? If so, what should be the required composition of the nominating committee? Would 51 percent, 100 percent, or some other percentage be sufficient to avoid undue influence by participants? What is the potential impact of requiring the nominating committee to be composed of a majority of independent directors? What is the potential impact of requiring the nominating committee to be solely composed of independent directors? What is the likely impact of requiring the nominating committee to be composed of another percentage of independent directors? Should the Commission require that all or a majority of the nominating committee be independent even if it does not establish requirements for independent directors on an SDR's board? Why or why not? What are the benefits or drawbacks of composition requirements directed specifically to an SDR's nominating committee?
- Should the Commission require an SDR to establish any other committee? If so, what would be the responsibilities of such committee?
- Should the Commission impose any ownership and voting limitations on SDR participants and others? If not, why not and what would be a better alternative to minimize any tensions between commercial interests and statutory goals? If so, what should the required ownership and voting limitations be? For example, would 20%

ownership and voting limitations on an SDR participant and its related persons be sufficient to limit the ability of a market participant or a group of participants from exercising undue influence or control over the governance of the SDR? Should the 20% limitations be higher or lower given the existing concentration of the industry in a small number of large dealers? Would a 40% ownership limitation for any person and its related persons be sufficient to limit anyone from exercising undue influence or control over the governance of the SDR? Should the 40% ownership limitation be higher or lower given the existing concentration of the industry in a small number of large dealers?

- Would requirements related to the governance arrangements (i.e., independent directors, nominating committee) of an SDR be more or less effective than ownership or voting limitations at addressing any tensions between commercial interests and statutory goals? Could restrictions regarding the governance arrangements of an SDR, on their own, be sufficient to effectively address concerns pertaining to undue influence (assuming that such restrictions are necessary for this purpose)? Would it be appropriate or necessary to require both governance arrangements and ownership or voting limitations in order to effectively address these concerns?
- If the Commission were to require ownership and voting interest limitations, should the Commission permit an SDR's board to waive the limitations for a person who is not an SDR participant and its related persons provided that certain conditions are met? If so, under what conditions (e.g., waiver is consistent with the SDR's statutory obligations, waiver would not impair the Commission's ability to enforce the federal securities laws and the rules and regulations thereunder, such person and its related

persons can comply with the federal securities laws and the rules and regulations thereunder, such person and its related persons irrevocably submit to the jurisdiction of the United States federal courts and Commission, such person's books and records related to an SDR's activities would be subject at all times to the Commission's inspection and examination, the Commission would have access to such person's books and records at all times)? Should the waiver be subject to the Commission's review?

- If the Commission were to impose ownership and voting interest limitations, should limitations be phased in for SDRs to provide a grace period for those entities that would not meet the limits at the outset, but that could potentially meet them at a later date, e.g., one year after the registration of an SDR with the Commission?
- If the Commission were to impose ownership and voting interest limitations, should the Commission specifically require remediation by any SDR when any person and its related persons exceed the ownership or voting limitations? For example, should the Commission explicitly require that an SDR's policies and procedures provide a mechanism to divest any interest owned or not give effect to any voting interest held by any person and its related persons in excess of the proposed limitations?
- Are there other methods for mitigating any tensions between commercial interests and statutory goals without placing any voting and ownership limitations?
- Are there potential ways to more narrowly target voting and ownership limitations while effectively mitigating any tensions between commercial interests and statutory goals?

- How do potential tensions between commercial interests and statutory goals for SDRs differ from tensions for clearing agencies and SEFs? Is there a qualitative difference? Are potential tensions more or less attenuated for SDRs?
- How are potential tensions between commercial interests and statutory goals for SDRs similar to potential tensions for clearing agencies and SEFs? Would such similarities warrant similar restrictions regarding their governance arrangements and/or voting and ownership limitations?
- Are there any other restrictions or measures that the Commission should impose on SDRs to improve governance and mitigate any tensions between commercial interests and statutory goals at SDRs?
- Is it important that the Commission and the CFTC adopt compatible provisions regarding governance for SDRs? To what degree are SDRs registered with the Commission also likely to register as swap data repositories with the CFTC? Would incompatible or conflicting governance provisions provide significant difficulties for SDRs?

c. Third Core Principle: Rules and Procedures for Minimizing and Resolving Conflicts of Interest

As mentioned above, each SDR is statutorily required to establish and enforce written policies and procedures reasonably designed to minimize conflicts of interest in the SDR's decision-making process and to establish a process for resolving any such conflicts of interest.[88] Based on information provided by industry representatives regarding how SDRs will likely operate, the Commission preliminarily believes that a small number of dealers could control

[88] See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(7)(C)).

SDRs, which may require SDR owners to balance competing interests.[89] Owners of an SDR could derive greater revenues from their non-repository activities in the SBS market than they would from sharing in the profits of the SDR in which they hold a financial interest. In addition, there may be a tension between an SDR's statutory obligations (e.g., maintaining the privacy of data reported to the SDR) and its own commercial interests or those of its owners.[90]

A few entities that presently provide or anticipate providing repository services have identified conflicts of interest that could arise at an SDR. First, owners of an SDR could have commercial incentives to exert undue influence to control the level of access to the services offered and data maintained by the SDR and to implement policies and procedures that would further their self-interests to the detriment of others.[91] Specifically, owners of an SDR could exert their influence and control to prohibit or limit access to the services offered and data maintained by the SDR in order to impede competition.[92] Second, an SDR could favor certain

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89 See Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2010 ("Derivatives activity in the U.S. banking system continues to be dominated by a small group of large financial institutions. Five large commercial banks represent 97% of the total banking industry notional amounts . . . .").

90 See, e.g., CPSS-IOSCO consultative report, supra note 55 (noting the conflicts of interest "between the unique public role of the [SDR] and its own commercial interests particularly if the [SDR] offers services other than record keeping or between commercial interests relating to different participants and linked market infrastructures and service providers").

91 See, e.g., Reval, Responses to the CFTC's Questions on the SDR Requirements (available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative9sub100110-reval.pdf) (stating that an SDR with any ownership or revenue sharing arrangements directly or indirectly with a dealer would be an obvious conflict of interest) ("Reval Response Letter").

92 See, e.g., Warehouse Trust Company. Draft Reponse to CFTC re: CFTC Request for Information regarding SDR Governance (available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative9sub100510-

market participants over others with respect to the SDR's services and pricing for such services.[93] Third, an SDR could require that services be purchased on a "bundled" basis, as discussed above.[94] Finally, an SDR or a person associated with the SDR could misuse or misappropriate data reported to the SDR for financial gain.[95] As one repository noted, "SDR data is extremely valuable and could be sold either stand alone or enhanced with other market data and analysis. The use of this data in this matter would present competitive problems" as well as conflicts of interest issues.[96] Because these conflicts have been identified by only a few potential SDRs, the Commission recognizes that this information may not reflect all business models for SDRs. The Commission invites comment on this issue.

Proposed Rule 13n-4(c)(3) would provide general examples of conflicts of interest that should be considered by an SDR, including, but not limited to: (1) conflicts between the commercial interests of an SDR and its statutory responsibilities, (2) conflicts in connection with the commercial interests of certain market participants or linked market infrastructures, third party service providers, and others, (3) conflicts between, among, or with persons associated

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wt.pdf) (stating that "ownership of an SDR could lead to access restrictions on non-owners.") ("Warehouse Trust Response Letter").

93 See Reval Response Letter, supra note 91 ("Preferential treatment in services provided by an SDR could also occur . . . .").

94 See Warehouse Trust Letter, supra note 92 ("The issue of vertical bundling could arise where [SEFs and clearing agencies] have preferred access or servicing arrangements with SDRs primarily due to ownership overlaps.").

95 See Reval Response Letter, supra note 91 ("There will always be an underlying conflict to ensure that the position information or client activity does not get into the hands of investors or an SDR business partner who could benefit from that information.").

96 See Warehouse Trust Letter, supra note 92; see also Reval Response Letter, supra note 91 ("[I]f only one SDR is created for an asset class and that SDR is held by a market participant that could gain by having an edge on when the information is received, it could have a trading edge.").

with the SDR, market participants, affiliates of the SDR, and nonaffiliated third parties,[97] and (4) misuse of confidential information, material, nonpublic information. and/or intellectual property. Such conflicts of interest could limit the benefits of an SDR and undermine the mandatory reporting requirement in Exchange Act Section 13(m)(G), thereby impacting efficiency in the SBS market.[98]

Proposed Rule 13n-4(c)(3)(i) would require each SDR to establish, maintain, and enforce written policies and procedures reasonably designed to identify and mitigate potential and existing conflicts of interest in the SDR's decision-making process on an ongoing basis. The Commission preliminarily believes that requiring an SDR to conduct ongoing identification and mitigation of conflicts of interest is important because such conflicts can arise gradually over time or unexpectedly. Furthermore, a situation that is acceptable one day may present a conflict of interest the next. In order to identify and address potential conflicts that may arise over time, the Commission believes that, in general, an SDR's procedures should provide a means for regular review of conflicts as they impact the SDR's decision making processes.

Proposed Rule 13n-4(c)(3)(ii) would require an SDR to recuse any person involved in a conflict of interest from the decision-making process for resolving any conflicts of interest. The Commission preliminarily believes that such recusal is necessary to eliminate an apparent conflict of interest in an SDR's decision-making process. Additionally, recusal would increase confidence in the SDR's decision-making process and avoid an appearance of impropriety.

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97 The term "nonaffiliated third party" of an SDR would be defined as any person except (1) the SDR, (2) an SDR's affiliate, or (3) a person employed by an SDR and any entity that is not the SDR's affiliate (and "nonaffiliated third party" includes such entity that jointly employs the person). See proposed Rule 13n-4(a)(8).

98 See Pub. L. No. 111-203, § 763(i). Exchange Act Section 13(m)(G) imposes a mandatory reporting requirement, which provides that "[e]ach security-based swap (whether cleared or uncleared) shall be reported to a registered security-based swap data repository."

Finally, proposed Rule 13n-4(c)(3)(iii) would require an SDR to establish, maintain, and enforce reasonable written policies and procedures regarding the SDR's non-commercial and/or commercial use of the SBS transaction information that it receives from a market participant, any registered entity, or any other person. The Commission recognizes that an SDR may have commercial incentives to operate as an SDR. To the extent that an SDR uses data that it receives from others for commercial purposes, the Commission preliminarily believes that such uses should be clearly defined and disclosed to market participants. If, for example, a market participant agrees to waive confidentiality of the data that it provides to an SDR, then, at the very least, the market participant should understand how an SDR is going to use that data and the scope of the market participant's waiver.

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed definition of "nonaffiliated third party" appropriate and sufficiently clear? If not, why not and how should it be defined?
- Are the Commission's proposed rules implementing the third core principle appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Are the Commission's examples of potential conflicts of interest in its proposed rules adequate? If not, are there other examples of conflicts that the Commission should identify in its rule?
- Do commenters agree with the potential conflict concerns that the Commission has identified in this release? How might conflicts of interest change as SDRs become more established? How might competitive forces within the SBS market affect or

change current conflicts of interest? What potential new conflicts of interest could arise that the Commission should consider? Will competition potentially create different or additional conflicts of interest that the Commission should consider? Will competition potentially mitigate conflicts of interest?

- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- Should the Commission require an SDR to identify and mitigate conflicts of interest in an SDR's governance arrangements periodically rather than on an ongoing basis? Should the proposed requirement extend to any other circumstances?
- Is the Commission's proposed rule requiring recusal of any person involved in a conflict of interest appropriate and sufficiently clear? If not, what would be a better alternative?
- Is the Commission's proposed requirement relating to an SDR's non-commercial and commercial use of data appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Are there conflicts of interest specific to the commercial use of data by an SDR that the Commission should address? What are these conflicts? Can they be mitigated? If so, by what means?

- Should the Commission restrict or prohibit an SDR's use of data for commercial purposes? If so, in what way? For example, should the Commission prohibit an SDR's use of data for commercial purposes unless an SDR obtains express written consent from the market participants submitting such data? Should the Commission require that an SDR's policies and procedures require it to obtain consent from market participants before the SDR uses the data for any purpose or transmits such data to other parties other than regulators? Should the Commission require that an SDR's policies and procedures require it to obtain consent from market participants before the SDR provides aggregated SBS transaction data to the public without charge?
- If some commercial use of data is permitted, should particular commercial uses of data by an SDR nonetheless be prohibited? If so, which uses should be prohibited and why? Should certain potential uses of data, or the use of particular types of data, pose particular concern to the Commission? Which uses or data types are they, and how should the Commission respond?
- Should an SDR's affiliates be subject to any or all of the restrictions on commercial use that are imposed on an SDR? Should the Commission restrict the ability of an SDR to share data with any of its affiliates? For example, should an SDR be prohibited from sharing data with an affiliate unless the same data is also made available at the same time and on reasonable terms to market participants that are not affiliates? Should an SDR be prohibited from sharing certain types of data with an affiliate that trades SBSs?

- Would full disclosure by an SDR of its commercial use of data provide meaningful protection for market participants? Are market participants likely to have a meaningful choice to preclude the commercial use of their transaction data by choosing to report transactions to an SDR that does not make commercial use of the data? If commercial use of data is permitted, is it likely that any SDR would refrain from such use?
- What are the possible consequences of restricting or prohibiting an SDR's use of the data that it receives for commercial purposes? For example, would it deter persons from registering as SDRs? Would it result in existing SDRs to cease operating as such? Would prohibiting an SDR from making commercial use of data reported to it have positive benefits, such as enhancing the confidence of market participants that their trade or position information will not leak into the market?
- Would an SDR need to use data that it receives for commercial purposes in order to be a viable business? If so, explain.
- Are there any additional requirements that the Commission should impose to implement the third core principle?

E. Proposed Rule Regarding Data Collection and Maintenance

The Commission is proposing Rule 13n-5 under the Exchange Act to specify the data collection and maintenance requirements applicable to SDRs.[99]

1. Definitions

Proposed Rule 13n-5(a) would define terms used in the proposed rule. Proposed Rule 13n-5(a)(1) would define "transaction data" to mean all the information reported to the SDR

[99] Proposed Rule 13n-5 is being promulgated under Exchange Act Sections 13(n)(4)(B), 13(n)(7)(D), and 13(n)(9). See Pub. L. No. 111-203, § 763(i).

pursuant to the Exchange Act and the rules and regulations thereunder.[100] This would include all information, including life cycle events, required to be reported to the SDR under Rule 901 of proposed Regulation SBSR.[101]

Proposed Rule 13n-5(a)(2) would define "position" as the gross and net notional amounts of open SBS transactions aggregated by one or more attributes, including, but not limited to, the (i) underlying instrument, index, or reference entity; (ii) counterparty; (iii) asset class; (iv) long risk of the underlying instrument, index, or reference entity; and (v) short risk of the underlying instrument, index, or reference entity.[102] Position data is required to be provided by SDRs to

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[100] In a separate proposal relating to implementation of Section 763(i) of the Dodd-Frank Act (adding Exchange Act Section 13(m)), the Commission is considering rules requiring an SDR to publicly disseminate certain SBS data that has been affirmed by the parties but has not necessarily been confirmed. See Regulation SBSR Release (proposed Rule 902), supra note 9. Any comments regarding the public dissemination proposed rules should be submitted in connection with that proposal. In another separate proposal relating to implementation of Section 763(i) of the Dodd-Frank Act (adding Exchange Act Section 13(n)(5)(E)), the Commission is considering rules that would require SDRs to collect data related to monitoring the compliance and frequency of end-user clearing exemption claims. Any comments regarding the end-user clearing exemption proposed rules should be submitted in connection with that proposal.

[101] A definition of "life cycle event" is being proposed in proposed Regulation SBSR. See Regulation SBSR Release (proposed Rule 900), supra note 9.

[102] For purposes of this definition, positions aggregated by long risk would be only for the aggregate notional amount of SBSs in which a market participant has long risk of the underlying instrument, index, or reference entity. Similarly, positions aggregated by short risk would be only for the aggregate notional amount of SBSs in which a market participant has short risk of the underlying instrument, index, or reference entity. For SBSs other than credit default swaps, a counterparty has long risk where the counterparty profits from an increase in the price of the underlying instrument or index, and a counterparty has short risk where the counterparty profits from a decrease in the price of the underlying instrument or index. For credit default swaps, a counterparty has long risk where the counterparty profits from a decrease in the price of the credit risk of the underlying index or reference entity, and a counterparty has short risk where the counterparty profits from an increase in the price of the credit risk of the underlying index or reference entity. As market events require, the Commission may request that an SDR calculate positions in another manner and to provide those positions to the Commission on a confidential basis.

certain entities pursuant to Exchange Act Section 13(n)(5)(G).[103] Therefore, the Commission proposes defining the term, and has designed this definition to reflect the way the term is currently used in the industry.[104] The proposed term is designed to be sufficiently specific so that SDRs are aware of the types of position calculations that regulators may require an SDR to provide, while at the same time, provide enough flexibility to encompass the types of position calculations that regulators and the industry will find important as new types of SBS are developed.

Proposed Rule 13n-5(a)(3) would define "asset class" as "those security-based swaps in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives." The Commission is proposing this definition in order to implement proposed Rule 13n-5(b)(1)(ii), discussed below. Proposed Rule 13n-5(b)(1)(ii) would require an SDR, if it accepts any SBS in a given asset class, to accept all SBSs in that asset class.

Request for Comment

The Commission requests comment on the following specific issues:

- Are these proposed definitions over-inclusive or under-inclusive? Is there some data that is captured by the term "transaction data" that should not be subject to the collection and maintenance requirements described below? Is there data that should

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103 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(5)(G)); see also proposed Rule 13n-4(b)(9).

104 The Commission notes that Section 763(h) of the Dodd-Frank Act adds Exchange Act Section 10B, which provides, among other things, for the establishment of position limits for any person that holds SBSs. Specifically, Section 10B(a) provides that "[a]s a means reasonably designed to prevent fraud and manipulation, the Commission shall, by rule or regulation, as necessary or appropriate in the public interest or for the protection of investors, establish limits (including related hedge exemption provisions) on the size of positions in any security-based swap that may be held by any person." In addition, Exchange Act Section 10B(d) provides that the Commission may establish position reporting requirements for any person that effects transactions in SBSs, whether cleared or uncleared. See Pub. L. No. 111-203, § 763(h).

be subject to these requirements that is not included in the proposed definition of "transaction data"?

- Is the proposed definition of "position" sufficiently precise?
- Are there other attributes of SBSs for which the Commission should specifically require SDRs to calculate positions?
- Exchange Act Section 10B authorizes the Commission to establish limits on the size of positions in any SBS that may be held by any person. Would the definition of "position" in proposed Rule 13n-5(a)(2) be appropriate for purposes of any rules the Commission might propose with regard to position limits?
- Is the proposed definition of "asset class" sufficiently precise? Is there another definition of "asset class" that better describes the broad categories of SBSs commonly referred to as credit derivatives, equity derivatives, and loan-based derivatives, but excluding those that are not SBSs?
- Should each SDR be allowed to define the "asset class" for which it will accept SBS transaction data under proposed Rule 13n-5(b)(1)(ii)?

2. <u>Requirements</u>

a. <u>Transaction Data</u>

Proposed Rule 13n-5(b)(1)(i) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed for the reporting of transaction data to the SDR, and would require the SDR to accept all transaction data that is reported to the SDR in accordance with such policies and procedures. A fundamental goal of Title VII is to have all

SBSs reported to SDRs.[105] This proposed requirement would prevent SDRs from rejecting SBSs for arbitrary or anti-competitive reasons, minimize the number of SBSs that are not accepted by an SDR, and to the extent that the SDR's policies and procedures make clear what SBSs the SDR will accept, make it easier for market participants to determine whether there is an SDR that will accept a particular SBS.[106]

Proposed Rule 13n-5(b)(1)(ii) would require an SDR, if it accepts any SBS in a given asset class, to accept all SBSs in that asset class that are reported to it in accordance with its policies and procedures required by paragraph (b)(1) of the proposed rule. This proposed requirement is designed to maximize the number of SBSs that are accepted by an SDR. The Commission preliminarily believes that if certain SBSs are not accepted by any SDR and are reported to the Commission instead, the purpose of the Dodd-Frank Act to have centralized data on SBSs for regulators and others to access could be undermined. Without this requirement, the transaction costs for the Commission and other regulators to gather complete information on the SBS market could be higher. In addition, the Commission preliminarily believes that this proposed requirement would make it easier for market participants to determine whether there is an SDR that will accept a particular SBS.

However, an SDR would be required to accept only those SBSs from the asset class that are reported in accordance with the SDR's policies and procedures required by paragraph (b)(1)

105 See Exchange Act Section 13(m)(1)(G) requiring "[e]ach security-based swap (whether cleared or uncleared)" to be reported to a registered SDR. Pub. L. No. 111-203, § 763(i).

106 In a separate proposal relating to implementation of Section 763(i) of the Dodd-Frank Act, the Commission is considering additional rules requiring an SDR to have policies and procedures relating to the reporting of SBS data to the SDR. See Regulation SBSR Release (proposed Rule 907), supra note 9. Any comments regarding the proposed reporting rules should be submitted in connection with that proposal.

of this proposed rule.[107] For example, an SDR's policies and procedures could prescribe the necessary security and connectivity protocols that market participants must have in place prior to transmitting transaction data to the SDR. An SDR would not be required to accept transaction data from market participants that did not comply with these protocols; otherwise the transmission of the transaction data could compromise the SDR's automated systems.

To the extent that an SDR already has systems in place to accept and maintain SBSs in a particular asset class, the Commission preliminarily believes that the requirement of proposed Rule 13n-5(b)(1)(ii) would not add a material incremental financial or regulatory burden to SDRs. The Commission preliminarily believes that SDRs may have commercial incentives to limit SBSs for which they receive reports to those with relatively standardized terms, for operational reasons and because standardized instruments lend themselves more readily to aggregation of information that would have commercial value (to the extent that SDRs are entitled under the rules the Commission adopts to use such information for commercial purposes). Given these incentives, the requirement that, if an SDR accepts any SBS in a given asset class, it must accept all SBSs in that asset class, is meant to facilitate the aggregation of and access to SBS transaction data.

Proposed Rule 13n-5(b)(1)(iii) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to satisfy itself by reasonable means that the transaction data that has been submitted to the SDR is accurate. This proposed rule

107 An SDR would be required to disclose to market participants its criteria for providing others with access to services offered and data maintained by the SDR pursuant to proposed Rule 13n-10(b)(1), as discussed in Section III.J of this release. Therefore, market participants would be aware of an SDR's policies and procedures for reporting data.

would also require SDRs to clearly identify the source for each trade side and the pairing method (if any) for each transaction in order to identify the level of quality of that transaction data.

Exchange Act Section 13(n)(5)(B) requires an SDR to "confirm with both counterparties to the security-based swap the accuracy of the data that was submitted."[108] This requirement is based on the premise that an SDR is useful only insofar as the data it retains is accurate.[109] SBS data that is not trusted does not enhance transparency. In order to ensure that the data submitted to an SDR is accurate and agreed to by both counterparties, the SDR must substantiate the accuracy of the data submitted with the counterparties. The Commission understands that with respect to certain asset classes, current market practice is for third party service providers to provide electronic confirmations prior to the SBS data reaching an SDR. The Commission preliminarily believes that an SDR would be able to fulfill its responsibilities under Exchange Act Section 13(n)(5)(B), proposed Rule 13n-4(b)(3),[110] and this proposed rule by developing reasonable policies and procedures that rely on confirmations completed by another entity, such as an SB SEF, clearing agency, or third party vendor, as long as such reliance is reasonable. The SDR would have a continuing responsibility to oversee and supervise the performance of the third party confirmation provider. This could include having policies and procedures in place to monitor the third party confirmation provider's compliance with the terms of any agreements and to assess the third party confirmation provider's continued fitness and ability to perform the confirmations.

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108 See also proposed Rule 13n-4(b)(3).

109 See, e.g., CPSS-IOSCO, supra note 55 (the primary public policy benefit of an SDR is facilitated by the integrity of the information maintained by an SDR).

110 Proposed Rule 13n-4(b)(3) would require SDRs to "[c]onfirm, as prescribed in Rule 13n-5, with both counterparties to the security-based swap the accuracy of the data that was submitted."

For example, if an SBS is traded on an SB SEF, that SB SEF would confirm the accuracy of the transaction data with both counterparties, and the SBS would then be reported to the SDR by the SB SEF. The SDR would not need to further substantiate the accuracy of the transaction data, as long as the SDR had a reasonable belief that the SB SEF had performed an accurate confirmation. However, the SDR would not comply with Exchange Act Section 13(n)(5)(B), proposed Rule 13n-4(b)(3), and this proposed rule if the confirmation proves to be inaccurate and the SDR had reason to know that its reliance on the SB SEF for providing accurate confirmations was unreasonable. If an SBS is transacted by two commercial end-users and is not electronically traded or cleared, and is reported to the SDR by one of those end-users, the SDR may not have any other entity that it can reasonably rely on, and may have to contact each of the counterparties itself to substantiate the accuracy of the transaction data.[111]

Transaction data may vary in terms of reliability. Some transaction data may have been affirmed by counterparties to an SBS, but not confirmed.[112] Some transaction data may have been confirmed informally by the back-offices of the counterparties, but not be considered authoritative. Other transaction data may have gone through an electronic confirmation process and be considered authoritative by the counterparties. In order for regulators to determine

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111 The Commission preliminarily believes that an SDR should make reasonable accommodations, including consideration of any cost burdens, for a non-reporting counterparty of an SBS transaction in connection with any follow-up by the SDR regarding the accuracy of the counterparty's SBS transaction. These accommodations could, for example, include providing means for non-reporting counterparties to substantiate the accuracy of the transaction data without having to incur significant systems or technology costs.

112 In a separate proposal relating to implementation of Section 763(i) of the Dodd-Frank Act (adding Exchange Act Section 13(m)), the Commission is considering rules requiring an SDR to publicly disseminate certain SBS data that has been affirmed by the parties but has not necessarily been confirmed. See Regulation SBSR Release (proposed Rule 902), supra note 9. Any comments regarding the public dissemination proposed rules should be submitted in connection with that proposal.

whether an SDR has reasonable policies and procedures for satisfying itself that the transaction data that has been submitted to the SDR is accurate, the SDR must document the processes used by third parties to substantiate the accuracy of the transaction data.

Proposed Rule 13n-5(b)(1)(iv) would require SDRs to record promptly the transaction data that it receives.[113] It is important that SDRs keep up-to-date records so that regulators and parties to SBSs will have access to accurate and current information.[114]

Request for Comment

The Commission requests comment on the following specific issues:

- What is the likely impact of these requirements on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for reporting SBSs to the SDR?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

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113 In a separate proposal, the Commission is proposing rules prescribing the data elements that an SDR is required to accept for each SBS in association with requirements under Section 763(i) of the Dodd-Frank Act, adding Exchange Act Section 13(n)(4)(A), relating to standard setting and data identification. See Regulation SBSR Release (proposed Rule 901), supra note 9. Any comments regarding the data elements should be submitted in connection with that proposal.

114 See, e.g., CPSS-IOSCO, supra note 55 ("A [trade repository] should promptly record the trade information it receives from its participants. . . . Ideally, a [trade repository] should record to its central registry information it receives from its participants in real-time, and at a minimum, within one business day.").

- Should the Commission require an SDR to have any particular substantive requirements in its policies and procedures, such as requirements pertaining to robust passwords for persons reporting transaction data?
- Does the definition of "asset class" in proposed Rule 13n-5(a)(3) provide sufficient guidance and clarity to entities that may register as SDRs and to other market participants?
- Should the Commission require an SDR to accept all SBSs of a given asset class? If not, what other mechanism should the Commission use to prevent "orphaned" SBSs? How should the Commission address SBSs that do not clearly belong to a particular asset class or that could arguably belong to more than one asset class? Should the Commission allow an SDR that accepts SBSs in one asset class to accept an SBS that arguably belongs to that asset class, but which could also belong to a second asset class, without requiring the SDR to then accept all SBSs in the second asset class?
- Will the requirement of proposed Rule 13n-5(b)(1)(ii) materially add to the costs of SDRs? How does this proposed requirement affect the possible business models under which an SDR may operate or the commercial viability of SDRs in general? Does it make any particular business model more or less attractive?
- Should the Commission impose other requirements that may increase access to an SDR, including:
    - Any other requirements that may prevent an SDR from rejecting those SBSs that are customized to such a degree that they are not in the SDR's economic interest to accept them because the SDR will not be able to perform

downstream processing on the SBSs and may incur costs in obtaining the information to calculate positions; and

  - o Requiring an SDR to employ technologies that accommodate a wide range of technological capabilities among persons that desire to report data to the SDR or other requirements that may prevent an SDR from rejecting SBSs from less sophisticated persons that do not engage in the volume of SBSs necessary to make it economically practicable to invest in technologies that are industry standards?

- Should the Commission require an SDR itself to substantiate the accuracy of the transaction data that has been submitted to the SDR?
- Should the Commission require an SDR to have any particular substantive requirements in its policies and procedures relating to these rules?
- Should the Commission give more guidance as to what constitutes reasonable reliance on a third party? For example, would it be reasonable to rely on documents provided by the party to an SBS that reports the SBS to an SDR? What if that party is a clearing agency that became a party to the SBS as the central counterparty?
- Where an SDR relies on a third party to provide confirmations, should the Commission give more guidance as to the oversight by the SDR of the third party? For example, how often should the SDR review the third party's confirmation procedures? Would annually be sufficient?
- Where an SDR is unable to reasonably satisfy itself that the transaction data is accurate, should the SDR reject the SBS? Should that SBS instead be reported to the

Commission pursuant to Exchange Act Section 13A(a)(1)(B) and the rules and regulations promulgated thereunder?

- Should the Commission give more guidance as to whether an SDR (or the entity that it reasonably relies on) needs to get an affirmative response from both counterparties when it attempts to satisfy itself that the transaction data is accurate? Alternatively, should the SDR submit the transaction data to a counterparty, and require a response only if the counterparty disagrees with the transaction data? Would this answer change if the SBS is cleared or if the counterparty is an end-user?
- Should the Commission give more guidance as to whether receipt by an SDR of a confirmation under Exchange Act Section 15F(i)(2) and the rules promulgated thereunder would be sufficient to fulfill the SDR's duties under Exchange Act Section 13(n)(5)(B), proposed Rule 13n-4(b)(3), and this proposed rule?
- Should the term "promptly" be defined or should the Commission use another term such as "as soon as technologically practicable after the time at which the data has been submitted"?
- Should an SDR be required to record transaction data promptly after execution of a transaction or promptly after confirmation of the transaction?

b. <u>Positions</u>

Proposed Rule 13n-5(b)(2) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to calculate positions for all persons with open SBSs for which the SDR maintains records. Position data is required to be provided by an SDR to certain entities pursuant to Exchange Act Section 13(n)(5)(G).[115] Position information is

[115] <u>See also</u> proposed Rule 13n-4(b)(9).

important to regulators for risk, enforcement, and examination purposes. In addition, having a readily available source of position information can be useful to counterparties themselves in evaluating their own risk. While much of the information necessary for an SDR to calculate positions (as defined in subsection (a)(2) of this proposed rule) will be reported to the SDR as transaction data, some information may not. For example, credit events for credit default swaps or events that result in the termination or adjustment to an equity swap may not be reported.[116] In order to meet its obligation to calculate positions, an SDR could require reporting parties to report such events or it could have a system that will monitor for and collect such information. In order for the positions to be calculated accurately, the SDR will need to promptly incorporate recently reported transaction data and collected unreported data. It is important that the SDR keep up-to-date records so that relevant authorities and parties to the SBS will have access to accurate and current information.[117]

Request for Comment

The Commission requests comment on the following specific issues:

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116 In a separate proposal, the Commission is proposing rules prescribing the data elements that an SDR is required to accept for each SBS in association with requirements under Section 763(i) of the Dodd-Frank Act, adding Exchange Act Section 13(n)(4)(A), relating to standard setting and data identification. See Regulation SBSR Release (proposed Rule 901), supra note 9. The proposed definition of "life cycle event" in proposed Regulation SBSR states, "Notwithstanding the above, a life cycle event shall not include the scheduled expiration of the security-based swap, a previously described and anticipated interest rate adjustment (such as a quarterly interest rate adjustment), or other event that does not result in any change to the contractual terms of the security-based swap." See Regulation SBSR Release (proposed Rule 900), supra note 9. In order to calculate positions, SDRs may need this information, which would not be required to be reported to it. Any comments regarding the data elements should be submitted in connection with that proposal.

117 See, e.g., CPSS-IOSCO, supra note 55 ("Ideally, a [trade repository] should record to its central registry information it receives from its participants in real-time, and at a minimum, within one business day.").

- Should the Commission specify particular standards or procedures for calculating positions?
- What information will an SDR need to obtain in order to calculate positions and how difficult will it be to obtain?
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for reporting SBSs to the SDR?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- The Commission understands that clearing agencies typically produce market values on cleared SBSs. However, many types of SBSs may not be cleared in the near term. Should the Commission require SDRs to calculate market values of each position at least daily and provide them to the Commission? In your comment, please consider the following:
    - What would be the benefits and burdens of such a requirement?
    - Should the requirement to calculate market values of positions be limited to certain types of SBSs, such as SBSs for which the counterparties have agreed that the transaction information maintained by the SDR is the primary record of the trade to the exclusion of any records held by the counterparties?
    - Should "market value" be defined, and if so, how?

- o Will the information necessary for calculating market values of the positions already be at the SDR? What information besides transaction data and positions will be required for the SDR to calculate the market values of positions? Would SDRs be able to obtain the necessary information to calculate market values? Why or why not? How could the SDR obtain the necessary information?
- o To the extent that other entities, such as SB SEFs, SBS dealers, or clearing agencies, already perform such calculations, would it be sufficient for the SDR to obtain the market values from such entity?
- o How frequently should such valuations be performed? Would daily valuation be too onerous for SDRs? What about weekly or monthly valuation?
- o Would market values be meaningful in assessing risk without knowing the margin calls and collateral posted? Should SDRs also be required to maintain margin call and collateral information?
- o How long should the SDR be required to maintain such market values? Would five years be adequate? What about the same time period as the Commission requires for positions?

c. Maintain Accurate Data

Proposed Rule 13n-5(b)(3) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the transaction data and positions that it maintains are accurate. Maintaining accurate records is a core function of an SDR.[118] Maintaining accurate records requires diligence on the part of an SDR; SBSs can be

118 See Section II, Role, Regulation, and Business Models of SDRs, of this release.

amended, assigned, or terminated and positions change upon the occurrence of new events (such as corporate actions). Therefore, it is important that an SDR has policies and procedures to ensure reasonably the accuracy of the transaction data and positions that it maintains. These policies and procedures could include portfolio reconciliation.[119]

Request for Comment

The Commission requests comment on the following specific issues:

- Should the Commission specify particular standards or procedures for maintaining accurate data, such as portfolio reconciliation and payment reconciliation?
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for maintaining SBSs at the SDR?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- If portfolio reconciliation and/or payment reconciliation is required, how often would it be done, and what should it entail? Would the following definition of portfolio reconciliation be sufficient: "a means of ensuring that the SDR's record of security-based swaps are synchronized with those of a person with open security-based swaps maintained by the SDR"? If not, how should the term be defined?

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119 See, e.g., ISDA Operations Committee, Process Working Group, Recommended Practices for Portfolio Reconciliation, version 4.7 (Feb. 2006) (describing recommended practices for portfolio reconciliation).

d. Data Retention

Proposed Rule 13n-5(b)(4) would require SDRs to maintain the transaction data for not less than five years after the applicable SBS expires and historical positions for not less than five years (i) in a place and format that is readily accessible to the Commission and other persons with authority to access or view such information; and (ii) in an electronic format that is non-rewriteable and non-erasable. A five-year retention period is the current requirement for the records of clearing agencies and other registered entities, and is the statutory requirement for SB SEFs.[120] Since an SBS transaction is ongoing, the transaction data should be maintained for the duration of the SBS and for five years after it expires. Positions are not tied to any particular SBS transaction; therefore, the Commission proposes to require positions, as required to be calculated pursuant to proposed Rule 13n-5(b)(2), to be maintained for five years, similar to the record retention requirement for clearing agencies.[121]

Alternatively, the Commission is considering requiring SDRs to "maintain transaction data for not less than five years after the applicable security-based swap expires or ten years after the applicable security-based swap is executed, whichever is greater, and historical positions for not less than five years." Some SBSs are, in practice, of very short duration due to various reasons, including being novated upon being submitted for clearing or being terminated through portfolio compression. By requiring SDRs to retain data of all SBSs for at least ten years after execution, regulators would be able to use the data of the SBSs for analytical studies.

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120 See Exchange Act Rule 17a-1, 17 CFR 240.17a-1 (for national securities exchanges, national securities associations, clearing agencies and the MSRB); Exchange Act Section 3D(d)(9), Pub. L. No. 111-203, § 763(c) (for SB SEFs).

121 See Exchange Act Rule 17a-1, 17 CFR 240.17a-1 (requiring clearing agencies to retain data for five years).

The Commission proposes that the transaction data and positions be in a place and format that is readily accessible to the Commission and other persons with authority to access or view such information. The Commission preliminarily believes that this proposed requirement would ensure that SDRs maintain the information in an organized and accessible manner so that users can easily obtain the data that they need. The Commission also preliminarily believes that this proposed requirement would ensure that the information is maintained in a common and easily accessible format, such as a language commonly used in financial markets.[122]

The proposed requirement for information to be in an electronic format that is non-rewriteable and non-erasable is consistent with the record retention format applicable to electronic broker-dealer records.[123] This proposed requirement would prevent the maintained information from being modified or removed without detection.[124]

Request for Comment

The Commission requests comment on the following specific issues:

- Is the appropriate time period for the Commission to require an SDR to maintain transaction data at least five years after the applicable SBS expires and for positions at least five years? For transaction data, would ten years after expiration of the

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122 An example of such a format is Financial products Markup Language ("FpML"). FpML is based on XML (eXtensible Markup Language), the standard meta-language for describing data shared between applications.

123 See Exchange Act Rule 17a-4(f)(2)(ii)(A), 17 CFR 240.17a-4(f)(2)(ii)(A). In Exchange Act Release No. 47806 (May 7, 2003), 68 FR 25281 (May 12, 2003), the Commission stated, among other things, that a broker-dealer would not violate Exchange Act Rule 17a-4(f)(2)(ii)(A) "if it used an electronic storage system that prevents the overwriting, erasing or otherwise altering of a record during its required retention period through the use of integrated hardware and software control codes." The Commission is proposing to incorporate this interpretation into proposed Rule 13n-5(b)(4).

124 Records made or kept by an SDR, other than transaction data and positions, will be governed by proposed Rule 13n-7, as discussed in Section III.G of this release.

applicable SBS be more appropriate and why?[125] What would be the benefits and burdens associated with each of these time periods? Are there other retention periods that would be more appropriate?

- Should the Commission require SDRs to maintain transaction data for five years after the applicable SBS expires or ten years after the applicable SBS is executed, whichever is greater? What if the Commission required SDRs to maintain transaction data for five years after the applicable SBS expires or eight years after the applicable SBS is executed, whichever is greater? What would be the benefits and burdens associated with each of these time periods?
- Should the Commission instead require an SDR to maintain the transaction data and positions for an indefinite period? What would be the benefits and burdens of requiring an SDR to maintain such information indefinitely?
- Should the Commission have additional requirements regarding access to the transaction data and positions, such as requiring such information be maintained on a server in the United States?
- What is the likely impact of these requirements on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for reporting and maintaining transaction data?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission

[125] The European Commission has recently proposed that trade repositories maintain reported data "for at least ten years following the termination of the relevant contracts." See European Commission, Proposal for a regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (2010) (available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf).

proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

- Should the Commission require such information be kept in a particular format that is accessible to the Commission, such as in FpML? Alternatively, if the Commission does not want to specify a particular technology, should it require such information be maintained in "a global standard for data modeling" or other standard? Should the Commission require that all SDRs maintain such information in the same format?
- Should the Commission require that SDRs establish and maintain effective interoperability and interconnectivity with other SDRs, market infrastructures, and venues?
- Should the Commission specifically require the SDR to organize and index accurately the transaction data and positions so that the Commission and other users of such information are easily able to obtain the specific information that they require?
- Is the proposed requirement that transaction data and positions be kept in a non-rewriteable and non-erasable format too restrictive? Are there other alternatives for protecting the accuracy of such information over the time period that such information is required to be maintained?
- Should the Commission require SDRs to verify automatically the quality and accuracy of the storage media recording process? Should the Commission require SDRs to serialize the original and, if applicable, duplicate units of storage media, and time-date for the required period of retention the information placed on such electronic storage media? Should the Commission require SDRs to have in place an

audit system providing for accountability regarding inputting of records required to be maintained and preserved pursuant to this section and inputting of any changes made to every original and duplicate record maintained and preserved thereby?[126]

e. Controls to Prevent Invalidation

Proposed Rule 13n-5(b)(5) would require every SDR to establish, maintain, and enforce written policies and procedures reasonably designed to prevent any provision in a valid SBS from being invalidated or modified through the procedures or operations of the SDR. Based on staff discussions with market participants, the Commission understands that SDRs, through their process of substantiating the accuracy of the data or in their user agreements, may, and without the knowledge of the counterparties, cause the modification of terms of an SBS. SBSs can be highly negotiated between the counterparties, and the Commission preliminarily believes these terms should not be modified or invalidated without the full consent of the counterparties.

Request for Comment

The Commission requests comment on the following specific issues:

- Should the Commission establish more specific requirements to avoid contract invalidation by an SDR?
- What is the practical effect of this proposed requirement?
- Are such modifications actually occurring?
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs and the willingness of persons to register as SDRs?

126 These requirements are consistent with the broker-dealer retention requirements. See Exchange Act Rule 17a-4(f), 17 CFR 240.17a-4(f).

- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

f. Dispute Resolution Procedures

Proposed Rule 13n-5(b)(6) would require every SDR to establish procedures and provide facilities reasonably designed to effectively resolve disputes over the accuracy of the transaction data and positions maintained by the SDR.[127] The data maintained by the SDR will be used by regulators to make assessments about counterparties, such as whether the counterparty is a major SBS participant. The counterparties also will use this data, and in some cases the data maintained by the SDR may be considered by the counterparties to be the legal record of the SBS. Counterparties, therefore, should have the ability to dispute the accuracy of the data regarding their SBSs held at the SDR. Providing the means to resolve such disputes should enhance data quality and integrity.

Request for Comment

The Commission requests comment on the following specific issues:

- Should the Commission require an SDR to have any particular requirements in its dispute resolution procedures under this rule?
- Is dispute resolution a necessary service that must be provided by an SDR?

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127 In a separate proposal, the Commission is proposing rules regarding the correction of errors in SBS information maintained by an SDR in association with requirements under Section 763(i) of the Dodd-Frank Act. See Regulation SBSR Release (proposed Rules 905 and 907(a)(3)), supra note 9. Any comments regarding those proposed rules should be submitted in connection with that proposal.

- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs and the willingness of persons to register as SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

g. Data Preservation After an SDR Ceases to do Business

Proposed Rule 13n-5(b)(7) would require an SDR, if it ceases to do business, or ceases to be registered pursuant to Exchange Act Section 13(n) and the rules and regulations thereunder, to continue to preserve, maintain, and make accessible the transaction data and historical positions required to be collected, maintained, and preserved by the rule in the manner required by the Exchange Act and the rules and regulations thereunder (including in a place and format that is readily accessible to the Commission and other persons with authority to access or view such information, in an electronic format that is non-rewriteable and non-erasable, and in a manner that protects confidentiality and accuracy) for the remainder of the period required by this rule (that is, not less than five years after the applicable SBS expires for transaction data and not less than five years for historical positions).[128] Given the importance of the records maintained by an SDR to the functioning of the SBS market, if an SDR ceases to do business, this could cause serious disruptions in the market should the information it maintains become unavailable.

Request for Comment

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[128] This proposed requirement is based on Exchange Act Rule 17a-4(g), 17 CFR 240.17a-4(g), which applies to broker-dealer books and records.

The Commission requests comment on the following specific issues:

- Should the Commission propose other requirements that might be necessary or useful in protecting the information maintained by an SDR if the SDR ceases to do business?
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for maintaining SBS data at the SDR?

h. Plan for Data Preservation

Proposed Rule 13n-5(b)(8) would require an SDR to make and keep current a plan to ensure that the transaction data and positions that are recorded in the SDR continue to be maintained in accordance with proposed Rule 13n-5(b)(7), which shall include procedures for transferring the transaction data and positions to the Commission or its designee (including another registered SDR). Given the importance of the records maintained by an SDR to the functioning of the SBS market, if an SDR ceases to do business, the absence of a plan to transfer information could cause serious disruptions. The Commission preliminarily expects that an SDR's plan would establish procedures and mechanisms so that another entity would be in the position to maintain this information after the SDR ceases to do business.

Request for Comment

The Commission requests comment on the following specific issues:

- Should the Commission propose other requirements that might be necessary or useful in protecting the information maintained by an SDR if the SDR ceases to do business?

- To what extent does this requirement provide additional protections beyond those of proposed Rule 13n-5(b)(7)?
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for maintaining SBS data at the SDR?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

F. Proposed Rule Regarding Automated Systems

The Commission is proposing Rule 13n-6 under the Exchange Act to provide standards for SDRs with regard to their automated systems' capacity, resiliency, and security.[129] The standards being proposed under this rule are comparable to the standards applicable to self-regulatory organizations ("SROs"), including exchanges and clearing agencies,[130] and certain other entities, including significant-volume alternative trading systems ("ATSs")[131] and market information dissemination systems,[132] pursuant to the Commission's Automation Review Policy

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129 Proposed Rule 13n-6 is being promulgated under Exchange Act Sections 13(n)(4)(B), 13(n)(7)(D), and 13(n)(9). See Pub. L. No. 111-203, § 763(i).

130 See Exchange Act Release No. 27445.(Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989) ("ARP I Release"); Exchange Act Release No. 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991) ("ARP II Release").

131 See Rule 301(b)(6) of Regulation ATS, 17 CFR 242.301(b)(6); Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844 (Dec. 22, 1998).

132 See ARP II Release, 56 FR 22490, supra note 130 (the Commission's ARP policies "encompass SRO systems that disseminate transaction and quotation information"); See also ARP I Release, 54 FR 48703, supra note 130 (discussing that "the SROs have

("ARP") standards. To promote the maintenance of a stable and orderly SBS market, the Commission preliminarily believes that SDRs should be required to meet the same capacity, resiliency, and security standards applicable to SROs and certain other entities under the Commission's current ARP program.[133]

Systems failures can limit access to data, call into question the integrity of data, and prevent market participants from being able to report transaction data, and thereby have a large impact on market confidence, risk exposure, and market efficiency. Proposed Rule 13n-6 would require an SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security; and submit to the Commission annual reviews of its automated systems, systems outage notices, and prior notices of planned system changes.

These proposed requirements essentially codify and parallel the ARP requirements that have been in place for almost twenty years. The staff has found these standards to be effective in overseeing the capacity, resiliency, and security of major automated systems in use in the securities markets. These proposed requirements as applied to the SBS market are designed to prevent and minimize the impact of systems failures that might negatively impact the stability of the SBS market.

1. <u>Requirements for SDRs' Automated Systems</u>

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developed and continue to enhance automated systems for the dissemination of transaction and quotation information").

133 Clearing agencies are SROs and are therefore subject to the Commission's Automation Review Policies. The Dodd-Frank Act requires that the data maintenance standards of SDRs "shall be comparable to the data standards imposed by the Commission on clearing agencies in connection with their clearing of security-based swaps." Exchange Act Section 13(n)(4)(C), Pub. L. No. 111-203, § 763(i). Proposed Rule 13n-6 will impose data maintenance standards on SDRs that are comparable to those imposed by the Commission on clearing agencies by applying the ARP standards to them.

a. Policies and Procedures

Proposed Rule 13n-6(b)(1) would require an SDR to "establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security. Such policies and procedures shall, at a minimum:

(i) establish reasonable current and future capacity estimates;

(ii) conduct periodic capacity stress tests of critical systems to determine such systems' ability to process transactions in an accurate, timely, and efficient manner;

(iii) develop and implement reasonable procedures to review and keep current its system development and testing methodology;

(iv) review the vulnerability of its systems and data center computer operations to internal and external threats, physical hazards, and natural disasters; and

(v) establish adequate contingency and disaster recovery plans."

This list of proposed requirements is based on existing ARP requirements applied to significant-volume ATSs under Rule 301(b)(6) of Regulation ATS.[134] In addition, the Commission has applied these requirements to SROs and other entities in the securities markets for a number of years in the context of its ARP inspection program.

As a general matter, the Commission preliminarily believes that, if an SDR's policies and procedures satisfy industry best practices standards, then these policies and procedures would be adequate for purposes of proposed Rule 13n-6(b)(1). However, in the unlikely event that industry best practices standards of widely recognized professional organizations are not

134 See 17 CFR 242.301(b)(6).

consistent with the public interest, protection of investors, or the maintenance of fair and orderly markets, the Commission staff would have flexibility to establish such standards.[135]

The proposed rule would require an SDR to quantify, in appropriate units of measure the limits of the SDR's capacity to receive (or collect), process, store, or display the data elements included within each function, and identify the factors (mechanical, electronic, or other) that account for the current limitations.[136] This will make it easier for the Commission to detect any potential capacity constraints of an SDR, which, if left unaddressed, could compromise the ability of an SDR to collect and maintain SBS data. An SDR's failure to clearly understand and have procedures to address its capacity limits would increase the likelihood that it would experience a loss or disruption of system operations.

b. Objective Review of Automated Systems

Proposed Rule 13n-6(b)(2) would require an SDR to submit an objective review of its systems that support or are integrally related to the performance of its activities to the Commission, on an annual basis, within thirty calendar days of completion. This proposed requirement is drawn from the ARP II Release.[137] This proposed requirement is critical to help ensure that SDRs have adequate capacity, resiliency, and security and that their automated systems are not subject to critical vulnerabilities. Proposed Rule 13n-6(a)(3) would define "objective review" as "an internal or external review, performed by competent, objective personnel following established procedures and standards, and containing a risk assessment

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135 Industry best practices standards currently are established by organizations such as: the Information Systems Audit and Control Foundation ("ISACF"); the Federal Financial Institutions Examination Council's ("FFIEC"); the Institute of Internal Auditors ("IIA"); and the SANS Institute.

136 Use of such appropriate units of measure is required in proposed Form SDR Item 31. See also Form SIP, Item #27 for SIPs. 17 CFR 249.1001.

137 See ARP II Release, 56 FR 22490, supra note 130.

conducted pursuant to a review schedule."[138] The proposed definition of "objective review" in proposed Rule 13n-6(a)(3) is based on the standard for the review of automated systems set forth in the ARP II Release.[139]

As in the current ARP program, the Commission staff preliminarily believes that a reasonable basis for determining that a review is objective for purposes of proposed Rule 13n-6 is if the level of objectivity of an SDR's reviewers complied with standards set by widely recognized professional organizations.[140] However, in the unlikely event that industry best practices standards of widely recognized professional organizations are not consistent with the public interest, protection of investors, or the maintenance of fair and orderly markets, the Commission staff would have flexibility to establish such standards.

The decision on which type of reviewer, an internal department or an external firm, should perform the review is a decision for each SDR to make. The Commission preliminarily believes that, as long as the reviewer has the competence, knowledge, consistency, and objectivity sufficient to perform the role, the review can be performed by either recognized

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138 Proposed Rule 13n-6(a)(4) would define "competent, objective personnel" as "a recognized information technology firm or a qualified internal department knowledgeable of information technology systems." This proposed definition is based on the standard for reviewers of automated systems set forth in the ARP II Release. See ARP II Release, 56 FR 22490, supra note 130. Proposed Rule 13n-6(a)(5) would define "review schedule" as "a schedule in which each element contained in subsection (b)(1) of this Rule 13n-6 would be assessed at specific, regular intervals." This proposed definition codifies the Commission's policy set forth in the ARP II Release. See ARP II Release, 56 FR 22490, supra note 130.

139 See ARP II Release, 56 FR 22490, supra note 130.

140 Such standards are currently established by organizations such as the IIA, the Information Systems Audit and Control Association ("ISACA") (formerly the Electronic Data Processing Auditors Association ("EDPAA")), and the American Institute of Certified Public Accountants ("AICPA").

information technology firms or by a qualified internal department knowledgeable of information technology systems.

Proposed Rule 13n-6(b)(2) would further require that, where the objective review is performed by an internal department, an objective, external firm must assess the internal department's objectivity, competency, and work performance with respect to the review performed by the internal department. Proposed Rule 13n-6(b)(2) would require that the external firm issue a report of that review, which the SDR must submit to the Commission on an annual basis, within thirty calendar days of completion of the review.

The proposed requirement in proposed Rule 13n-6(b)(2) that an SDR submit an annual objective review to the Commission is drawn from the ARP II Release.[141] In addition, the proposed requirement in proposed Rule 13n-6(b)(2) that, where the objective review is performed by an internal department, an objective, external firm must assess the internal department's objectivity, competency, and work performance, is similarly drawn from the ARP II Release.[142]

The proposed annual review would not be required to address each element contained in proposed subsections (i)-(v) of Rule 13n-6(b)(1) every year. Rather, using its own risk assessment, an SDR's reviewer would review each element on a "review schedule," as defined in proposed Rule 13n-6(a)(5), in which each element would be assessed at specific, regular intervals, thus facilitating systematic and timely review of each element. This should provide a reasonable and cost-effective level of assurance that automated systems of SDRs are being adequately developed and managed with respect to capacity, security, development, and contingency planning concerns.

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141 See ARP II Release, 56 FR 22490, supra note 130.

142 See id.

The proposed requirement to submit an objective review within thirty days of completion assures the Commission will have timely notice of the information required. The Commission has found through its experience with the current ARP program for SROs and other entities in the securities market that an entity generally requires approximately thirty calendar days after completion of the review to complete the internal review process necessary to submit an annual review to the Commission. A shorter timeframe might not provide an SDR with sufficient time to complete its internal review of the document; a longer timeframe might serve to encourage unnecessary delays.

c. Material Systems Outages

Under proposed subsection (3) of Rule 13n-6(b), an SDR would be required to promptly notify the Commission of material systems outages and any remedial measures that have been implemented or are contemplated, including (i) immediately notifying the Commission when a material systems outage is detected; (ii) immediately notifying the Commission when remedial measures are selected to address the material systems outage; (iii) immediately notifying the Commission when the material systems outage is addressed; and (iv) submitting to the Commission within five business days of when the material systems outage occurred a detailed written description and analysis of the outage and any remedial measures that have been implemented or are contemplated.

This subsection would codify the procedures followed by SROs and certain other entities under the Commission's current ARP program in providing the staff with notification of material system outages. In particular, proposed subsection (3) would clarify that the Commission expects to receive immediate notification that an outage has been detected, that remedial measures have been selected to address the outage, and that the outage has been addressed.

Proposed subsection (3) would also clarify that an SDR should submit a detailed written description and analysis of the outage within five business days of the occurrence of the outage.

The Commission preliminarily believes that the proposed rule would assist the Commission in assuring that an SDR has diagnosed and is taking steps to correct system disruptions, so that systems of the SDR are reasonably equipped to accept and securely maintain transaction data. The Commission preliminarily believes that requiring an SDR to submit notifications of material system outages to the Commission is essential to help ensure that the Commission can continue to effectively oversee the SDR.

Proposed Rule 13n-6(a)(1) would define "material systems outage" as an unauthorized intrusion into any system, or an event at an SDR involving systems or procedures that results in (i) a failure to maintain service level agreements or constraints;[143] (ii) a disruption of normal operations, including switchover to back-up equipment with no possibility of near-term recovery of primary hardware; (iii) a loss of use of any system; (iv) a loss of transactions; (v) excessive back-ups or delays in processing; (vi) a loss of ability to disseminate transaction data, or positions;[144] (vii) a communication of an outage situation to other external entities; (viii) a report or referral of an event to the SDR's board or senior management; (ix) a serious threat to systems operations even though systems operations were not disrupted; (x) a queuing of data between system components or queuing of messages to or from customers of such duration that a

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143 A service level agreement is a contract between a third party that manages and distributes software-based services and a customer, which commits the third party to a required level of service. A service level agreement should contain a specified level of service, support options, enforcement or penalty provisions for services not provided, a guaranteed level of system performance regarding downtime or uptime, a specified level of customer support, and indicate what software or hardware will be provided and for what fee.

144 Proposed Rule 13n-6(a)(6) would give the term "transaction data" the same meaning as in proposed Rule 13n-5(a)(1). Proposed Rule 13n-6(a)(7) would give the term "position" the same meaning as in proposed Rule 13n-5(a)(2). <u>See</u> Section III.E.1 of this release for the discussion of these definitions.

customer's normal service delivery is affected; or (xi) a failure to maintain the integrity of systems that results in the entry of erroneous or inaccurate transaction data or other information in the SDR or the securities markets.

Based on its experience in requiring SROs and other entities to report material systems outages in the context of the current ARP program, the Commission preliminarily believes that this definition is appropriate for SDRs. The Commission preliminarily believes that each of the events listed in paragraphs (i) through (xii) of proposed Rule 13n-6(a)(1) are significant events that warrant reporting to the Commission because such material systems outages could negatively impact the stability of the SBS market. The application of the proposed definition is relatively straightforward, and it focuses on the types of events that the Commission preliminarily believes should require notification to the Commission under proposed Rule 13n-6(b)(3), so that the Commission can respond appropriately to the event that caused the loss or disruption.

Specifically, the Commission preliminarily believes that proposed subsections (i), (ii), (iii), (iv), and (v) address events that cause a significant loss or disruption of normal system operations sufficient to warrant notification to the Commission. In addition, the Commission preliminarily believes that proposed subsection (vi) addresses a type of event that impairs transparency or accurate and timely regulatory reporting.

The Commission also preliminarily believes that proposed subsections (vii) and (viii) are appropriate because communications of an outage to entities outside of the SDR, the board, or senior management are indicia of a significant system outage sufficient to warrant notification to the Commission. Specifically, proposed subsection (viii)'s reference to "a report or referral of an event . . ." seeks to address situations in which an SDR might seek to apply an overly narrow definition of an "outage situation" in proposed subsection (vii), in order to avoid reporting a problem that nevertheless has a significant impact on the performance of the SDR's systems and therefore warrants reporting to the Commission. For example, where an SDR experiences a slowing, but not a stoppage, of its ability to accept transaction data, and that slowing of data acceptance is sufficiently significant to have been reported or referred to the SDR's board or senior management, the Commission preliminarily believes that this situation would constitute a material system outage under proposed subsection (viii) that must be reported to the Commission. By including proposed subsection (viii) in the definition of "material system outage," the Commission seeks to ensure that it is informed of events that most entities subject to current ARP standards would already understand should be covered under the current program. This should permit the Commission to effectively monitor the operation of SDRs' automated systems. The Commission preliminarily believes that proposed subsections (ix) and (x) are appropriate because threats to system operations and queuing of data are events that may result in a significant disruption of normal system operations warranting notification to the Commission.

Subsection (xi) covers a failure to maintain the integrity of systems that results in the entry of erroneous or inaccurate transaction data or other information in an SDR or to market participants. This subsection is designed to address the unique role of SDRs in the SBS market. In particular, it is intended to cover such events as breakdowns in an SDR's internal controls that result in the entry of erroneous orders into the market. For example, it is possible that an SDR could, while in the process of testing its systems, inadvertently retain "test" data in its database. This, in turn, could result in erroneous reporting of SBSs to the Commission, other regulators, and counterparties. Counterparties may become uncertain of their positions, leading to market disruptions. This, in turn, could erode investor confidence in the integrity of the SBS market, damaging liquidity and impeding the capital formation process. Accordingly, the Commission preliminarily believes that this type of breakdown in an SDR's systems controls should be reported to the Commission.

By including proposed subsection (xi) in the definition of "material system outage," the Commission is seeking to ensure that it is informed of events that could negatively impact the integrity of systems that result in the entry of erroneous or inaccurate transaction data or other information in an SDR or the securities markets. This should permit the Commission to monitor effectively the operation of each SDR's automated systems.

The definition of material systems outage also includes an unauthorized intrusion by outside persons, insiders, or unknown persons, into any system. The Commission preliminarily believes that this provision would permit the Commission to effectively monitor the operation of SDR's automated systems by requiring SDRs to notify the Commission of unauthorized intrusions into systems or networks. SDRs would need to immediately report unauthorized intrusions regardless of whether the intrusions were part of a cyber attack; potential criminal activity; other unauthorized attempts to retrieve, manipulate, or destroy data or to disrupt or destroy systems or networks; or any other malicious activity affecting data, systems, or networks. If unauthorized intrusions were successful in breaching systems or networks, SDRs would need to report these intrusions even if the parties conducting the unauthorized intrusion were unsuccessful in achieving their apparent goals (such as the introduction of malware or other means of disrupting or manipulating data, systems, or networks). SDRs would need to supplement their initial reports by sending the Commission updates on any harm to data, systems, or networks as well as any remedial measures that the SDRs are contemplating or undertaking to address the unauthorized intrusions. SDRs, however, would not need to report unsuccessful attempts at unauthorized intrusions that did not breach systems or networks.

The Commission preliminarily believes that the proposed five business day requirement regarding submission of a written description of material system outages is an appropriate time period. In the Commission's experience with the current ARP program for SROs and other entities in the securities market, an entity generally requires approximately five business days after the occurrence of a material system outage to gather all the relevant details regarding the scope and cause of the outage. A shorter timeframe might not provide sufficient time for the SDR to gather all relevant details surrounding the outage and describe them in a written submission; a longer timeframe might encourage unnecessary delays.

d. Material Systems Changes

Under proposed subsection (4) of Rule 13n-6(b), an SDR would be required to notify the Commission in writing at least thirty calendar days before implementation of any planned material systems changes. This proposed requirement is drawn from the ARP II Release.[145]

Proposed Rule 13n-6(a)(2) would define "material systems change" as "a change to automated systems that: (i) significantly affects existing capacity or security; (ii) in itself, raises significant capacity or security issues, even if it does not affect other existing systems; (iii) relies upon substantially new or different technology; (iv) is designed to provide a new service or function; or (v) otherwise significantly affects the operations of the security-based swap data repository." Based on its experience in requiring SROs and other entities to report material systems changes in the context of the current ARP program, the Commission preliminarily believes that this definition is appropriate for SDRs. Each of the events listed in paragraphs (i)

[145] See ARP II Release, 56 FR 22490, supra note 130.

through (v) are significant events that warrant reporting to the Commission because any of those events can lead to a material systems outage that could negatively affect the stability of the SBS market. The application of the proposed definition is relatively straightforward, and it focuses on the types of events that should require notification to the Commission under proposed Rule 13n-6(b)(2). Specifically, the proposed subsections (i) – (iv) are events that concern the adequacy of capacity estimates, testing, and security measures taken by an SDR, and thus are sufficiently significant to warrant notification to the Commission. Proposed subsection (v) covering a change that "otherwise significantly affects the operations of the security-based swap data repository" is more open-ended in order to require notification of other major systems changes. Examples of changes that fall within proposed subsection (v) include, but are not limited to: major systems architectural changes; reconfigurations of systems that cause a variance greater than five percent in throughput or storage;[146] introduction of new business functions or services; material changes in systems; changes to external interfaces; changes that could increase susceptibility to major outages; changes that could increase risks to data security; changes that were, or will be, reported to or referred to an SDR's board or senior management; and changes that may require allocation or use of significant resources.

The Commission preliminarily believes that the proposed thirty calendar day requirement regarding pre-implementation written notification to the Commission of planned material systems changes is an appropriate time period. The Commission has found through its experience with the current ARP program that this amount of time is necessary for the

146 The Commission has identified the five percent threshold as triggering the definition of "material systems change" in proposed Rule 13n-6(a)(2) because, based on experience in administrating the ARP program in the equities markets for almost twenty years, it believes that reconfigurations that exceed five percent in throughput or storage typically have the greatest potential to cause significant disruptions to automated systems.

Commission staff to evaluate the issues raised by a planned material systems change. A shorter timeframe might not provide sufficient time for the Commission staff to analyze the issues raised by the systems change; a longer timeframe might unnecessarily delay the covered entity in implementing the change.

Request for Comment

The Commission requests comment on the following specific issues:

- Should the Commission consider imposing other requirements or standards? Should any of the proposed requirements be eliminated or refined? If so, please explain your reasoning.
- Are there factors specific to SBS transactions that would make applying a system that is traditionally used in the equity markets inappropriate?
- What is the likely impact of these requirements on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for maintaining SBS data at the SDR?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- Should the Commission expressly require by rule:

- An SDR's contingency and disaster recovery plans (required in proposed paragraph (b)(1)(v)) to be tested periodically to assure their effectiveness and adequacy?[147]
- An SDR's contingency and disaster recovery plans (required in proposed paragraph (b)(1)(v)) to cover at a minimum:
  - preparation for contingencies through such devices as appropriate remote and on-site hardware back-up and periodic duplication and off-site storage of data files?
  - off-site storage of up-to-date, duplicative software, files and critical forms and supplies need for processing operations, including a geographically diverse back-up site that does not rely on same infrastructure components (e.g., transportation, telecommunications, water supply, and electric power) as the SDR primary operations center?
  - immediate availability of software modifications, detailed procedures, organizational charts, job descriptions, and personnel for the conduct of operations under a variety of possible contingencies?
  - emergency mechanisms for establishing and maintaining communications with participants, regulators and other entities involved?[148]
- An SDR's contingency and disaster recovery plans (required in proposed paragraph (b)(1)(v)) to include resources, emergency procedures, and backup

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147 This requirement would be similar to what is required of clearing agencies. See Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (June 20, 1980).

148 These requirements are similar to requirements related to disaster recovery plans of clearing agencies. See id. The requirement for geographical diversity is currently applicable to securities firms. See Exchange Act Release No. 47638 (April 7, 2003), 68 FR 17809 (April 11, 2003) (the "BCP Whitepaper").

facilities sufficient to enable timely recovery and resumption of its operations and resumption of its ongoing fulfillment of its duties and obligations as an SDR, including, without limitation, the duties set forth in Rule 13n-4, following any disruption of its operations?[149] If so, what should the recovery time objective be? Should the SDR's contingency and disaster plans (required in proposed paragraph (b)(1)(v)) and resources generally enable resumption of the SDR's operations and resumption of ongoing fulfillment of the SDR's duties and obligations during the next business day following the disruption?

- An SDR, to the extent practicable, to coordinate its contingency and disaster recovery plans (required in proposed paragraph (b)(1)(v)) with those of the SB SEFs, SBS markets, clearing agencies, SBS dealers, and major SBS participants who report transaction data to the SDR, and with those of regulators identified in Exchange Act Section 13(n)(5)(G), with a view to enabling effective resumption of the SDR's operations, including programs for periodic, synchronized testing of these plans?
- An SDR, in developing its contingency and disaster recovery plans, to take into account the business continuity-disaster recovery plans of its telecommunications, power, water, and other essential service providers?
- An SDR, if it offers services in addition to acting as a SDR, to establish, maintain, and enforce written policies and procedures reasonably designed to

149 For example, the BCP Whitepaper requires clearing and settlement organizations to have a recovery time objective of "within the business day on which the disruption occurs with the overall goal of achieving recovery and resumption with two hours after an event."

assure that the additional services do not adversely impact the operational reliability of its core function as an SDR?[150]

- An SDR to identify the potential risks that can arise as a result of interoperability and/or interconnectivity with other market infrastructures and venues from which data can be submitted to the SDR (such as exchanges, SB SEFs, clearing agencies, SBS dealers, and major SBS participants) and service providers and how the SDR mitigates such risks?[151]
- An SDR to abide by substantive requirements (in addition to, or in place of, the policies and procedures approach of proposed Rule 13n-6(b)(1)), such as (i) having robust system controls and safeguards to protect the data from loss and information leakage, (ii) having high-quality safeguards and controls regarding the transmission, handling, and protection of data to ensure the accuracy, integrity, and confidentiality of the trade information recorded in the SDR, or (iii) having reliable and secure systems and having adequate, scalable capacity? and
- An SDR to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the transaction data that it accepts is from the entity it purports to be from, such as requiring robust passwords?

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150 See, e.g., CPSS-IOSCO, supra note 55 ("Where a [trade repository] offers services in addition to its record keeping function, or considers doing so, it should ensure that it has adequate resources to do so effectively and that the additional service will not adversely impact the operational reliability of its core function of record keeping").

151 See, e.g., id. (Trade repositories "should evaluate the potential sources of risks that can arise, and ensure that the risks that can arise in the design and operation of [domestic or cross-border links with other trade repositories, market infrastructures or service providers] are managed prudently on an ongoing basis.").

- Are the time periods specified in proposed Rule 13n-6(b)(2)-(4) with respect to submission of annual reviews and written notices of material system outages and material systems changes the correct time periods to use? Should any of the proposed time periods be shortened or lengthened? Should the time periods be replaced with less specific requirements, such as "promptly" or "timely"? If so, please explain your reasoning.
- Should the Commission require the notification required by proposed Rule 13n-6(b)(4) to be sufficiently detailed to explain the new system development process, the new configuration of the system, its relationship to other systems, the timeframes or schedule for installation, any testing performed or planned, and an explanation on the impact of the change on the SDR's capacity estimates, contingency protocols and vulnerability estimates?[152]
- Are there specific provisions in the proposed definitions that should be eliminated or refined? Are there some events which should be included in the definitions of "material systems outage" and "material systems change" that are not, or events that should not be included in these definitions but are? If so, please explain your reasoning.
- Should the Commission require the use of a specific framework by outside or inside parties for evaluating whether SDRs have adequate capacity, resiliency, and security and that their automated systems are not subject to critical vulnerabilities? If so, what would the critical components of the framework include? Are existing frameworks

152 See ARP II Release, 56 FR 22490, supra note 130.

available that are suitable for this purpose and, if so, which ones would be considered appropriate?

- Are the definitions "objective review" and "competent, objective personnel" parallel to the requirements for SROs and other entities in the securities markets in the context of the current ARP program?
- Should the objective review required in proposed Rule 13n-6(b)(2) be done on a regular, periodic basis, rather than on an annual basis?
- Is the requirement in proposed Rule 13n-6(b)(2) for an objective, external firm to assess the objectivity, competency, and work performance of an internal department that performed an objective review necessary or appropriate? If the objective review is done by an internal department, should the Commission require that it be done by a department or persons other than those responsible for the development or operation of the systems being tested?

2. <u>Electronic Filing</u>

Proposed Rule 13n-6(c) would require that every notification, review, or description and analysis required to be submitted to the Commission under proposed Rule 13n-6 (other than those required under proposed Rule 13n-6(b)(3)(i), (ii), and (iii), which can be verbal) be submitted in an appropriate electronic format to the Office of Market Operations at the Division of Trading and Markets at the Commission's principal office in Washington, DC. This proposed requirement is intended to make proposed Rule 13n-6 consistent with electronic-reporting standards set forth in other Commission rules under the Exchange Act, such as Rule 17a-25 (Electronic Submission of Securities Transaction Information by Exchange Members, Brokers, and Dealers)[153] and Rule 19b-4 (Filings with respect to Proposed Rule Changes by Self-regulatory Organizations).[154]

The Commission preliminarily believes that the proposed provision would benefit SDRs by automating the process by which they submit notifications, reviews, and descriptions and analyses under proposed Rule 13n-6 to the Commission. The Commission currently receives this type of information from SROs and other entities in the securities market in electronic format. Moreover, as noted above, this provision is intended to be consistent with other Commission rules.

Proposed Rule 13n-6(c) would require submission of notifications, reviews, and descriptions and analyses in an "appropriate electronic format." The Commission anticipates that, if the provision is adopted, the staff would work with SDRs to determine appropriate electronic formats that could be used.

Request for Comment

The Commission requests comment on the following specific issues:

- Are there specific provisions in proposed Rule 13n-6(c) that should be eliminated or refined? If so, please explain your reasoning.
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for reporting information to the Commission?

3. Confidential Treatment

153 17 CFR 240.17a-25.

154 17 CFR 240.19b-4.

Proposed Rule 13n-6(d) would provide that a person who submits a notification, review, or description and analysis pursuant to this rule for which he or she seeks confidential treatment should clearly mark each page or segregable portion of each page with the words "Confidential Treatment Requested." Proposed Rule 13n-6(d) would state that "[a] notification, review, or description and analysis submitted pursuant to this [rule] will be accorded confidential treatment to the extent permitted by law."

The Commission would use the information collected under proposed Rule13n-6 to evaluate whether SDRs are reasonably equipped to handle market demand. For this reason, requiring SDRs to submit this information would be critical to the Commission's ability to effectively oversee SDRs.

Much of the information that the Commission expects to receive from SDRs is, by its nature, competitively sensitive. If the Commission were unable to afford confidential protection to the information that it expects to receive, then the SDRs may hesitate to submit the required information to the Commission. This result could potentially undermine the Commission's ability effectively to oversee SDRs, which, in turn, could undermine investor confidence in the SBS market.

The Freedom of Information Act ("FOIA") provides at least two exemptions under which the Commission has authority to grant confidential treatment for the information submitted under proposed Rule 13n-6. First, FOIA Exemption 4 provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential."[155] As specified in proposed Rule 13n-6(d), "a notification, review, or description and analysis submitted pursuant to this [rule] will be accorded confidential treatment to the extent permitted

[155] 5 U.S.C. 552(b)(4).

by law." The information required to be submitted to the Commission under proposed Rule 13n-6 may contain proprietary information regarding automated systems that is privileged or confidential and thus subject to protection from disclosure under Exemption 4 of the FOIA.

Second, FOIA Exemption 8 provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions."[156] Similarly, Commission Rule 80(b)(8), Commission Records and Information, implementing Exemption 8, states that the Commission generally will not publish or make available to any person matters that are "[c]ontained in, or related to, any examination, operating, or condition report prepared by, on behalf of, or for the use of, the Commission, any other Federal, state, local, or foreign governmental authority or foreign securities authority, or any securities industry self-regulatory organization, responsible for the regulation or supervision of financial institutions."[157]

Request for Comment

The Commission requests comment on the following specific issues:

- Are there specific provisions in proposed Rule 13n-6(d) that should be eliminated or refined? If so, please explain your reasoning.
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs and the willingness of persons to register as SDRs?

G. Proposed Rule Regarding SDR Recordkeeping

[156] 5 U.S.C. 552(b)(8).

[157] 17 CFR 200.80(b)(8).

The Commission is proposing Rule 13n-7 under the Exchange Act to specify the books and records requirements applicable to SDRs. Proposed Rule 13n-7's requirements are discussed below.

1. Records to be Made by SDRs

Proposed Rule 13n-7(a) would require SDRs to make and keep current certain books and records relating to its business. Proposed Rule 13n-7(a)(1) would require SDRs to make and keep current "a record for each office listing, by name or title, each person at that office who, without delay, can explain the types of records the security-based swap data repository maintains at that office and the information contained in those records." SDR recordkeeping practices may vary in ways ranging from format and presentation to the name of a record. Therefore, each SDR must be able to promptly explain how it makes, keeps, and titles its records. To comply with this proposed rule, an SDR may identify more than one person and list which records each person is able to explain. Because it may be burdensome for an SDR to keep this record current if it lists each person by name, a firm may satisfy this proposed requirement by recording the persons capable of explaining the firm's records by either name or title.

Proposed Rule 13n-7(a)(2) would require SDRs to make and keep current "a record listing each officer, manager, or person performing similar functions of the security-based swap data repository responsible for establishing policies and procedures that are reasonably designed to ensure compliance with the [Exchange] Act and the rules and regulations thereunder." This proposed rule is intended to assist securities regulators by identifying individuals responsible for designing an SDR's compliance procedures and managing the SDR.

These two proposed requirements are based on Exchange Act Rules 17a-3(a)(21) and (22), respectively, which are applicable to broker-dealers.[158] The purpose of these rules is to assist the Commission in its inspection and examination function.[159] It is important for the Commission's examiners to have the ability to find quickly what records are maintained in a particular office and who is responsible for establishing particular policies and procedures of the SDR. These proposed requirements are designed to assist in obtaining this information. Based on the Commission's experience in conducting examinations of broker-dealers, we believe that requiring SDRs to comply with these two rules will facilitate the Commission's inspections and examinations of SDRs.

2. Records to be Preserved by SDRs

Proposed Rule 13n-7(b)(1) would require SDRs to "keep and preserve at least one copy of all documents, including all documents and policies and procedures required by the [Exchange] Act and the rules and regulations thereunder, correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it in the course of its business as such." This proposed rule is designed to include all electronic documents and correspondence such as emails and instant messages. Proposed Rule 13n-7(b)(2) would require SDRs to "keep all such documents for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection." Proposed Rule 13n-7(b)(3) would require SDRs to, "upon request of any representative of the

158 17 CFR 240.17a-3(a)(21) and (22).

159 Exchange Act Section 13(n)(2), Pub. L. No. 111-203, § 763(i), states that "[e]ach registered security-based swap data repository shall be subject to inspection and examination by any representative of the Commission." See also proposed Rule 13n-4(b)(1).

Commission, promptly furnish to the possession of such representative copies of any documents required to be kept and preserved by it pursuant to sections (a) and (b) of this Rule."

Proposed Rule 13n-7(b) is based on Exchange Act Rule 17a-1, which is the recordkeeping rule for national securities exchanges, national securities associations, registered clearing agencies, and the Municipal Securities Rulemaking Board ("MSRB").[160] Proposed Rule 13n-7(b) is intended to set forth the recordkeeping obligation of SDRs and thereby facilitate implementation of the broad inspection authority given to the Commission in Exchange Act Section 13(n)(2).[161] The Commission believes that Exchange Act Rule 17a-1 is better suited as a basis for SDR recordkeeping than the broker-dealer recordkeeping rules because the broker-dealer recordkeeping rules are specifically tailored for the business of broker-dealers.

3. Recordkeeping After an SDR Ceases to do Business

Proposed Rule 13n-7(c) would require an SDR, if the SDR ceases doing business, or ceases to be registered pursuant to Exchange Act Section 13(n) and the rules and regulations thereunder, to continue to preserve, maintain, and make accessible the records/data required to be collected, maintained, and preserved by Rule 13n-7 in the manner required by this rule and for the remainder of the period required by this rule.[162] This proposed requirement is intended to allow the Commission to perform effective inspections and examinations of the SDRs pursuant to Exchange Act Section 13(n)(2).[163] The Commission preliminarily expects that an SDR would need to establish contingency plans so that another entity would be in the position to maintain this information after the SDR ceases to do business.

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160 17 CFR 240.17a-1.

161 See also proposed Rule 13n-4(b)(1).

162 This proposed requirement is based on Exchange Act Rule 17a-4(g), 17 CFR 240.17a-4(g), which applies to broker-dealer books and records.

163 See also proposed Rule 13n-4(b)(1).

4. Applicability

Proposed Rule 13n-7(d) states that "this section does not apply to data collected and maintained pursuant to Rule 13n-5." This is to clarify that the requirements under proposed Rule 13n-7 are designed to capture those records of an SDR other than the transaction data, positions, and market data that would be required to be maintained in accordance with proposed Rule 13n-5, as discussed in Section III.E of this release.

Request for Comment

The Commission requests comment on the following specific issues:

- Should the Commission recommend a rule similar to Exchange Act Rule 17a-6 for SDRs?[164]
- Should the Commission recommend other requirements that might be necessary or useful in protecting the records of an SDR upon the failure of such entity?
- Should the Commission require records retained under this section to be retained electronically or furnished to the Commission electronically?
- What is the likely impact of these requirements on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for maintaining records at the SDR?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in

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164 17 CFR 240.17a-6. Exchange Act Rule 17a-6 applies to national securities exchanges, national securities associations, registered clearing agencies, and the MSRB. Exchange Act Rule 17a-6 allows for the destruction or disposal of records by these entities prior to the 5 year retention period of Exchange Act Rule 17a-1 if done according to a plan for destruction or disposal that is filed with and approved by the Commission.

connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

H. Proposed Rule Regarding Reports to be Provided to the Commission

The Commission is proposing Rule 13n-8 under the Exchange Act to specify certain reports that the SDR would have to provide to the Commission. Proposed Rule 13n-8 would require an SDR to "promptly report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the [Exchange] Act and the rules and regulations thereunder." While the Commission has "direct electronic access" to the SBS transaction information maintained by the SDR,[165] there may be times when a report may be more useful to Commission staff in fulfilling their duties. For example, the Commission may request a report on the number of complaints the SDR has received pertaining to data integrity.

Request for Comment

The Commission requests comment on the following specific issues:

- What are the benefits and burdens of this requirement? Should any limitations be put on the types or frequency of reports requested by the Commission?
- Should the term "promptly" be defined or should the Commission use another term such as "as soon as technologically practicable after the time at which the request has been submitted"?
- What is the likely impact of this requirement on the SBS market, including the impact on the incentives and behaviors of SDRs, the willingness of persons to register as SDRs, and the technologies used for maintaining SBS data at the SDR?

[165] See Pub. L. No. 111-203 (adding Exchange Act Section 13(n)(5)(D)(i)).

- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

I. <u>Proposed Rule Regarding Privacy of SBS Transaction Information</u>

The Commission is proposing Rule 13n-9 to require each SDR to establish, maintain, and enforce written policies and procedures reasonably designed to protect the privacy of any and all SBS transaction information that the SDR receives from an SBS dealer, counterparty, or any registered entity. As mentioned above, this requirement is specifically enumerated in the Dodd-Frank Act.[166] The proposed rule would further provide that such policies and procedures shall include, but are not limited to, policies and procedures to protect the privacy of any and all SBS transaction information that the SDR shares with affiliates and nonaffiliated third parties.[167]

The proposed rule would also require each SDR to establish and maintain safeguards, policies, and procedures reasonably designed to prevent the misappropriation or misuse, directly or indirectly, of: (1) any confidential information received by the SDR, including, but not limited to, trade data, position data, and any nonpublic personal information about a market participant or any of its customers;[168] (2) material, nonpublic information; and/or (3) intellectual property,

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166 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(5)).

167 Proposed Rule 13n-9(b)(1).

168 Under the proposed rule, the term "nonpublic personal information" would be defined as (1) personally identifiable information and (2) any list, description, or other grouping of market participants (and publicly available information pertaining to them) that is derived using personally identifiable information that is not publicly available information. Proposed Rule 13n-9(a)(5). The term "personally identifiable information" would be defined as any information (i) a market participant provides to an SDR to obtain service from the SDR, (ii) about a market participant resulting from any transaction involving a

such as trading strategies or portfolio positions, by the SDR or any person associated with the SDR for their personal benefit or the benefit of others.[169] Such safeguards, policies, and procedures shall address, without limitation, (1) limiting access to such confidential information, material, nonpublic information, and intellectual property, (2) standards pertaining to the trading by persons associated with the SDR for their personal benefit or the benefit of others, and (3) adequate oversight to ensure compliance of this provision.[170] This particular requirement incorporates current requirements regarding the treatment of proprietary information of clearing members, which are contained in exemptive orders issued to SBS clearing agencies,[171] and draws

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service between the SDR and the market participant, or (iii) the SDR obtains about a market participant in connection with providing a service to that market participant. Proposed Rule 13n-9(a)(6).

169 Proposed Rule 13n-9(b)(2).

170 Id.

171 See, e.g., ICE Trust Order stating "ICE Trust shall establish and maintain adequate safeguards and procedures to protect clearing members' confidential trading information. Such safeguards and procedures shall include: (A) limiting access to the confidential trading information of clearing members to those employees of ICE Trust who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and (B) establishing and maintaining standards controlling employees of ICE Trust trading for their own accounts. ICE Trust must establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed." Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), Exchange Act Release No. 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009), and Exchange Act Release No. 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) (temporary exemptions in connection with CDS clearing by ICE Trust US LLC). See also Exchange Act Release No. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) and Exchange Act Release No. 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited); Exchange Act Release No. 60373 (July 23, 2009), 74 FR 37740 (July 29, 2009) and Exchange Act Release No. 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG); Exchange Act Release No. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), Exchange Act Release No. 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009) and Exchange Act Release No. 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.).

from Exchange Act Section 15(g), which requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.[172]

The Commission anticipates that as a central recordkeeper of SBS transactions, each SDR will receive proprietary and highly sensitive information, which could disclose, for instance, a market participant's trade information, trading strategy, or nonpublic personal information. Proposed Rule 13n-9 is designed to ensure that an SDR has reasonable safeguards, policies, and procedures in place to protect such information from being misappropriated or misused by the SDR or any person associated with the SDR. The Commission preliminarily believes that an SDR's governance arrangements should have adequate internal controls to protect against such misappropriation or misuse. For instance, an SDR should limit access to the proprietary and sensitive information by creating informational, technological, and physical barriers. The Commission also preliminarily believes that an SDR should limit access to the data that it maintains to only those officers, directors, employees, and agents who need to know the data to perform their job responsibilities; such access should not necessarily be granted on an all-or-nothing basis. An SDR should also have controls to prevent unauthorized or unintentional access to its data.

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172 See 15 U.S.C. 78o(g). See also Pub. L. No. 111-203 (adding Exchange Act Section 15F(j)(5) (requiring SBS dealers and major SBS participants to "establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any security-based swap or acting in a role of providing clearing activities or making determinations as to accepting clearing customers are separated by appropriate informational partitions with the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the [enumerated] core principles of open access and the business conduct standards . . . .").

Additionally, an SDR should consider restricting the trading activities of individuals who have access to proprietary or sensitive information maintained by the SDR or implementing firm-wide restrictions on trading certain SBSs, as well as underlying or related investment instruments. Such restrictions could include, for example, a pre-trade clearance requirement. An SDR should also have systems in place to prevent and detect insider trading by the SDR or persons associated with the SDR. Such systems could include a mechanism to monitor such persons' access to the SDR's data, their trading activities, and their e-mails.

The Commission preliminarily believes that to the extent that an SDR or any person associated with the SDR shares information with a nonaffiliated third party, an SDR's policies and procedures should ensure the privacy of the information shared. For instance, an SDR should consider requiring the nonaffiliated party to consent to being subject to the SDR's privacy policies and procedures as a condition of receiving any sensitive information from the SDR.

<u>Request for Comment</u>

The Commission requests comment on the following specific issues:

- Are the Commission's proposed definitions of "nonpublic personal information" and "personally identifiable information" appropriate and sufficiently clear? If not, what specific modifications are appropriate or necessary?
- Are the Commission's privacy requirements appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Should the proposed SDR's protection of privacy extend to any other person (e.g., third party service providers, market infrastructures, or venues from which data can be submitted to the SDR)?

- What other examples of confidential information, material, nonpublic information, and intellectual property should be protected by an SDR?
- Should the Commission require anything else to be protected in an SDR's privacy policies and procedures?
- Should the Commission prescribe any other preventive measures that an SDR must include in its privacy policies and procedures?
- With respect to entities that currently perform repository services for SBSs or other entities, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

J. Proposed Rule Regarding Disclosure To Market Participants

Pursuant to the Commission's authority under Exchange Act Sections 13(n)(3), 13(n)(7)(D)(i), and 13(n)(9),[173] the Commission is proposing Rule 13n-10 to enhance transparency in the SBS market, bolster market efficiency, promote standardization, and foster competition. Specifically, the proposed rule would provide that before accepting any SBS data from a market participant or upon a market participant's request, each SDR shall furnish to the market participant a disclosure document that contains the following written information, which must reasonably enable the market participant to identify and evaluate accurately the risks and costs associated with using the SDR's services: (1) the SDR's criteria for providing others with access to services offered and data maintained by the SDR, (2) the SDR's criteria for those seeking to connect to or link with the SDR, (3) a description of the SDR's policies and

[173] See Pub. L. No. 111-203, § 763(i).

procedures regarding its safeguarding of data and operational reliability to protect the confidentiality and security of such data, (4) a description of the SDR's policies and procedures reasonably designed to protect the privacy of any and all SBS transaction information that the SDR receives from an SBS dealer, counterparty, or any registered entity, (5) a description of the SDR's policies and procedures regarding its non-commercial and/or commercial use of the SBS transaction information that it receives from a market participant, any registered entity, or any other person, (6) a description of the SDR's dispute resolution procedures involving market participants, (7) a description of all the SDR's services, including any ancillary services, (8) the SDR's updated schedule of any dues; unbundled prices, rates, or other fees for all of its services, including any ancillary services; any discounts or rebates offered; and the criteria to benefit from such discounts or rebates, and (9) a description of the SDR's governance arrangements.[174]

These proposed disclosure requirements are intended to promote competition and foster service transparency by enabling market participants to identify the range of services that each SDR offers and to evaluate the risks and costs associated with using such services. The Commission also preliminarily believes that service transparency is particularly important in light of the complexity of OTC derivatives products and their markets, and that greater service transparency could improve market participants' confidence in an SDR and result in greater use of the SDR, which would ultimately increase market efficiency.

Request for Comment

The Commission requests comment on the following specific issues:

- Are the proposed disclosure requirements to market participants appropriate and sufficiently clear? If not, why not and what would be a better alternative?

174 See proposed Rule 13n-10(b).

- Should the Commission require SDRs to make the proposed disclosure to market participants in any other instances?
- Should the Commission not require disclosure of any of the information specified in this proposed rule? If so, what and why?
- Should the Commission require disclosure of the specified information only upon request and not necessarily before an SDR accepts SBS data from a market participant?
- Should the Commission require disclosure of any other information? If so, what and why?
- Should the Commission require SDRs to provide market participants with updated disclosure documents? If so, how often (e.g., annually, when there are material changes to an SDR's disclosed policies and procedures)?
- Should the Commission require disclosure of the proposed information to anyone else besides market participants? If so, to whom and why? Should the disclosure be the same or vary depending on the recipient?
- Should the Commission permit disclosure of the proposed information on an SDR's website? If so, would such disclosure be as meaningful? How should the Commission address the problem of the disclosure possibly being embedded in an SDR's website so as to make it difficult for market participates to navigate their way to find the disclosure? Would a disclosure on an SDR's website be equally effective, less effective, or more effective than a disclosure document furnished to market participants? Should the Commission prescribe any restrictions regarding disclosure on an SDR's website?

- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?

K. Proposed Rule Regarding Chief Compliance Officer of Each SDR

The Commission is proposing Rule 13n-11, which would incorporate the duties of an SDR's CCO that are enumerated in Exchange Act Section 13(n)(6)[175] and impose additional requirements.

1. Enumerated Duties of Chief Compliance Officer

Specifically, proposed Rule 13n-11(a) would require each SDR to identify on Form SDR a person who has been designated by the board to serve as a CCO of the SDR. The proposed rule would also provide that the compensation and removal of the CCO shall require the approval of a majority of the SDR's board.[176] This proposed requirement is intended to promote the independence and effectiveness of the CCO.

Under proposed Rule 13n-11(c), each CCO shall: (1) report directly to the board or to the chief executive officer of the SDR, (2) review the compliance of the SDR with respect to the requirements and core principles described in Exchange Act Section 13(n) and the rules and regulations thereunder, (3) in consultation with the board or the SDR's chief executive officer, resolve any conflicts of interest that may arise, (4) be responsible for administering each policy and procedure that is required to be established pursuant to Exchange Act Section 13 and the rules and regulations thereunder, (5) ensure compliance with the Exchange Act and the rules and

175 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(6)).

176 Proposed Rule 13n-11(a).

regulations thereunder relating to SBSs, including each rule prescribed by the Commission under Exchange Act Section 13, (6) establish procedures for the remediation of noncompliance issues identified by the CCO through any (a) compliance office review, (b) look-back, (c) internal or external audit finding, (d) self-reported error, or (e) validated complaint, and (7) establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

The Commission notes that an SDR would not be required to hire an additional person to serve as its CCO. Instead, an SDR can designate an individual already employed with the SDR as its CCO. The CCO would be responsible for, among other things, keeping the board or the SDR's chief executive officer apprised of significant compliance issues and advising the board or chief executive officer of needed changes in the SDR's policies and procedures. Given the critical role that a CCO is intended to play in ensuring an SDR's compliance with the Exchange Act and the rules and regulations thereunder, the Commission believes that an SDR's CCO should be competent and knowledgeable regarding the federal securities laws and should be empowered with full responsibility and authority to develop and enforce appropriate policies and procedures for the SDR. To meet his statutory obligations, a CCO should also have a position of sufficient seniority and authority within the SDR to compel others to adhere to the SDR's policies and procedures.

The Commission is concerned that an SDR's commercial interests might discourage its CCO from making forthright disclosure to the board or chief executive officer about any compliance failures. To mitigate this potential conflict of interest, the Commission preliminarily believes that an SDR's CCO should be independent from its management so as not to be conflicted in reporting or addressing any compliance failures. As mentioned, each CCO of an

SDR is statutorily required to report directly to the board or its chief executive officer, but only the board would be able to discharge the CCO from his or her responsibilities and would be able to approve the CCO's compensation.

Request for Comment

The Commission requests comment on the following specific issues:

- Are there any terms in the proposed rule incorporating the duties of a CCO that need to be clarified or modified (e.g., "look-back," "self-reported error," "validated complaint")? If so, which terms and how should they be defined?
- Should the Commission require a CCO of an SDR to report to any other senior officer besides its chief executive officer? If so, to whom and why?
- Is the Commission's proposed requirement regarding an SDR's board approval of a CCO's compensation and a CCO's removal appropriate? If not, why and what would be a better alternative to promote the independence and effectiveness of the CCO? Should the required percentage of board approval be lower or higher?
- Should the Commission prohibit a CCO of an SDR from being a member of the SDR's legal department or the SDR's general counsel?
- Should the Commission prohibit any officers, directors, or employees of an SDR from, directly or indirectly, taking any action to coerce, manipulate, mislead, or fraudulently influence the SDR's CCO in the performance of his responsibilities?
- Should the Commission prohibit an SDR's board from requiring its CCO to make any changes to his annual compliance report? Would such a prohibition be necessary in light of the CCO's statutory requirement to certify that the compliance report is accurate and complete?

- Are there other measures that would further enhance the independence and effectiveness of a CCO and that should be prescribed in a rule?
- Should the Commission impose any additional duties on a CCO of an SDR that are not already enumerated in the legislation and incorporated in the proposed rule?
- Should the Commission provide guidance in its proposed rules about the CCO's procedures for the remediation of noncompliance issues?
- Should the Commission provide guidance in its proposed rules on what would be considered "appropriate procedures" for the handling, management response, remediation, retesting, and closing of noncompliance issues? If so, what factors should the Commission take into consideration?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- How might the evolution of the SBS market over time affect SDRs or impact the Commission's proposed rule?

2. Annual Reports

A CCO of an SDR is required, under Exchange Act Section 13(n)(6)(C)(i), to annually prepare and sign a report that contains a description of the compliance of the SDR with respect to the Exchange Act and the rules and regulations thereunder and each policy and procedure of the

SDR (including the code of ethics and conflicts of interest policies of the SDR).[177] The Commission is proposing Rule 13n-11(d) to require each annual compliance report to contain, at a minimum, a description of: (1) the SDR's enforcement of its policies and procedures, (2) any material changes[178] to the policies and procedures since the date of the preceding compliance report, (3) any recommendation for material changes to the policies and procedures as a result of the annual review, the rationale for such recommendation, and whether such policies and procedures were or will be modified by the SDR to incorporate such recommendation, and (4) any material compliance matters[179] identified since the date of the preceding compliance report. The Commission notes that individual compliance matters may not be material when viewed in isolation, but may collectively suggest a material compliance matter.

Although the proposed rule would require only annual reviews, CCOs should consider the need for interim reviews in response to significant compliance events, changes in business arrangements, and regulatory developments. For example, if there is an organizational restructuring of an SDR, then its CCO should evaluate whether its policies and procedures are adequate to guard against potential conflicts of interest. Additionally, if a new rule regarding SDRs is adopted by the Commission, then a CCO should review its policies and procedures to ensure compliance with the rule. Furthermore, a CCO should review, on an ongoing basis, the

177 See Pub. L. No. 111-203, § 763(i).

178 The term "material change" would be defined as a change that a CCO would reasonably need to know in order to oversee compliance of the SDR. See proposed Rule 13n-11(b)(5).

179 The term "material compliance matter" would be defined as any compliance matter that the board would reasonably need to know to oversee the compliance of the SDR and that involves, without limitation: (1) a violation of the federal securities laws by the SDR, its officers, directors, employees, or agents; (2) a violation of the policies and procedures of the SDR, its officers, directors, employees, or agents; or (3) a weakness in the design or implementation of the SDR's policies and procedures. See proposed Rule 13n-11(b)(6).

SDR's service levels, costs, pricing, and operational reliability, with the view to preventing anticompetitive practices and discrimination, and encouraging innovation and the use of the SDR.

Under the proposed rule, an SDR would be required to file with the Commission a financial report, as discussed further in Section III.K.3 below, along with a compliance report, which must include a certification that, under penalty of law, the compliance report is accurate and complete.[180] The compliance report would also be required to be filed in a tagged data format in accordance with instructions contained in the EDGAR Filer Manual, as described in Rule 301 of Regulation S-T.[181]

In addition, a CCO would be required to submit the annual compliance report to the board for its review prior to the submission of the report to the Commission under proposed Rule 13n-11(d)(2).[182] The Commission notes that a CCO should promptly bring serious compliance issues to the board's attention rather than wait until an annual report is prepared.

Request for Comment

The Commission requests comment on the following specific issues:

- Are the Commission's proposed rules regarding annual compliance reports appropriate and sufficiently clear? If not, why not and what would be a better approach?

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180 See proposed Rule 13n-11(d)(2).

181 See id.; see also 17 CFR 232.301. The information in each compliance report would be tagged using an appropriate machine-readable, data tagging format to enable the efficient analysis and review of the information contained in the report.

182 Proposed Rule 13n-11(e).

- Are the proposed definitions of "material change" and "material compliance matter" appropriate? If not, are they over-inclusive or under-inclusive and how should they be defined?
- Is the Commission's proposed timeframe for a CCO to submit his annual report to the board appropriate? If not, should the timeframe be shorter or longer? Should the Commission permit the SDR to request an extension to file an annual report (e.g., due to substantial, undue hardship)?
- If a CCO reports to the chief executive officer of the SDR rather than its board, should the Commission permit the CCO to submit his annual report to the chief executive officer rather than the board, in addition to the board, or only when an SDR does not have a board? Would any of these alternatives lessen the independence of the CCO in any way?
- If the Commission were to require an SDR to have independent directors, should the Commission require a CCO to meet separately with the independent directors at least annually? If not, why not and what would be a better alternative?
- Are the Commission's proposed minimum disclosure requirements in the CCO's annual report appropriate? If not, why not and what would be a better alternative?
- Should the Commission require any other disclosure in the CCO's annual report?
- Should the CCO's compliance reports be deemed confidential, by rule, or should an SDR simply rely on the FOIA exemptions discussed in Section III.F.3 of this release?
- Would keeping the compliance reports confidential encourage the CCO to be more forthcoming about sensitive compliance issues or would it likely not have any impact on the disclosure of such issues?

- Are there any disadvantages to keeping the CCO's compliance report confidential? How could the Commission address any such disadvantage?
- Would making the CCO's compliance report public be useful to the public or other regulators?
- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in this rule? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rule?
- How might the evolution of the SBS market impact the SDRs or the Commission's proposed rule?

3. Financial Reports

The Commission is proposing Rule 13n-11(f) to require each financial report to be a complete set of financial statements of the SDR that are prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for the most recent two fiscal years of the SDR.[183] Additionally, the proposed rule would provide that each financial report shall be audited in accordance with the standards of the Public Company Accounting Oversight Board ("PCAOB") by a registered public accounting firm[184] that is qualified and independent in

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183 Proposed Rule 13n-11(f)(1).

184 The term "registered public accounting firm" is defined in Exchange Act Section 3(a)(59) to have the same meaning as in Section 2 of the Sarbanes-Oxley Act of 2002. See 15 U.S.C. 78c(a)(59). Section 2 of the Sarbanes-Oxley Act defines "registered public

accordance with Rule 2-01 of Regulation S-X.[185] Each financial report would be required to include a report of the registered accounting firm that complies with paragraphs (a) through (d) of Rule 2-01 of Regulation S-X.[186] This proposed rule is drawn from Exchange Act Rule 17a-5.[187]

If an SDR's financial statements contain consolidated information of a subsidiary of the SDR, then the SDR's financial statements must provide condensed financial information, in a financial statement footnote, as to the financial position, changes in financial position and results of operations of the SDR, as of the same dates and for the same periods for which audited consolidated financial statements are required.[188] Such financial information need not be presented in greater detail than is required for condensed statements by Rules 10-01(a)(2), (3), and (4) of Regulation S-X.[189] Detailed footnote disclosure that would normally be included with complete financial statements may be omitted with the exception of disclosures regarding material contingencies, long-term obligations, and guarantees.[190] Descriptions of significant provisions of the SDR's long-term obligations, mandatory dividend or redemption requirements of redeemable stocks, and guarantees of the SDR shall be provided along with a five-year schedule of maturities of debt.[191] If the material contingencies, long-term obligations, redeemable stock requirements, and guarantees of the SDR have been separately disclosed in the

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accounting firm" as a public accounting firm registered with the PCAOB in accordance with the Sarbanes-Oxley Act.

185 Proposed Rule 13n-11(f)(2).

186 Proposed Rules 13n-11(f)(3).

187 17 CFR 240.17a-5.

188 Proposed Rule 13n-11(f)(4).

189 Id.

190 Id.

191 Id.

consolidated statements, then they need not be repeated in this schedule.[192] This proposed requirement is substantially similar to Rule 12-04 of Regulation S-X, which pertains to condensed financial information of registrants.[193]

Proposed Rule 13n-11(f) would also require an SDR's financial reports to be provided in XBRL consistent with Rules 405(a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T.[194] Specifically, information in an SDR's financial report would be required to be tagged using XBRL to allow the Commission to assess and analyze effectively the SDR's financial and operational condition.

Finally, annual compliance reports and financial reports filed pursuant to proposed Rule 13n-11 would be required to be filed within 60 days after the end of the fiscal year covered by such reports.[195]

The Commission notes that with respect to its other registrants, the Commission has required, at a minimum, the proposed financial information and, in some instances, significantly more information.[196] The Commission believes that it is necessary to obtain an audited annual financial report from each registered SDR to understand the SDR's financial and operational condition, particularly because SDRs are intended to play a pivotal role in improving the transparency and efficiency of the SBS market and because SBSs (whether cleared or uncleared) are required to be reported to a registered SDR.[197] Among other things, the Commission would

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192 Id.

193 See 17 CFR 210.9-06.

194 See 17 CFR 232.405 (imposing content, format, submission, and website posting requirements for an interactive data file, as defined in Rule 11 of Regulation S-T).

195 Proposed Rule 13n-11(g).

196 See, e.g., Exchange Act Rule 17a-5(d), 17 CFR 240.17a-5(d).

197 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(m)(1)(G)).

need to know whether an SDR has adequate financial resources to comply with its statutory obligations or is having financial difficulties. If an SDR ultimately ceases doing business, it could create a significant disruption in the OTC derivatives market.

Request for Comment

The Commission requests comment on the following specific issues:

- Is the Commission's proposed rule regarding an SDR's financial report appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Should the Commission permit a financial report to be in compliance with International Financial Reporting Standards as an alternative to GAAP? If so, are there any disadvantages to permitting this?
- Is the Commission's proposed rule requiring financial reports to cover the most recent two fiscal years of an SDR appropriate? If not, should the timeframe be shorter or longer (e.g., the most recent three fiscal years)?
- Is the Commission's proposed requirement regarding an SDR's condensed financial information appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Is the Commission's proposed 60-day timeframe for an SDR to file the financial report appropriate? If not, should the timeframe be shorter or longer (e.g., 90 days)?
- Would an SDR's financial report be useful to the public or other regulators? If so, explain.
- Are there any terms in the Commission's proposed rule regarding an SDR's financial report that need to be defined or clarified? If so, which terms?

- What is the likely impact of the Commission's proposed rule on the SBS market? Would the proposed rule potentially promote or impede the establishment of SDRs?
- How might the evolution of the SBS market over time impact the SDRs or affect the Commission's proposed rule?

IV. General Request for Comment

The Commission is requesting comment from all members of the public. The Commission particularly requests comments from the point of view of entities that plan to register as SDRs; entities operating platforms that currently trade or clear SBSs; SBS dealers, broker-dealers, financial institutions, major SBS participants, and other persons that trade SBSs; and investors generally. The Commission will carefully consider the comments that it receives. The Commission seeks comment generally on all aspects of the proposed rules. In addition, The Commission seeks comment on the following:

1. Should the Commission clarify or modify any of the definitions included in the proposed rules? If so, which definitions and what specific modifications are appropriate or necessary?
2. Are the obligations in the proposed rules sufficiently clear? Is additional guidance from the Commission necessary?
3. What documents and data are typically and currently kept by entities that may register as SDRs? In what format? How long are such records currently maintained by SDRs?
4. What types of documents and data should be retained by SDRs pursuant to the proposed rules? What burdens or costs would the retention of such information entail?

5. What are the technological or administrative burdens of maintaining the information specified in the proposed rules?
6. Is there an industry standard format for information and records regarding SBSs? Are there different standard formats depending on the type or class of SBS? Please answer with specificity.
7. Are the burdens of any of the requirements in the proposed rules greater than the benefits that would be attained by such requirement?
8. Should the Commission implement substantive requirements in addition to, or in place of, the policies and procedures required in the proposed rules?
9. The role of SDRs is still developing and may change significantly as the SBS market develops. In particular, the new provisions in the Dodd-Frank Act relating to SDRs are not yet effective. Once they become effective, SDRs will be subject to substantially more regulation. How will the incentives and behavior of market participants be likely to change as the reporting of SBSs to SDRs becomes more established? How will potential changes in the trading of SBSs affect SDRs? How might competition issues affect or change existing SDRs and new SDRs?
10. With respect to entities that currently perform repository services for SBSs or other instruments, how do current practices compare to the practices that the Commission proposes to require in these rules? What are the incremental costs to potential SDRs in connection with adding to or revising their current practices in order to implement the Commission's proposed rules?

In addition, the Commission seeks commenters' views regarding any potential impact of the proposals on users of any SDRs, other market participants, and the public generally. The

Commission seeks comment on the proposal as a whole, including its interaction with the other provisions of the Dodd-Frank Act. The Commission seeks comment on whether the proposal would help achieve the broader goals of increasing transparency and accountability in the SBS market.

The Commission requests comment generally on whether the rules proposed today to govern the SDR registration process, duties, and core principles are necessary or appropriate for those purposes. If commenters do not believe one or all such rules are necessary and appropriate, why not? What would be the preferred action?

Title VII requires the SEC to consult and coordinate, to the extent possible, with the CFTC for the purposes of assuring regulatory consistency and comparability, to the extent possible, and states that in adopting rules, the CFTC and SEC shall treat functionally or economically similar products or entities in a similar manner.

The CFTC is adopting rules related to swap data repositories as required under Section 728 of the Dodd-Frank Act. Understanding that the Commission and the CFTC regulate different products and markets, and as such, may appropriately be proposing alternative regulatory requirements, we request comment on the impact of any differences between the Commission and CFTC's approaches to the regulation of SDRs and swap data repositories, respectively. Specifically, do the regulatory approaches under the Commission's proposed rulemaking pursuant to Section 763(i) of the Dodd-Frank Act and the CFTC's proposed rulemaking pursuant to Section 728 of the Dodd-Frank Act result in duplicative or inconsistent efforts on the part of market participants subject to both regulatory regimes or result in gaps between those regimes? If so, in what ways do commenters believe that such duplication, inconsistencies, or gaps should be minimized? Do commenters believe that the approaches proposed by the Commission and the CFTC to regulate SDRs and swap data repositories, respectively, are comparable? If not, why? Do commenters believe there are approaches that would make the regulation of swap data repositories and SDRs more comparable? If so, what? Do commenters believe that it would be appropriate for us to adopt an approach proposed by the CFTC that differs from our proposal? If so, which one?

Commenters should, when possible, provide the Commission with empirical data to support their views. Commenters suggesting alternative approaches should provide comprehensive proposals, including any conditions or limitations that they believe should apply, the reasons for their suggested approaches, and their analysis regarding why their suggested approaches would satisfy the statutory mandate contained in Section 763(i) of the Dodd-Frank Act governing SDRs.

V. Paperwork Reduction Act

Certain provisions of the proposed rules would impose new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[198] The Commission has submitted them to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title of the new collection of information is "Form SDR and Security-Based Swap Data Repository Registration, Duties, and Core Principles." 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 of information..

A. Summary of Collection of Information

1. Registration Requirements and Form SDR

198 44 U.S.C. 3501 et seq.

Proposed Rule 13n-1(b) would require an SDR to apply for registration with the Commission by filing electronically in tagged data format on Form SDR in accordance with the instructions contained therein. Under Proposed Rule 13n-1(f), SDRs would be required to both designate and authorize on Form SDR an agent in the United States, other than a Commission member, official, or employee, to accept notice or service of process, pleadings, or other documents in any action or proceedings brought against the SDR to enforce the federal securities laws and the rules and regulations thereunder. Under proposed Rule 13n-1(g) a non-resident SDR must certify on Form SDR and provide an opinion of counsel that the SDR can, as a matter of law, provide the Commission with prompt access to the books and records of such SDR and can, as a matter of law, submit to onsite inspection and examination by the Commission. Under proposed Rule 13n-3(a), in the event that an SDR succeeds to and continues the business of a registered SDR, the successor SDR would be required to file an application for registration on Form SDR within 30 days after such succession in order for the registration of the predecessor to be deemed to remain effective as the registration of the successor. Also, under proposed Rule 13n-11(a), SDRs would be required to identify on Form SDR a person who has been designated by the board to serve as CCO of the SDR.

Proposed Rule 13n-1(e) would require SDRs to file an amendment on Form SDR annually as well as when updating any information provided in items 1 through 16, 25, and 44 on Form SDR if any information contained in those items is or becomes inaccurate for any reason. Under proposed Rule 13n-3(b), if an SDR succeeds to and continues the business of a registered SDR and the succession is based solely on a change in the predecessor's date or state of incorporation, form of organization, or composition of a partnership, the successor SDR would be permitted, within 30 days after such succession, to amend the registration of the predecessor SDR to reflect these changes.

2. <u>SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access</u>

Proposed Rule 13n-4(b) sets out a number of duties for SDRs. Under proposed Rule 13n-4(b)(2) and (4), SDRs would be required to accept data as prescribed in proposed Regulation SBSR,[199] and maintain such data as required in proposed Rule 13n-5 for each SBS reported to the SDRs. SDRs would be required, pursuant to proposed Rule 13n-4(b)(5), to provide direct electronic access to the Commission or its designees.[200] The Commission has reserved the ability to specify the form and manner in which an SDR provides this direct electronic access. SDRs would be required, pursuant to Rule 13n-4(b)(6), to provide this data in such form and at such frequency as required by proposed Regulation SBSR.

SDRs would have an obligation under proposed Rule 13n-4(b)(3) to confirm with both counterparties the accuracy of the information submitted to the SDR. Under proposed Rule 13n-4(b)(7), at such time and in such manner as may be directed by the Commission, an SDR would be required to establish automated systems for monitoring, screening, and analyzing SBS data.[201] Under proposed Rule 13n-4(b)(9), SDRs would be required to, on a confidential basis and after notification to the Commission, make available all data obtained by the SDR upon the request of certain government bodies such as the CFTC and the Department of Justice.[202] Under proposed

199 <u>See</u> Regulation SBSR Release, <u>supra</u> note 9.

200 <u>See</u> <u>also</u> proposed Rule 13n-4(a)(6) (defining "direct electronic access").

201 The Commission is not making any such direction in this release. <u>See</u> <u>supra</u> Section III.D.1. Should the Commission do so, the collection of information would be amended to reflect the change.

202 SDRs would also be required under proposed Rule 13n-4(b)(9) to make all data available to "any other person that the Commission determines to be appropriate," including such

Rule 13n-4(b)(10), before sharing information with any entity described in proposed Rule 13n-4(b)(9), the SDR must obtain a written agreement from each entity stating that the entity shall abide by the confidentiality requirements of Exchange Act Section 24 as well as indemnify the SDR and the Commission for any expenses arising from litigation relating to the information provided.

Proposed Rule 13n-5 would establish rules regarding SDR data collection and maintenance. Proposed Rule 13n-5(b)(1) would require that SDRs establish, maintain, and enforce written policies and procedures reasonably designed for the reporting of transaction data to the SDR,[203] to accept all transaction data reported to it in accordance with these policies and procedures, to accept all data provided to it regarding all SBSs in an asset class if the SDR accepts data on any SBS in that particular asset class, and to satisfy itself by reasonable means that the transaction data that has been submitted to the SDR is accurate, including clearly identifying the source for each trade side, and the pairing method (if any) for each transaction in order to identify the level of quality of the transaction data. An SDR would also be required under proposed Rule 13n-5(b)(1)(iv) to promptly record transaction data it receives.

Proposed Rule 13n-5(b) would also require that SDRs establish, maintain, and enforce written policies and procedures reasonably designed (1) to calculate positions for all persons with open\SBSs for which the SDR maintains records; (2) to ensure that the transaction data and positions that it maintains are accurate; and (3) to prevent any provision in a valid SBS from being invalidated or modified through the procedures or operations of the SDR.

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entities as foreign financial supervisors, provided that the SDR obtains a written agreement as set forth in proposed Rule 13n-4(b)(10).

203 Transaction data is defined in proposed Rule 13n-5(a)(1).

Proposed Rule 13n-5(b)(4) would require that SDRs maintain the transaction data for not less than five years after the applicable SBS expires and historical positions for not less than five years. This data would be required to be maintained in a place and format that is readily accessible to the Commission and other persons with authority to access or view the information and would also be required to be maintained in an electronic format that is non-rewritable and non-erasable. Under proposed Rule 13n-5(b)(7), the SDR's recordkeeping obligation would extend to the periods required under these rules even if the SDR ceases to do business or to be registered pursuant to Section 13(n) of the Act. Proposed Rule 15n-5(b)(8) would require SDRs to make and keep current a plan to ensure that the transaction data and positions that are recorded in the SDR continue to be maintained in accordance with Rule 13n-5(b)(7), including procedures for transferring the transaction data and positions to the Commission or its designee (including another registered SDR).

Proposed Rule 13n-6 would establish rules regarding SDR automated systems. As detailed above, proposed Rule 13n-6(b)(1) would require that SDRs establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the SDR's systems provide adequate levels of capacity, resiliency, and security and such policies and procedures shall include, among other elements, reasonable capacity limits, periodic capacity stress testing, and review of vulnerabilities of the SDR's systems.

Proposed Rule 13n-6(b)(3) would require that the SDR promptly notify the Commission of any material systems outages and submit to the Commission within five business days of when the outage occurred a written description and analysis of the outage and any remedial measures implemented or contemplated. The definition of "material system outage" in proposed Rule 13n-6(a)(1) refers to a number of documents that would trigger such an event, such as a communication of an outage situation to other external entities and a report or referral of an event to the SDR's board or senior management. Proposed Rule 13n-6(b)(4) would require that the SDR notify the Commission in writing at least thirty days before implementation of a planned material systems change. Pursuant to proposed Rule 13n-6(c), these notifications and description and analysis would be required to be submitted to the Division of Trading and Markets in an appropriate electronic format. Pursuant to proposed Rule 13n-6(d), these notifications and description and analysis can be afforded confidential treatment, to the extent permitted by law, if the requestor marks each page or segregable portion of each page with a notation.

3. Recordkeeping

Proposed Rule 13n-7(d) would require that the SDR keep records, in addition to those required under proposed Rule 13n-5. SDRs would be required, under proposed Rule 13n-7(a)(1), to make and keep current a record for each office listing, by name or title, each person at that office who, without delay, can explain the types of records the SDR maintains at that office and the information contained in those records. SDRs would also be required, under proposed Rule 13n-7(a)(2), to make and keep current a record listing each officer, manager, or person performing similar functions of the SDR responsible for establishing policies and procedures that are reasonably designed to ensure compliance with the Exchange Act and the rules and regulations thereunder. Proposed Rule 13n-7(b) would require every SDR to keep and preserve at least one copy of all documents as shall be made or received by it in the course of its business as such. These records would be required to be kept for a period of not less than five years, the first two years in a place immediately available to Commission staff for inspection and examination. Upon the request of any representative of the Commission, an SDR would be required to furnish promptly to such representative copies of any documents required to be kept and preserved by the SDR pursuant to proposed Rule 13n-7(a) or (b). Under proposed Rule 13n-7(c), the SDR's recordkeeping obligation would extend to the periods required under these rules even if the SDR ceases to do business or to be registered pursuant to Section 13(n) of the Act.

SDRs would also be required to make available the books and records required by proposed Rules 13n-1 through 13n-11 upon request by representatives from the Commission for examination and inspection.[204]

4. Reports and Reviews

The proposed rules would require that a number of reports or reviews be submitted to the Commission. Under proposed Rule 13n-6(b)(2), SDRs would be required to submit to the Commission an annual objective review with respect to those systems that support or are integrally related to the performance of the SDR's activities. If the objective review is performed by an internal department, an objective, external firm would be required to assess the internal department's objectivity, competency, and work performance.

Under proposed Rule 13n-8, SDRs would be required to promptly report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines necessary or appropriate for the Commission to perform the duties of the Commission.

5. Disclosure

Proposed Rule 13n-10 describes disclosures that SDRs would be required to provide to a market participant before accepting any SBS data from that market participant or upon a market participant's request. The information required in the disclosure document would be (1) the

[204] See, e.g., proposed Rules 13n-4(b)(1) and 13n-7(b)(3).

SDR's criteria for providing others with access to services offered and data maintained by the SDR; (2) the SDR's criteria for those seeking to connect to or link with the SDR; (3) a description of the SDR's policies and procedures regarding its safeguarding of data and operational reliability to protect the confidentiality and security of such data (as described in proposed Rule 13n-6); (4) the SDR's policies and procedures required by proposed Rule 13n-9(b)(1); (5) the SDR's policies and procedures regarding its non-commercial and commercial use of the transaction information that it receives; (6) the SDR's dispute resolution procedures required by proposed Rule 13n-5(b)(6); (7) a description of all of the SDR's services, including any ancillary services; (8) an updated schedule of the SDR's dues, unbundled prices, rates or other fees of all its services, as well as any discounts or rebates offered and the criteria to benefit from those discounts or rebates; and (9) a description of the SDR's governance arrangements.

6. Chief Compliance Officer

Proposed Rules 13n-4(b)(11) and 13n-11(a) would require the board of an SDR to designate a CCO to perform the duties identified in proposed Rule 13n-11. Under proposed Rule 13n-11(c)(6) and (7), the CCO would be responsible for, among other things, establishing procedures for the remediation of noncompliance issues identified by the CCO and establishing and following appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

The CCO would also be required under proposed Rule 13n-11(d) and (g) to prepare and submit annual compliance reports to the Commission and the SDR's board containing, at a minimum, the SDR's enforcement of its policies, any material changes to the policies and procedures since the date of the preceding compliance report, any recommendation for material changes to the policies and procedures, and any material compliance matters identified since the date of the preceding compliance report. This report must be filed in a tagged data format in accordance with the instructions contained in the EDGAR Filer Manual.[205]

Proposed Rule 13n-11(f) and (g) would require that annual financial reports be prepared and submitted to the Commission. These financial reports must, among other things, be prepared in conformity with GAAP for the most recent two fiscal years of the SDR, audited by a registered public accounting firm that is qualified and independent in accordance with Rule 2-01 of Regulation S-X, and are in accordance with standards of the Public Company Accounting Oversight Board. This report must be provided in XBRL as required in Rules 405(a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T.[206]

7. Other Provisions Relevant to the Collection of Information

Proposed Rule 13n-4(c)(1) sets forth the proposed requirements related to market access to services and data. Among these are requirements that the SDR (1) establish, monitor on an ongoing basis, and enforce clearly stated objective criteria that would permit fair, open, and not unreasonably discriminatory access to services offered and data maintained by the SDR, as well as fair, open, and not unreasonably discriminatory participation by those seeking to connect or link with the SDR and (2) establish, maintain, and enforce written policies and procedures reasonably designed to review any prohibition or limitation of any person with respect to services offered or data maintained by the SDR and to grant such person access to such services or data if such person has been discriminated against unfairly.

Proposed Rule 13n-4(c)(2)(iv) would require that SDRs establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the SDR's senior management and each member of the board or committee that has the authority to act on behalf of the board

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205 See 17 CFR 232.301.

206 See 17 CFR 232.405.

possess requisite skills and expertise to fulfill their responsibilities in the management and governance of the SDR, to have a clear understanding of their responsibilities, and to exercise sound judgment about the SDR's affairs.

Proposed Rule 13n-4(c)(3) sets forth the proposed conflicts of interest controls that would be required of SDRs. SDRs would be required to establish and enforce written policies and procedures reasonably designed to minimize conflicts of interest, including establishing, maintaining, and enforcing written policies and procedures reasonably designed to identify and mitigate potential and existing conflicts of interest in the SDR's decision-making process on an on-going basis and regarding the SDR's non-commercial and commercial use of the SBS transaction information that it receives.

Proposed Rule 13n-5(b)(6) would require that SDRs establish procedures and provide facilities reasonably designed to effectively resolve disputes over the accuracy of the transaction data and positions that are recorded in the SDR.

Proposed Rule 13n-9 relates to the privacy requirements that would be required of SDRs. Proposed Rule 13n-9(b)(1) would require SDRs to establish, maintain, and enforce written policies and procedures reasonably designed to protect the privacy of any and all SBS transaction information that the SDR receives from any SBS dealer, counterparty, or any registered entity. Proposed Rule 13n-9(b)(2) would require SDRs to establish and maintain safeguards, policies, and procedures reasonably designed to prevent the misappropriation or misuse of any confidential information received by the SDR, material, nonpublic information, or intellectual property. At a minimum, such policies and procedures must limit access to such information, include standards that control persons associated with the SDR in trading for their personal benefit of the benefit of others, and adequate oversight.

B. Proposed Use of Information

1. Registration Requirements and Form SDR

As discussed above, proposed Rules 13n-1 and 13n-3 would require SDRs to register on Form SDR and make amendments to Form SDR. Certain additional information would be required on Form SDR, including agent for service of process and identification of the SDR's CCO pursuant to proposed Rule 13n-11(a). The information collected in these provisions would be used to enhance the ability of the Commission to monitor SDRs and ensure compliance with the Exchange Act and the rules and regulations thereunder by helping the Commission identify SDRs, as well as understand their operations and organizational structure.

2. SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access

As discussed above, proposed Rules 13n-4(b), 13n-5, and 13n-6 would require that SDRs comply with specified duties, collect specific data that is provided to certain entities in specific ways as well as maintain that data in specific ways, and establish certain oversight programs over its automated systems. The information that would be collected under these provisions would help ensure an orderly and transparent SBS market as well as provide the Commission and other parties with tools to help oversee this market.

3. Recordkeeping

As discussed above, proposed Rule 13n-7 would require an SDR to make and keep records associated with all the proposed rules except for the data collected and maintained pursuant to proposed Rule 13n-5 for a proscribed period. The information that would be collected under these provisions would be necessary for the Commission to conduct its inspection and examination programs regarding SDRs.

4. Reports and Reviews

As discussed above, proposed Rules 13n-6(b)(2) and 13n-8 would require certain reports or reviews be provided to the Commission. The information that would be collected under these provisions would be used by the Commission to assist in its oversight of SDRs, including ensuring an orderly and transparent SBS market.

5. Disclosure

As discussed above, proposed Rule 13n-10 would require that SDRs provide certain specific disclosures to a market participant before accepting any data from that market participant. These disclosures would help market participants understand the risks and protections available to them.

6. Chief Compliance Officer

As discussed above, proposed Rule 13n-11 would require that an SDR's CCO establish certain policies relating to noncompliance issues as well as prepare and submit to the Commission an annual compliance report. Proposed Rule 13n-11 would also require that an annual financial report be prepared and filed with the Commission. The information that would be collected under this rule would help ensure compliance by SDRs of the provisions of the Exchange Act and the rules and regulations thereunder as well as assist the Commission in ensuring such compliance.

7. Other Provisions Relevant to the Collection of Information

As discussed above, (1) proposed Rule 13n-4(c)(1) would require SDRs to comply with certain requirements relating to market access to services and data including establishment of certain policies and procedures or clearly stated objective criteria; (2) proposed Rule 13n-4(c)(2)(iv) would require SDRs to establish policies and procedures regarding the skills and expertise of an SDR's senior management and members of the board or committee that has the authority to act on behalf of the board; (3) proposed Rule 13n-4(c)(3) would require SDRs to establish and enforce written conflicts of interest policies and procedures as well as require ongoing identification and mitigation of conflicts and to establish written policies and procedures regarding their noncommercial and commercial use of transaction information; (4) proposed Rule 13n-5(b)(6) would require that SDRs establish dispute resolution procedures and facilities reasonably designed to effectively resolve disputes regarding the accuracy of the transaction data and positions that are recorded in the SDR; and (5) proposed Rule 13n-9 would require SDRs to establish policies, procedures, and safeguards regarding privacy and misappropriation or misuse of certain information. The information that would be collected pursuant to these provisions would help ensure a transparent and orderly marketplace for SBSs, protect users' privacy, and enable Commission oversight of these programs.

C. Respondents

1. Registration Requirements and Form SDR

The registration requirements of proposed Rules 13n-1, 13n-3, 13n-11(a), and Form SDR would apply to every SDR. The Dodd-Frank Act does not limit the number of persons that may register as SDRs. Commission staff is aware of five persons that have indicated the ability and/or interest in providing SDR services for SBS. For PRA purposes, the Commission believes that it is reasonable to expect that, at most, ten persons may register with the Commission as SDRs.[207] Furthermore, for PRA purposes, the Commission preliminarily estimates that three

207 In order to withdraw from registration, SDRs would be required to file a notice of withdrawal with the Commission and update any inaccurate information by filing an amended Form SDR with the Commission prior to the withdrawal. However, since the Commission expects a total of only 10 SDRs to register, we estimate that there would be fewer than 10 potential respondents for this requirement and therefore this requirement also would not constitute part of the collection of information.

such persons may be "non-resident" SDRs subject to the additional requirements of proposed Rule 13n-1(g).

2. SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access

The duties, data collection and maintenance, and automated systems requirements of proposed Rules 13n-4(b), 13n-5, and 13n-6 would, as a general matter, apply to all SDRs. Thus, for these provisions, the Commission estimates that there will be 10 respondents.

3. Recordkeeping

The recordkeeping requirements of proposed Rule 13n-7 would apply to all SDRs. Thus, for these provisions, the Commission estimates that there will be 10 respondents.

4. Reports and Reviews

The reports and review requirements of proposed Rules 13n-6(b)(2) and 13n-8 would apply to all SDRs. Thus, for these provisions, the Commission estimates that there will be 10 respondents.

5. Disclosure

The disclosure requirements of proposed Rule 13n-10 would apply to all SDRs. Thus, for these provisions, the Commission estimates that there will be 10 respondents.

6. Chief Compliance Officer

The provisions regarding CCOs set forth in proposed Rule 13n-11 would apply to all SDRs. Thus, for these provisions, the Commission estimates that there will be 10 respondents.

7. Other Provisions Relevant to the Collection of Information

The remaining requirements of the proposed rules relevant to the collection of information, specifically proposed Rules 13n-4(c), 13n-5(b)(6) and 13n-9, would apply to all SDRs. Thus, for these provisions, the Commission estimates that there will be 10 respondents.

The Commission seeks comment regarding the accuracy of any of the above figures.

D. Total Annual Reporting and Recordkeeping Burden

1. Registration Requirements and Form SDR

Proposed Rules 13n-1(b) and 13n-3(a), relating to successor SDRs as described above, would require SDRs to apply for registration using Form SDR and file such form electronically in tagged data format with the Commission in accordance with the instructions contained therein. Further, proposed Rule 13n-1(f) would require SDRs to designate an agent for service of process on Form SDR, and proposed Rule 13n-11(a) would require SDRs to identify its CCO on Form SDR. For purposes of the PRA, the Commission estimates that it would take an SDR approximately 400 hours to complete the initial Form SDR with the information required and in compliance with these proposals. The Commission bases this estimate on the number of hours necessary to complete Form SIP.[208] As noted above, the Commission currently estimates that 10 entities will be subject to this burden. Accordingly, the Commission estimates that the one-time initial registration burden for all SDRs would be approximately 4000 burden hours. The Commission believes that SDRs will prepare Form SDR internally, but the Commission solicits comment as to whether SDRs will do so or outsource this requirement.

Under proposed Rule 13n-1(g) a non-resident SDR must certify on Form SDR and provide an opinion of counsel that the SDR can, as a matter of law, provide the Commission with access to the books and records of such SDR and can, as a matter of law, submit to onsite inspection and examination by the Commission. This creates additional burdens for non-resident

208. The Commission calculated in 2008 that Form SIP takes 400 hours to complete. 73 FR 34060 (June 16, 2008) (outlining the most recent Commission calculations regarding the PRA burdens for Form SIP). While the requirements of Form SIP and Form SDR are not identical, the Commission believes that there is sufficient similarity for PRA purposes that the burden would be roughly equivalent.

SDRs. We estimate, based on the similar requirements of Form 20-F, that this additional burden will add 3 hours and $900 in outside legal costs per respondent.[209] As stated above, the Commission believes that there will be three respondents to this collection, for a total additional burden for non-resident SDRs to comply with proposed Rule 13n-1(g) of 9 hours and $2700.[210]

SDRs would also be required to amend Form SDR pursuant to proposed Rule 13n-1(e) annually as well as when information in certain enumerated items is or becomes inaccurate. Amendments are also required in certain situations involving successor SDRs outlined above pursuant to proposed Rule 13n-3(b). For purposes of Form SIP, the Commission considered amendments to be part of the 400 hours of the annual burden.[211] However, the Commission believes that Form SDR will have different initial burden as compared to the ongoing annual amendments. When amendments to Form ADV were proposed in 2008, the Commission estimated that the hours burden for amendments to be roughly 3% of the initial burden.[212] The Commission believes that this ratio would be the same for filers of Form SDR. Thus, the Commission estimates that the ongoing annualized burden for complying with these registration amendment requirements would be approximately 12 burden hours for each SDR per amendment and approximately 120 burden hours for all SDRs per amendment. Proposed Rule 13n-1(e)

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209 Exchange Act Release No. 49616 (Apr. 26, 2004); 69 FR 24016 (Apr. 30, 2004). The $900 figure is based on an estimate of $400 an hour for legal services.

210 The base burden of 4000 hours includes resident and non-resident SDRs. The 9 hour and $2700 figures are the additional costs as a result of proposed 13n-1(g) for non-resident SDRs not already accounted for in the 4000 hour figure.

211 "This annual reporting and recordkeeping burden does not include the burden hours or cost of amending a Form SIP because the Commission has already overstated the compliance burdens by assuming that the Commission will receive one initial registration pursuant to Rule 609 on Form SIP a year." Id.

212 Investment Advisors Act Release No. 2711 (Mar. 3, 2008); 73 FR 13958 (Mar. 14, 2008). In that proposal, the initial burden was calculated to be 22.25 hours per respondent and 0.75 hours per respondent for amendments.

would require one annual compulsory amendment on Form SDR as well as interim amendments on Form SDR when reported information thereto is or becomes inaccurate or, under proposed Rule 13n-3(b), in certain circumstances involving successor SDRs detailed above. When Form ADV was amended earlier this year, the Commission estimated that there were 2 amendments per year for that form.[213] The Commission believes that would be a reasonable estimate for the number of amendments per year to correct inaccurate information or in situations involving successor SDRs. Including the required annual amendment, the Commission estimates that respondents will be required to file on average 3 amendments per year. Therefore, the Commission estimates that each respondent will have an average annual burden of 36 hours for a total estimated average annual burden of 360 hours.[214] The Commission believes, based on discussions with industry participants, that this work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

2. <u>SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access</u>

As outlined above, under proposed Rules 13n-4(b)(2) and (4) and 13n-5, SDRs would be required to accept and maintain data received from third parties including transaction data and to calculate and maintain position information. SDRs would be required, pursuant to proposed Rule 13n-4(b)(5), to provide direct electronic access to the Commission or its designees and, pursuant to proposed Rule 13n-4(b)(9), make available data obtained by the SDR to other parties, including certain government bodies. SDRs would also have an obligation under proposed Rules

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213 Investment Advisors Act Release No. 3060 (July 28, 2010); 75 FR 49234 (Aug. 12, 2010). Although this information is based upon investment advisor statistics, the Commission believes that for these purposes the differences between investment advisors and SDRs are minimal.

214 The 36 hours figure is the result of the estimated burden per SDR per amendment (12) times the estimated number of amendments per year (3). The 360 hour figure is the result of the estimated burden per SDR (36) times the number of SDRs (10).

13n-4(b)(3) and 13n-5(b)(1)(iii) to establish and maintain written policies and procedures reasonably designed to confirm and to satisfy itself by reasonable means that the transaction data that has been submitted to the SDR is accurate. Also, proposed Rule 13n-5(b)(4) would require that SDRs maintain the transaction data for not less than five years after the applicable SBS expires and historical positions for not less than five years.[215] Under the proposal, this obligation would continue even if an SDR withdraws from registration or ceases doing business.[216] SDRs would be required to make and keep current a plan to ensure compliance with this requirement.[217]

The Commission estimates that the average one-time start-up burden per SDR of establishing systems compliant with all of these requirements, including the recordkeeping requirements of proposed Rules 13n-5(b)(4), (7), and (8), would be 42,000 hours and $10 million in information technology costs. This estimate is based on the Commission's discussions with market participants. Based on the expected number of respondents, the Commission estimates a total start-up cost of 420,000 hours and $100 million in information technology costs. Based on discussions with potential respondents, the Commission further estimates that the average ongoing annual costs of these systems to be 25,200 hours and $6 million per respondent or a total of 252,000 hours and $60 million for a total ongoing annual burden. The Commission solicits comment as to the accuracy of this information.

215 This data would be required to be maintained in a place and format that is readily accessible to the Commission and other persons with authority to access or view the information and would also be required to be maintained in an electronic format that is non-rewritable and non-erasable.

216 Proposed Rule 13n-5(b)(7).

217 Proposed Rule 13n-5(b)(8).

Under proposed Rule 13n-4(b)(10), before sharing information with any entity described in new Exchange Act Section 13(n)(5)(G), an SDR must obtain written confidentiality and indemnification agreements. The Commission estimates that these agreements will require four hours per respondent in outside legal costs to create for an initial outside cost of $1600 per respondent.[218] As outlined above, the Commission estimates a total of 10 respondents to this requirement. Therefore, the Commission estimates the initial burden for this requirement would be $16,000. The Commission estimates, for PRA purposes only, that SDRs will need to enter into these agreements on an average of at most 1 time per year.[219] The Commission further estimates that each such agreement, subsequent to the initial one, will require an average of 3 hours to draft. Thus, the Commission estimates an average annual burden of 30 hours. The Commission believes that in light of the nature of the parties involved, these agreements will be created internally at the parties entering into them after the initial agreement is drafted or reviewed by outside counsel. The Commission solicits comment as to the accuracy of this information.

Each SDR would also be required to establish, maintain, and enforce written policies and procedures, specifically (1) under proposed Rule 13n-5(b)(1), reasonably designed for the reporting of transaction data to the SDR and to satisfy itself of the accuracy of such information; (2) under proposed Rule 13n-5(b)(2), reasonably designed to calculate positions for all persons with open SBSs for which the SDR maintains records; (3) under proposed Rule 13n-5(b)(3),

218 This is based on an estimated $400 an hour cost for outside legal services. This is the same estimate used by the Commission for these services in the proposed consolidated audit trail rule. Exchange Act Release No. 62174 (May 26, 2010); 75 FR 32556 (June 8, 2010).

219 As noted above, there are other avenues available to the Commission to share this information with appropriate entities. As a result, for PRA purposes, the Commission believes that SDRs will enter into only a few confidentiality and indemnification agreements.

reasonably designed to ensure data and calculations are accurate; (4) under proposed Rule 13n-5(b)(5), reasonably designed to prevent any provision in an SBS from being invalidated; and (5) under proposed Rule 13n-6(b)(1), reasonably designed to ensure that the SDR's systems provide adequate levels of capacity, resiliency, and security. While these policies and procedures will vary in exact cost, the Commission estimates that such policies and procedures would require an average of 210 hours per respondent per policy and procedure to prepare and implement. The Commission further estimates that these policies and procedures would require $100,000 for outside legal costs.[220] In sum, the Commission estimates the initial burden for all respondents to be 10,500 hours and $1,000,000 for outside legal costs.[221] The Commission based these estimates upon those estimates we used with regards to establishing policies and procedures regarding Regulation NMS.[222] Once these policies and procedures are established, the Commission estimates that it will take on average 60 hours annually to maintain each of these policies and procedures per respondent, with a total estimated average annual burden of 3,000 hours.[223] The Commission believes that this maintenance work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

220 This figure is the result of an estimated $400 an hour cost for outside legal services (as noted above) times 50 hours of outside legal consulting per policy and procedure, times 5 policies and procedures.

221 The 10,500 hour figure is the result of the number of hours per policy and procedure (210) times the number of policies and procedures required by these provisions (5), times the number of respondents (10). The $1,000,000 figure is the result of the outside dollar cost per respondent ($100,000) times the number of respondents (10).

222 Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005). The Commission based these estimates on those for non-SRO trading centers rather than for SRO trading centers because we believe that for these purposes non-SRO trading center burdens are more like those that SDRs would face under the proposals.

223 The 3,000 hour figure is the result of the estimated average hourly burden to maintain each policy and procedure (60), times the total number of policies and procedures required under this requirement (5), times the total number of SDRs (10).

For each material systems outage, SDRs would be required under proposed Rule 13n-6(b)(3) to promptly notify the Commission and submit to the Commission, after the outage, a written description and analysis of the outage and any remedial measures implemented or contemplated. Also, the definition of "material system outage" refers to a number of documents that would trigger such an event, such as a communication of an outage situation to other external entities and a report or referral of an event to the SDR's board or senior management. The Commission estimates, based on our experience with the ARP program,[224] that the burden imposed by these requirements would be 15.4 hours on average per respondent per year, for a total estimated burden of 154 hours per year.[225] The Commission believes that this work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

Proposed Rule 13n-6(b)(4) would require an SDR to notify the Commission in writing at least thirty days before implementation of a planned material systems change. Based on our discussions with market participants, the Commission estimates that there would be an average of 60 such events per respondent per year.[226] Based on the Commission's experience with the ARP program, we estimate that each of these notices would require an average of 2 hours for a

224 Under the Commission's ARP inspection program of SROs and certain alternative trading systems ("ATS"), the Commission staff conducts on-site inspections and attends periodic technology briefings presented by SRO and ATS staff to the Commission staff, generally covering systems capacity and testing, review of system vulnerability, review of planned system development, and business continuity planning. Under the ARP inspection program, the Commission staff also monitors system failures and planned system changes on a daily basis.

225 Included in this burden is the time to mark these documents confidential under proposed Rule 13n-6(d), as the Commission believes it is likely that an SDR will mark all documents in this manner.

226 This would account for weekly maintenance that would rise to the standard of a "material systems change" as well as possible planned software upgrades, throughout the year, that would also rise to this level.

total burden for all respondents of 1200 hours annually.[227] The Commission believes that this work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

3. Recordkeeping

SDRs would be required, under proposed Rule 13n-7(a)(1), to make and keep current a record of persons at each office of the SDR that can assist with explaining the SDR's records as well as, under proposed Rule 13n-7(a)(2), to make and keep current a record listing officers, managers, or persons performing similar functions with responsibility for the policies and procedures of the SDR to ensure compliance with the Exchange Act and the rules and regulations thereunder. The Commission estimates that these records would create an initial burden, at a maximum, of 1 hour per respondent, for a total initial burden of 10 hours. The Commission estimates that the ongoing annual burden would be 0.17 hours (10 minutes) per respondent to keep these records current and to store these documents based on our estimates for similar requirements for broker-dealers.[228] This results in a total ongoing annual burden of 1.7 hours. The Commission believes that this work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

Proposed Rule 13n-7(b) would require each SDR to keep and preserve at least one copy of all documents as shall be made or received by it in the course of its business as such, other than the data collected and maintained pursuant to proposed Rule 13n-5. These records would be

227 Included in this burden is the time to mark these documents confidential under proposed Rule 13n-6(d), as the Commission believes it is likely that an SDR will mark all documents in this manner. The 1200 hour figure is the result of the number of events per year (60), times the estimated average burden hours per notice (2), times the number of SDRs (10).

228 See Exchange Act Release No. 44992 (Oct. 26, 2001); 66 FR 55818 (Nov. 2, 2001) (regarding the collection of information pursuant to Rule 17a-3(a)(21) and (22)).

required to be kept for a period of not less than five years, the first two years in a place immediately available to Commission staff for inspection and examination.[229] Upon the request of any representative of the Commission, an SDR would be required to furnish promptly documents kept and preserved by it pursuant to proposed Rule 13n-7(a) or (b) to such a representative. Based on the Commission's experience with recordkeeping costs and consistent with prior burden estimates for similar provisions,[230] the Commission estimates that this storage requirement would create an initial burden of 345 hours and $1800 in information technology costs per respondent, for a total initial burden of 3450 hours and $18,000. The Commission further estimates that the ongoing annual burden would be 279 hours per respondent and per respondent for a total ongoing annual burden of 2790 hours. The Commission solicits comment as to the accuracy of this information.

4. Reports and Reviews

Proposed Rule 13n-6(b)(2) would require SDRs to submit to the Commission an annual objective review with respect to those systems that support or are integrally related to the performance of the SDR's activities. If the objective review is performed by an internal department, an objective, external firm would be required to assess the internal department's objectivity, competency, and work performance. Based on its experience with the ARP program, the Commission believes that the annual burden per respondent of conducting an internal audit is approximately 625 hours.[231] As a result, the Commission estimates the total average annual

229 Under the proposal, this obligation would continue even if the SDR withdraws from registration or ceases doing business. Proposed Rule 13n-7(c).

230 See Exchange Act Release No. 59342 (Feb. 2, 2009); 74 FR 6456 (Feb. 9, 2009).

231 Further, the Commission's experience with the ARP program has indicated that an additional 200 hours per respondent per year would be required on average to oversee and establish the independent review of these audits.

burden to be 8250 hours for all respondents in total for the collection.[232] In addition, based on its experience with the ARP program, the Commission estimates that the annual cost to hire an objective, external firm to be approximately $90,000 per respondent annually. For this reason, the Commission estimates that the average annual cost of complying with proposed Rule 13n-6(b)(2) for all respondents is approximately $900,000.

Under proposed Rule 13n-8, SDRs would be required to report promptly to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines necessary or appropriate for the Commission to perform the duties of the Commission. For PRA purposes only, the Commission estimates that it will request these reports at a maximum of once per year, per respondent. For PRA purposes only, the Commission estimates that these reports would be limited to information already compiled under these proposed rules and thus would require only 1 hour per response to compile and transmit. Thus, the Commission estimates, for PRA purposes only, that the total annual burden for these reports to be 10 hours. The Commission believes that this work, should it be required, will be conducted internally. The Commission solicits comment as to the accuracy of this information.

5. Disclosure

As detailed above, pursuant to proposed Rule 13n-10, SDRs would be required to provide certain disclosures to a market participant. The Commission estimates that the average one-time start-up burden per SDR of preparing this disclosure document is 97.5 hours and $4,400 of external legal costs and $5,000 of external compliance consulting costs, resulting in a total initial burden of 975 hours and $94,000. This estimate reflects the Commission's experience with and

[232] The 8250 hour figure is the result of the estimate of annual burden per respondent to conduct the internal audit (625), plus the estimate of the annual burden per respondent to oversee and establish the independent review of these audits (200), times the number of SDRs (10).

burden estimates for similar disclosure document requirements imposed on entities with 1000 or fewer employees and as a result of our discussions with market participants.[233] The Commission expects that this requirement will result in an average annual burden, after the initial creation of the disclosure document, of 1 hour per respondent, with a total annual burden of 10 hours. The Commission believes that this ongoing annual work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

6. Chief Compliance Officer

Under proposed Rule 13n-11(c)(6) and (7), an SDR's CCO would be responsible for, among other things, establishing procedures for the remediation of noncompliance issues identified by the CCO, and establishing and following appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues. As outlined above, the Commission estimates a total of 10 respondents for this requirement. Based on the Commission's estimates regarding Regulation NMS,[234] it estimates that on average these two requirements will require 420 hours to create and 120 hours to administer per year per respondent, for a total burden of 4200 hours initially and 1200 hours on average, annually.[235] Also based on the estimates regarding Regulation NMS, the Commission estimates that a total of

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233 See Investment Advisers Act Release No. 3060 (Aug. 12, 2010); 75 FR 49234 (Aug. 12, 2010).

234 See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005).

235 The 420 hour figure is the result of the estimated average hour burden to create one policy and procedure (210) times the 2 policies and procedures required by these provisions. The 120 hour figure is the result of the estimated average hour burden to administer one policy and procedure (60) times the 2 policies and procedures required by these provisions. The 4200 hour figure is the result of the estimated average hour burden per respondent to create these policies and procedures (420) times the number of SDRs (10). The 1200 hour figure is the result of the estimated average hour burden per respondent to maintain these policies and procedures (120) times the number of SDRs (10).

$40,000 in initial outside legal costs will be incurred as a result of this burden per respondent, for a total outside cost burden of $400,000.[236] The Commission solicits comment regarding the accuracy of this information.

A CCO would also be required under proposed Rule 13n-11(d) and (h) to prepare and submit annual compliance reports to the Commission and the SDR's board. Based upon the Commission's estimates for similar annual reviews by CCOs of investment companies,[237] the Commission estimates that these reports will require on average 5 hours per respondent per year. Thus, the Commission estimates a total annual burden of 50 hours. Because the report will be submitted by an internal CCO, the Commission does not expect any external costs. The Commission solicits comment as to the accuracy of this information.

Proposed Rule 13n-11(f) and (g) would require that annual financial reports be prepared and filed with the Commission. The Commission estimates, based on its experience with entities of similar size to the respondents to this collection, that these reports will generally require on average 500 hours per respondent and cost $500,000 for independent public accounting services. Thus, the Commission estimates a total annual burden of 5000 hours and $5,000,000. The Commission solicits comment as to the accuracy of this information.

The compliance and financial reports submitted to the Commission would be required to be "tagged" pursuant to the requirements of proposed Rule 13n-11. The compliance reports must be filed in a tagged data format in accordance with the instructions contained in the

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236 $400,000 figure is the result of an estimated $400 an hour cost for outside legal services (as noted above) times 50 hours, times 2 policies and procedures, times the number of SDRs (10).

237 See Investment Company Act Release No. 25925 (Feb. 5, 2003); 68 FR 7038 (Feb. 11, 2003).

EDGAR Filer Manual,[238] and the financial reports must be provided in XBRL as required in Rules 405(a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T.[239] These requirements would create an additional burden on respondents beyond the preparation of these reports. The Commission preliminarily estimates, based on our experience with other data tagging initiatives, that these requirements would add an additional burden of an average of 54 hours and $22,772 in outside software and other costs per respondent per year, creating an estimated total annual burden of 540 hours and $227,720 to tag the data for both the compliance and financial reports that would be required under proposed Rule 13n-11. The Commission solicits comment as to the accuracy of this information.

7. Other Provisions Relevant to the Collection of Information

Proposed Rule 13n-4(c)(1)(v) would require SDRs to establish, maintain, and enforce certain policies and procedures reasonably designed to review any prohibition or limitation of any person with respect to access to services offered or data maintained by the SDR and to grant such person access to such services or data if such person has been discriminated against unfairly. As outlined above, the Commission estimates a total of 10 respondents for this requirement. Based on the Commission's estimates regarding Regulation NMS,[240] it estimates that, on average, this requirement will require 210 hours to create and 60 hours to administer per year per respondent, for a total burden of 2100 hours initially and 600 hours on average, annually. The Commission also estimates, based on this earlier estimate, that a total of $20,000 in initial outside legal costs will be incurred as a result of this burden per respondent for a total

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238 See 17 CFR 232.301.

239 See 17 CFR 232.405.

240 See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005).

outside cost burden of $200,000.[241] The Commission solicits comment as to the accuracy of this information.

Proposed Rule 13n-4(c)(1) also would require SDRs to establish, monitor on an ongoing basis, and enforce clearly stated objective criteria that would permit fair, open, and not unreasonably discriminatory access to services offered and data maintained by the SDR. For PRA purposes only, the Commission believes that this should be a lesser burden than for written policies and procedures. Thus, the Commission estimates that this requirement will require 157.5 hours to create, with an associated outside legal cost of $15,000.[242] This would result in an estimate of an initial burden for this requirement for all respondents of 1575 hours and $150,000. The Commission estimates that the average annual burden would be 45 hours each, for a total estimated average annual burden of 450 hours.[243] The Commission believes that this work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

Proposed Rule 13n-4(c)(2)(iv) would require SDRs to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the SDR's senior management and each member of the board or committee that has the authority to act on behalf of the board

241 This figure is the result of an estimated $400 an hour cost for outside legal services (as noted above) times 50 hours, for 10 respondents.

242 These numbers are based on 75% of the 210 hour and $20,000 (50 hours of outside legal costs at $400 an hour) estimates to create one set of written policies and procedures under Regulation NMS for non-SRO trading centers. See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005). This is based on an estimate that this requirement will create 75% of the burden of creating written policies and procedures under Regulation NMS.

243 These numbers are 75% of the 60 hour estimates of the ongoing burden regarding one set of written policies and procedures under Regulation NMS for non-SRO trading centers. See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005). This is based on an estimate that this requirement will create 75% of the ongoing burden of written policies and procedures under Regulation NMS.

possess requisite skills and expertise to fulfill their responsibilities in the management and governance of the SDR, to have a clear understanding of their responsibilities, and to exercise sound judgment about the SDR's affairs. As outlined above, the Commission estimates a total of 10 respondents for this requirement. Based on the Commission's estimates regarding similar requirements in Regulation NMS,[244] it estimates that, on average, this requirement will require 210 hours to create and 60 hours to administer per year per respondent, for a total burden of 2100 hours initially and 600 hours on average, annually. The Commission also estimates, based on this earlier estimate, that a total of $20,000 in outside legal costs will be incurred as a result of this burden per respondent for a total outside cost burden of $200,000.[245] The Commission solicits comment as to the accuracy of this information.

Proposed Rule 13n-4(c)(3) outlines the proposed conflicts of interest controls that would be required of SDRs. SDRs would be required to establish and enforce written policies and procedures reasonably designed to minimize conflicts of interest, including establishing, maintaining, and enforcing written policies and procedures reasonably designed to identify and mitigate potential and existing conflicts of interest in the SDR's decision-making process on an on-going basis and regarding the SDR's non-commercial and commercial use of the SBS transaction information that it receives. As outlined above, the Commission estimates a total of 10 respondents for this requirement. Based on the Commission's estimates regarding Regulation NMS,[246] it estimates that on average these two requirements will require 420 hours to create and 120 hours to administer per year per respondent, for a total burden of 4200 hours initially and

244 See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005).

245 This figure is the result of an estimated $400 an hour cost for outside legal services (as noted above) times 50 hours, for 10 respondents.

246 See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005).

1200 hours on average annually.[247] Also based on the Regulation NMS estimates, the Commission estimates that a total of $40,000 in initial outside legal costs will be incurred as a result of this burden per respondent for a total outside cost burden of $400,000.[248]

Proposed Rule 13n-5(b)(6) would require that SDRs establish procedures and provide facilities reasonably designed to effectively resolve disputes over the accuracy of the transaction data and positions that are recorded in the SDR. For PRA purposes only, the Commission believes that this would be a greater burden than that for written policies and procedures alone. Thus, the Commission estimates that this requirement will require 315 hours to create.[249] There would likely be a need for a respondent to consult with outside legal counsel which the Commission estimates to cost $30,000 per respondent.[250] In total, the Commission estimates an initial burden for all respondents of 3150 hours and $300,000 in outside costs. The Commission

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247 The 420 hour figure is the result of the estimated average hour burden to create one policy and procedure (210) times the 2 policies and procedures required by these provisions. The 120 hour figure is the result of the estimated average hour burden to administer one policy and procedure (60) times the 2 policies and procedures required by these provisions. The 4200 hour figure is the result of the estimated average hour burden per respondent to create these policies and procedures (420) times the number of SDRs (10). The 1200 hour figure is the result of the estimated average hour burden per respondent to maintain these policies and procedures (120) times the number of SDRs (10).

248 This $400,000 figure is the result of an estimated $400 an hour cost for outside legal services (as noted above) times 50 hours, times 2 policies and procedures, times the number of SDRs (10).

249 This number is 150% of the 210 hour estimate to create one set of written policies and procedures under Regulation NMS for non-SRO trading centers. See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005). This is based on an estimate that this requirement will create 150% of the burden of creating written policies and procedures under Regulation NMS.

250 This number is 150% of the estimate of outside legal costs (50 hours) to create one set of written policies and procedures under Regulation NMS for non-SRO trading centers, at an estimate of $400 per hour. See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005). This is based on an estimate that this requirement will create 150% of the burden of creating written policies and procedures under Regulation NMS.

estimates the ongoing average annual burden of this requirement to be 90 hours per respondent for a total of 900 hours for the estimated total annual burden for all respondents.[251] The Commission believes that this ongoing work will be conducted internally. The Commission solicits comment as to the accuracy of this information.

Proposed Rule 13n-9 relates to the privacy requirements that would be required of SDRs. Proposed Rule 13n-9(b)(1) would require SDRs to establish, maintain, and enforce written policies and procedures reasonably designed to protect the privacy of any and all SBS transaction information that the SDR receives from any SBS dealer, counterparty, or any registered entity. As outlined above, the Commission estimates a total of 10 respondents for this requirement. Based on the Commission's estimates regarding Regulation NMS,[252] it estimates that on average these two requirements will require 420 hours to create and 120 hours to administer per year per respondent, for a total burden of 4200 hours initially and 1200 hours on average, annually.[253] Also based on the Regulation NMS estimates, the Commission estimates that a total of $40,000

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251 These numbers are based on 150% of the 60 hour estimate of the ongoing burden regarding one set of written policies and procedures under Regulation NMS for non-SRO trading centers. See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005). This is based on an estimate that this requirement will create 150% of the ongoing burden of written policies and procedures under Regulation NMS.

252 See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005).

253 The 420 hour figure is the result of the estimated average hour burden to create one policy and procedure (210) times the 2 policies and procedures required by these provisions. The 120 hour figure is the result of the estimated average hour burden to administer one policy and procedure (60) times the 2 policies and procedures required by these provisions. The 4200 hour figure is the result of the estimated average hour burden per respondent to create these policies and procedures (420) times the number of SDRs (10). The 1200 hour figure is the result of the estimated average hour burden per respondent to maintain these policies and procedures (120) times the number of SDRs (10).

in initial outside legal costs will be incurred as a result of this burden per respondent for a total outside cost burden of $400,000.[254]

Proposed Rule 13n-9(b)(2) would require SDRs to establish and maintain safeguards, policies, and procedures reasonably designed to prevent the misappropriation or misuse of any confidential data received by the SDR, material, nonpublic information, or intellectual property. At a minimum, this program must limit access to such information, include standards that control persons associated with the SDR in trading for their personal benefit or the benefit of others, and adequate oversight. As outlined above, the Commission estimates a total of 10 respondents for this requirement. Based on the Commission's estimates regarding Regulation NMS,[255] it estimates that on average this requirement will require 210 hours to create and 60 hours to administer per year per respondent, for a total burden of 2100 hours initially and 600 hours on average, annually. Also based on the Regulation NMS estimates, the Commission estimates that a total of $20,000 in initial outside legal costs will be incurred as a result of this burden per respondent for a total outside cost burden of $200,000.[256]

E. Collection of Information is Mandatory

1. Registration Requirements and Form SDR

The collection of information relating to registration requirements and Form SDR is mandatory for all SDRs when registering with the Commission or amending their registration.

2. SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access

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254 This $400,000 figure is the result of an estimated $400 an hour cost for outside legal services (as noted above) times 50 hours, times 2 policies and procedures, times the number of SDRs (10).

255 See Exchange Act Release No. 51808 (June 9, 2005); 70 FR 37496 (June 29, 2005).

256 This figure is the result of an estimated $400 an hour cost for outside legal services (as noted above) times 50 hours, for 10 respondents.

The collection of information relating to SDR duties, data collection and maintenance, automated systems, and direct electronic access is mandatory for all SDRs.

3. Recordkeeping

The collection of information relating to recordkeeping is mandatory for all SDRs.

4. Reports and Reviews

The collection of information relating to reports and reviews is mandatory for all SDRs.

5. Disclosure

The collection of information relating to disclosure is mandatory for all SDRs.

6. Chief Compliance Officers

The collection of information relating to CCOs is mandatory for all SDRs.

7. Other Provisions Relevant to the Collection of Information

The collection of information relating to other relevant provisions is mandatory for all SDRs.

F. Confidentiality

1. Registration Requirements and Form SDR

The collection of information relating to registration requirements and Form SDR, including attachments thereto, would generally not be kept confidential. However, confidential treatment can be requested by the applicant pursuant to the FOIA and the rules of the Commission thereunder.[257]

[257] "The information will be used for the principal purpose of determining whether the Commission should grant or deny registration to an applicant. Except in cases where confidential treatment is requested by the applicant and granted by the Commission pursuant to the Freedom of Information Act and the rules of the Commission thereunder, information supplied on this form will be included routinely in the public files of the Commission and will be available for inspection by any interested person." General instruction 5 of Form SDR.

2. SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access

Under the Commission's proposed rules, SDRs would provide participants access to their own SBS data submitted to SDRs. The policies and procedures required under proposed Rules 13n-5(b)(1), (2), (3), and (5) would be made publicly available, as attachments to Form SDR, unless confidential treatment is requested, as explained above. A description of the SDR's policies and procedures regarding its safeguarding of data and operational reliability to protect the confidentiality and security of such data, as described in proposed Rule 13n-6, would be required to be disclosed to a market participant by the SDR pursuant to proposed Rule 13n-10(b)(3) and would be made publicly available, as exhibits to Form SDR, unless confidential treatment is requested, as explained above.

Upon the request of certain entities described in Exchange Act Section 13(n)(5)(G), information would be made available upon request if the entity making the request agrees to keep that information confidential. Pursuant to proposed Rule 13n-6(d), SDRs may request confidential treatment in connection with the documents provided to the Commission pursuant to proposed Rule 13n-6, and the Commission will accord confidential treatment to those documents to the extent permitted by law. Other than these items, all elements to the collection of data identified above relating to SDR duties, data collection and maintenance, automated systems, and direct electronic access may be provided to Commission staff, but would not be subject to public availability.

3. Recordkeeping

The collection of information relating to recordkeeping would be provided to Commission staff, but not subject to public availability.

4. Reports and Reviews

The collection of information relating to reports and reviews would be provided to Commission staff, but not subject to public availability.

5. Disclosure

The collection of information relating to disclosure would be provided to the party entitled to the disclosure and to Commission staff, but not subject to public availability.

6. Chief Compliance Officer

The financial report required to be provided to the Commission pursuant to proposed Rules 13n-11(f) and (g) may be provided as an exhibit to Form SDR. If this is done, that report would be made publicly available, as an attachment to Form SDR, unless confidential treatment is requested, as explained above. Regarding all other elements of the collection of information relating to the CCO, the collection of information would not be confidential and would be made publicly available.

7. Other Provisions Relevant to the Collection of Information

A list of instances of prohibiting or limiting access to the services of the SDR or the data maintained by an SDR would be required as an exhibit to Form SDR and, as such, would be made publicly available unless confidential treatment is requested as explained above. The policies and procedures that must be reasonably designed to review any prohibition or limitation of any person with respect to access to services offered or data maintained by the SDR as would be required in proposed Rule 13n-4(c)(1)(vi) would be made publicly available, as attachments to Form SDR, unless confidential treatment is requested, as explained above.

The policies and procedures regarding skills and expertise of senior management and certain board or committee members that would be required under proposed Rule 13n-4(c)(2)(iv), conflicts of interest that would be required under proposed Rule 13n-4(c)(3), and privacy under proposed Rule 13n-9(b)(1) would be made publicly available as attachments to Form SDR unless confidential treatment is requested, as explained above. The procedures and a description of the facilities of the SDR for resolving disputes, which would be required pursuant to proposed Rule 13n-5(b)(6), would be made publicly available, as exhibits to Form SDR, unless confidential treatment is requested, as explained above. A description of the SDR's policies relating to misuse of information, which would be required pursuant to proposed Rule 13n-9(b)(2), would be made publicly available, as an exhibit to Form SDR, unless confidential treatment is requested, as explained above. Pursuant to proposed Rule 13n-10(b), the SDR would disclose to market participants its policies and procedures described in proposed Rules 13n-5(b)(6) and 13n-9(b)(1).

Regarding all other elements of the collection of information relating to other relevant provisions, the collection of information would be provided to Commission staff, but not subject to public availability.

G. Retention Period of Recordkeeping Requirements

With regards to proposed Rule 13n-5, proposed Rule 13n-5(b)(4) would require that SDRs maintain the transaction data for not less than five years after the applicable SBS expires and historical positions for not less than five years. This data would be required to be maintained in a place and format that is readily accessible to the Commission and other persons with authority to access or view the information and would also be required to be maintained in an electronic format that is non-rewritable and non-erasable.

Pursuant to proposed Rule 13n-7(b) an SDR would be required to preserve at least one copy of all documents as shall be made by it in the course of its business as such, including all records that would be required under the Exchange Act and the rules and regulations thereunder.

These records would be required to be kept for a period of not less than five years, the first two years in a place immediately available to Commission staff for inspection and examination.

H. Request for Comment

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

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-35-10. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. S7-35-10, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549-1090. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Consideration of Costs and Benefits

Earlier this year, Congress passed the Dodd-Frank Act in response to the recent financial crisis. Among other things, the Dodd-Frank Act is designed to strengthen oversight, improve consumer protections, and reduce systemic risks throughout the financial system. Title VII of the Dodd-Frank Act specifically addresses the OTC derivatives markets, including the market for SBSs. Pursuant to Subtitle B of Title VII, the Commission is the designated regulator for SBSs.

The swap markets have been described as being opaque[258] and transaction-level data is not publicly available. One of the purposes of the Dodd-Frank Act is to improve the transparency of the OTC derivatives market.[259] In order to shed light on the SBS market, Title VII requires the Commission to undertake a number of rulemakings to implement the regulatory framework for SBSs that is set forth in the legislation, including the reporting of SBS transactions.

The Commission views the process of implementing SBS data reporting as incremental. On October 13, 2010, the Commission adopted an interim final temporary rule that requires certain SBS dealers and other parties to report any SBSs entered into prior to the July 21 passage

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258 With respect to CDS, for example, the Government Accountability Office found that "comprehensive and consistent data on the overall market have not been readily available," that "authoritative information about the actual size of the CDS market is generally not available," and that regulators currently are unable "to monitor activities across the market." Government Accountability Office, "Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps," GAO-09-397T (March 2009), at 2, 5, 27. See Robert E. Litan, "The Derivatives Dealers' Club and Derivatives Market Reform," Brookings Institution (April 7, 2010) at 15-20. See also Michael Mackenzie, June 25, 2010, Era of an opaque swaps market ends, FIN. TIMES, June 25, 2010.

259 See, e.g., 156 Cong. Rec. S5915 (daily ed. July 15, 2010) (statement of Sen. Reed) ("A major problem with derivatives is that they have not been regulated nor well-understood by even those buying and selling them. The legislation changes that and brings transparency to the marketplace for swaps . . . by requiring the reporting of the terms of these contracts to regulators and market participants.").

of the Dodd-Frank Act as the first step in that process.[260] The interim final temporary rule provides for the reporting of pre-enactment SBSs and enables the Commission to obtain data on pre-enactment SBSs until registered SDRs are operating and able to accept the reports.

Today, the Commission is proposing new rules and a new form that provide for the registration of SDRs and establish and expand upon the core principles and duties applicable to registered SDRs. SDRs are intended to play a critical role in enhancing transparency in the SBS market, bolstering market efficiency and liquidity, promoting standardization, and reducing systemic risks. In conjunction with recordkeeping and reporting rules to be proposed with respect to other SBS market entities, such as SB SEFs, SBS exchanges, SBS dealers, and major SBS participants, the proposed SDR rules will lead to a more robust, transparent environment for the market for SBSs.[261]

Proposed Rules 13n-1 through 13n-3 and proposed Form SDR establish the mechanism by which entities meeting the definition of a "security-based swap data repository" must register as such pursuant to Exchange Act Section 13(n). Proposed Rules 13n-4 through 13n-10 prescribe the duties and core principles for SDRs and provide further guidance with respect to compliance with such duties and core principles. Finally, proposed Rule 13n-11 provides for the designation of and imposes obligations on SDR CCOs.

The Commission is sensitive to the costs and benefits imposed by its rules, and it has identified the following costs and benefits. In particular, the Commission focus our discussion below on the costs and benefits of the decisions made by the Commission to fulfill the mandates

260 Reporting of Security-Based Swap Transaction Data, Exchange Act Release No. 63094 (Oct. 13, 2010), 75 FR 64643 (Oct. 20, 2010).

261 See, e.g., 156 Cong. Rec. S5920 (daily ed. July 15, 2010) (statement of Sen. Lincoln) ("These new 'data repositories' will be required to register with the CFTC and the SEC and be subject to the statutory duties and core principles which will assist the CFTC and the SEC in their oversight and market regulation responsibilities.").

of the Dodd-Frank Act within the permitted discretion, rather than the mandates of the Dodd-Frank Act. However, to the extent that the Commission's discretion is aligned to take full advantage of the benefits intended by the Dodd-Frank Act, the two types of benefits are not entirely separable. The Commission requests that commenters provide data and any other information or statistics that the commenters relied on to reach any conclusions on such estimates.

A. Registration Requirements and Form SDR

The Commission is proposing Rule 13n-1 to set forth the information that must be submitted by a person on new Form SDR to register as an SDR and also provides for amendments to Form SDR, including interim amendments and required annual amendments that must be filed within 60 days after the end of each fiscal year. Each non-resident SDR would be required to certify on Form SDR and provide an opinion of counsel that the SDR can, as a matter of law, provide the Commission with access to the books and records of such SDR and can submit to onsite inspection and examination by the Commission. Proposed Rule 13n-2 sets forth the process by which a registered SDR would withdraw its registration and proposed Rule 13n-3 sets forth the process for a succession of registration for SDRs.[262] The proposed rules and form are in response to the mandate of the Dodd-Frank Act, which, among other things, requires the Commission to prescribe, by rule, the process for registration to be used by SDRs. The proposed rules and form prescribe information and documents to be submitted by SDRs in order to register with the Commission.

1. Benefits

[262] See supra Sections III.A – III.C.

The proposed rules and form described in this section provide for the registration of SDRs, and the withdrawal from registration and/or successor registration of SDRs. Congress enacted the new registration requirements as part of the Dodd-Frank Act in order to bring transparency to the SBS market. The registration process is intended to assist the Commission in overseeing and regulating the SBS market. The requirement that a non-resident SDR certify and provide an opinion of counsel that it can provide the Commission with access to its books and records and submit to inspection and examination will allow the Commission to better evaluate an SDR's ability to meet the requirements for registration and ongoing supervision.

The proposed rules and form described in this section would be issued pursuant to specific grants of rulemaking authority in the Dodd-Frank Act[263] and are designed to further the legislation's goals by enhancing the Commission's ability to oversee the marketplace for SBSs, which is critical to the continued integrity of our markets. The information to be provided in Form SDR is necessary in order to enable the Commission to assess whether an applicant has the capacity to perform the duties of an SDR and to comply with the duties, core principles, and other requirements imposed on registered SDRs pursuant to Exchange Act Section 13(n) and the rules and regulations promulgated thereunder.

The Commission solicits comment on the benefits associated with the registration-related rules and new Form SDR. The Commission specifically requests comment on whether it should require different and/or additional information to be provided on the form and the frequency with which routine amendments should be filed. Please describe and, to the extent practicable, quantify the benefits associated with any comments that are submitted.

2. Costs

263 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(1)).

The Commission preliminarily anticipates that the primary costs to SDRs from the proposed registration-related rules and form result from the requirement to complete Form SDR and any amendments thereto.

As discussed above, the Commission estimates that the average initial paperwork cost of SDR registration would be 400 hours per SDR and the average ongoing paperwork cost of interim and annual updated Form SDR would be 36 hours for each registered SDR.[264] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $584,000[265] and the aggregate ongoing estimated dollar cost per year would be $49,080[266] to comply with the proposed rule.

As discussed above, the Commission estimates that the average initial paperwork cost for each non-resident SDR to provide an opinion of counsel that the SDR can, as a matter of law, provide the Commission with prompt access to its books and records and submit to onsite

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264 See supra Section V.D.1.

265 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney and a Compliance Clerk. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour and the cost of a Compliance Clerk is $59 per hour. Thus, the total one-time estimated dollar cost of complying with the initial registration-related requirements is $58,400 per SDR and $584,000 for all SDRs, calculated as follows: (Compliance Attorney at $291 per hour for 150 hours) + (Compliance Clerk at $59 per hour for 250 hours) x (10 registrants) = $584,000.

266 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney and a Compliance Clerk. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour and the cost of a Compliance Clerk is $59 per hour. Thus, the total ongoing estimated dollar cost of complying with the registration amendment requirements is $4,908 per year per SDR and $49,080 per year for all SDRs, calculated as follows: (Compliance Attorney at $291 per hour for 12 hours) + (Compliance Clerk at $59 per hour for 24 hours) x (10 registrants) = $49,080.

inspection and examination would be 3 hours and $900 per SDR. Assuming a maximum of three non-resident SDRs,[267] the aggregate one-time estimated dollar cost would be $5,544.[268]

The Commission solicits comment on the costs associated with the registration-related rules and new Form SDR. The Commission specifically requests comment on the estimated number of respondents that would be filing proposed Form SDR and the initial costs associated with completing the registration form and the ongoing annual costs of completing the required annual amendments. Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted.

The Commission does not expect these initial costs to have any significant effect on how SDRs conduct business because such costs would not be so large as to result in a change in how such SDRs conduct business, create a barrier to entry, or otherwise alter the competitive landscape among SDRs.[269]

B. SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access

Proposed Rules 13n-4(b)(2) – (7), (9), and (10), 13n-5, and 13n-6 include various requirements relating to SDRs' information technology systems. Proposed Rules 13n-4(b)(2) –

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267 See supra Section V.C.1.

268 The Commission estimates that an SDR will assign these responsibilities to an Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of an Attorney is $316 per hour. Thus, the total ongoing estimated dollar cost of complying with the registration amendment requirements is $1,848 per year per SDR and $5,544 per year for all SDRs, calculated as follows: ($900 for outside legal services + (Attorney at $316 per hour for 3 hours)) x (3 non-resident registrants) = $5,544.

269 The Commission notes that industry representatives have indicated that, based on their knowledge of existing SEC registration forms for other types of registrants, such as clearing agencies, they do not believe that completion of registration forms would impose a significant cost.

(7), 13n-5, and 13n-6 are intended to codify and elucidate the statutorily mandated duties and core principles relating to an SDR's collection, maintenance, and analysis of transaction data and other records, including upon an SDR's cessation of business.[270]

Under proposed Rule 13n-4(b)(2) and (4), an SDR would be required to accept and maintain transaction data as required by proposed Rule 13n-5.[271] Proposed Rule 13n-4(b)(5) states that each SDR must provide direct electronic access to the Commission or any designee of the Commission. Proposed Rule 13n-4(b)(9) would require an SDR to make available all data obtained by the SDR upon the request of certain government bodies, such as the CFTC and the Department of Justice, on a confidential basis and after notification to the Commission.

Proposed Rule 13n-5 would establish requirements for transaction data collection and maintenance. Proposed Rule 13n-5(b), among other things, would require an SDR to promptly record transaction data, and to establish, maintain, and enforce written policies and procedures (1) reasonably designed to calculate positions for all persons with open SBSs for which the SDR maintains records; (2) reasonably designed to ensure that the transaction data and positions that it maintains are accurate; and (3) reasonably designed to prevent any provision in a valid SBS from being invalidated or modified through the procedures or operations of the SDR. Proposed Rule 13n-5(b)(4) would establish requirements related to the time periods for which an SDR must preserve, maintain, and make accessible transaction data. Proposed Rule 13n-5(b)(7) would require an SDR that ceases doing business to preserve, maintain, and make accessible the data and records described above for the remainder of the time period required by proposed Rule 13n-5. Proposed Rule 13n-5(b)(8) would require SDRs to make and keep current a plan to ensure

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270 See supra Section III.D – III.F.

271 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(5)(D)(i)).

that the transaction data and positions that are recorded in the SDR continue to be maintained in accordance with proposed Rule 13n-5(b)(7).

Proposed Rule 13n-6(b) would require SDRs to establish policies and procedures relating to the SDRs' system capacity, resiliency, and security. Such policies and procedures must include periodic capacity stress tests, reviews of system vulnerability, and adequate contingency and disaster recovery plans. SDRs would be required to promptly notify the Commission of material systems outages and submit a description and analysis of the outages within five business days, and notify the Commission in writing at least thirty calendar days before planned material systems changes.

1. Benefits

The SDR provisions in the Dodd-Frank Act depend on the accuracy of the data maintained by registered SDRs. Exchange Act Section 13(n) specifically instructs the Commission to "prescribe data collection and maintenance standards for" SDRs. The proposed rules related to an SDR's information technology and related policies and procedures are designed to facilitate accurate data collection and retention with respect to SBSs in order to promote transparency with respect to the market for SBSs, as well as facilitate orderly execution and confirmation of SBS transactions and standardization of such transactions.

The proposed rules discussed in this section would be issued pursuant to specific grants of rulemaking authority in the Dodd-Frank Act[272] and are designed to further the legislation's goals by enhancing the Commission's ability to oversee the marketplace for SBSs, which is critical to the continued integrity of our markets. The ability of the Commission and other regulators to monitor risk and detect fraudulent activity depends on having access to market data.

[272] See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Sections 13(n)(4) and (5)).

In particular, the direct electronic access requirement described in proposed Rule 13n-4(b)(5) will permit the Commission, its designees, and other regulators to carry out these responsibilities in an effective and efficient manner. The proposed requirement that each SDR make and keep current a plan to ensure that SBS data recorded in such SDR continues to be maintained is essential to ensure that regulators will continue to have access to and the ability to analyze SBS data in the event that the SDR ceases to do business. The proposed provisions relating to material systems outages are important to ensure that the Commission is apprised when an SDR's ability to accept, maintain, and provide access to regulators and market participants to accurate and timely transaction data may be impaired.

The requirements in the proposed rules are likely to create various benefits including increased transparency and reduction of systemic risk by providing the Commission and other regulators to access SBS market information. In addition, this data will enhance the Commission's ability to detect and deter fraudulent and manipulative activity and other trading abuses in connection with the derivatives markets, conduct inspections and examinations to monitor the financial responsibility and soundness of market participants, and verify compliance with the statutory requirements and duties of SDRs. For systemic risk monitoring, it is necessary that the Commission and other regulators have access to information regarding all cleared and uncleared trades of market participants and their positions. Pursuant to the proposed rules, in conjunction with Regulation SBSR,[273] SDRs will receive and maintain systemically important information from multiple trade execution facilities, SBS clearing agencies, and other market participants. The resulting benefit will derive from the increased transparency on where exposures to risk reside in financial markets, which will allow regulators to monitor and act

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273 See Regulation SBSR Release, supra note 9.

before the risks become systemically relevant. Therefore, SDRs will help achieve systemic risk monitoring.

Benefits also may accrue from the Commission's and other regulators' ability to use SBS data in order to oversee the SBS market for illegal conduct. Proposed Rule 13n-5 requires SDRs to satisfy itself of the accuracy of transaction data and preserve such data for a sufficient period so that transaction level data is available to assist regulators in analyzing data to detect market abuse. The proposed rule also requires SDRs to accept data regarding all SBSs in an asset class if the SDR accepts data on any SBS in that particular asset class. These requirements may help the Commission and other regulators to identify fraudulent or other predatory market activity.

The richness of data collected by SDRs also will facilitate market analysis studies by regulators. Periodic reviews of market behavior through the study of SBS transactions will help identify the costs and benefits of Commission rules that can be used to evaluate the overall efficiency of market regulation. Such studies can inform the Commission and other regulators on potential changes to the rules to improve their efficiency.

Central repositories of information also may create benefits from non-core duties, such as facilitating the reporting of life cycle events, asset servicing, or payment calculations. These activities may be less costly to perform when SBS market transaction data is centrally located and accessible.

Since Exchange Act Section 13(n) and the rules and regulations promulgated thereunder allow for multiple SDRs to register with the Commission, potentially within the same asset class, with each collecting data from a subset of market participants, proposed Rule 13n-4(b)(2) requires all SDRs to accept data as prescribed by Regulation SBSR[274] and proposed Rule 13n-

274 See Regulation SBSR Release, supra note 9.

5(b)(1) requires all SDRs to maintain the transaction data in a format that is readily accessible to the Commission and other persons with authority to access or view such information. The effect of these provisions, in conjunction with the requirements of Regulation SBSR,[275] is that the same transaction data will be accepted across SBS market entities (including exchanges, SB SEFs, clearing agencies, SBS dealers, and major SBS participants) and service providers and each SDR will maintain the transaction data in a manner that allows the Commission and others with authority to access and view such data. Thus, the rule both attempts to maintain benefits of competition and allow proper aggregation of market-wide SBS data.

The reliability of the aggregation of market-wide SBS data depends upon data integrity and consistent structuring across all service providers. The proposed rule requires an SDR to create policies and procedures such that all transactions are recorded accurately. Aggregating data across SDRs by regulators and other users of such data will benefit to the extent that policies and procedures result in more accurate data reporting.

The Commission solicits comment on the benefits related to Rules 13n-4(b)(2) – (7), (9), and (10), 13n-5, and 13n-6. The Commission specifically requests comment on whether any additional benefits would accrue if the Commission imposed further, more specific technology-related requirements. Are there alternatives that the Commission should consider? Please describe and, to the extent practicable, quantify the benefits associated with any comments that are submitted.

2. Costs

The Commission anticipates that the primary costs to SDRs from the proposed rules described in this section would relate to the cost of developing and maintaining systems to

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275 See id.

collect and store SBS transaction data. Registered SDRs also would need to develop, maintain, and ensure compliance with related policies and procedures and provide applicable training.

As discussed above, the Commission estimates that the average initial paperwork cost associated with creating the SDR information technology systems would be 42,000 hours and $10,000,000 for each SDR and the average ongoing paperwork cost would be 25,200 hours and $6,000,000 per year for each SDR.[276] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $200,020,000[277] and the aggregate ongoing estimated dollar cost per year would be $120,012,000[278] to comply with the proposed rules. Based on conversations with industry representatives, the Commission estimates that the cost imposed on

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276 See supra Section V.D.2.

277 The Commission estimates that an SDR will assign these responsibilities to an Attorney, a Compliance Manager, a Programmer Analyst, and a Senior Business Analyst. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of an Attorney is $316 per hour, a Compliance Manager is $294 per hour, a Programmer Analyst is $190 per hour, and a Senior Business Analyst is $234 per hour. Thus, the total initial estimated dollar cost would be $20,002,000 per SDR and $200,020,000 for all SDRs, calculated as follows: ($10,000,000 for information technology systems + (Attorney at $316 per hour for 7,000 hours) + (Compliance Manager at $294 per hour for 8,000 hours) + (Programmer Analyst at $190 per hour for 20,000 hours) + (Senior Business Analyst at $234 per hour for 7,000 hours)) x 10 registrants = $200,020,000.

278 The Commission estimates that an SDR will assign these responsibilities to an Attorney, a Compliance Manager, a Programmer Analyst, and a Senior Business Analyst. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of an Attorney is $316 per hour, a Compliance Manager is $294 per hour, a Programmer Analyst is $190 per hour, and a Senior Business Analyst is $234 per hour. Thus, the total ongoing estimated dollar cost would be $12,001,200 per SDR and $120,012,000 for all SDRs, calculated as follows: ($6,000,000 for information technology systems + (Attorney at $316 per hour for 4,200 hours) + (Compliance Manager at $294 per hour for 4,800 hours) + (Programmer Analyst at $190 per hour for 12,000 hours) + (Senior Business Analyst at $234 per hour for 4,200 hours)) x 10 registrants = $120,012,000.

SDRs to provide direct electronic access to the Commission should be minimal as SDRs likely have or will establish comparable electronic access mechanisms to enable market participants to provide data to SDRs and review transactions to which such participants are parties.

As discussed above, the Commission estimates that the average initial paperwork cost associated with proposed Rule 13n-4(b)(10) would be $1,600 for each SDR and the average ongoing paperwork cost would be 3 hours for each SDR.[279] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $16,000[280] and the aggregate ongoing estimated dollar cost per year would be $9,480[281] to comply with the proposed rule.

As discussed above, the Commission estimates that the average initial paperwork cost associated with developing policies and procedures necessary to comply with Rules 13n-5(b)(1), (2), (3), and (5) and 13n-6(b)(1) would be 1,050 hours and $100,000 for each SDR and the average ongoing paperwork cost would be 300 hours per year for each SDR.[282] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $3,926,250[283] and

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279 See supra Section V.D.2.

280 $1,600 for outside legal services x 10 registrants = $16,000.

281 The Commission estimates that an SDR will assign these responsibilities to an Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of an Attorney is $316 per hour. Thus, the total ongoing estimated dollar cost would be $948 per SDR and $9,480 for all SDRs, calculated as follows: (Compliance Attorney at $316 per hour for 3 hours) x 10 registrants = $9,480.

282 See supra Section V.D.2.

283 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager, an Attorney, a Senior Systems Analyst, and an Operations Specialist. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour, the cost of an Attorney is $316 per hour, the cost of a Senior Systems Analyst is $251 per hour, and the cost of an Operation Specialist is $114 per hour. Thus, the total initial estimated dollar cost would be

the aggregate ongoing estimated dollar cost per year would be $908,400[284] to comply with the proposed rules.

As discussed above, the Commission estimates that the average ongoing paperwork cost associated with the proposed Rules 13n-6(b)(3) and (4) would be 135.4 hours for each SDR.[285] Assuming a maximum of ten SDRs, the aggregate ongoing estimated dollar cost per year would be $368,965 to comply with the proposed rules.[286]

The Commission believes that persons currently operating as SDRs may have developed and implemented aspects of the proposed rules already. However, such persons currently are not subject to regulation by the Commission and may not be subject to regulation or oversight by other regulatory bodies and may need to enhance their information technology systems and

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$392,625 per SDR and $3,926,250 for all SDRs, calculated as follows: ($100,000 for outside legal services + (Compliance Manager at $294 per hour for 385 hours) + (Attorney at $316 per hour for 435 hours) + (Senior Systems Analyst at $251 per hour for 115 hours) + (Operations Specialist at $114 per hour for 115 hours)) x 10 registrants = $3,926,250.

284 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager and an Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour and the cost of an Attorney is $216 per hour. Thus, the total ongoing estimated dollar cost would be $90,840 per SDR and $908,400 for all SDRs, calculated as follows: ((Compliance Manager at $294 per hour for 180 hours) + (Attorney at $316 per hour for 120 hours)) x 10 registrants = $908,400.

285 See supra Section V.D.2.

286 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager and a Senior Systems Analyst. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour and the cost of a Senior Systems Analyst is $251 per hour. Thus, the total ongoing estimated dollar cost would be $36,896.50 per SDR and $368,965 for all SDRs, calculated as follows: ((Compliance Manager at $294 per hour for 67.7 hours) + (Senior Systems Analyst at $251 per hour for 67.7 hours)) x 10 registrants = $368,965.

related policies and procedures to comply with the proposed rules. However, the Commission does not believe that the one-time cost of such changes will be significant. The ongoing annual costs for persons currently operating as SDRs likely will be consistent with the estimates provided above.

Exchange Act Section 13(n) and the proposed rules and regulations promulgated thereunder allow for multiple SDRs to register with the Commission, potentially within the same asset class, with each SDR collecting data from a subset of market participants. While multiple SDRs per asset class will allow for market competition to decide how data is collected, it may hinder market-wide data aggregation due to coordination costs, particularly if market participants adopt incompatible reporting standards and practices. The proposed rules do not specify a particular reporting format or structure, which may create the possibility that entities reporting to SDRs, and regulators or other market participants accessing transaction data, will have to accommodate different data standards and develop different systems to accommodate each. This may result in increased costs for reporting entities and users of transaction data.

The costs associated with aggregating data across multiple SDRs by regulators and other users of such data will increase to the extent that SDRs choose to use different identifying information for transactions, counterparties, and products. Data aggregation costs also could accrue to the extent that there is variation in the quality of data maintained across SDRs. Each SDR has discretion over how to implement its policies and procedures in the recording of reportable data, and variations in quality may result. Since aggregated data used for surveillance and risk monitoring requires that the underlying components are provided with the same level of accuracy, variations in the quality of data could be costly if subsequent interpretations of analysis based on the data suffer from issues of integrity. To the extent that market competition among

SDRs impacts profit margins and the level of resources devoted to collecting and maintaining transaction data, there is an increased likelihood of variations in the quality of reported data and aggregation of data across multiple SDRs may be difficult.

The Commission solicits comment on the costs related to proposed Rules 13n-4(b)(2) – (7), (9), and (10), 13n-5, and 13n-6. The Commission specifically requests comment on the initial and ongoing costs associated with establishing and maintaining the technology systems and related policies and procedures. Are there additional costs to creating an SDR that the Commission should consider? Are there alternatives that the Commission should consider? Do the estimates accurately reflect the cost of storing data in a convenient and usable electronic format for the required retention period? Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted.

The Commission does not expect the initial and ongoing costs necessary to comply with these proposed rules to have any significant effect on how SDRs conduct business because such costs would not be so large as to result in a change in how such SDRs conduct business, create a barrier to entry, or otherwise alter the competitive landscape among SDRs.

C. Recordkeeping

Proposed Rule 13n-7 would require an SDR to make and keep certain records relating to its business and retain a copy of records made by the SDR in the course of its business for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination. The proposed rule also would require an SDR that ceases doing business to preserve, maintain, and make accessible the records required to be made and kept pursuant to the rule for the remainder of the time period required by proposed Rule 13n-7.[287]

1. <u>Benefits</u>

The rule discussed in this section is designed to further the Dodd-Frank Act's goals by enhancing the Commission's ability to oversee SDRs, which are critical components of the new regulatory scheme governing SBS. The proposed rule will assist the Commission in monitoring whether an SDR is complying with Exchange Act Section 13(n) and the rules and regulations promulgated thereunder. In addition, the rule is designed to reduce systemic risks by requiring the making and keeping of records pertaining to the day-to-day business of SDRs. Finally, the legislative goals of Title VII depend on the ongoing operation of SDRs as the source for transaction data, and the recordkeeping requirements contained in the proposed rule will enhance the ability of the Commission and other regulators to monitor the financial responsibility and soundness of SDRs.

To the extent that the proposed rule standardizes the business recordkeeping practices of SDRs, regulators will benefit by being able to perform more efficient, targeted inspections and examinations with an increased likelihood of identifying improper conduct at earlier stages in the inspection or examination. In addition, SDRs should benefit from standardized recordkeeping requirements by having their operations interrupted by inspections or examinations for shorter time periods. Both regulators and SDRs should benefit from standardized recordkeeping requirements to the extent that uniform records will enable regulators and SDRs to know what records the SDRs should have on hand.

The Commission solicits comment on the benefits related to proposed Rule 13n-7.

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287 <u>See</u> <u>supra</u> Section III.G.

Would additional benefits accrue if the Commission imposed different or additional recordkeeping requirements and, if so, what would these requirements entail? Please describe and, to the extent practicable, quantify the benefits associated with any comments that are submitted.

2. Costs

The Commission anticipates that the primary costs to SDRs from proposed Rule 13n-7 would relate to the cost of making and keeping current a list of officers, managers, or persons performing similar functions who are responsible for policies and procedures and developing and maintaining information technology systems to collect and store the various records created in the course of an SDR's business.

As discussed above, the Commission estimates that the average initial paperwork cost associated with making and keeping a list of responsible officer, manager, or persons performing similar functions and developing and maintaining information technology systems to ensure compliance with the proposed recordkeeping requirements would be 346 hours and $1,800 for each SDR and the average ongoing paperwork cost associated with developing policies and procedures to ensure compliance with the proposed recordkeeping requirements would be 279.17 hours per year for each SDR.[288] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $1,015,460[289] and the aggregate ongoing estimated dollar cost per year would be $820,760[290] to comply with the proposed rule.

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288 See supra Section V.D.3.

289 The Commission estimates that an SDR will assign these responsibilities primarily to a Compliance Manager as well as a Senior Systems Analyst. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour and the cost of a Senior Systems Analyst is $251

The Commission does not believe that persons currently operating as SDRs will be subject to significant additional recordkeeping costs as a result of proposed Rule 13n-7 because such persons already maintain business records as part of their day-to-day operations. However, the proposed rule provides specific parameters relating to the retention and maintenance of these records and the proposed requirements may be more extensive than current market practices.

The Commission solicits comment on the costs related to proposed Rule 13n-7. The Commission specifically requests comment on the initial and ongoing costs associated with establishing and maintaining the recordkeeping systems and related policies and procedures, including whether currently-operating SDRs would incur different recordkeeping costs. Are there additional costs related to recordkeeping that the Commission should consider? Are there alternatives that the Commission should consider? Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted.

The Commission does not expect the initial and ongoing costs necessary to comply with the proposed rule to have any significant effect on how SDRs conduct business because such costs would not be so large as to result in a change in how such SDRs conduct business, create a barrier to entry, or otherwise alter the competitive landscape among SDRs.

D. Reports and Reviews

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per hour. Thus, the total initial estimated dollar cost would be $101,546 per SDR and $1,015,460 for all SDRs, calculated as follows: ($1,800 in information technology costs + (Compliance Manager at $294 per hour for 300 hours) + (Senior Systems Analyst at $251 per hour for 46 hours)) x 10 registrants = $1,015,460.

290 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour. Thus, the total ongoing estimated dollar cost would be $82,076 per SDR and $820,760 for all SDRs, calculated as follows: (Compliance Manager at $294 per hour for 279.17 hours) x 10 registrants = $820,760.

Proposed Rule 13n-6(b)(2) would require an SDR to submit an annual review of its systems that support or integrally relate to its performance as an SDR to the Commission.[291] Proposed Rule 13n-8 would require an SDR to comply with certain reporting requirements, including promptly providing reports or information upon request by the Commission.[292]

1. Benefits

Title VII of the Dodd-Frank Act establishes a regulatory framework for the OTC derivatives market that depends on the Commission's and other regulators' access to information regarding the current and historical operation of the SBS market to verify compliance with the statute and effective monitoring for market risk and abuse. In addition, specific provisions of Title VII require routine, targeted monitoring of certain types of events. The rules discussed in this section would be issued pursuant to specific grants of rulemaking authority in the Dodd-Frank Act[293] and are designed to further the legislation's goals by (a) ensuring that each SDR's systems provide adequate levels of capacity, resiliency, and security, and (b) facilitating access by the Commission and other regulators to information necessary to achieve their legislative mandates and to establish mechanisms by which SDRs will provide routine reports to the Commission. Access to such information will enhance regulators' ability to oversee the SBS market, which is critical to the continued integrity of our markets; and detect and deter fraudulent and manipulative activity and other trading abuses in connection with the derivatives markets.

The Commission solicits comment on the benefits related to the requirements contained in proposed Rules 13n-6(b)(2) and 13n-8. Please describe and, to the extent practicable, quantify the benefits associated with any comments that are submitted.

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291 See supra Section III.F.

292 See supra Section III.H.

293 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)).

2. Costs

The Commission anticipates that the primary costs to an SDR from proposed Rule 13n-6(b)(2) would relate to the cost of conducting an annual review of the SDR's systems and, if the review is performed by an internal department, the cost associated with hiring an objective, external firm to assess the internal department's objectivity, competency, and work performance. The Commission anticipates that the primary costs to SDRs from proposed Rule 13n-8 would relate to the cost of developing and maintaining systems to respond to requests for information and provide the necessary reports and establishing related policies and procedures. In addition, SDRs will need to maintain staff to respond to the requests and provide the reports required under the proposed rules.[294]

As discussed above, the Commission estimates that the average ongoing paperwork cost associated with proposed Rule 13n-6(b)(2) would be 825 hours and $90,000.[295] Assuming a maximum of ten SDRs, the aggregate ongoing estimated dollar cost per year would be $2,845,750 to comply with the proposed rule.[296]

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294 The Commission understands some currently-existing SDRs may have dedicated personnel who are responsible for responding to and providing ad hoc report requests from regulators, including the Commission. To the extent that proposed Rule 13n-8 may result in more automated reporting, the need for such dedicated personnel resources may be reduced.

295 See supra Section V.D.4.

296 The Commission estimates that an SDR will assign these responsibilities to an Attorney, a Manager Internal Audit, and a Senior Internal Auditor. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of an Attorney is $316 per hour, the cost of a Manager Internal Audit is $291 per hour, and the cost of a Senior Internal Auditor is $195 per hour. Thus, the total ongoing estimated dollar cost would be $284,575 per SDR and $2,845,750 for all SDRs, calculated as follows: ($90,000 for external audit firm + (Attorney at $316 per hour for 100 hours) + (Manager Internal Auditor at $291 per hour for 225 hours) + (Senior Systems Analyst at $251 per hour for 500 hours)) x 10 registrants = $2,845,750.

As discussed above, the Commission estimates that the average ongoing paperwork cost associated with proposed Rule 13n-8 would be 1 hour per year for each SDR.[297] Assuming a maximum of ten SDRs, the aggregate ongoing estimated dollar cost per year would be $2,340 to comply with the proposed rule.[298]

The Commission solicits comment on the costs related to proposed Rules 13n-6(b)(2) and 13n-8. The Commission specifically requests comment on the initial and ongoing costs associated with establishing and providing the reports required under the proposed rules. Are there additional costs associated with supplying the required reports that the Commission should consider? Are there alternatives that the Commission should consider? Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted.

The Commission does not expect the initial and ongoing costs necessary to comply with proposed Rules 13n-6(b)(2) and 13n-8 to have any significant effect on how SDRs conduct business because such costs would not be so large as to result in a change in how such SDRs conduct business, create a barrier to entry, or otherwise alter the competitive landscape among SDRs.

E. Disclosure

Under proposed Rule 13n-10, before collecting any transaction data from a market participant or upon the market participant's request, each SDR would be required to furnish the

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297 See supra Section V.D.4.

298 The Commission estimates that an SDR will assign these responsibilities to a Senior Business Analyst. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Senior Business Analyst is $234 per hour. Thus, the total ongoing estimated dollar cost would be $234 per SDR and $2,340 for all SDRs, calculated as follows: (Senior Business Analyst at $234 per hour for 1 hour) x 10 registrants = $2,340.

market participant a disclosure document containing certain information that reasonably will enable the market participant to identify and evaluate the risks and costs associated with using the services of the SDR.[299] An SDR's disclosure document must include, among other things, the SDR's criteria for providing others with access to services offered and data maintained by the SDR; the SDR's criteria for those seeking to connect to or link with the SDR; a description of the SDR's policies and procedures regarding safeguarding of data and operational reliability, and privacy; the SDR's policies and procedures regarding its non-commercial and/or commercial use of transaction data; dispute resolution procedures; description of all services, including ancillary services; schedule of dues, unbundled prices, and discounts or rebates; and a description of the SDR's governance arrangements.

1. Benefits

Proposed Rule 13n-10 is intended to provide certain information regarding an SDR to market participants prior to entering into an agreement to provide transaction data to the SDR. Although the Commission anticipates that there may be only one SDR for any given asset class, to the extent that multiple SDRs accept data for the same asset class, the disclosure document would enable market participants to make an informed choice among SDRs. Even if only one SDR serves a given asset class, the disclosure document is necessary to inform market participants of the nature of the services provided by the SDR and the conditions and obligations that are imposed on market participants in order for the participants to submit data to the SDR.

The rule discussed in this section is designed to further the Dodd-Frank Act's goals by providing market participants with applicable information regarding the operation of SDRs. The Commission solicits comment on the benefits related to proposed Rule 13n-10. Should the

299 See supra Section III.J.

Commission narrow or broaden the scope of the information to be included in the disclosure document? Should the Commission adjust the frequency with which the disclosure document is provided to market participants? Please describe and, to the extent practicable, quantify the benefits associated with any comments that are submitted.

2. Costs

As discussed above, the Commission estimates that the average initial paperwork cost associated with developing the disclosure document and related policies and procedures would be 97.5 hours and $9,400 for each SDR and the average ongoing paperwork cost would be 1 hour per year for each SDR.[300] Assuming a maximum of ten registered SDRs, the aggregate one-time estimated dollar cost would be $266,087.50[301] and the aggregate ongoing estimated dollar cost per year would be $1,765[302] to comply with the proposed rule.

The Commission solicits comment on the costs related to proposed Rule 13n-10. The

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300 See supra Section V.D.5.

301 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager and a Compliance Clerk. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour and a Compliance Clerk is 59 per hour. Thus, the total initial estimated dollar cost would be $26,608.75 per SDR and $266,087.50 for all SDRs, calculated as follows: ($4,400 for external legal costs + $5,000 for external compliance consulting costs + (Compliance Manager at $294 per hour for 48.75 hours) + (Compliance Clerk at $59 per hour for 48.75 hours)) x 10 registrants = $266,087.50.

302 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager and a Compliance Clerk. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour and a Compliance Clerk is 59 per hour. Thus, the total ongoing estimated dollar cost would be $176.50 per SDR and $1,765 for all SDRs, calculated as follows: ((Compliance Manager at $294 per hour for 0.5 hours) + (Compliance Clerk at $59 per hour for 0.5 hours)) x 10 registrants = $1,765.

Commission specifically requests comment on the initial and ongoing costs associated with drafting, reviewing, printing, and providing the required disclosure document. Are there alternatives that the Commission should consider? Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted.

The Commission does not expect the initial and ongoing costs necessary to comply with proposed Rule 13n-10 to have any significant effect on how SDRs conduct business because such costs would not be so large as to result in a change in how such SDRs conduct business, create a barrier to entry, or otherwise alter the competitive landscape among SDRs.

F. Chief Compliance Officer and Compliance Functions

Proposed Rules 13n-4(b)(11) and 13n-11 would require each registered SDR to designate on Form SDR a CCO whose duties include preparing an annual compliance report, which would be submitted to the Commission annually along with an annual financial report.[303] The CCO would be appointed by the SDR's board and would report directly to the chief executive officer of the SDR or the board. The CCO would be responsible for reviewing the compliance of the SDR with the duties and core principles contained in Exchange Act Section 13(n) and the rules promulgated thereunder and reviewing and administering, and ensuring compliance with, the SDR's policies and procedures reasonably designed to achieve compliance with the federal securities laws. The CCO also would resolve any conflicts of interest, in consultation with the board or the SDR's chief executive officer, and establish procedures for the remediation of noncompliance issues. The CCO would be required to prepare and sign an annual compliance report and submit the report to the board for its review prior to the submission of the report to the Commission. Finally, the annual compliance report must be included with the annual financial

303 See supra Sections III.D and III.K.

report that must be prepared and filed with the Commission pursuant to the requirements of proposed Rule 13n-11(f). The compliance report must be filed in a tagged data format in accordance with the instructions contained in the EDGAR Filer Manual,[304] and the financial report must be provided in XBRL as required in Rules 405(a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T.[305]

1. Benefits

Proposed Rules 13n-4(b)(11) and 13n-11 would be issued pursuant to specific grants of rulemaking authority in the Dodd-Frank Act[306] and are designed to further the legislation's goals by enhancing the Commission's ability to oversee the marketplace for SBS, which is critical to the continued integrity of our markets. The proposed rules are designed to ensure that SDRs comply with the federal securities laws, including Exchange Act Section 13(n) and the rules and regulations promulgated thereunder. Although persons currently operating as SDRs already may have CCOs in place, the proposed rules would make this standard practice for all registered SDRs, as mandated by the Dodd-Frank Act.

The reliability of the aggregation of market-wide transaction data depends upon data integrity and consistent structuring across all service providers. As a result of the proposed rule, the accuracy, reliability, integrity, and consistency of data and other records maintained by each SDR would be less likely to be harmed by violations of the securities laws because experience has shown that strong internal compliance programs lower the likelihood of securities laws violations and enhance the likelihood that any violations that do occur will be detected and

304 See 17 CFR 232.301.

305 See 17 CFR 232.405 (imposing content, format, submission and website posting requirements for an interactive data file, as defined in Rule 11 of Regulation S-T).

306 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(6)).

corrected. The designation of a CCO, who will, among other things, monitor the application of the rules proposed herein and the relevant SDR policies and procedures, will help ensure that each SDR complies with the policies and procedures that it adopts. The ability of regulators and other users of transaction data to aggregate such data across SDRs will improve to the extent that compliance with applicable policies and procedures result in more accurate data reporting.

Proposed Rule 13n-11(f) would require SDRs to submit annual financial reports to the Commission. This rule would enhance Commission oversight by facilitating the Commission's monitoring of an SDR's financial and managerial resources. The financial reports also would assist the Commission in monitoring potential conflicts of interests of a financial nature arising from the operation of an SDR.

Benefits also will accrue from requiring SDRs to submit the filings required by the proposed rules using the interactive data format. This requirement would enable regulators to analyze the reported information more quickly, more accurately, and at a lower cost. In particular, the tagged data will make it easier to aggregate information collected from SDRs and compare across entities and over time, which the Commission believes is important for regulators to perform their duties under the Dodd-Frank Act.

The Commission solicits comment on the benefits related to Rules 13n-4(b)(11) and 13n-11. The Commission specifically requests comment on the benefits that would accrue from designating a CCO who would be responsible for preparing and certifying as accurate an annual compliance report and reporting annually to the board. Are there alternative reporting structures that could be established? Should the Commission consider additional provisions related to the annual compliance report? The Commission also requests comment on the benefits associated with the annual financial reports. Please describe and, to the extent practicable, quantify the benefits associated with any comments that are submitted.

2. Costs

The establishment of a designated CCO and compliance with the accompanying responsibilities of a CCO would impose certain costs on registered SDRs. As discussed above, the Commission estimates that the average initial paperwork cost associated with establishing procedures for the remediation of noncompliance issues identified by the CCO and establishing and following appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues would be 420 hours and $40,000 for each registered SDR and the average ongoing paperwork cost would be 120 hours for each registered SDR.[307] In addition, each SDR would be required to hire a CCO in order to comply with the proposed rules, at an annual cost of $703,800.[308] Assuming a maximum of ten SDRs, the aggregate initial estimated dollar cost per year would be $1,622,200[309] and the aggregate ongoing estimated dollar cost per year would be $7,387,200[310] to comply with the proposed rules.

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307 See supra Section V.D.6.

308 Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a CCO is $391 per hour.

309 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total initial estimated dollar cost would be $162,220 per SDR and $1,622,200 for all SDRs, calculated as follows: ($40,000 for outside legal services + (Compliance Attorney at $291 per hour for 420 hours)) x 10 registrants = $1,622,200.

310 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and

As discussed above, the Commission estimates that the average ongoing paperwork cost associated with preparing and submitting annual compliance reports to the SDR's board pursuant to proposed Rule 13n-11(d) and (g) would be 5 hours.[311] Assuming a maximum of ten SDRs, the aggregate ongoing estimated dollar cost per year would be $14,550 to comply with the proposed rule.[312]

As discussed above, the Commission estimates that the average ongoing paperwork cost associated with preparing annual financial reports pursuant to proposed Rule 13n-11(f) and (g) would be 500 hours and $500,000 for each registered SDR.[313] Assuming a maximum of ten SDRs, the aggregate ongoing estimated dollar cost per year would be $5,915,000 to comply with the proposed rules.[314]

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multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total ongoing estimated dollar cost would be $738,720 per SDR and $7,387,200 for all SDRs, calculated as follows: ($703,800 for a CCO + (Compliance Attorney at $291 per hour for 120 hours)) x 10 registrants = $7,387,200.

311 See supra Section V.D.6.

312 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total ongoing estimated dollar cost would be $1,455 per SDR and $14,550 for all SDRs, calculated as follows: (Compliance Attorney at $291 per hour for 5 hours) x 10 registrants = $14,550.

313 See supra Section V.D.6.

314 The Commission estimates that an SDR will assign these responsibilities to a Senior Accountant. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Senior Accountant is $183 per hour. Thus, the total ongoing estimated dollar cost would be $591,500 per SDR and $5,915,000 for all SDRs, calculated as follows: ($500,000 for independent public accounting services (Senior Accountant at $183 per hour for 500 hours)) x 10 registrants = $5,915,000.

As discussed above, the Commission estimates that the average ongoing paperwork cost associated with submitting annual compliance and financial reports to the Commission pursuant to proposed Rule 13n-11(d), (f), and (g) would be 54 hours and $22,772 for each registered SDR.[315] Assuming a maximum of ten SDRs, the aggregate ongoing estimated dollar cost per year would be $363,260 to comply with the proposed rules.[316]

The Commission believes that currently-existing SDRs already maintain compliance programs that are overseen by a CCO or an individual who effectively serves as a CCO. In addition, such SDRs may prepare compliance reports presented to senior management and/or the SDRs' boards as part of their current business practice. Therefore, the Commission expects that SDRs with substantial commitments to compliance would incur only minimal costs in connection with the adoption of the proposed rule. However, the preparation of annual compliance and financial reports and implementation of related policies and procedures may require a staff beyond just a CCO, and therefore the proposed rules may result in additional direct costs to entities that register as SDRs.

The Commission believes that currently-existing SDRs already prepare financial reports similar to those that would be prepared in accordance with proposed Rule 13n-1(f). Therefore, the Commission expects that most SDRs would incur only minimal costs in connection with the adoption of the proposed financial reporting requirement.

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315 See supra Section V.D.6.

316 The Commission estimates that an SDR will assign these responsibilities to a Senior Systems Analyst. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Senior Systems Analyst is $251 per hour. Thus, the total ongoing estimated dollar cost would be $36,236 per SDR and $363,260 for all SDRs, calculated as follows: ($22,772 for information technology services (Senior Systems Analyst at $251 per hour for 54 hours)) x 10 registrants = $363,260.

The Commission solicits comment on the costs related to Rules 13n-4(b)(11) and 13n-11. The Commission specifically requests comment on the initial and ongoing costs associated with designating a CCO and the costs associated with any personnel that may be necessary to support the CCO and create the annual compliance and financial reports. Are there additional costs that the Commission should consider? Are there alternatives that the Commission should consider? Do the estimates accurately reflect the cost of preparing annual compliance and financial reports? Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted.

The Commission does not expect the costs necessary to comply with proposed Rules 13n-4(b)(11) and 13n-11 to have any significant effect on how SDRs conduct business because such costs would not be so large as to result in a change in how such SDRs conduct business, create a barrier to entry, or otherwise alter the competitive landscape among SDRs.

G. Other Policies and Procedures Relating to an SDR's Business

The proposed rules explicitly and implicitly will require registered SDRs to develop and maintain various policies and procedures.[317] Proposed Rule 13n-9 will require each SDR to comply with certain duties and core principles pertaining to confidentiality, disclosure, and use of information.[318] Proposed Rule 13n-4(c) would require each SDR to comply with certain core principles pertaining to market access to services and data, governance arrangements, and conflicts of interest, including developing policies and procedures related to fees, operational

317 See supra Section VI.B for a discussion of the cost and benefits associated with the policies and procedures SDRs must develop and maintain with respect to their information systems.

318 See supra Section III.I.

reliability, and objective access and participation criteria.[319] Proposed Rule 13n-5(b)(6) would require SDRs to develop dispute resolution mechanisms.[320]

1. Benefits

The proposed rules described in this section would be issued pursuant to specific grants of rulemaking authority in the Dodd-Frank Act[321] and are designed to further the legislation's goals by specifying the obligations of registered SDRs necessary to comply with the goals of the Dodd-Frank Act. The proposed privacy requirement is intended to safeguard transaction data provided to SDRs by market participants. Privacy is necessary in order to ensure that market participants will utilize the services of registered SDRs.

The proposed rule relating to market access to services and data is designed to further the legislation's goals by ensuring that SDRs impose fair, reasonable, and consistently applied fees and maintain objective access and participation criteria. As with the privacy requirement, this rule would encourage market participants to make use of SDRs' services.

The proposed governance requirements are designed to reduce the conflicts of interest relating to SDRs. In addition, by requiring fair representation of market participants on the board with the opportunity to participate in the process for nominating directors and the right to petition for alternative candidates, the proposed rule will help reduce the likelihood that an incumbent SBS market participant could exert undue influence on the board.

While the above requirements will serve to prevent and constrain potential conflicts of interest, proposed Rule 13n-4(c)(3) directly addresses conflicts of interest through targeted

319 See supra Section III.D.

320 See supra Section III.E.

321 See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Sections 13(n)(5)(F) – (H) and (7)(A) – (C)).

policies and procedures and an obligation to establish a process for resolving conflicts of interest. This rule would help mitigate the possibility that SDRs' business practices and internal structures might disadvantage market participants and provide a mechanism through which conflicts may be resolved once identified.

The proposed dispute resolution requirements also serve the legislative purpose of maintaining accurate records relating to SDRs. In addition to ensuring the accuracy of data contained in SDRs, the dispute resolution requirement would provide a forum in which market participants could correct inaccuracies in transaction data regarding transactions to which they are parties, thereby fostering increased confidence from market participants in SDRs and the transaction records such SDRs maintain.

Collectively, the rules described in this section would help ensure that SDRs operate consistently with the objectives set forth in the Exchange Act by providing fair, open, and not unreasonably discriminatory access to all market participants without taking advantage of the SDRs' access to transaction data that market participants are required to submit to the SDRs.

The Commission solicits comment on the benefits related to Rules 13n-4(c), 13n-5(b)(6), and 13n-9. Would additional benefits accrue if the Commission imposed further requirements related to the policies and procedures that SDRs must maintain and, if so, what would these additional requirements be? Please describe and, to the extent practicable, quantify the benefits associated with any comments that are submitted.

2. Costs

The Commission anticipates that the primary costs to SDRs from proposed Rules 13n-4(c), 13n-5(b)(6), and 13n-9 will derive from developing, maintaining, and ensuring compliance with the required policies and procedures.

The governance requirements could impose costs resulting from educating senior management and each director about SBS trading and reporting and the new regulatory structure that will govern SBS, which could slow management or board processes at least initially.

The dispute resolution requirement also would impose costs on registered SDRs because SDRs would be required to develop and implement processes through which market participants could challenge the validity of the transaction data relating to agreements to which such participant is a counterparty.

As discussed above, the Commission estimates that the average initial paperwork cost associated with proposed Rule 13n-4(c)(1) would be 367.5 hours and $35,000 and the average ongoing cost would be 105 hours per year for each SDR.[322] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $1,374,800[323] and the aggregate ongoing estimated dollar cost per year would be $294,070[324] to comply with the proposed rule.

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322 See supra Section V.D.7.

323 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager, an Attorney, a Senior Systems Analyst, and an Operations Specialist. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour, the cost of an Attorney is $316 per hour, the cost of a Senior Systems Analyst is $251 per hour, and the cost of an Operation Specialist is $114 per hour. Thus, the total initial estimated dollar cost would be $137,480 per SDR and $1,374,800 for all SDRs, calculated as follows: ($35,000 for outside legal services + (Compliance Manager at $294 per hour for 135 hours) + (Attorney at $316 per hour for 152.5 hours) + (Senior Systems Analyst at $251 per hour for 40 hours) + (Operations Specialist at $114 per hour for 40 hours)) x 10 registrants = $1,374,800.

324 The Commission estimates that an SDR will assign these responsibilities to a Compliance Manager, an Attorney, a Senior Systems Analyst, and an Operations Specialist. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Manager is $294 per hour, the cost of an Attorney is $316 per hour, the cost of a Senior Systems Analyst is $251 per hour, and the cost of an Operation

As discussed above, the Commission estimates that the average initial paperwork cost associated with proposed Rule 13n-4(c)(2) would be 210 hours and $20,000 for each SDR and the average ongoing paperwork cost would be 60 hours per year for each SDR.[325] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $811,100[326] and the aggregate ongoing estimated dollar cost per year would be $174,600[327] to comply with the proposed rule.

As discussed above, the Commission estimates that the average initial paperwork cost associated with proposed Rule 13n-4(c)(3) would be 420 hours and $40,000 for each SDR and the average ongoing paperwork cost would be 120 hours per year for each SDR.[328] Assuming a

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Specialist is $114 per hour. Thus, the total ongoing estimated dollar cost would be $29,407 per SDR and $294,070 for all SDRs, calculated as follows: ((Compliance Manager at $294 per hour for 38 hours) + (Attorney at $316 per hour for 45 hours) + (Senior Systems Analyst at $251 per hour for 11 hours) + (Operations Specialist at $114 per hour for 11 hours)) x 10 registrants = $294,070.

325 See supra Section V.D.7.

326 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total initial estimated dollar cost would be $81,110 per SDR and $811,100 for all SDRs, calculated as follows: ($20,000 for outside legal services + (Compliance Attorney at $291 per hour for 210 hours)) x 10 registrants = $811,100.

327 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total ongoing estimated dollar cost would be $17,460 per SDR and $174,600 for all SDRs, calculated as follows: (Compliance Attorney at $291 per hour for 120 hours) x 10 registrants = $174,600.

328 See supra Section V.D.7.

maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $1,622,200[329] and the aggregate ongoing estimated dollar cost per year would be $349,200[330] to comply with the proposed rule.

As discussed above, the Commission estimates that the average initial paperwork cost associated with proposed Rule 13n-5(b)(6) would be 315 hours and $30,000 for each SDR and the average ongoing paperwork cost would be 90 hours per year for each SDR.[331] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $1,216,650[332] and the aggregate ongoing estimated dollar cost per year would be $261,900[333] to comply with the

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329 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total initial estimated dollar cost would be $162,220 per SDR and $1,622,200 for all SDRs, calculated as follows: ($40,000 for outside legal services + (Compliance Attorney at $291 per hour for 420 hours)) x 10 registrants = $1,622,200.

330 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total ongoing estimated dollar cost would be $34,920 per SDR and $349,200 for all SDRs, calculated as follows: (Compliance Attorney at $291 per hour for 120 hours) x 10 registrants = $349,200.

331 See supra Section V.D.7.

332 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total initial estimated dollar cost would be $121,665 per SDR and $1,216,650 for all SDRs, calculated as follows: ($30,000 for outside legal services + (Compliance Attorney at $291 per hour for 315 hours)) x 10 registrants = $1,216,650.

333 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and

proposed rule.

As discussed above, the Commission estimates that the average initial paperwork cost associated with proposed Rule 13n-9 would be 630 hours and $60,000 for each SDR and the average ongoing paperwork cost would be 180 hours per year for each SDR.[334] Assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost would be $2,433,300[335] and the aggregate ongoing estimated dollar cost per year would be $523,800[336] to comply with the proposed rule.

The Commission solicits comment on the costs related to proposed Rules 13n-4(c), 13n-5(b)(6), and 13n-9. The Commission specifically requests comment on the initial and ongoing costs associated with establishing and maintaining the policies and procedures required by the proposed rules, particularly as the costs apply to entities currently operating as SDRs. Are there

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multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total initial estimated dollar cost would be $26,190 per SDR and $261,900 for all SDRs, calculated as follows: (Compliance Attorney at $291 per hour for 90 hours) x 10 registrants = $261,900.

334 See supra Section V.D.7.

335 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total initial estimated dollar cost would be $243,330 per SDR and $2,433,300 for all SDRs, calculated as follows: ($60,000 for outside legal services + (Compliance Attorney at $291 per hour for 630 hours)) x 10 registrants = $2,433,300.

336 The Commission estimates that an SDR will assign these responsibilities to a Compliance Attorney. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that the cost of a Compliance Attorney is $291 per hour. Thus, the total ongoing estimated dollar cost would be $52,380 per SDR and $523,800 for all SDRs, calculated as follows: (Compliance Attorney at $291 per hour for 180 hours) x 10 registrants = $523,800.

additional costs implicated by the proposed rules related to policies and procedures that the Commission should consider? Are there alternatives that the Commission should consider? Do the estimates accurately reflect the cost of maintaining, implementing, and revising the required policies and procedures? Please describe and, to the extent practicable, quantify the costs associated with any comments that are submitted.

The Commission does not expect the initial and ongoing costs necessary to comply with the rules relating to policies and procedures to have any significant effect on how SDRs conduct business because such costs would not be so large as to result in a change in how such SDRs conduct business, create a barrier to entry, or otherwise alter the competitive landscape among SDRs.

H. Total Costs

Based on the analyses described above, the Commission preliminarily estimates that proposed Rules 13n-1 through 13n-11 and proposed Form SDR would impose on registered SDRs an aggregate total initial one-time estimated dollar cost of approximately \$214,913,592.[337] The Commission further preliminarily estimates that proposed Rules 13n-1 through 13n-11 and proposed Form SDR would impose on registered SDRs a total ongoing annualized aggregate dollar cost of approximately \$140,302,120.[338] Altogether, the Commission preliminarily

337 The Commission derived its estimate from the following: (\$589,544 (\$584,000 + \$5,544) for Registration Requirements and Form SDR) + (\$203,962,250 (\$200,020,000 + \$16,000 + \$3,926,250) for SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access) + (\$1,015,460 for Recordkeeping) + (\$266,088 for Disclosure) + (\$1,622,200 for Chief Compliance Officer and Compliance Functions) + (\$7,458,050 (\$1,374,800 + \$811,100 + \$1,622,200 + \$1,216,650 + \$2,433,300) for Other Policies and Procedures Relating to an SDR's Business) = \$214,913,592.

338 The Commission derived its estimate from the following: (\$49,080 for Registration Requirements and Form SDR) + (\$121,298,845 (\$120,012,000 + \$9,480 + \$908,400 + \$368,965) for SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access) + (\$820,760 for Recordkeeping) + (\$2,848,090 (\$2,845,750 +

estimates that proposed Rules 13n-1 through 13n-11, proposed Form SDR, and proposed Regulation SBSR[339] would impose on registered SDRs aggregate initial estimated dollar costs of approximately $295,891,852[340] and aggregate ongoing annualized dollar costs of approximately $245,428,520.[341]

1. Request for Comment

The Commission requests data to quantify the costs and the value of the benefits above. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits not already defined, which may result from the adoption of the proposed rules and Form SDR. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposals.

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

Exchange Act Section 23(a)[342] requires the Commission, when making rules and regulations under the Exchange Act, to consider the impact a new rule would have on competition. 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

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$2,340) for Reports and Reviews) + ($1,765 for Disclosure) + ($13,680,010 ($7,387,200 + $14,550 + $5,915,000 + $363,260) for Chief Compliance Officer and Compliance Functions) + ($1,603,570 ($294,070 + $174,600 + $349,200 + $261,900 + $523,800) for Other Policies and Procedures Relating to an SDR's Business) = $140,302,120.

339 See Regulation SBSR Release, supra note 9.

340 The Commission derived its estimate from the following: ($214,913,592 for proposed Rules 13n-1 through 13n-11 and proposed Form SDR) + ($80,978,260 for proposed Regulation SBSR) = $295,891,852.

341 The Commission derived its estimate from the following: ($140,302,120 for proposed Rules 13n-1 through 13n-11 and proposed Form SDR) + ($105,126,400 for proposed Regulation SBSR) = $245,428,520.

342 15 U.S.C. 78w(a).

purposes of the Exchange Act. Securities Act Section 2(b)[343] and Exchange Act Section 3(f)[344] require the Commission, when engaging in rulemaking that requires it to consider 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. Below, the Commission addresses these issues for the proposed rules regarding data collection and maintenance and recordkeeping by SDRs and books and records relating to SBS. The Commission focuses on the effects of the discretion used by the Commission rather than the mandates of the Dodd-Frank Act. However, to the extent that the discretion is used to take full advantage of the benefits intended by the Dodd-Frank Act, the two types of benefits are not entirely separable.

The economic effects of the proposed rules were discussed in detail in the costs and benefits section. These economic benefits encompassed effects on economic efficiency, competition, and capital formation.

To reiterate, by allowing multiple SDRs to provide data collection, maintenance, and recordkeeping services, the rules are intended to promote competition among SDRs. We do not preliminarily believe that the provisions would give undue market influence to any potential market participants. We believe that non-resident SDRs generally can take steps to comply with their home country requirements and the Commission's supervisory requirements, and therefore can register with the Commission. We recognize that there potentially could be instances in which a non-resident SDR is unable to register because, for example, they cannot make the certification or provide the opinion of counsel required by proposed Rule 13n-1(g). We believe,

343 15 U.S.C. 77b(b).

344 15 U.S.C. 78c(f).

however, that these requirements are necessary and appropriate in furtherance of the purpose of the Exchange Act.

However, by allowing multiple SDRs, the proposed rules may result in inefficiencies as explained in the benefits and costs section of this release. In particular, the potential reporting of transaction data to multiple SDRs would create a need to aggregate those data by regulators and other interested parties. From a systemic risk perspective, monitoring costs increase if identifiers or data field definitions used by different SDRs are not compatible with each other and aggregation is difficult. The complications associated with aggregation could be particularly costly when aggregation is required across the same asset class and different legs of the same transaction reside in different SDRs. However, the current market structure essentially consists of only one SDR per asset class, and it is likely that the market would, under competitive forces, ultimately converge to an efficient outcome that does not present compatibility problems or that entails fewer, rather than many, SDRs.

The Commission believes that the proposed rules use the discretion that the Dodd-Frank Act permits the Commission to use to promote data collection, maintenance, and recordkeeping according to existing best practices that are used in similar capital market institutions. This is likely to positively affect transparency in credit markets. Therefore, the proposed rules would help capital formation in the broader capital markets whose participants rely on SBS markets to meet their hedging objectives.

The practices that are proposed in the rules would also help regulators perform their supervisory functions in an effective manner. The resulting increase in market integrity is likely to affect capital formation in our capital markets positively. In addition, regulators would be better equipped to perform their duties in the management and mitigation of systemic risk.

VIII. Initial Regulatory Flexibility Act Certification

Section 603(a) of the Regulatory Flexibility Act[345] ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis of the impact of proposed Rules 13n-1 through 13n-11 on small entities, unless the Commission certifies that the proposed rules, if adopted, would not have significant economic impact on a substantial number of small entities.[346]

A. SDRs

Proposed Rules 13n-1 through 13n-11 would apply to all SDRs. In the Dodd-Frank Act, Congress defined for the first time what activity would constitute an SDR and mandated the registration of these new entities. The Commission does not know exactly how many entities may seek to register as SDRs and become subject to the requirements of the proposed rules. However, based on its understanding of the market and conversations with industry sources, the Commission preliminarily believes that likely no more than ten SDRs could be subject to the requirements of proposed Rules 13n-1 through 13n-11.

For purposes of Commission rulemaking in connection with the RFA, an issuer or person, other than an investment company, is a small business if its total assets on the last day of its most recent fiscal year were $5 million or less.[347] The Commission preliminarily believes that the entities likely to register as SDRs will not be considered small entities. The Commission preliminarily believes that most, if not all, of the SDRs will be part of large business entities, and that all SDRs will have assets in excess of $5 million and total capital in excess of $500,000.[348]

345 5 U.S.C. 603(a).

346 5 U.S.C. 605(b).

347 17 CFR 230.157. See also 17 CFR 240.0-10(a).

348 Commission staff based this determination on its review of public sources of financial information about the current repositories that are providing services in the OTC derivatives market.

Therefore, the Commission preliminarily believes that none of the SDRs will be considered small entities.

B. Certification

In the Commission's preliminary view, the proposed rules would not have a significant economic impact on a substantial number of small entities, including national securities exchanges, clearing agencies, or other small businesses or small organizations. For the above reasons, the Commission certifies that the proposed rules would not have a significant economic impact on a substantial number of small entities. The Commission requests comment regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, including national securities exchanges, clearing agencies, or other small businesses or small organizations that may register as SDRs, and provide empirical data to support the extent of the impact.

IX. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[349] the Commission must advise the OMB as to whether the proposed regulations constitute 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 consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation.

The Commission requests comment on the potential impact of the proposed rules on the economy on an annual basis, on the costs or prices for consumers or individual industries, and on

349 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).

competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

X. Statutory Authority

Pursuant to the Exchange Act, and particularly Sections 13(n) and 23(a) thereof, 15 U.S.C. 78m(n) and 78w(a), the Commission proposes new Rules 13n-1 to 13n-11, which would govern SDRs.

List of Subjects in 17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, 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.; 18 U.S.C. 1350; and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

2. Sections 240.13n-1 to 240-13n-11 are added to read as follows:

§ 240.13n-1 Registration of security-based swap data repository.

(a) Definition. For purposes of this section –

(1) EDGAR Filer Manual has the same meaning as set forth in Rule 11 of Regulation S-T (17 CFR 232).

(2) Non-resident security-based swap data repository means:

(i) In the case of an individual, one who resides in or has his principal place of business in any place not in the United States;

(ii) In the case of a corporation, one incorporated in or having its principal place of business in any place not in the United States; or

(iii) In the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not in the United States.

(3) Tag (including the term tagged) means an identifier that highlights specific information submitted to the Commission that is in the format required by the EDGAR Filer Manual, as described in Rule 301 of Regulation S-T (17 CFR 232.301).

(b) An application for the registration of a security-based swap data repository shall be filed electronically in a tagged data format on Form SDR (17 CFR 249.1500) with the Commission in accordance with the instructions contained therein. As part of the application process, each SDR shall provide additional information to the Commission upon request.

(c) Within 90 days of the date of the filing of such application (or within such longer period as to which the applicant consents), the Commission shall –

(1) By order grant registration, or

(2) Institute proceedings to determine whether registration should be denied. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing on the record and shall be concluded not later than 180 days after the date on which the application for registration is filed with the Commission under paragraph (b) of this section. At the conclusion of such proceedings, the Commission, by order, shall grant or deny such registration. The Commission may extend the time for conclusion of such proceedings for up to

90 days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the applicant consents.

(3) The Commission shall grant the registration of a security-based swap data repository if the Commission finds that such security-based swap data repository is so organized, and has the capacity, to be able to assure the prompt, accurate, and reliable performance of its functions as a security-based swap data repository, comply with any applicable provision of the federal securities laws and the rules and regulations thereunder, and carry out its functions in a manner consistent with the purposes of Section 13(n) of the Act (15 U.S.C. 78m(n)) and the rules and regulations thereunder. The Commission shall deny the registration of a security-based swap data repository if it does not make any such finding.

(d) For any application of registration as a security-based swap data repository, the Commission, upon the request of a security-based swap data repository, may grant temporary registration of the security-based swap data repository that shall expire on the earlier of:

(1) The date that the Commission grants or denies registration of the security-based swap data repository; or

(2) The date that the Commission rescinds the temporary registration of the security-based swap data repository.

(e) If any information reported in items 1 through 16, 25, and 44 of Form SDR (17 CFR 249.1500) or in any amendment thereto is or becomes inaccurate for any reason, whether before or after the registration has been granted, the security-based swap data repository shall promptly file an amendment on Form SDR updating such information. In addition, the security-based swap data repository shall annually file an amendment on Form SDR within 60 days after the end of each fiscal year of such security-based swap data repository.

(f) Each security-based swap data repository shall designate and authorize on Form SDR an agent in the United States, other than a Commission member, official, or employee, who shall accept any notice or service of process, pleadings, or other documents in any action or proceedings brought against the security-based swap data repository to enforce the federal securities laws and the rules and regulations thereunder.

(g) Any non-resident security-based swap data repository applying for registration pursuant to this section shall certify on Form SDR and provide an opinion of counsel that the security-based swap data repository can, as a matter of law, provide the Commission with prompt access to the books and records of such security-based swap data repository and that the security-based swap data repository can, as a matter of law, submit to onsite inspection and examination by the Commission.

(h) An application for registration or any amendment thereto that is filed pursuant to this section shall be considered a "report" filed with the Commission for purposes of Sections 18(a) and 32(a) of the Act (15 U.S.C. 78r(a) and 78ff(a)) and the rules and regulations thereunder and other applicable provisions of the United States Code and the rules and regulations thereunder.

§ 240.13n-2 Withdrawal from registration.

(a) Definitions. For purposes of this section –

(1) Control (including the terms controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(i) Is a director, general partner, or officer exercising executive responsibility (or having similar status or functions);

(ii) Directly or indirectly has the right to vote 25 percent of more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(iii) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(2) Person associated with a security-based swap data repository means:

(i) Any partner, officer, or director of such security-based swap data repository (or any person occupying a similar status or performing similar functions);

(ii) Any person directly or indirectly controlling, controlled by, or under common control with such security-based swap data repository; or

(iii) Any employee of such security-based swap data repository.

(b) A registered security-based swap data repository may withdraw from registration by filing a notice of withdrawal with the Commission. The security-based swap data repository shall designate on its notice of withdrawal a person associated with the security-based swap data repository to serve as the custodian of the security-based swap data repository's books and records. Prior to filing a notice of withdrawal, a security-based swap data repository shall file an amended Form SDR (17 CFR 249.1500) to update any inaccurate information.

(c) A notice of withdrawal from registration filed by a security-based swap data repository shall become effective for all matters (except as provided in this paragraph (c)) on the 60th day after the filing thereof with the Commission, within such longer period of time as to which such security-based swap data repository consents or which the Commission, by order, may determine as necessary or appropriate in the public interest or for the protection of investors, or within such shorter period of time as the Commission may determine.

(d) A notice of withdrawal that is filed pursuant to this section shall be considered a "report" filed with the Commission for purposes of Sections 18(a) and 32(a) of the Act (15 U.S.C. 78r(a) and 78ff(a)) and the rules and regulations thereunder and other applicable provisions of the United States Code and the rules and regulations thereunder.

(e) If the Commission finds, on the record after notice and opportunity for hearing, that any registered security-based swap data repository has obtained its registration by making any false and misleading statements with respect to any material fact or has violated or failed to comply with any provision of the federal securities laws and the rules and regulations thereunder, the Commission, by order, may revoke the registration. Pending final determination of whether any registration shall be revoked, the Commission, by order, may suspend such registration, if such suspension appears to the Commission, after notice and opportunity for hearing on the record, to be necessary or appropriate in the public interest or for the protection of investors.

(f) If the Commission finds that a registered security-based swap data repository is no longer in existence or has ceased to do business in the capacity specified in its application for registration, the Commission, by order, may cancel the registration.

§ 240.13n-3 Registration of successor to registered security-based swap data repository.

(a) In the event that a security-based swap data repository succeeds to and continues the business of a security-based swap data repository registered pursuant to Section 13(n) of the Act (15 U.S.C. 78m(n)), the registration of the predecessor shall be deemed to remain effective as the registration of the successor if, within 30 days after such succession, the successor files an application for registration on Form SDR (17 CFR 249.1500), and the predecessor files a notice of withdrawal from registration with the Commission; provided, however, that the registration of the predecessor security-based swap data repository shall cease to be effective 90 days after the application for registration on Form SDR is filed by the successor security-based swap data repository.

(b) Notwithstanding paragraph (a) of this section, if a security-based swap data repository succeeds to and continues the business of a registered predecessor security-based swap data repository, and the succession is based solely on a change in the predecessor's date or state of incorporation, form of organization, or composition of a partnership, the successor may, within 30 days after the succession, amend the registration of the predecessor security-based swap data repository on Form SDR to reflect these changes. This amendment shall be deemed an application for registration filed by the predecessor and adopted by the successor.

§ 240.13n-4 Duties and core principles of security-based swap data repository.

Preliminary Note to § 240.13n-4: This rule is not intended to limit, or restrict, the applicability of other provisions of the federal securities laws, including, but not limited to, Section 13(m) of the Act (15 U.S.C. 78m(m)) and the rules and regulations thereunder.

(a) Definitions. For purposes of this section –

(1) Affiliate of a security-based swap data repository means a person that, directly or indirectly, controls, is controlled by, or is under common control with the security-based swap data repository.

(2) Board means the board of directors of the security-based swap data repository or a body performing a function similar to the board of directors of the security-based swap data repository.

(3) Control (including the terms controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management

and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(i) Is a director, general partner, or officer exercising executive responsibility (or having similar status or functions);

(ii) Directly or indirectly has the right to vote 25 percent of more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(iii) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(4) Director means any member of the board.

(5) Direct electronic access means access, which shall be in a form and manner acceptable to the Commission, to data stored by a security-based swap data repository in an electronic format and updated at the same time as the security-based swap data repository's data is updated so as to provide the Commission or any of its designees with the ability to query or analyze the data in the same manner that the security-based swap data repository can query or analyze the data.

(6) End-user means any counterparty to a security-based swap that is described in Section 3C(g)(1) of the Act (15 U.S.C. 78c-3(g)(1)) and the rules and regulations thereunder.

(7) Market participant means any person participating in the security-based swap market, including, but not limited to, security-based swap dealers, major security-based swap participants, and any other counterparties to a security-based swap transaction.

(8) Nonaffiliated third party of a security-based swap data repository means any person except:

(i) The security-based swap data repository,

(ii) Any affiliate of the security-based swap data repository, or

(iii) A person employed by a security-based swap data repository and any entity that is not the security-based swap data repository's affiliate (and "nonaffiliated third party" includes such entity that jointly employs the person).

(9) Person associated with a security-based swap data repository means:

(i) Any partner, officer, or director of such security-based swap data repository (or any person occupying a similar status or performing similar functions);

(ii) Any person directly or indirectly controlling, controlled by, or under common control with such security-based swap data repository; or

(iii) Any employee of such security-based swap data repository.

(b) Duties. To be registered, and maintain registration, as a security-based swap data repository, a security-based swap data repository shall:

(1) Subject itself to inspection and examination by the Commission;

(2) Accept data as prescribed in Regulation SBSR for each security-based swap;

(3) Confirm, as prescribed in Rule 13n-5, with both counterparties to the security-based swap the accuracy of the data that was submitted;

(4) Maintain, as prescribed in Rule 13n-5, the data described in Regulation SBSR in such form, in such manner, and for such period as provided therein and in the Act and the rules and regulations thereunder;

(5) Provide direct electronic access to the Commission (or any designee of the Commission, including another registered entity);

(6) Provide the information described in Regulation SBSR in such form and at such frequency as prescribed in Regulation SBSR to comply with the public reporting requirements set forth in Section 13(m) of the Act (15 U.S.C. 78m(m)) and the rules and regulations thereunder;

(7) At such time and in such manner as may be directed by the Commission, establish automated systems for monitoring, screening, and analyzing security-based swap data;

(8) Maintain the privacy of any and all security-based swap transaction information that the security-based swap data repository receives from a security-based swap dealer, counterparty, or any registered entity as prescribed in Rule 13n-9;

(9) On a confidential basis, pursuant to Section 24 of the Act (15 U.S.C. 78x) and the rules and regulations thereunder, upon request, and after notifying the Commission of the request, make available all data obtained by the security-based swap data repository, including individual counterparty trade and position data, to the following:

(i) Each appropriate prudential regulator, as defined in Section 3(a)(74) of the Act (15 U.S.C. 78c(a)(74));

(ii) The Financial Stability Oversight Council;

(iii) The Commodity Futures Trading Commission;

(iv) The Department of Justice; and

(v) The Federal Deposit Insurance Corporation and any other person that the Commission determines to be appropriate, including, but not limited to –

(A) Foreign financial supervisors (including foreign futures authorities);

(B) Foreign central banks; and

(C) Foreign ministries;

(10) Before sharing information with any entity described in paragraph (b)(9) of this section, obtain a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in Section 24 of the Act (15 U.S.C. 78x) and the rules and regulations thereunder relating to the information on security-based swap transactions that is provided, and each entity shall agree to indemnify the security-based swap data repository and the Commission for any expenses arising from litigation relating to the information provided under Section 24 of the Act (15 U.S.C. 78x) and the rules and regulations thereunder; and

(11) Designate an individual to serve as a chief compliance officer who shall comply with Rule 13n-11.

(c) Compliance with core principles. A security-based swap data repository shall comply with the core principles as described in this paragraph.

(1) Market Access to Services and Data. Unless necessary or appropriate to achieve the purposes of the Act and the rules and regulations thereunder, the security-based swap data repository shall not adopt any policies and procedures or take any action that results in an unreasonable restraint of trade or impose any material anticompetitive burden on the trading, clearing, or reporting of transactions. To comply with this core principle, each security-based swap data repository shall:

(i) Ensure that any dues, fees, or other charges imposed by, and any discounts or rebates offered by, a security-based swap data repository are fair and reasonable and not unreasonably discriminatory. Such dues, fees, other charges, discounts, or rebates shall be applied consistently across all similarly-situated users of such security-based swap data repository's services, including, but not limited to, market participants, market infrastructures (including central counterparties), venues from which data can be submitted to the security-based swap data repository (including exchanges, security-based swap execution facilities, electronic trading venues, and matching and confirmation platforms), and third party service providers;

(ii) Permit market participants to access specific services offered by the security-based swap data repository separately;

(iii) Establish, monitor on an ongoing basis, and enforce clearly stated objective criteria that would permit fair, open, and not unreasonably discriminatory access to services offered and data maintained by the security-based swap data repository as well as fair, open, and not unreasonably discriminatory participation by market participants, market infrastructures, venues from which data can be submitted to the security-based swap data repository, and third party service providers that seek to connect to or link with the security-based swap data repository; and

(iv) Establish, maintain, and enforce written policies and procedures reasonably designed to review any prohibition or limitation of any person with respect to access to services offered, directly or indirectly, or data maintained by the security-based swap data repository and to grant such person access to such services or data if such person has been discriminated against unfairly.

(2) <u>Governance arrangements</u>. Each security-based swap data repository shall establish governance arrangements that are transparent to fulfill public interest requirements under the Act and the rules and regulations thereunder; to carry out functions consistent with the Act, the rules and regulations thereunder, and the purposes of the Act; and to support the objectives of the Federal Government, owners, and participants. To comply with this core principle, each security-based swap data repository shall:

(i) Establish governance arrangements that are well defined and include a clear organizational structure with effective internal controls;

(ii) Establish governance arrangements that provide for fair representation of market participants;

(iii) Provide representatives of market participants, including end-users, with the opportunity to participate in the process for nominating directors and with the right to petition for alternative candidates; and

(iv) Establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the security-based swap data repository's senior management and each member of the board or committee that has the authority to act on behalf of the board possess requisite skills and expertise to fulfill their responsibilities in the management and governance of the security-based swap data repository, to have a clear understanding of their responsibilities, and to exercise sound judgment about the security-based swap data repository's affairs.

(3) Conflicts of interest. Each security-based swap data repository shall establish and enforce written policies and procedures reasonably designed to minimize conflicts of interest in the decision-making process of the security-based swap data repository and establish a process for resolving any such conflicts of interest. Such conflicts of interest include, but are not limited to: conflicts between the commercial interests of a security-based swap data repository and its statutory responsibilities; conflicts in connection with the commercial interests of certain market participants or linked market infrastructures, third party service providers, and others; conflicts between, among, or with persons associated with the security-based swap data repository, market participants, affiliates of the security-based swap data repository, and nonaffiliated third parties; and misuse of confidential information, material, nonpublic information, and/or intellectual property. To comply with this core principle, each security-based swap data repository shall:

(i) Establish, maintain, and enforce written policies and procedures reasonably designed to identify and mitigate potential and existing conflicts of interest in the security-based swap data repository's decision-making process on an ongoing basis;

(ii) With respect to the decision-making process for resolving any conflicts of interest, require the recusal of any person involved in such conflict from such decision-making; and

(iii) Establish, maintain, and enforce reasonable written policies and procedures regarding the security-based swap data repository's non-commercial and/or commercial use of the security-based swap transaction information that it receives from a market participant, any registered entity, or any other person.

§ 240.13n-5 Data collection and maintenance.

(a) Definitions. For purposes of this section –

(1) Transaction data means all information reported to a security-based swap data repository pursuant to the Act and the rules and regulations thereunder.

(2) Position means the gross and net notional amounts of open security-based swap transactions aggregated by one or more attributes, including, but not limited to, the:

(i) Underlying instrument, index, or reference entity;

(ii) Counterparty;

(iii) Asset class;

(iv) Long risk of the underlying instrument, index, or reference entity; and

(v) Short risk of the underlying instrument, index, or reference entity.

(3) Asset class means those security-based swaps in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives.

(b) Requirements. Every security-based swap data repository registered with the Commission shall comply with the following data collection and data maintenance standards:

(1) Transaction data.

(i) Every security-based swap data repository shall establish, maintain, and enforce written policies and procedures reasonably designed for the reporting of transaction data to the security-based swap data repository and shall accept all transaction data that is reported in accordance with such policies and procedures.

(ii) If a security-based swap data repository accepts any security-based swap in a particular asset class, the security-based swap data repository shall accept all security-based swaps in that asset class that are reported to it in accordance with its policies and procedures required by paragraph (b)(1) of this section.

(iii) Every security-based swap data repository shall establish, maintain, and enforce written policies and procedures reasonably designed to satisfy itself by reasonable means that the transaction data that has been submitted to the security-based swap data repository is accurate, including clearly identifying the source for each trade side and the pairing method (if any) for each transaction in order to identify the level of quality of the transaction data.

(iv) Every security-based swap data repository shall promptly record the transaction data it receives.

(2) Positions. Every security-based swap data repository shall establish, maintain, and enforce written policies and procedures reasonably designed to calculate positions for all persons with open security-based swaps for which the security-based swap data repository maintains records.

(3) Every security-based swap data repository shall establish, maintain, and enforce written policies and procedures reasonably designed to ensure that the transaction data and positions that it maintains are accurate.

(4) Every security-based swap data repository shall maintain transaction data for not less than five years after the applicable security-based swap expires and historical positions for not less than five years:

(i) In a place and format that is readily accessible to the Commission and other persons with authority to access or view such information; and

(ii) In an electronic format that is non-rewriteable and non-erasable.

(5) Every security-based swap data repository shall establish, maintain, and enforce written policies and procedures reasonably designed to prevent any provision in a valid security-based swap from being invalidated or modified through the procedures or operations of the security-based swap data repository.

(6) Every security-based swap data repository shall establish procedures and provide facilities reasonably designed to effectively resolve disputes over the accuracy of the transaction data and positions that are recorded in the security-based swap data repository.

(7) If a security-based swap data repository ceases doing business, or ceases to be registered pursuant to Section 13(n) of the Act (15 U.S.C. 78m(n)) and the rules and regulations thereunder, it must continue to preserve, maintain and make accessible the transaction data and historical positions required to be collected, maintained and preserved by this section in the manner required by the Act and the rules and regulations thereunder and for the remainder of the period required by this section.

(8) Every security-based swap data repository shall make and keep current a plan to ensure that the transaction data and positions that are recorded in the security-based swap data repository continue to be maintained in accordance with Rule 13n-5(b)(7), which shall include procedures for transferring the transaction data and positions to the Commission or its designee (including another registered security-based swap data repository).

§ 240.13n-6 Automated systems.

(a) Definitions. For purposes of this section –

(1) Material system outage means an unauthorized intrusion into any system, or an event at a security-based swap data repository that causes a problem in its systems or procedures that results in:

(i) A failure to maintain service level agreements or constraints;

(ii) A disruption of normal operations, including switchover to back-up equipment with no possibility of near-term recovery of primary hardware;

(iii) A loss of use of any system;

(iv) A loss of transactions;

(v) Excessive back-ups or delays in processing;

(vi) A loss of ability to disseminate transaction data and positions;

(vii) A communication of an outage situation to other external entities;

(viii) A report or referral of an event to the security-based swap data repository's board of directors, a body performing a function similar to the board of the directors, or senior management;

(ix) A serious threat to its systems operations even though its systems operations were not disrupted;

(x) A queuing of data between system components or queuing of messages to or from customers of such duration that a customer's normal service delivery is affected; or

(xi) A failure to maintain the integrity of its systems that results in the entry of erroneous or inaccurate transaction data or other information in the security-based swap data repository or the securities markets.

(2) Material systems change means a change to automated systems of a security-based swap data repository that:

(i) Significantly affects its existing capacity or security;

(ii) In itself, raises significant capacity or security issues, even if it does not affect other existing systems;

(iii) Relies upon substantially new or different technology;

(iv) Is designed to provide a new service or function; or

(v) Otherwise significantly affects the operations of the security-based swap data repository.

(3) Objective review means an internal or external review, performed by competent, objective personnel following established procedures and standards, and containing a risk assessment conducted pursuant to a review schedule.

(4) Competent, objective personnel means a recognized information technology firm or a qualified internal department knowledgeable of information technology systems.

(5) Review schedule means a schedule in which each element contained in paragraph (b)(1) of this section would be assessed at specific, regular intervals.

(6) Transaction data has the same meaning as in Rule 13n-5(a)(1).

(7) Position has the same meaning as in Rule 13n-5(a)(2).

(b) Requirements for security-based swap data repositories. Every security-based swap data repository, with respect to those systems that support or are integrally related to the performance of its activities, shall:

(1) establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security. These policies and procedures shall, at a minimum:

(i) Establish reasonable current and future capacity estimates;

(ii) Conduct periodic capacity stress tests of critical systems to determine such systems' ability to process transactions in an accurate, timely, and efficient manner;

(iii) Develop and implement reasonable procedures to review and keep current its system development and testing methodology;

(iv) Review the vulnerability of its systems and data center computer operations to internal and external threats, physical hazards, and natural disasters; and

(v) Establish adequate contingency and disaster recovery plans.

(2) On an annual basis, submit an objective review to the Commission within thirty calendar days of its completion. Where the objective review is performed by an internal department, an objective, external firm shall assess the internal department's objectivity, competency, and work performance with respect to the review performed by the internal department. The external firm must issue a report of the objective review, which the security-based swap data repository must submit to the Commission on an annual basis, within 30 calendar days of completion of the review;

(3) Promptly notify the Commission of material systems outages and any remedial measures that have been implemented or are contemplated. Prompt notification includes the following:

(i) Immediately notify the Commission when a material systems outage is detected;

(ii) Immediately notify the Commission when remedial measures are selected to address the material systems outage;

(iii)Immediately notify the Commission when the material systems outage is addressed; and

(iv)Submit to the Commission within five business days of the occurrence of the material systems outage a detailed written description and analysis of the outage and any remedial measures that have been implemented or are contemplated; and

(4) Notify the Commission in writing at least thirty calendar days before implementation of any planned material systems changes.

(c) Electronic filing. Every security-based swap data repository shall submit every notification, review, or description and analysis that is required to be submitted to the Commission pursuant to this section (other than the notifications pursuant to paragraph (b)(3)(i), (ii), or (iii) of this section) in an appropriate electronic format. Every such notification, review, or description and analysis shall be submitted to the Division of Trading and Markets, Office of Market Operations, at the principal office of the Commission in Washington, DC. Every such notification, review, or description and analysis shall be considered submitted when an electronic version is received at the Division of Trading and Markets, Office of Market Operations, at the principal office of the Commission in Washington, DC.

(d) Confidential treatment. A person who submits a notification, review, or description and analysis pursuant to this section for which he or she seeks confidential treatment shall clearly mark each page or segregable portion of each page with the words "Confidential Treatment Requested." A notification, review, or description and analysis submitted pursuant to this section will be accorded confidential treatment to the extent permitted by law.

§ 240.13n-7 Recordkeeping of security-based swap data repository.

(a) Every security-based swap data repository shall make and keep current the following books and records relating to its business:

(1) A record for each office listing, by name or title, each person at that office who, without delay, can explain the types of records the security-based swap data repository maintains at that office and the information contained in those records; and

(2) A record listing each officer, manager, or person performing similar functions of the security-based swap data repository responsible for establishing policies and procedures that are reasonably designed to ensure compliance with the Act and the rules and regulations thereunder.

(b) Recordkeeping rule for security-based swap data repositories.

(1) Every security-based swap data repository shall keep and preserve at least one copy of all documents, including all documents and policies and procedures required by the Act and the rules and regulations thereunder, correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it in the course of its business as such.

(2) Every security-based swap data repository shall keep all such documents for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination.

(3) Every security-based swap data repository shall, upon request of any representative of the Commission, promptly furnish to the possession of such representative copies of any documents required to be kept and preserved by it pursuant to paragraphs (a) and (b) of this section.

(c) If a security-based swap data repository ceases doing business, or ceases to be registered pursuant to Section 13(n) of the Act (15 U.S.C. 78m(n)) and the rules and regulations thereunder, it must continue to preserve, maintain, and make accessible the records/data required to be collected, maintained and preserved by this section in the manner required by this section and for the remainder of the period required by this section.

(d) This section does not apply to data collected and maintained pursuant to Rule 13n-5.

§ 240.13n-8 Reports to be provided to the Commission.

Every security-based swap data repository shall promptly report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission to perform the duties of the Commission under the Act and the rules and regulations thereunder.

§ 240.13n-9 Privacy requirements of security-based swap data repository.

(a) Definitions. For purposes of this section –

(1) Affiliate of a security-based swap data repository means a person that, directly or indirectly, controls, is controlled by, or is under common control with the security-based swap data repository.

(2) Control (including the terms controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management

and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(i) Is a director, general partner, or officer exercising executive responsibility (or having similar status or functions);

(ii) Directly or indirectly has the right to vote 25 percent of more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(iii) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(3) Market participant means any person participating in the security-based swap market, including, but not limited to, security-based swap dealers, major security-based swap participants, and any other counterparties to a security-based swap transaction.

(4) Nonaffiliated third party of a security-based swap data repository means any person except:

(i) The security-based swap data repository,

(ii) The security-based swap data repository's affiliate, or

(iii) A person employed by a security-based swap data repository and any entity that is not the security-based swap data repository's affiliate (and nonaffiliated third party includes such entity that jointly employs the person).

(5) Nonpublic personal information means:

(i) Personally identifiable information and

(ii) Any list, description, or other grouping of market participants (and publicly available information pertaining to them) that is derived using personally identifiable information that is not publicly available information.

(6) Personally identifiable information means any information:

(i) A market participant provides to a security-based swap data repository to obtain service from the security-based swap data repository,

(ii) About a market participant resulting from any transaction involving a service between the security-based swap data repository and the market participant, or

(iii) The security-based swap data repository obtains about a market participant in connection with providing a service to that market participant.

(7) Person associated with a security-based swap data repository means:

(i) Any partner, officer, or director of such security-based swap data repository (or any person occupying a similar status or performing similar functions);

(ii) Any person directly or indirectly controlling, controlled by, or under common control with such security-based swap data repository; or

(iii) Any employee of such security-based swap data repository.

(b) Each security-based swap data repository shall:

(1) Establish, maintain, and enforce written policies and procedures reasonably designed to protect the privacy of any and all security-based swap transaction information that the security-based swap data repository receives from a security-based swap dealer, counterparty, or any registered entity. Such policies and procedures shall include, but are not limited to, policies and procedures to protect the privacy of any and all security-based swap transaction information

that the security-based swap data repository shares with affiliates and nonaffiliated third parties; and

(2) Establish and maintain safeguards, policies, and procedures reasonably designed to prevent the misappropriation or misuse, directly or indirectly, of:

(i) Any confidential information received by the security-based swap data repository, including, but not limited to, trade data, position data, and any nonpublic personal information about a market participant or any of its customers;

(ii) Material, nonpublic information; and/or

(iii) Intellectual property, such as trading strategies or portfolio positions,

by the security-based swap data repository or any person associated with the security-based swap data repository for their personal benefit or the benefit of others. Such safeguards, policies, and procedures shall address, without limitation,

(A) Limiting access to such confidential information, material, nonpublic information, and intellectual property,

(B) Standards pertaining to the trading by persons associated with the security-based swap data repository for their personal benefit or the benefit of others, and

(C) Adequate oversight to ensure compliance with this subparagraph.

§ 240.13n-10 Disclosure requirements of security-based swap data repository.

(a) Definition. For purposes of this section –

(1) Market participant means any person participating in the over-the-counter derivatives market, including, but not limited to, security-based swap dealers, major security-based swap participants, and any other counterparties to a security-based swap transaction.

(b) Before accepting any security-based swap data from a market participant or upon a market participant's request, a security-based swap data repository shall furnish to the market participant a disclosure document that contains the following written information, which must reasonably enable the market participant to identify and evaluate accurately the risks and costs associated with using the services of the security-based swap data repository:

(1) The security-based swap data repository's criteria for providing others with access to services offered and data maintained by the security-based swap data repository;

(2) The security-based swap data repository's criteria for those seeking to connect to or link with the security-based swap data repository;

(3) A description of the security-based swap data repository's policies and procedures regarding its safeguarding of data and operational reliability to protect the confidentiality and security of such data, as described in Rule 13n-6;

(4) A description of the security-based swap data repository's policies and procedures reasonably designed to protect the privacy of any and all security-based swap transaction information that the security-based swap data repository receives from a security-based swap dealer, counterparty, or any registered entity, as described in Rule 13n-9(b)(1);

(5) A description of the security-based swap data repository's policies and procedures regarding its non-commercial and/or commercial use of the security-based swap transaction information that it receives from a market participant, any registered entity, or any other person;

(6) A description of the security-based swap data repository's dispute resolution procedures involving market participants, as described in Rule 13n-5(b)(6);

(7) A description of all the security-based swap data repository's services, including any ancillary services;

(8) The security-based swap data repository's updated schedule of any dues; unbundled prices, rates, or other fees for all of its services, including any ancillary services; any discounts or rebates offered; and the criteria to benefit from such discounts or rebates; and

(9) A description of the security-based swap data repository's governance arrangements.

§ 240.13n-11 Designation of chief compliance officer of security-based swap data repository.

(a) In general. Each security-based swap data repository shall identify on Form SDR (17 CFR 249.1500) a person who has been designated by the board to serve as a chief compliance officer of the security-based swap data repository. The compensation and removal of the chief compliance officer shall require the approval of a majority of the security-based swap data repository's board.

(b) Definitions. For purposes of this section –

(1) Affiliate of a security-based swap data repository means a person that, directly or indirectly, controls, is controlled by, or is under common control with the security-based swap data repository.

(2) Board means the board of directors of the security-based swap data repository or a body performing a function similar to the board of directors of the security-based swap data repository.

(3) Director means any member of the board.

(4) EDGAR Filer Manual has the same meaning as set forth in Rule 11 of Regulation S-T (17 CFR 232.11).

(5) Material change means a change that a chief compliance officer would reasonably need to know in order to oversee compliance of the security-based swap data repository.

(6) Material compliance matter means any compliance matter that the board would reasonably need to know to oversee the compliance of the security-based swap data repository and that involves, without limitation:

(i) A violation of the federal securities laws by the security-based swap data repository, its officers, directors, employees, or agents;

(ii) A violation of the policies and procedures of the security-based swap data repository by the security-based swap data repository, its officers, directors, employees, or agents; or

(iii) A weakness in the design or implementation of the policies and procedures of the security-based swap data repository.

(7) Tag (including the term tagged) means an identifier that highlights specific information submitted to the Commission that is in the format required by the EDGAR Filer Manual, as described in Rule 301 of Regulation S-T (17 CFR 232.301).

(c) Duties. Each chief compliance officer of a security-based swap data repository shall:

(1) Report directly to the board or to the chief executive officer of the security-based swap data repository;

(2) Review the compliance of the security-based swap data repository with respect to the requirements and core principles described in Section 13(n) of the Act (15 U.S.C. 78m(n)) and the rules and regulations thereunder;

(3) In consultation with the board or the chief executive officer of the security-based swap data repository, resolve any conflicts of interest that may arise;

(4) Be responsible for administering each policy and procedure that is required to be established pursuant to Section 13 of the Act (15 U.S.C. 78m) and the rules and regulations thereunder;

(5) Ensure compliance with the Act and the rules and regulations thereunder relating to security-based swaps, including each rule prescribed by the Commission under Section 13 of the Act (15 U.S.C. 78m);

(6) Establish procedures for the remediation of noncompliance issues identified by the chief compliance officer through any –

(i) Compliance office review;

(ii) Look-back;

(iii) Internal or external audit finding;

(iv) Self-reported error; or

(v) Validated complaint; and

(7) Establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of noncompliance issues.

(d) Annual reports.

(1) In general.- The chief compliance officer shall annually prepare and sign a report that contains a description of the compliance of the security-based swap data repository with respect to the Act and the rules and regulations thereunder and each policy and procedure of the security-based swap data repository (including the code of ethics and conflicts of interest policies of the security-based swap data repository). Each compliance report shall also contain, at a minimum, a description of:

(i) The security-based swap data repository's enforcement of its policies and procedures;

(ii) Any material changes to the policies and procedures since the date of the preceding compliance report;

(iii) Any recommendation for material changes to the policies and procedures as a result of the annual review, the rationale for such recommendation, and whether such policies and procedures were or will be modified by the security-based swap data repository to incorporate such recommendation; and

(iv) Any material compliance matters identified since the date of the preceding compliance report.

(2) Requirements. A financial report of the security-based swap data repository shall be filed with the Commission as described in paragraph (f) of this section and shall accompany a compliance report as described in paragraph (d)(1) of this section. The compliance report shall include a certification that, under penalty of law, the compliance report is accurate and complete. The compliance report shall also be filed in a tagged data format in accordance with the instructions contained in the EDGAR Filer Manual, as described in Rule 301 of Regulation S-T (17 CFR 232.301).

(e) The chief compliance officer shall submit the annual compliance report to the board for its review prior to the submission of the report to the Commission.

(f) Financial report. Each financial report filed with a compliance report shall:

(1) Be a complete set of financial statements of the security-based swap data repository that are prepared in accordance with U.S. generally accepted accounting principles for the most recent two fiscal years of the security-based swap data repository;

(2) Be audited in accordance with the standards of the Public Company Accounting Oversight Board by a registered public accounting firm that is qualified and independent in accordance with Rule 2-01 of Regulation S-X (17 CFR 210.2-01);

(3) Include a report of the registered public accounting firm that complies with paragraphs (a) through (d) of Rule 2-02 of Regulation S-X (17 CFR 210.2-02);

(4) If the security-based swap data repository's financial statements contain consolidated information of a subsidiary of the security-based swap data repository, provide condensed financial information, in a financial statement footnote, as to the financial position, changes in financial position and results of operations of the security-based swap data repository, as of the same dates and for the same periods for which audited consolidated financial statements are required. Such financial information need not be presented in greater detail than is required for condensed statements by Rules 10-01(a)(2), (3), and (4) of Regulation S-X (17 CFR 210.10-01). Detailed footnote disclosure that would normally be included with complete financial statements may be omitted with the exception of disclosures regarding material contingencies, long-term obligations, and guarantees. Descriptions of significant provisions of the security-based swap data repository's long-term obligations, mandatory dividend or redemption requirements of redeemable stocks, and guarantees of the security-based swap data repository shall be provided along with a five-year schedule of maturities of debt. If the material contingencies, long-term obligations, redeemable stock requirements, and guarantees of the security-based swap data repository have been separately disclosed in the consolidated statements, then they need not be repeated in this schedule; and

(5) Be provided in eXtensible Business Reporting Language consistent with Rules 405 (a)(1), (a)(3), (b), (c), (d), and (e) of Regulation S-T (17 CFR 232.405).

(g) Reports filed pursuant to paragraphs (d) and (f) of this section shall be filed within 60 days after the end of the fiscal year covered by such reports.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq. and 7201; and 18 U.S.C. et seq. unless otherwise noted.

4. Subpart P and § 249.1500 are added to read as follows:

Subpart P – FORM FOR REGISTRATION OF SECURITY-BASED SWAP DATA REPOSITORIES

§ 249.1500. Form SDR, application for registration as a security-based swap data repository.

[Note: The text of Form SDR does not, and the amendments will not, appear in the Code of Federal Regulations.]

The form shall be used for registration as a security-based swap data repository, and for the amendments to, such registration pursuant to Section 13(n) of the Exchange Act (15 U.S.C. 78m(n)).

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

FORM SDR

APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION AS SECURITY-BASED SWAP DATA REPOSITORY UNDER THE SECURITIES EXCHANGE ACT OF 1934

GENERAL INSTRUCTIONS FOR PREPARING AND FILING FORM SDR

1. Form SDR and Exhibits thereto are to be filed electronically in a tagged data format with the Securities and Exchange Commission by an applicant for registration as a security-based swap data repository, or by a registered security-based swap data repository amending its registration, pursuant to Section 13(n) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 13n-1 thereunder. No application for registration shall be effective unless the Commission grants such registration.

2. Individuals' names shall be given in full (last name, first name, middle name).

3. Form SDR shall be signed by a person who is duly authorized to act on behalf of the security-based swap data repository.

4. If Form SDR is being filed as an application for registration, all applicable items must be answered in full. If any item is not applicable, indicate by "none" or "N/A" as appropriate.

5. Disclosure of the information specified on this form is mandatory prior to processing of an application for registration as a security-based swap data repository. The information will be used for the principal purpose of determining whether the Commission should grant or deny registration to an applicant. Except in cases where confidential treatment is requested by the applicant and granted by the Commission pursuant to the Freedom of Information Act and the rules of the Commission thereunder, information supplied on this form will be included routinely in the public files of the Commission and will be available for inspection by any interested person. A form that is not prepared and executed in compliance with applicable requirements may be deemed as not acceptable for filing. Acceptance of this form, however, shall not constitute any finding that it has been filed as required or that the information submitted is true, current, or complete. Intentional misstatements or omissions of fact constitute federal criminal violations (see 18 U.S.C. § 1001 and 15 U.S.C. § 78ff(a)).

6. Rule 13n-1(c) under the Exchange Act requires a security-based swap data repository to amend promptly Form SDR if any information contained in items 1 through 16, 25, and 44 of this application, or any supplement or amendment thereto, is or becomes inaccurate for any reason.

7. For the purposes of this form, the term "applicant" includes any applicant for registration as a security-based swap data repository or any registered security-based swap data repository that is amending Form SDR.

8. Applicants filing Form SDR as an amendment (other than an annual amendment) need file only the cover page (items 1 through 3), the signature page (item 12), and any pages on which an answer is being amended, together with such exhibits as are being amended. An applicant submitting an amendment represents that all unamended items and exhibits remain true, current, and complete as previously filed.

DEFINITIONS: Unless the context requires otherwise, all terms used in this form have the same meaning as in the Exchange Act, as amended, and in the rules and regulations of the Commission thereunder.

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

FORM SDR

APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION AS SECURITY-BASED SWAP DATA REPOSITORY UNDER THE SECURITIES EXCHANGE ACT OF 1934

____
(Exact Name of Applicant as Specified in Charter)

____
(Address of Principal Executive Offices)

If this is an APPLICATION for registration, complete in full and check here . . . . ☐

If this is an AMENDMENT to an application, or to an effective registration (including an annual amendment), list all items that are amended and check here . . . . ☐

____

____

____

GENERAL INFORMATION

1. Name under which business is conducted, if different than name specified herein: ____________________

____

2. If name of business is amended, state previous business name: ____________________

____

3. Mailing address, if different than address specified herein: ____________________

____
(Number and Street)

____
(City) (State) (Zip Code)

4. List of principal office(s) and address(es) where security-based swap data repository activities are conducted:

Office	Address

5. If the applicant is a successor (within the definition of Rule 12b-2 under the Exchange Act) to a previously registered security-based swap data repository, please complete the following:

   a. Date of succession ____________________

   b. Full name and address of predecessor security-based swap data repository ____________________

   ____
   (Name)

   ____
   (Number and Street)

   ____
   (City) (State) (Zip Code)

6. List all asset classes of security-based swaps for which the applicant is collecting and maintaining or for which it proposes to collect and maintain.

   ____

   ____

7. Furnish a description of the function(s) that the applicant performs or proposes to perform. ____________________

   ____

   ____

   ____

BUSINESS ORGANIZATION

8. Applicant is a: ☐ Corporation
   ☐ Partnership
   ☐ Other Form of Organization (Specify) ____________________

9. If Applicant is a corporation:

   a. Date of incorporation ____________________

b. Place of incorporation or state/country of formation ______________________

10. If Applicant is a partnership:

a. Date of filing of partnership articles ______________________

b. Place where partnership agreement was filed ______________________

11. Applicant understands and consents that any notice or service of process, pleadings, or other documents in connection with any action or proceeding against the applicant may be effectuated by certified mail to the officer specified or person named below at the U.S. address given. Such officer or person cannot be a Commission member, official, or employee.

____
(Name of Person or, if Applicant is a Corporation, Title of Officer)

____
(Name of Applicant or Applicable Entity)

____
(Number and Street)

____
(City) (State) (Zip Code)

____
(Area Code) (Telephone Number)

12. SIGNATURES: Applicant has duly caused this application or amendment to be signed on its behalf by the undersigned, hereunto duly authorized, this __________ day of ______________________, ________. Applicant and the undersigned hereby represent that all information contained herein is true, current, and complete. It is understood that all required items and exhibits are considered integral parts of this form and that the submission of any amendment represents that all unamended items and Exhibits remain true, current, and complete as previously filed. If the applicant is a non-resident security-based swap data repository, Applicant and the undersigned further represent that the applicant can, as a matter of law, provide the Commission with prompt access to the applicant's books and records and that the applicant can submit to an onsite inspection and examination by the Commission. For purposes of this certification, "non-resident security-based swap data repository" means (i) in the case of an individual, one who resides in or has his principal place of business in any place not in the United States; (ii) in the case of a corporation, one incorporated in or having its principal place of business in any place not in the United States; or (iii) in the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not in the United States.

____
(Name of Applicant)

____
(Signature of General Partner, Managing Agent or Principal Officer)

____
(Title)

EXHIBITS — BUSINESS ORGANIZATION

13. List as Exhibit A any person as defined in Section 3(a)(9) of the Exchange Act that owns 10 percent or more of the applicant's stock or that, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the applicant. State in Exhibit A the full name and address of each such person and attach a copy of the agreement or, if there is none written, describe the agreement or basis upon which such person exercises or may exercise such control or direction.

14. Attach as Exhibit B the following information about the chief compliance officer who has been appointed by the board of directors of the security-based swap data repository or a person or group performing a function similar to such board of directors:

    a. Name
    b. Title
    c. Date of commencement and, if appropriate, termination of present term of position
    d. Length of time the chief compliance officer has held the same position
    e. Brief account of the business experience of the chief compliance officer over the last five years
    f. Any other business affiliations in the securities industry or OTC derivatives industry
    g. Details of:

        (1) any order of the Commission with respect to such person pursuant to Sections 15(b)(4), 15(b)(6), 19(h)(2), or 19(h)(3) of the Exchange Act;
        (2) any conviction or injunction of a type described in Sections 15(b)(4)(B) or (C) of the Exchange Act within the past ten years;
        (3) any action of a self-regulatory organization with respect to such person imposing a final disciplinary sanction pursuant to Sections 6(b)(6), 15A(b)(7), or 17A(b)(3)(G) of the Exchange Act;
        (4) any final action by a self-regulatory organization with respect to such person constituting a denial, bar, prohibition, or limitation of membership, participation, or association with a member, or of access to services offered by, such organization of a member thereof; and
        (5) any final action by another federal regulatory agency, including the Commodity Futures Trading Commission, any state regulatory agency, or any foreign financial regulatory authority resulting in:
            i. a finding that such person has made a false statement or omission, or has been dishonest, unfair, or unethical;
            ii. a finding that such person has been involved in a violation of any securities-related regulations or statutes;
            iii. a finding that such person has been a cause of a business having its authorization to do business denied, suspended, revoked, or restricted;
            iv. an order entered, in the past ten years, against such person in connection with a securities-related activity; or
            v. any disciplinary sanction, including a denial, suspension, or revocation of such person's registration or license or otherwise, by order, a prevention from associating with a securities-related business or a restriction of such person's activities.

15. Attach as Exhibit C a list of the officers, directors, governors, and persons performing similar functions, and the members of all standing committees grouped by committee of the security-based swap data repository or of the entity identified in item 18 that performs the security-based swap data repository activities of the applicant, indicating for each:

    a. Name
    b. Title
    c. Dates of commencement and, if appropriate, termination of present term of office or position
    d. Length of time each present officer, director, governor, persons performing similar functions, or member of a standing committee has held the same office or position
    e. Brief account of the business experience of each officer, director, governor, persons performing similar functions, or member of a standing committee over the last five years
    f. Any other business affiliations in the securities industry or OTC derivatives industry

g. Details of:

(1) any order of the Commission with respect to such person pursuant to Sections 15(b)(4), 15(b)(6), 19(h)(2), or 19(h)(3) of the Exchange Act;
(2) any conviction or injunction of a type described in Sections 15(b)(4)(B) or (C) of the Exchange Act within the past ten years;
(3) any action of a self-regulatory organization with respect to such person imposing a final disciplinary sanction pursuant to Sections 6(b)(6), 15A(b)(7), or 17A(b)(3)(G) of the Exchange Act;
(4) any final action by a self-regulatory organization with respect to such person constituting a denial, bar, prohibition, or limitation of membership, participation, or association with a member, or of access to services offered by, such organization of a member thereof; and
(5) any final action by another federal regulatory agency, including the Commodity Futures Trading Commission, any state regulatory agency, or any foreign financial regulatory authority resulting in:
   i. a finding that such person has made a false statement or omission, or has been dishonest, unfair, or unethical;
   ii. a finding that such person has been involved in a violation of any securities-related regulations or statutes;
   iii. a finding that such person has been a cause of a business having its authorization to do business denied, suspended, revoked, or restricted;
   iv. an order entered, in the past ten years, against such person in connection with a securities-related activity; or
   v. any disciplinary sanction, including a denial, suspension, or revocation of such person's registration or license or otherwise, by order, a prevention from associating with a securities-related business or a restriction of such person's activities.

16. Attach as Exhibit D a copy of documents relating to the governance arrangements of the applicant, including, but not limited to, the nomination and selection process of the members on the applicant's board of directors, a person or group performing a function similar to a board of directors (collectively, "board"), or any committee that has the authority to act on behalf of the board; the responsibilities of each of the board and such committee; the composition of each board and such committee; and the applicant's policies and procedures reasonably designed to ensure that the applicant's senior management and each member of the board or such committee possess requisite skills and expertise to fulfill their responsibilities in the management and governance of the applicant, to have a clear understanding of their responsibilities, and to exercise sound judgment about the applicant's affairs.

17. Attach as Exhibit E a copy of the constitution, articles of incorporation or association with all amendments thereto, existing by-laws, rules, procedures, and instruments corresponding thereto, of the applicant.

18. Attach as Exhibit F a narrative and/or graphic description of the organizational structure of the applicant. Note: If the security-based swap data repository activities of the applicant are conducted primarily by a division, subdivision, or other segregable entity within the applicant's corporation or organization, describe the relationship of such entity within the overall organizational structure and attach as Exhibit F the description that applies to the segregable entity.

19. Attach as Exhibit G a list of all affiliates of the security-based swap data repository and indicate the general nature of the affiliation. For purposes of this application, an "affiliate" of a security-based swap data repository means a person that, directly or indirectly, controls, is controlled by, or is under common control with the security-based swap data repository.

20. Attach as Exhibit H a brief description of any material pending legal proceeding(s), other than ordinary and routine litigation incidental to the business, to which the applicant or any of its affiliates is a party or to which any of its property is the subject. Include the name of the court or agency in which the proceeding(s) are pending, the date(s) instituted, the principal parties to the proceeding, a description of the factual basis alleged to underlie the proceeding(s) and the relief sought. Include similar information as to any such proceeding(s) known to be contemplated by any governmental agencies.

21. Attach as Exhibit I copies of all material contracts with any security-based swap execution facility, clearing agency, central counterparty, or third party service provider. To the extent that form contracts are used by the applicant, submit a sample of each type of form contract used. In addition, include a list of security-based swap execution facilities, clearing agencies, central counterparties, and third party service providers with whom the applicant has entered into material contracts.

22. Attach as Exhibit J procedures implemented by the applicant to minimize conflicts of interest in the decision-making process of the security-based swap data repository and to resolve any such conflicts of interest.

EXHIBITS — FINANCIAL INFORMATION

23. Attach as Exhibit K a balance sheet, statement of income and expenses, statement of sources and application of revenues and all notes or schedules thereto, as of the most recent fiscal year of the applicant. If a balance sheet and statements certified by an independent public accountant are available, such balance sheet and statement shall be submitted as Exhibit K. Alternatively, a financial report, as described in Rule 13n-11(f) under the Exchange Act, may be filed as Exhibit K.

24. Attach as Exhibit L a balance sheet and statement of income and expenses for each affiliate of the security-based swap data repository as of the end of the most recent fiscal year of each such affiliate. Alternatively, identify, if available, the most recently filed Annual Report on Form 10-K under the Exchange Act for any such affiliate as Exhibit L.

25. Attach as Exhibit M the following:

    a. A complete list of all dues, fees, and other charges imposed, or to be imposed, as well as all discounts or rebates offered, or to be offered, by or on behalf of the applicant for its services, including the security-based swap data repository's services and any ancillary services, and identify the service(s) provided for each such due, fee, other charge, discount, or rebate;

    b. A description of the basis and methods used in determining at least annually the level and structure of the services as well as the dues, fees, other charges, discounts, or rebates listed in paragraph a of this item; and

    c. If the applicant differentiates, or proposes to differentiate, among its customers, or classes of customers in the amount of any dues, fees, or other charges imposed or any discount or rebate offered for the same or similar services, then state and indicate the amount of each differential. In addition, identify and describe any differences in the cost of providing such services, and any other factors, that account for such differences.

EXHIBITS — OPERATIONAL CAPABILITY

26. Attach as Exhibit N a narrative description, or the functional specifications, of each service or function listed in item 7 and performed as a security-based swap data repository. Include a description of all procedures utilized for the collection and maintenance of information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by market participants.

27. Attach as Exhibit O a list of all computer hardware utilized by the applicant to perform the security-based swap data repository functions listed in item 7, indicating:

    a. Name of manufacturer and manufacturer's equipment identification number;

    b. Whether such hardware is purchased or leased (If leased, state from whom leased, duration of lease, and any provisions for purchase or renewal); and

    c. Where such equipment (exclusive of terminals and other access devices) is physically located.

28. Attach as Exhibit P a description of the personnel qualifications for each category of professional, non-professional, and supervisory employees employed by the security-based swap data repository or the division, subdivision, or other segregable entity within the security-based swap data repository as described in item 18.

29. Attach as Exhibit Q a description of the measures or procedures implemented by the applicant to provide for the security of any system employed to perform the functions of the security-based swap data repository. Include a general description of any physical and operational safeguards designed to prevent unauthorized access (whether by input or retrieval) to the system. Describe any circumstances within the past year in which the described security measures or safeguards failed to prevent any such unauthorized access to the system and any measures taken to prevent a reoccurrence. Describe any measures used by the applicant to satisfy itself that the information received or disseminated by the system is accurate.

30. Where security-based swap data repository functions are performed by automated facilities or systems, attach as Exhibit R a description of all backup systems or subsystems that are designed to prevent interruptions in the performance of any such function as a result of technical malfunctions or otherwise in the system itself, in any permitted input or output system connection, or as a result of any independent source.

31. Attach as Exhibit S the following:

   a. For each of the security-based swap data repository functions described in item 7:

      (1) quantify in appropriate units of measure the limits on the security-based swap data repository's capacity to receive (or collect), process, store, or display the data elements included within each function; and

      (2) identify the factors (mechanical, electronic or other) that account for the current limitations reported in answer to (1) on the security-based swap data repository's capacity to receive (or collect), process, store, or display the data elements included within each function.

   b. If the applicant is able to employ, or presently employs, its system(s) for any use other than for performing the functions of a security-based swap data repository, state the priorities of assignment of capacity between such functions and such other uses, and state the methods used or able to be used to divert capacity between such functions and other uses.

EXHIBITS — ACCESS TO SERVICES AND DATA

32. Attach as Exhibit T the following:

   a. State the number of persons who subscribe, or who have notified the applicant of their intention to subscribe, to the security-based swap data repository's services.

   b. For each instance during the past year in which any person has been prohibited or limited with respect to access to services offered or data maintained by the applicant, indicate the name of each such person and the reason for the prohibition or limitation.

   c. For each service that is furnished in machine-readable form, state the storage media of any service furnished and define the data elements of such service.

33. Attach as Exhibit U copies of all contracts governing the terms by which persons may subscribe to the security-based swap data repository services and any ancillary services provided by the applicant. To the extent that form contracts are used by the applicant, submit a sample of each type of form contract used.

34. Attach as Exhibit V a description of any specifications, qualifications, or other criteria that limit, are interpreted to limit, or have the effect of limiting access to or use of any security-based swap data repository services

offered or data maintained by the applicant and state the reasons for imposing such specifications, qualifications, or other criteria.

35. Attach as Exhibit W any specifications, qualifications, or other criteria required of persons who supply security-based swap information to the applicant for collection and maintenance by the applicant or of persons who seek to connect to or link with the applicant.

36. Attach as Exhibit X any specifications, qualifications, or other criteria required of any person, including, but not limited to, regulators, market participants, market infrastructures, venues from which data could be submitted to the applicant, and third party service providers who request access to data maintained by the applicant.

37. Attach as Exhibit Y policies and procedures implemented by the applicant to review any prohibition or limitation of any person with respect to access to services offered or data maintained by the applicant and to grant such person access to such services or data if such person has been discriminated against unfairly.

EXHIBITS — OTHER POLICIES AND PROCEDURES

38. Attach as Exhibit Z policies and procedures implemented by the applicant to protect the privacy of any and all security-based swap transaction information that the security-based swap data repository receives from a market participant or any registered entity.

39. Attach as Exhibit AA a description of safeguards, policies, and procedures implemented by the applicant to prevent the misappropriation or misuse of (a) any confidential information received by the applicant, including, but not limited to, trade data, position data, and any nonpublic personal information about a market participant or any of its customers; (b) material, nonpublic information; and/or (c) intellectual property by applicant or any person associated with the applicant for their personal benefit or the benefit of others.

40. Attach as Exhibit BB policies and procedures implemented by the applicant regarding its use of the security-based swap transaction information that it receives from a market participant, any registered entity, or any person for non-commercial and/or commercial purposes.

41. Attach as Exhibit CC procedures and a description of facilities of the applicant for effectively resolving disputes over the accuracy of the transaction data and positions that are recorded in the security-based swap data repository.

42. Attach as Exhibit DD policies and procedures relating to the applicant's calculation of positions.

43. Attach as Exhibit EE policies and procedures implemented by the applicant to prevent any provision in a valid security-based swap from being invalidated or modified through the procedures or operations of the applicant.

44. Attach as Exhibit FF a plan to ensure that the transaction data and position data that are recorded in the applicant continue to be maintained after the applicant withdraws from registration as a security-based swap data repository, which shall include procedures for transferring the transaction data and position data to the Commission or its designee (including another registered security-based swap data repository).

45. Attach as Exhibit GG all of the policies and procedures required under Regulation SBSR.

EXHIBIT — LEGAL OPINION

46. If the applicant is a non-resident security-based swap data repository, then attach as Exhibit HH an opinion of counsel that the security-based swap data repository can, as a matter of law, provide the Commission with prompt access to the books and records of such security-based swap data repository and that the security-based swap data repository can, as a matter of law, submit to onsite inspection and examination by the Commission.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: November 19, 2010

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

Release No. 34-63346; File No. S7-34-10
RIN 3235-AK80

Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: In accordance with Section 763 ("Section 763") and Section 766 ("Section 766") of Title VII ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Securities and Exchange Commission ("SEC" or "Commission") is proposing Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information ("Regulation SBSR") under the Securities Exchange Act of 1934 ("Exchange Act").[1] Proposed Regulation SBSR would provide for the reporting of security-based swap information to registered security-based swap data repositories or the Commission and the public dissemination of security-based swap transaction, volume, and pricing information. Registered security-based swap data repositories would be required to establish and maintain certain policies and procedures regarding how transaction data are reported and disseminated, and participants of registered security-based swap data repositories that are security-based swap dealers or major security-based swap participants would be required to establish and maintain policies and procedures that are reasonably designed to ensure that they comply with applicable reporting obligations. Finally, proposed Regulation SBSR also would require a registered SDR to register with the Commission as a securities information processor on existing Form SIP.

[1] 15 U.S.C. 78a et seq. All references in this release to the Exchange Act refer to the Securities Exchange Act of 1934, as amended by the Dodd-Frank Act.

DATES: Comments should be received on or before [insert date 45 days after publication in Federal Register].

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/final.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-   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 Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number **S7-34-10**. 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 Web site viewing and printing 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Michael Gaw, Assistant Director, at (202) 551-5602, David Michehl, Senior Special Counsel, at (202) 551-5627, Sarah Albertson, Special

Counsel, at (202) 551-5647, Natasha Cowen, Special Counsel, at (202) 551-5652, Yvonne Fraticelli, Special Counsel, at (202) 551-5654, Geoffrey Pemble, Special Counsel, at (202) 551-5628, Brian Trackman, Special Counsel, at (202) 551-5616, Mia Zur, Special Counsel, at (202) 551-5638, Kathleen Gray, Attorney, at (202) 551-5305, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is proposing Regulation SBSR under the Exchange Act providing for the reporting of security-based swap information to registered security-based swap data repositories or the Commission, and the public dissemination of security-based swap transaction, volume, and pricing information. The Commission is soliciting comments on all aspects of the proposed rules and will carefully consider any comments received.

I. Introduction

A. Background

On July 21, 2010, the President signed the Dodd-Frank Act into law.[2] The Dodd-Frank Act was enacted to, among other things, promote the financial stability of the United States by improving accountability and transparency in the financial system.[3] Title VII of the Dodd-Frank Act provides the Commission and the Commodity Futures Trading Commission ("CFTC") with the authority to regulate over-the-counter ("OTC") derivatives in light of the recent financial crisis, which demonstrated the need for enhanced regulation in the OTC derivatives markets. The Dodd-Frank Act is intended to close loopholes in the existing regulatory structure and to provide the Commission and the CFTC with effective regulatory tools to oversee the OTC

2 The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, H.R. 4173).

3 See id. at Preamble.

derivatives markets, which have grown exponentially in recent years and are capable of affecting significant sectors of the U.S. economy. The primary goals of Title VII, among others, are to increase the transparency and efficiency of the OTC derivatives markets and to reduce the potential for counterparty and systemic risk.[4]

The Dodd-Frank Act provides that the CFTC will regulate "swaps," the Commission will regulate "security-based swaps" ("SBSs"), and the CFTC and the Commission will jointly regulate "mixed swaps."[5] The Dodd-Frank Act amends the Exchange Act to require the Commission to adopt rules providing for, among other things (1) the reporting of SBSs to a

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4 See "Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision and Regulation," U.S. Department of Treasury, pp. 47-48 (June 17, 2009).

5 Section 712(d) of the Dodd-Frank Act provides that the Commission and the CFTC, in consultation with the Board of Governors of the Federal Reserve System ("Federal Reserve"), shall jointly further define the terms "swap," "security-based swap," "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," "eligible contract participant," and "security-based swap agreement." These terms are defined in Sections 721 and 761 of the Dodd-Frank Act and, with respect to the term "eligible contract participant," in Section 1a(18) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 1a(18), as re-designated and amended by Section 721 of the Dodd-Frank Act. Further, Section 721(c) of the Dodd-Frank Act requires the CFTC to adopt a rule to further define the terms "swap," "swap dealer," "major swap participant," and "eligible contract participant," and Section 761(b) of the Dodd-Frank Act requires the Commission to adopt a rule to further define the terms "security-based swap," "security-based swap dealer," "major security-based swap participant," and "eligible contract participant," with regard to SBSs, for the purpose of including transactions and entities that have been structured to evade Title VII of the Dodd-Frank Act. Finally, Section 712(a) of the Dodd-Frank Act provides that the Commission and CFTC, after consultation with the Federal Reserve, shall jointly prescribe regulations regarding "mixed swaps," as may be necessary to carry out the purposes of Title VII. To assist the Commission and CFTC in further defining the terms specified above, and to prescribe regulations regarding "mixed swaps" as may be necessary to carry out the purposes of Title VII, the Commission and the CFTC sought comment from interested parties. See Securities Exchange Act Release No. 62717 (August 13, 2010), 75 FR 51429 (August 20, 2010) (File No. S7-16-10) (advance joint notice of proposed rulemaking regarding definitions contained in Title VII of the Dodd-Frank Act) ("Definitions Release").

registered security-based swap data repository ("SDR")[6] or to the Commission; and (2) real-time public dissemination of SBS transaction, volume, and pricing information.[7] To fulfill these requirements, the Commission today is proposing Regulation SBSR, which would be comprised of Rules 900 to 911 under the Exchange Act. In preparation for the rulemakings required by the Dodd-Frank Act, the Commission and the CFTC held a joint public roundtable (the "Market Data Roundtable") on September 14, 2010, to gain further insight into many of the issues addressed in this proposal.[8] In addition, the Commission has offered the opportunity for the public to express its views on the Commission rulemakings required by the Dodd-Frank prior to proposing rules.[9] The rules proposed today generally take into account the views expressed at the Market Data Roundtable, as well as any comments received.

In a separate release, the Commission is today proposing new rules under the Exchange Act governing the security-based swap data repository registration process, duties, and core

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6 A SDR is "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security based swaps." See Section 3(a)(75) of the Exchange Act, 15 U.S.C. 78c(a)(75). The Commission is also proposing today new Rules 13n-1 through 13n-11 under the Exchange Act relating to the SDR registration process, the duties of SDRs, and the core principles for operating a registered SDR. See Securities Exchange Act Release No. 63347 (November 19, 2010) ("SDR Registration Proposing Release").

7 Rules governing the reporting and dissemination of swaps are the subject of a separate rulemaking by the CFTC.

8 The Commission and the CFTC solicited comments on the Market Data Roundtable. See Securities Exchange Act Release No. 62863 (September 8, 2010), 75 FR 55575 (September 13, 2010). Comments received by the Commission are available at http://www.sec.gov/cgi-bin/ruling-comments?ruling=df-title-vii-real-time-reporting&rule_path=/comments/df-title-vii/real-time-reporting&file_num=DF%20Title%20VII%20-%20Real%20Time%20Reporting&action=Show_Form&title=Real-Time%20Reporting%20-%20Title%20VII%20Provisions%20of%20the%20Dodd-Frank%20Wall%20Street%20Reform%20and%20Consumer%20Protection%20Act.

9 See http://www.sec.gov/spotlight/regreformcomments.shtml.

principles.[10] Proposed Rules 13n-1 through 13n-11 under the Exchange Act would, among other things, require SDRs to comply with the requirements and core principles described in Section 13(n) of the Exchange Act. An SDR also would be required to appoint a chief compliance officer and specify the duties of the chief compliance officer.

Taken together, the rules that the Commission proposes today would establish comprehensive regulation of SBS data and thus provide transparency for SBSs to regulators and the markets. The proposed rules would require SBS transaction information to be (1) provided to registered SDRs in accordance with uniform data standards; (2) verified and maintained by registered SDRs, which would serve as secure, centralized recordkeeping facilities that are accessible by regulators and relevant authorities; and (3) publicly disseminated in a timely fashion by registered SDRs. In combination, these proposed rules are designed to promote transparency and efficiency in the SBS markets and create an infrastructure to assist the Commission and other regulators in performing their market oversight functions.

In proposing these rules, the Commission is mindful that there may be differences between the SBS market and the other securities markets that the Commission regulates. For example, though the marketplace has developed standardized terms for various types of SBSs, contracts are nevertheless customizable. Furthermore, unlike bonds or equity securities, SBSs are not today readily fungible. The liquidity characteristics of SBSs also may differ in comparison with other markets. Relative to the overall equity markets, SBSs trade much less frequently, though the trading frequency of some illiquid equities would be comparable to that of some SBSs. The liquidity of SBSs compared to the bond market depends on the specifics of the SBS and the bond (e.g., Treasury, corporate, municipal). Many bonds do not have standardized

[10] See SDR Registration Proposing Release, supra note 6.

SBS analogs and would therefore be more liquid than bespoke customizable SBS contracts that would function as the analog. But some market participants have found the SBSs written on some issuers and securities to be more liquid and readily tradable during certain periods of time than the underlying securities themselves.

Another notable distinction is that the SBS market does not generally have the equivalent of a "retail" segment characterized by a high-volume of small-sized trades. Though some swaps on some interest rates, indices, and currencies may support high volumes, many SBSs trade infrequently. For example, an analysis by the staff of trading in single-name credit default swaps ("CDS") show that approximately 90% of single-name CDS on corporate issuers trade at an average of five times or less per day, with an average trade size of over $5 million.[11] This same analysis shows that 89% of single-name CDS on sovereign issuers trade at an average of ten times or less per day, with an average trade size of over $12 million.

The Commission also is mindful that, both over time and as a result of Commission proposals to implement the Dodd-Frank Act, the further development of the SBS market may alter some of the specific calculus for future regulation of reporting and real-time public dissemination of SBS transaction information. During the process of implementing the Dodd-Frank Act and beyond, the Commission will therefore closely monitor developments in the SBS market.

B. Overview of Security-Based Swap Reporting and Dissemination Requirements in the Dodd-Frank Act

1. Security-Based Swap Reporting Requirements

[11] This analysis is based on a sample of dollar-quoted, gold record transactions submitted to the Depository Trust & Clearing Corporation ("DTCC") between August 1, 2009, and July 30, 2010.

The Dodd-Frank Act adds several provisions to the Exchange Act that require the reporting of information relating to SBSs. Section 3C(e) of the Exchange Act[12] requires the Commission to adopt rules that provide for the reporting of SBS data as follows: (1) SBSs entered into before the date of enactment of Section 3C shall be reported to a registered SDR or the Commission no later than 180 days after the effective date of Section 3C (i.e., 540 days after the enactment of the Dodd-Frank Act); and (2) SBSs entered into on or after the date of enactment of Section 3C shall be reported to a registered SDR or to the Commission no later than the later of (1) 90 days after the effective date of Section 3C (i.e., 450 days after the enactment of the Dodd-Frank Act), or (2) such other time after entering into the SBS as the Commission may prescribe by rule or regulation.

In addition, Section 13A(a)(1) of the Exchange Act[13] requires that each SBS that is not accepted for clearing by any clearing agency or derivatives clearing organization be reported to (1) an SDR, or (2) in the case in which there is no SDR that would accept such SBS, to the Commission, within such time period as the Commission may by rule or regulation prescribe. Section 13(m)(1)(G) of the Exchange Act[14] provides, further, that each SBS (whether cleared or uncleared) shall be reported to a registered SDR. Section 13(m)(1)(F) of the Exchange Act[15] states that the parties to a SBS, including agents of the parties to a SBS, shall be responsible for reporting SBS transaction information to the appropriate registered entity in a timely manner as may be prescribed by the Commission.[16]

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12 15 U.S.C. 78c-3(e).

13 15 U.S.C. 78m-1(a)(1).

14 15 U.S.C. 78m(1)(G).

15 15 U.S.C. 78m(m)(1)(F).

16 In addition, Section 13A(a)(2) of the Exchange Act requires the Commission to adopt an interim final rule providing for the reporting of SBSs entered into before the date of

Section 13(n)(4)(A)(i) of the Exchange Act[17] requires the Commission to prescribe standards that specify the data elements for each SBS that must be collected and maintained by each registered SDR. Further, Section 13(n)(4)(A)(ii) of the Exchange Act[18] requires the Commission, in carrying out Section 13(n)(4)(A)(i) of the Exchange Act, to prescribe consistent data element standards applicable to registered entities and reporting counterparties. Under Section 13(n)(5) of the Exchange Act, a registered SDR must, among other things, maintain the SBS data it collects in the form and manner prescribed by the Commission, provide the Commission or its designee with direct electronic access, and make SBS data available on a confidential basis, upon request, to certain regulatory authorities.[19]

2. Security-Based Swap Dissemination Requirements

Section 13(m)(1)(B) of the Exchange Act[20] authorizes the Commission to make SBS transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery, subject to the general requirement in Section 13(m)(1)(C) of the Exchange Act[21] that all SBS transactions be subject to real-time public reporting. Section 13(m)(1)(C) authorizes the Commission to provide by rule for the public availability of SBS transaction, volume, and pricing data as follows:

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enactment of the Dodd-Frank Act the terms of which had not expired as of that date.. To satisfy this requirement, the Commission adopted Rule 13Aa-2T under the Exchange Act, an interim final temporary rule for the reporting of such SBSs. See Securities Exchange Act Release No. 63094 ("Interim Rule Release").

17 15 U.S.C. 78(n)(4)(A)(i).

18 15 U.S.C. 78(n)(4)(A)(ii).

19 These responsibilities of registered SDRs under Section 13(n)(5) of the Exchange Act, 15 U.S.C. 78m(n)(5), will be the subject of a separate Commission rulemaking. See SDR Registration Proposing Release, supra note 6.

20 15 U.S.C. 78m(m)(1)(B).

21 15 U.S.C. 78m(m)(1)(C).

(1) With respect to those SBSs that are subject to the mandatory clearing requirement described in Section 3C(a)(1) of the Exchange Act (including those SBSs that are excepted from the requirement pursuant to Section 3C(g) of the Exchange Act), the Commission shall require real-time public reporting for such transactions;[22]

(2) With respect to those SBSs that are not subject to the mandatory clearing requirement described in Section 3C(a)(1) of the Exchange Act, but are cleared at a registered clearing agency, the Commission shall require real-time public reporting for such transactions;

(3) With respect to SBSs that are not cleared at a registered clearing agency and which are reported to a SDR or the Commission under Section 3C(a)(6),[23] the Commission shall require real-time public reporting for such transactions, in a manner that does not disclose the business transactions and market positions of any person; and

(4) With respect to SBSs that are determined to be required to be cleared under Section 3C(b) of the Exchange Act but are not cleared, the Commission shall require real-time public reporting for such transactions.[24]

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22 Section 3C(a)(1) of the Exchange Act provides that it shall be unlawful for any person to engage in a SBS unless that person submits such SBS for clearing to a clearing agency that is registered under the Exchange Act or a clearing agency that is exempt from registration under the Exchange Act if the SBS is required to be cleared. Section 3C(g)(1) of the Exchange Act provides that requirements of Section 3C(a)(1) will not apply to a SBS if one of the counterparties to the SBS (1) is not a financial entity; (2) is using SBSs to hedge or mitigate commercial risk; and (3) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared SBSs.

23 The reference in Section 13(m)(1)(C)(iii) of the Exchange Act to Section 3C(a)(6) of the Exchange Act is incorrect. Section 3C of the Exchange Act does not contain a paragraph (a)(6).

24 Section 3C(b)(1) of the Exchange Act requires the Commission to review on an ongoing basis each SBS, or any group, category, type, or class of SBS to make a determination that such SBS, or group, category, type, or class of SBS should be required to be cleared.

Section 13(m)(1)(A) of the Exchange Act[25] states that the term "real-time public reporting" means to report data relating to a SBS transaction, including price and volume, as soon as technologically practicable after the time at which the SBS transaction has been executed.

With respect to SBSs that are subject to Sections 13(m)(1)(C)(i) and (ii) of the Exchange – i.e., SBSs that are subject to the mandatory clearing requirement in Section 3C(a)(1) (including those SBSs that are not cleared pursuant to the exception in Section 3C(g)(1)) and SBSs that are not subject to the mandatory clearing requirement in Section 3C(a)(1) but are cleared – Section 13(m)(1)(E) of the Exchange Act[26] requires that the Commission's rule providing for the public availability of SBS transaction and pricing data contain provisions to: (1) ensure that such information does not identify the participants; (2) specify the criteria for determining what constitutes a large notional SBS transaction (block trade) for particular markets and contracts; (3) specify the appropriate time delay for reporting large notional SBS transactions (block trades) to the public; and (4) that take into account whether public disclosure will materially reduce market liquidity.

Section 13(m)(1)(D) of the Exchange Act[27] authorizes the Commission to require registered entities[28] to publicly disseminate the SBS transaction and pricing data required to be reported under Section 13(m)(1) of the Exchange Act. In addition, Section 13(n)(5)(D)(ii) of the

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25 15 U.S.C. 78m(m)(1)(A).

26 15 U.S.C. 78m(m)(1)(E).

27 15 U.S.C. 78m(m)(1)(D).

28 The Exchange Act does not define the term "registered entity" or "registered entities." The Commission believes that the term "registered entities" in Sections 13(m)(1)(F) and 13(n)(4)(A)(ii) of the Exchange Act includes registered SDRs because SDRs are required to register with the Commission pursuant to Section 13(n) of the Exchange Act, 15 U.S.C. 78m(n).

Exchange Act states that a registered SDR shall provide data "in such form and at such frequency as the Commission may require to comply with the public reporting requirements set forth in subsection (m)."[29]

II. Description of Proposed Rules

A. Overview

In general, proposed Regulation SBSR would provide for the reporting of three broad categories of SBS information: (1) information that would be required to be reported to a registered SDR in real time and publicly disseminated;[30] (2) additional information that would be required to be reported to a registered SDR or, if there is no registered SDR that would receive such information, to the Commission, within specified timeframes, but that would not be publicly disseminated; and (3) information about "life cycle events", as defined in proposed Rule 900[31] and discussed below, that would be reported as a result of a change to information previously reported for a SBS. As described in greater detail below, proposed Regulation SBSR would identify the SBS transaction information that would be required to be reported, establish reporting obligations, and specify the timeframes for reporting and disseminating information.

In addition, proposed Regulation SBSR would require a registered SDR to publicly disseminate the SBS information that would be required to be reported in real time. Proposed

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29 15 U.S.C. 78m(n)(5)(D)(ii).

30 See proposed Rule 900 (defining "real time" to mean, with respect to the reporting of SBS information, as soon as technologically practicable, but in no event later than 15 minutes after the time of execution of the SBS, and defining "time of execution" as the point at which the counterparties to a SBS become irrevocably bound under applicable law). See also infra Section III (discussing proposed rules relating to real-time public dissemination of SBS transaction information).

31 Proposed Rule 900 would provide definitions of various terms used in proposed Regulation SBSR and further provide that terms that appear in Section 3 of the Exchange Act, 15 U.S.C. 78c, would have the same meaning as in Section 3 and the rules or regulations thereunder.

Regulation SBSR also would require a registered SDR to register with the Commission as a securities information processor ("SIP") on existing Form SIP.

B. Who must report

Section 13(m)(1)(F) of the Exchange Act[32] provides that parties to a SBS (including agents of parties to a SBS) shall be responsible for reporting SBS transaction information to the appropriate registered entity in a timely manner as may be prescribed by the Commission. Section 13A(a)(3) of the Exchange Act[33] specifies the party obligated to report SBSs that are not accepted by any clearing agency or derivative clearing organization. Proposed Rule 901(a) would specify which counterparty is the "reporting party" for a SBS, thereby implementing Sections 13(m)(1)(F) and 13A(a)(3) of the Exchange Act, as follows:

- With respect to a SBS in which only one counterparty is a security-based swap dealer ("SBS dealer") or major security-based swap participant ("major SBS participant"),[34] the SBS dealer or major SBS participant shall be the reporting party;
- With respect to a SBS in which one counterparty is a SBS dealer and the other counterparty is a major SBS participant, the SBS dealer shall be the reporting party; and
- With respect to any other SBS not described in the first two cases, the counterparties to the SBS shall select a counterparty to be the reporting party.

The Exchange Act, as modified by the Dodd-Frank Act, does not explicitly specify which counterparty should be the reporting party for those SBSs that are cleared by a clearing agency or derivative clearing organization. The Commission preliminarily believes that, for the sake of

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32 15 U.S.C. 78m(m)(1)(F).

33 15 U.S.C. 78m[A(a)(3)].

34 See 15 U.S.C. 78c(a)(71) (defining "security-based swap dealer"); 15 U.S.C. 78c(a)(67) (defining "major security-based swap participant"). See also supra note 5.

uniformity and ease of applicability, the duty to report a SBS should attach to the same counterparty regardless of whether the SBS is cleared or uncleared. In addition, the Commission preliminarily believes that SBS dealers and major SBS participants generally should have the responsibility to report SBS transactions, as they are more likely than other counterparties to have appropriate systems in place to facilitate reporting.

Accordingly, with respect to a SBS where both counterparties are U.S. persons,[35] proposed Rule 901(a) would assign reporting responsibilities as follows:

- With respect to a SBS in which only one counterparty is a SBS dealer or major SBS participant, the SBS dealer or major SBS participant would be the reporting party;
- With respect to a SBS in which one counterparty is a SBS dealer and the other counterparty is a major SBS participant, the SBS dealer would be the reporting party; and
- With respect to any other SBS not described in the first two cases, the counterparties to the SBS would select a counterparty to be the reporting party.

Proposed Rule 901(a)(1) would provide that, where only one counterparty to a SBS is a U.S. person, the U.S. person would be the reporting party. The Commission preliminarily believes that, where only one counterparty is a U.S. person, assigning the reporting duty to the counterparty that is a U.S. person would help to assure compliance with the reporting requirements of proposed Regulation SBSR.

In addition, it is possible that a SBS executed in the United States or through any means of interstate commerce, or that is cleared through a clearing agency having its principal place of

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35 See proposed Rule 900 (defining "U.S. person" to mean a natural person that is a U.S. citizen or U.S. resident or a legal person that is organized under the corporate laws of any part of the United States or has its principal place of business in the United States). See also infra Section VIII (discussing application of proposed Regulation SBSR to cross-border SBS transactions).

business in the United States, could be executed between two counterparties neither of which is a U.S. person. Proposed Rule 901(a)(3) would provide that, if neither party is a U.S. person but the SBS is executed in the United States or through any means of interstate commerce, or is cleared through a clearing agency having its principal place of business in the United States,[36] the counterparties to the SBS would be required to select a counterparty to be the reporting party.[37]

To comply with the duty to report in real time itself, a reporting party likely would need to develop and maintain an internal order management system ("OMS") capable of capturing all relevant SBS data and sending it in real time. The Commission further believes that each reporting party likely would need to establish and maintain an appropriate compliance program and support for the operation of the OMS and reporting mechanism, which could include transaction verification and validation protocols, and necessary technical, administrative, and legal support. However, proposed Rule 901(a) would not prevent a reporting party to a SBS from entering into an agreement with a third party to report the transaction on behalf of the reporting party. For example, for a SBS executed on a security-based swap execution facility ("SB SEF")[38] or a national securities exchange, the SB SEF or national securities exchange could transmit a transaction report for the SBS to a registered SDR. By specifying the reporting party with the duty to report SBS information under proposed Regulation SBSR, the Commission does not intend to inhibit the development of commercial ventures to provide trade processing

[36] See proposed Rules 908(a)(2) and (3) and infra Section VIII.

[37] See infra Section VIII (discussing the requirements for the reporting of a SBS if the SBS is executed in the United States or through any means of interstate commerce, or is cleared through a registered clearing agency having its principal place of business in the United States).

[38] See 15 U.S.C. 78c(a)(77) (defining "security-based swap execution facility"). The registration and regulation of SB SEFs the subject of a separate Commission rulemaking.

services to SBS counterparties. Nevertheless, a SBS counterparty that is a reporting party would retain the obligation to ensure that information is provided to a registered SDR in the manner and form required by proposed Regulation SBSR, even if the reporting party has entered into an agreement with a third party to report on its behalf.[39]

Request for Comment

The Commission requests comment on all aspects of the proposal as to who would be responsible for reporting SBSs to a registered SDR.

1. Do any entities currently have the functionality to report SBSs, as proposed, to data repositories? If so, who? Do commenters think it is likely that entities other than SBS counterparties will develop the functionality to report SBSs to registered SDRs? If so, what are these entities and how will they operate?
2. Should the Commission require one or more entities other than a SBS counterparty, such as a registered SB SEF, a national securities exchange, a clearing agency, or a broker, to report SBSs? Or do commenters agree with the Commission's approach of assigning the responsibility to report to a counterparty, while allowing the counterparty to have an agent (such as a SB SEF) act on its behalf?
3. In practice, would reporting parties employ agents? Should the Commission encourage this?
4. Are the obligations assigned in proposed Rule 901(a) sufficiently clear?
5. For SBSs executed on a SB SEF or national securities exchange, would the counterparties to the SBS have the information necessary to know which counterparty would incur the

39 Thus, a reporting party would be liable for a violation of proposed Rule 901 if, for example, a SB SEF acting on the reporting party's behalf reported a SBS transaction to a registered SDR late or inaccurately.

reporting obligation? For example, for an anonymous SBS executed on a SB SEF and cleared by a clearing agency, would the counterparties know each other's identities? If not, what steps could they take to obtain enough information to be able to ascertain which party has the reporting obligation? Could the SB SEF provide that information to the counterparties? Alternatively, should the reporting obligation be assigned to the SB SEF or other trading venue?

6. In cases where counterparties would be required to select which counterparty would report the transaction, is additional Commission guidance likely to be necessary? Should the Commission adopt a default mechanism to allocate the reporting obligation in such cases? For example, if a SBS is between two SBS dealers, should the Commission mandate that the "seller" always have the responsibility for reporting?
7. Do commenters agree with the Commission's proposed approach for reporting for SBSs where only one counterparty is a U.S. person? If not, how should it be revised?
8. Do commenters agree with the Commission's proposed approach for reporting for SBSs where neither counterparty is a U.S. person? If not, how should it be revised?
9. To what extent would reporting parties have to obtain new or update existing OMSs and establish appropriate compliance programs to satisfy the real-time reporting obligations of proposed Rule 901(c)? Would current systems be able to handle this responsibility? Could current systems be upgraded or would they have to be replaced completely?

C. Where information is reported

Proposed Rule 901(b) would require a reporting party to report the information required under proposed Regulation SBSR to a registered SDR or, if there is no registered SDR that would accept the information, to the Commission. The Commission believes that it would be very unlikely that there would be a situation where a reporting party would be required to report to the Commission rather than a registered SDR. Proposed Rule 13n-5(b)(1)(ii) under the Exchange Act would require a registered SDR that accepts reports for any SBS in a particular asset class to accept reports for all SBSs in that asset class.[40] Thus, a reporting party would not be able to report a SBS transaction to the Commission unless no registered SDR accepts transaction information for any SBS in the same asset class as the transaction. In addition, there currently exist entities that accept SBS transaction data in CDS and equity swaps that would likely be required to register as a SDR.

Request for Comment

10. Is the Commission's belief that it would be unlikely to have a situation where a reporting party must report to the Commission rather than a registered SDR reasonable?
11. Do commenters believe that there will be at least one registered SDR in each SBS asset class?
12. Are there any SBS asset classes for which there might not be a registered SDR?

III. Information to be Reported in Real Time

A. Introduction

Proposed Rule 901 divides the SBS information that would be required to be reported into three broad categories: (1) information that would be required to be reported in real time pursuant to proposed Rule 901(c)[41] and publicly disseminated pursuant to proposed Rule 902; (2) additional information that would be required to be reported (but not publicly disseminated)

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40 See SDR Registration Proposing Release, supra note 6.

41 See infra Section III.B (discussing the categories of information to be provided for real-time reporting).

pursuant to proposed Rule 901(d)(1)[42] within the timeframes specified in proposed Rule 901(d)(2), which would vary depending on whether the transaction was executed and confirmed electronically or manually; and (3) life cycle event information that would be required to be reported under proposed Rule 901(e).[43]

The Commission notes that, although only the information specified in proposed Rule 901(c) would be required to be reported in real time, proposed Rule 901(c) would not prevent a reporting party from reporting some or all of the additional information required under proposed Rule 901(d)(1) at the same time that it reports the information required under proposed Rule 901(c). In other words, proposed Rule 901 would not mandate separate reports for the SBS information required under paragraphs (c) and (d) of proposed Rule 901; if a reporting party wished to provide all of the information required under proposed Rule 901 in a single transaction report, it would be free to do so – provided it could provide all of the information within the timeframe required by proposed Rule 901(c).

B. Categories of information to be provided for real-time reporting

Proposed Rule 901(c) would set forth the categories of information pertaining to a SBS transaction that a reporting party would be required to report to a registered SDR in real time. For the reasons discussed below, the Commission preliminarily believes that the SBS information required to be reported under proposed Rule 901(c) – which the registered SDR would publicly disseminate pursuant to proposed Rule 902 – would serve the objectives of Section 13(m) of the Exchange Act by enhancing price discovery in the SBS market.

42 See infra Section IV.B (discussing those data elements required under Rule 901(d)(1)).

43 See infra Section IV.D (discussing the reporting of life cycle event information). A registered SDR would be required to adopt policies and procedures to determine, among other things, whether and how it would publicly disseminate reports of life cycle events. See proposed Rule 907(a)(4).

The Commission recognizes that the SBS market involves complex instruments and that reporting conventions continue to evolve. Consequently, in developing proposed Rule 901, the Commission explored various alternative approaches, including mandating by rule an enumerated list of all specific data elements to be reported. The Commission believes that such a list likely would have to vary by asset class (e.g., CDS and equity-based swaps), and would require further variations based on sub-asset type.[44] The Commission understands, based on discussion with industry participants, that between 50 and 100 or more separate data elements could be used to express a typical CDS.

A Commission rule that attempted to identify each data element for each SBS asset class or sub-asset type could be less flexible in responding to changes in the marketplace, including the introduction of new types of SBSs, because it would be necessary for the Commission to amend its rules each time it sought to require the reporting of additional or different data elements. Accordingly, rather than enumerating each data element for each SBS asset class or sub-asset type that would be required to be reported, proposed Rule 901(c) would instead specify the categories of information that would be required to be reported for each SBS transaction. Furthermore, proposed Rule 907, discussed more fully below, would require each registered SDR to establish, maintain, and make publicly available policies and procedures that, among other things, specify the data elements of a SBS (or a life cycle event) that a reporting party would be required to report. These data elements would be required to include, at a minimum, the data elements required under proposed Rule 901(c) (for information that will be publicly disseminated) and proposed Rule 901(d) (for non-disseminated regulatory information). The Commission preliminarily believes that proposed Rule 901(c), together with these policies and

44 For example, the following types of CDS could each require a different list of data elements: single-name CDS, index CDS, loan CDS, and CDS on asset-backed securities.

procedures, would promote the reporting of uniform, material information for each SBS, while providing flexibility to account for changes to the SBS market over time.

The Commission discusses below the SBS data that would be required to be reported in real time, and which would be publicly disseminated.

1. Asset class

Proposed Rule 901(c)(1) would require the reporting party to report the asset class of the SBS and, if the SBS is an equity derivative, whether the SBS is a total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the SBS is based. Proposed Rule 900 would define "asset class" to mean those SBSs in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives. The Commission believes that identifying the asset class would provide market participants with basic information about the SBS transaction to identify the type of SBS being publicly reported. In addition, requiring the reporting party to indicate whether the SBS is an equity total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the SBS is based would enable a registered SDR to know if the SBS was excluded from being a block trade.[45]

2. Date and time of execution

Proposed Rule 901(c)(4) would require the reporting party to report the date and time, to the second, of execution of a SBS, so that prices of transactions that are disseminated in real time can be properly ordered, and so the Commission can have a detailed record of when any given SBS was executed. In the absence of this information, market participants and regulators would not know whether transaction reports they are seeing reflect the current state of the market.

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45 See proposed Rule 907(b)(4)(ii).

The Commission preliminarily believes that the time at which the SBS transaction has been executed should be the point at which the counterparties to a SBS become irrevocably bound under applicable law.[46] For example, in the context of SBSs, an oral agreement over the phone will create an enforceable contract, and the time of execution would be deemed to be the time that the parties to the telephone call agree to the material terms.[47] The Commission recognizes that trades agreed to over the phone would need to be systematized for purposes of fulfilling this reporting requirement (as well as real-time reporting of other data elements) by being entered in an electronic system that assigns a time stamp. The Commission believes that it is consistent with Congress' intent for orally negotiated SBS transactions to be systematized as quickly as possible so that they could be publicly disseminated using electronic means.[48]

The Commission is proposing that the date and time of execution be expressed using Coordinated Universal Time ("UTC"), a slight variation on Greenwich Mean Time.[49] SBSs are

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46 See proposed Rule 900. Section 13(m)(1)(A) of the Exchange Act defines "real time" in relation to the "execution" of the SBS, not when it is confirmed or cleared.

47 The Dodd-Frank Act amends the definition of "security" under the Securities Act and Exchange Act to explicitly include SBSs, and the execution of the transaction will be the sale for purposes of the federal securities laws. See Securities Act Release No. 3591 (July 19, 2005), 70 FR 44722 (August 3, 2005), notes 391 and 394 (explaining when a sale occurs under the Securities Act).

48 The Senate Report accompanying the Dodd-Frank Act indicates that "[m]arket participants – including exchanges, contract markets, brokers, clearing houses and clearing agencies –were consulted and affirmed that the existing communications and data infrastructure for the swaps markets could accommodate real time swap transaction and price reporting." The Senate Report stated, further, that real time swap transaction and price reporting would narrow swap bid/ask spreads, make for a more efficient swaps market and benefit consumers and counterparties overall. See 156 Cong. Rep. S5921 (July 15, 2010). In light of this acknowledgement of the benefits of real-time SBS transaction and price reporting, and the apparent feasibility of such reporting, the Commission believes that Congress intended for orally negotiated SBS transactions to be systematized as quickly as possible and reported in real time.

49 The generally acknowledged acronym for Coordinated Universal Time is "UTC," rather than "CUT." The International Telecommunication Union, an agency of the United

traded globally, and the Commission expects that many SBSs subject to these reporting and dissemination rules would be executed between counterparties in different time zones. In the absence of a uniform standard, it might not be clear whether the date and time of execution were being expressed from the standpoint of the time zone of the first counterparty, the second counterparty, or the registered SDR itself. Mandating a common standard for expressing date and time is designed to alleviate any potential confusion on the part of registered SDRs, counterparties, other market participants, and the public as to when the SBS was executed. The Commission believes that UTC is an appropriate and well known standard suitable for purposes of reporting the time of execution of SBSs.

3. Price

Proposed Rule 901(c)(7) would require the reporting of the price of a SBS transaction, expressed in terms of the commercial conventions used in that asset class.[50] The Commission recognizes that the price of a SBS generally would not be a simple number, as with stocks, but would be expressed in terms of the quoting conventions for that SBS. For example, a CDS may be quoted in terms of the economic spread – which is variously referred to as the "traded spread," "quote spread," or "composite spread" – expressed as a number of basis points per annum. Alternately, CDS can be quoted in terms of prices representing a discount or premium

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Nations that oversees information and communication technology issues, wanted Coordinated Universal Time to have the same symbol in all languages. English and French speakers wanted the initials of both their respective language's terms to be used internationally: "CUT" for "coordinated universal time" and "TUC" for "temps universel coordonné." This resulted in the final compromise of "UTC." See http://www.nist.gov/physlab/div847/utenist.cfm#cut.

50 One commenter identified the traded price as one of the elements that should be included in a SBS transaction report. See letter from James W. Toffey, Chief Executive Officer, Benchmark Solutions, to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, Commission, dated October 1, 2010 ("Benchmark Letter") at 2.

over par. In contrast, an equity or loan total return swap may be quoted in terms of a LIBOR-based floating rate payment, expressed as a floating rate plus a fixed number of basis points.

The Commission preliminarily believes that, because these quoting conventions are widely used and understood by SBS market participants, requiring the price of a SBS to be reported in terms of one of these existing quoting conventions would be consistent with the mandate in Section 13(m)(1)(B) of the Exchange Act to enhance price discovery. As discussed further below, however, proposed Rule 907(a)(1) would require a registered SDR to establish, maintain, and make publicly available policies and procedures that specify the data elements of a SBS that a reporting party must report, which would include the elements that constitute the price. The Commission preliminarily believes that, because of the many different conventions that exist to express the price in various SBS markets and the new conventions that might arise in the future, some flexibility should be given to registered SDRs to select appropriate conventions for denoting the price of different asset classes of SBSs.

4. Other terms of the SBS

Proposed Rule 901(c) would require the reporting of, among other things, information that identifies the SBS instrument[51] and the specific asset(s) or issuer(s) of a security or indexes on which the SBS is based; the notional amount(s) of the SBS and the currenc(ies) in which the notional amount(s) is expressed; the effective date of the SBS; the scheduled termination date of the SBS; and the terms of any fixed or floating rate payments and the frequency of any payments. The Commission preliminarily believes that this information is fundamental to

[51] See proposed Rule 900 (defining "security-based swap instrument" to mean each SBS in the same asset class, with the same underlying reference asset, reference issuer, or reference index).

understanding the SBS transaction being publicly reported, and that a SBS transaction report that lacked such information would not be meaningful.

For example, some types of SBSs are contractual agreements that generally involve the periodic exchange of cash flows from specified assets over a defined time period. These cash flows are based on the notional amount(s) of the SBS – i.e., the notional principal(s) of the SBS is used to calculate the periodic payments made under the agreement. Accordingly, information that identifies the asset(s), including a narrow-based index, or issuer(s) of the security or securities on which a SBS is based, the notional amount(s) of the SBS (including the currenc(ies) in which it is expressed), the effective date, and the scheduled termination date of that SBS are fundamental elements of the transaction that would enhance price discovery.[52]

The Commission anticipates that, for at least some standardized instruments, conventions about how a SBS instrument is referred to can become so well known that certain terms of the underlying contract can be assumed, and thus would not need to be specifically provided pursuant to other provisions of proposed Rule 901(c).

5. Whether the SBS will be cleared by a clearing agency

Proposed Rule 901(c)(9) would require the reporting party to indicate whether or not the SBS will be cleared by a clearing agency. This factor can impact the price of the SBS. If a SBS

[52] One commenter believed that a SBS transaction report should include: (1) the traded price and execution time; (2) the counterparty type, including a designation for an "end user;" (3) the notional size of the transaction; and (4) contract "open interest." See Benchmark Letter at 2. In addition, the commenter believed that the reference data for a SBS must include "standard attributes necessary to derive cash flows and any contingent claims that can alter or terminate payments" of the SBS. See id. at 1. As described above, the proposed rules would require the real-time reporting of price and time of execution, notional size, and an indication of whether a SBS is between two dealers. The proposed rules would not require the reporting of "open interest." However, another Commission rulemaking will provide regulators with the ability to monitor open SBS positions. See SDR Registration Proposing Release, supra note 6.

is not cleared, one counterparty might charge a higher price to do the trade because of the counterparty credit risk it would incur (which might be significantly diminished if the SBS were centrally cleared). Because the use of a clearing agency to clear a SBS would thus impact price, knowing whether a SBS will be cleared should provide market participants with additional information that would be useful in assessing the reported price for a SBS, thus enhancing price discovery. Therefore, the Commission is proposing to require that this data element be reported in real time and publicly disseminated.

6. Indication that a transaction is between two SBS dealers

Proposed Rule 901(c)(10) would require the reporting party to indicate if both counterparties to the SBS are SBS dealers. The Commission preliminarily believes that such an indication would enhance market transparency and provide more accurate information about the pricing of the SBS transaction, and thus about trading activity in the SBS market. Prices of transactions involving a dealer and non-dealer are typically "all-in" prices that include a mark-up or mark-down, while interdealer transaction prices typically do not. Thus, the Commission believes that requiring an indication of whether a SBS was an interdealer transaction or a transaction between a dealer and a non-dealer counterparty would enhance transparency by allowing market participants to more accurately assess the reported price for a SBS.

7. If applicable, an indication that the SBS transaction does not accurately reflect the market

In some instances, a SBS transaction might not reflect the current state of the market. Thus, publicly disseminating a report of that transaction without an indication to that effect could mislead market participants and other observers. The Commission does not expect that a registered SDR would be able to identify such cases. Therefore, proposed Rule 901(c)(11) would require the reporting party to alert the registered SDR in such cases. This could occur, for example, if the reporting party were reporting the transaction late (i.e., over 15 minutes after the time of execution). An aged transaction by definition no longer represents the current state of the market, and a reporting party would therefore be required to indicate that the transaction is being reported late.[53] Other situations where this could occur are inter-affiliate transfers and assignments where the new counterparty has no opportunity to negotiate the terms, including the price, of taking on the position. In such cases, there might not be an arm's length negotiation over the terms of the SBS transaction, and disseminating a report of the transaction report without noting that fact would be inimical to price discovery. Accordingly, the Commission preliminarily believes that a reporting party must note such circumstances in its real-time transaction report to a registered SDR.

The Commission further notes that a registered SDR would be required to have policies and procedures that, among other things, describe how reporting parties shall report SBS transactions that, in the estimation of the registered SDR, do not accurately reflect the market.[54] The Commission expects that these policies and procedures would require, among other things, different indicators being applied in different situations.

8. Indication for customized trades

Proposed Rule 901(c)(12) would provide that the reporting party must indicate if the SBS is customized to the extent that the other information provided pursuant to proposed Rule 901(c) does not provide all of the material information necessary to identify such customized SBS or

53 The registered SDR could deduce that a transaction has been reported late by looking to the time of execution, a data element required to be reported by proposed Rule 901(c)(4). However, if a registered SDR received a transaction report submitted with an anomalous time stamp, the registered SDR might not know whether the time stamp was correct and the trade was reported late, or whether the trade was reported in a timely fashion but the time stamp was inaccurate. Supplementing the time stamp with a "late" indicator would confirm to the registered SDR that the transaction was in fact being reported late.

54 See proposed Rule 907(a)(4); infra Section VI.A.

does not contain the data elements necessary to calculate the price of the SBS. The Commission believes that reporting highly customized SBS in this manner would promote transparency by providing market participants with knowledge of the transaction in a given asset class and on certain reference securities or issuers while, at the same time, making clear that the reported data elements would not, and would not be required to, provide sufficient information to fully understand all aspects of the customized transaction. The Commission preliminarily believes that requiring public dissemination of more detailed information about customized SBSs would be of limited utility in facilitating price discovery because of the unique nature of such transactions.

Request for Comment.

The Commission requests comment generally on all aspects of the categories of information that would be required to be reported in real time for public dissemination.

13. Do commenters agree with the proposed categories of information that would be required to be reported in real time for public dissemination? If not, what additional specific categories of information should be required to be reported in real time for public dissemination, and why? How would public dissemination of such additional information enhance price discovery or market liquidity?
14. What categories of information, if any, should not be required to be reported in real time for public dissemination, and why? Would the public dissemination of certain information materially reduce market liquidity? If so, how, specifically, would dissemination of the particular information affect liquidity? Please supply data to support your answer.

15. Does proposed Rule 901(c) provide adequate guidance with respect to the information that must be reported? If not, what additional guidance do commenters believe is necessary?

16. Would the real-time dissemination of the categories of information specified in proposed Rule 901(c) serve the objectives of Section 13(m) of the Exchange Act by enhancing price discovery in the SBS market? If so, how? Would disclosure of certain categories of information not further price discovery? If so, why not? Please provide examples.

17. Is it necessary to require dissemination of the date of execution, unless it is a date other than the current date?

18. Do commenters agree that it would be feasible to require SBSs agreed to by phone to be entered into an electronic system that assigns a time stamp? Why or why not?

19. Do commenters agree that the time of execution should be reported to the second? Why or why not? Should it be reported in a finer increment?

20. Would requiring the reporting and dissemination of price in terms of the existing quoting conventions provide adequate information regarding the price of a SBS? Where more than one quoting or pricing convention exists within an asset class, what convention should be used? Should proposed Regulation SBSR require specific conventions to be used?

21. Are there specific data elements that should be required to be reported to help understand the price of a SBS? If so, what are they, and do they vary by asset class? Or by some further categorization?

22. Are there categories of SBSs that do not have an existing quoting convention? If so, how should "price" be expressed for those SBSs? What data elements should be required to be reported and disseminated to capture the price of such SBSs?

23. Would information regarding whether a SBS is cleared impact the price of the SBS? If not, why not? Would the reporting party in all cases know whether the SBS transaction will be cleared?

24. Would information concerning whether a SBS is a transaction between two SBS dealers enhance transparency and provide more accurate information about the pricing of the SBS? If not, why not?

25. In a SBS executed on a SB SEF or national securities exchange, would a counterparty know in real time the category of its counterparty, e.g., whether its counterparty is a SBS dealer, a major SBS participant, or not?

26. Do commenters agree that it would be appropriate for reporting parties to report whether a SBS transaction accurately reflects the market? How should such "off-market" transactions be defined? Could public dissemination of potential off-market transactions (e.g., related to portfolio compressions) make it more difficult for market participants to understand and analyze market pricing?

27. Do commenters agree with the proposed approach for real-time reporting and public dissemination with respect to customized SBSs? Should the Commission require that additional information be reported and publicly disseminated for these SBSs? How practical would it be to report and publicly disseminate sufficient details about a customized SBSs in real time? Is there sufficient agreement over which SBSs should be considered customized for this purpose or is additional guidance needed? Is there a risk

that this rule could be applied inconsistently by counterparties or across asset classes? Would public dissemination of information concerning customized SBSs materially reduce market liquidity? If so, why?

28. Would real-time transaction reports of customized SBSs have price discovery value? If so, in what way and how much? If not, why not? Would price discovery be enhanced by requiring public dissemination of additional details of a customized SBS at a later time? If so, what additional details of the transaction should be publicly disseminated, and when?

29. Would any of the data elements specified in proposed Rule 901(c), if reported in real time, reveal the trading strategies or positions of any person? If so, how?

30. What do commenters believe would be the costs of reporting and publicly disseminating the proposed categories of information for SBSs? Or the benefits? Please be specific in your responses, and quantify your answers to the extent possible.

C. Definition of Real Time

Proposed Rule 900 would define "real time" to mean, with respect to the reporting of SBS transaction information, "as soon as technologically practicable, but in no event later than 15 minutes after the time of execution of the SBS transaction."[55] The Commission preliminarily believes that this proposed definition of "real-time" reporting is consistent with Sections 13(m)(1)(A) and (B) of the Exchange Act and technologically practicable in light of current industry practice.[56] Based on its discussions with market participants, the Commission

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55 See supra note 30 (noting that the "time of execution" would mean the point at which the counterparties to a SBS become irrevocably bound under applicable law).

56 The Commission notes, in addition, that the Senate report accompanying the Dodd-Frank Act indicates that "[m]arket participants – including exchanges, contract markets, brokers, clearing houses and clearing agencies – were consulted and affirmed that the

understands that much of the infrastructure necessary to support real-time reporting to a registered SDR may already be in place.[57] The Commission understands, further, that the SBS market is almost entirely institutional, and large institutions have in place the systems and processes necessary to support trading and risk management of complex structured products. In many cases, trade details will already be systematized and little or no manual intervention would be necessary to aggregate or send the transaction data. In such cases, where it is technologically practicable for a reporting party to report the SBS transaction information required by proposed Rule 901(c) in one second, then it would be required to report the SBS transaction to a registered SDR in one second.

The Commission recognizes that, in other cases, a SBS transaction might be negotiated orally, and some manual data entry might be necessary before a transaction report could be sent. At the same time, however, the Commission believes it is appropriate to encourage market participants to take steps to minimize manual handling of such transactions, because the Dodd-Frank Act requires price and volume information of all SBS transactions to be disseminated publicly as soon as technologically practicable after the time of execution. Furthermore, the

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existing communications and data infrastructure for the swaps markets could accommodate real time swap transaction and price reporting." See 156 Cong. Rec. S5921 (July 15, 2010).

57 See, e.g., CFTC and SEC, Public Roundtable to Discuss Swap Data, Swap Data Repositories, and Real Time Reporting, transcript available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/derivative18sub091410.pdf, comments of Sean Bernardo, Managing Director of Tullett Prebon Americas Corp. and representing the Wholesale Market Brokers Association, at 297 ("From the brokers' perspective, however you tell us to send those [transactions] straight to you, whatever the time frame is, we're able to do that, whether it's done voice, whether it's done electronic, or whether it's done hybrid"), and at 310 ("From the brokers' perspective, we already have these systems in place for 99 percent of these products already in some way, shape, or form. So, as far as upgrading them, we're upgrading the systems on a regular basis. So, I think, again, we can accommodate the needs that you have, and we currently do a lot of the reporting and ... processing with the firms").

Commission notes that real-time reporting under proposed Rule 901(c) would require only certain elements of the trade to be systematized and reported, not all of the data elements that are required for full regulatory reporting under proposed Rule 901(d). The Commission is, therefore, proposing a 15-minute outer boundary for real-time public reporting of the data elements specified in proposed Rule 901(c) following the SBS's time of execution.[58]

Under the proposed approach, a reporting party would not be permitted to delay submission of a transaction report required by proposed Rule 901(c) while preparing the information necessary to provide a transaction report under proposed Rule 901(d), even if the reporting party could prepare the latter in under 15 minutes. Assume, for example, that two counterparties execute a SBS on an electronic trading platform, which permits the collection and

58 One commenter believed that SBS transaction reports should be disseminated to the market within five minutes of execution, or as soon as technologically feasible. See Benchmark Letter at 2. The commenter noted that "the sooner post trade data is accessible to the market, the more effectively it can feed back into the update cycle of pre-trade information. Better pre-trade information allows investors to make more well-informed decisions regarding market values, risk and helps assure that investors achieve best execution." Id. Another commenter argued that "voice/hybrid execution systems" should have the same reporting timeframes as venues that execute electronically, because "a bifurcated requirement could result in an inaccurate trade tape confusing the market and regulator alike," and because "such a bifurcation might also create a 'race to the slowest' . . . as certain market participants, seeking to shroud their trading, favor slower reporting SEF's with their business over more efficient and transparent counterparts." See letter from James Cawley, CEO, Javelin Capital Markets, to SEC and CFTC (October 20, 2010) ("Javelin Letter") at 2. The Commission further notes that the Financial Industry Regulatory Authority ("FINRA") requires its members to report transactions in corporate and agency debt securities to FINRA's Transaction Reporting and Compliance Engine ("TRACE") within 15 minutes of the time of execution. See FINRA Rule 6730(a). For purposes of TRACE reporting, the time of execution generally means the time when the parties to the trade agree to all of the terms of the transaction that are sufficient to calculate the dollar price of the trade. See FINRA Rule 6710(d). FINRA has indicated that, based on 2009 figures, approximately 98% of corporate bond trades were reported within 15 minutes, 96% within ten minutes, and 92% within five minutes. See e-mail from Steve Joachim, Executive Vice President for Transparency Services, FINRA, to Michael Gaw, Assistant Director, Division of Trading and Markets, Commission (November 17, 2010).

transmission of all information required by proposed Rule 901(c) in one second, and all other details of the SBS can be confirmed in eight minutes. The reporting party would not be permitted to wait eight minutes to send a single transaction report containing the information required under proposed Rules 901(c) and (d) to a registered SDR. Instead, the reporting party would be required to send the information required by proposed Rule 901(c) in one second – because one second in this example is as soon as technologically practicable – and to send the information required by proposed Rule 901(d) in eight minutes. The Commission preliminarily believes that this approach is most conducive to price discovery. Collecting data elements that have less bearing on price discovery (such as those required by proposed Rule 901(d)) should not slow down the public dissemination of data elements that would facilitate price discovery (i.e., those required by proposed Rule 901(c)).

Request for Comment

31. Do commenters agree with the proposed definition of "real time"? Would it be technologically practicable in all cases to report the information that would be required under proposed Rule 901(c) within 15 minutes? If not, why not? Would it be technologically practicable for some, but not all, SBSs? Or some, but not all, of the data elements? If so, what are the differentiating factors?
32. Should the Commission require shorter reporting time frames for certain SBS transactions? For example, should electronically executed SBSs be reported as soon as technologically practical but in any event no later than 5 seconds? 30 seconds? Some other period? What should that period be, and why?
33. Should the Commission require a longer reporting time frames for orally executed SBS transactions (such as 30 minutes)? If so, what should that longer period be, and why?

34. If there were a longer reporting time frame for orally executed SBSs, would the potential benefits of real-time public reporting be compromised? If so, how? If not, why not? Would this create an incentive for market participants to prefer oral negotiation of SBSs to delay real-time reporting of their transactions?

35. In the context of real-time reporting of SBS transactions, what is "technologically practicable"? Should the Commission define that term specifically? What systems and processes would be necessary to report orally concluded SBSs as soon as technologically practicable? Does this imply a requirement that all such SBSs must be immediately systematized?

36. What do commenters believe would be the costs of reporting the proposed data elements within 15 minutes? What would be the benefits? Please be specific in your response, and quantify the costs and benefits to the extent possible.

IV. Additional Reporting of Regulatory Information

A. Introduction

Proposed Rule 901(d) would require the reporting, within specified timeframes, of certain SBS transaction information that would not be publicly disseminated, in addition to the information required to be reported in real time pursuant to proposed Rule 901(c) that would be publicly disseminated. The Commission believes that the information that would be reported pursuant to proposed Rule 901(d) would facilitate regulatory oversight and monitoring of the SBS market by providing comprehensive information regarding SBS transactions and trading activity.[59] The Commission believes, further, that this information would assist the Commission in detecting and investigating fraud and trading abuses in the SBS market.

B. Data elements required under proposed Rule 901(d)

The data elements that would be required to be reported by the reporting party for each SBS pursuant to proposed Rule 901(d) are discussed below.

1. Unique identifiers

Proposed Rule 901(d) would require the reporting of a participant ID of each counterparty and, as applicable, the broker ID, desk ID, and trader ID of the reporting party. The Commission preliminarily believes that reporting of this information would help promote effective oversight, enforcement, and surveillance of the SBS market by the Commission and other regulators. For example, activity could be tracked by a particular participant, a particular desk, or a particular trader. Regulators could observe patterns and connections in trading activity, or examine whether a trader had engaged in questionable activity across different SBS instruments. These identifiers also would facilitate aggregation and monitoring of the positions of SBS counterparties, which could be of significant benefit for systemic risk management.

The Commission understands that some efforts have been undertaken – in both the private and public sectors, both domestically and internationally – to establish a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally. Such a system could be of significant benefit to regulators worldwide, as each market participant could readily be identified using a single reference code regardless of the jurisdiction or product market in which the market participant was engaging.

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59 To the extent the Commission receives information that is reported under proposed Rule 901(d), such information would be kept confidential, subject to the provisions of the Freedom of Information Act.

Such a system also could be of significant benefit to the private sector, as market participants would have a common identification system for all counterparties and reference entities, and would no longer have to use multiple identification systems. The enactment of the Dodd-Frank Act and the establishment of a comprehensive system for reporting and dissemination of SBSs – and for reporting and dissemination of swaps, under the jurisdiction of the CFTC – offer a unique opportunity to facilitate the establishment of a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally.[60]

The Commission preliminarily believes that a registered SDR must have a systematic means to identify and track all products and all persons involved in SBS transactions captured and recorded by the registered SDR. Therefore, the Commission is requiring that a "unique identification code" ("UIC") be assigned to each such product or person (or unit thereof, such as a branch or desk of a financial institution). Thus, under proposed Regulation SBSR, the

60 One commenter believes that a single source of reference data and a standard set of unique identifiers must be used across the industry (i.e., SB SEFs and SDRs) to ensure the comparability of similar contracts. The commenter urged the Commission to work with the industry to standardize terms and definitions of all reference data components and establish a single master reference data source. See Benchmark Letter at 1. See also Neal S. Wolin, Deputy Secretary of the Treasury, Remarks at Georgetown University McDonough School of Business (October 25, 2010), available at http://www.treas.gov/press/releases/tg923.htm (stating that the Office of Financial Research ("OFR") " is working with regulators and industry, laying the groundwork to standardize financial reporting and develop reference data that will identify and describe financial contracts and institutions. Data standardization will provide for more consistent and complete reporting, making the data available to decision makers easier to obtain, digest, and utilize. Over the coming weeks and months, the OFR will begin to define a set of standards for reporting of financial transaction and position data. The OFR will collaborate with the financial industry, data experts, and regulators to develop an approach to standardization that works for everyone").

"participant ID" would mean the UIC assigned to a participant.[61] "Broker ID" would be defined as the UIC assigned to an entity acting as a broker for a participant. "Desk ID" would be defined as the UIC assigned to the trading desk of a participant or of a broker of a participant, and "trader ID" would be defined as the UIC assigned to a natural person who executes SBSs.

Under the definition of "unique identification code" in proposed Rule 900, a UIC would have to be assigned by or on behalf of an internationally recognized standards-setting body ("IRSB") that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory. The Commission seeks to avoid requiring market participants to participate in a system that would require them to pay unreasonable fees, or that would permit discrimination among potential users of the system. Thus, the definition of "UIC" would further provide that, if no standards-setting body meets these criteria, a registered SDR would be required to assign all necessary UICs using its own methodology.

The Commission preliminarily believes that, if an IRSB meets these criteria, the UICs employed by a registered SDR must come from the IRSB, and participants of that registered SDR must take necessary steps to obtain UICs from that IRSB. However, it could take an extended period for an IRSB to assign, or establish protocols for assigning, UICs for all entities participating in the SBS market. A registered SDR would be required to use the UICs available from the IRSB's system, while using its own methodology to assign the rest. In addition, the definition of "UIC" would provide that, if a standards-setting body meets these criteria but has not assigned a UIC to a particular person, unit of a person, or product, a registered security-based

61 "Participant" would be defined as: (1) a U.S. person that is a counterparty to a SBS that is required to be reported to a registered SDR; or (2) a non-U.S. person that is a counterparty to a SBS that is (i) required to be reported to a registered SDR; and (ii) executed in the United States or through any means of interstate commerce, or cleared through a clearing agency having its principal place of business in the United States. See proposed Rule 900.

swap data repository would be required to assign a UIC to that person, unit of a person, or product using its own methodology.

The proposed definition of "UIC" would not require that a UIC be assigned "by" a IRSB itself. Rather, the proposed definition would provide only that the UIC be assigned "by or on behalf of" the IRSB. This is designed to preserve flexibility in how UICs may be assigned. An IRSB might establish the general protocols under which UICs are assigned, while another entity operating as an agent on behalf of the IRSB might assign the UICs pursuant to the protocols established by the IRSB. The proposed definition would allow for that possibility.

2. Other Terms of the SBS

Proposed Rule 901(d) would require identification of the amount(s) and currenc(ies) of any up-front payment(s) and a description of the terms and contingencies of the payment streams of each counterparty to the other;[62] the title of any master agreement, or any other agreement governing the transaction (including the title of any document governing the satisfaction of margin obligations), incorporated by reference and the date of any such agreement; and the data elements necessary to calculate the market value of a transaction.[63] In addition, for a SBS that is not cleared, proposed Rule 901(d) would require a description of the settlement terms, including

62 For example, this would include, for a CDS, an indication of the counterparty purchasing protection and the counterparty selling protection, and the terms and contingencies of their payments to each other; and for other SBSs, an indication of which counterparty is long and which is short. This information could be useful to regulators in investigating suspicious trading activity.

63 The Commission believes that these elements would include, for a SBS that is not cleared, information related to the provision of collateral, such as the title and date of the relevant collateral agreement.

whether the SBS is cash-settled or physically settled, and the method for determining the settlement value.[64]

The Commission believes that each of these data elements would facilitate regulatory oversight of counterparties and the SBS market generally by providing information concerning counterparty obligations and risk exposures. For example, the reporting of data elements necessary to calculate the market value of a transaction would allow regulators to value an entity's SBS positions and calculate the exposure resulting from those positions. The Commission understands, based on discussions with industry participants, that market participants currently provide this information regarding SBSs to data repositories.

3. Clearing information

Proposed Rule 901(d) would require the reporting of the name of the clearing agency, if the SBS is cleared. The Commission believes that the identity of the clearing agency that cleared a SBS is fundamental information regarding a cleared SBS. This information would allow regulators to verify, if necessary, that a SBS was cleared, and to easily identify the clearing agency that cleared the transaction.

Proposed Rule 901(d) also would require the reporting party to report, if the SBS is not cleared, whether the exception provided in Section 3C(g) of the Exchange Act was invoked. Section 3C(g)(1) of the Exchange Act provides that the requirements of Section 3C(a)(1) will not apply to a SBS if one of the counterparties to the SBS: (1) is not a financial entity; (2) is using SBSs to hedge or mitigate commercial risk; and (3) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with

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64 One commenter believed that a SBS transaction report should include information necessary to derive cash flows and any contingent claims that could alter or terminate payments of the SBS. See Benchmark Letter at 1. This is similar to the information required by proposed Rule 901(d)(1)(iii).

entering into non-cleared SBSs. The application of the clearing exception in Section 3C(g)(1) of the Exchange Act is solely at the discretion of the SBS counterparty that satisfies these conditions.[65] Section 3C(g)(6) of the Exchange Act[66] authorizes the Commission, among other things, to request information from those persons claiming the clearing exception as necessary to prevent abuse of the exceptions described in Section 3C(g) of the Exchange Act. The Commission believes that information regarding whether the exception in Section 3C(g)(1) was invoked for a non-cleared SBS would assist the Commission in overseeing and monitoring the use of the exception. This information would be a necessary preliminary step in determining whether the exception was properly invoked.[67]

4. Execution venue

Proposed Rule 901(d) would require the reporting party to report the venue where the SBS was executed, or whether the SBS was executed bilaterally in the OTC market. The venue where a SBS is executed is necessary for investigating any potential improper behavior relating to the transaction. For example, regulators investigating a suspected abuse or other impropriety would need to know the execution venue in order to obtain records from the venue to assist in their investigation.

Request for Comment

The Commission requests comment on all aspects of the proposed additional information that would be required to be reported pursuant to proposed Rule 901(d).

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65 See 15 U.S.C. 78c[C(g)(2)].

66 15 U.S.C. 78c[C(g)(6)].

67 The use of this exception, and further information required to be reported regarding this exception, will be the subject of another Commission rulemaking. Any comments regarding this exception should be submitted in connection with that proposal.

37. Do commenters agree with the information that the Commission has proposed to be required to be reported pursuant to proposed Rule 901(d)? Should additional information be reported? If so, what information, and why?

38. Are there any data elements proposed to be reported that commenters believe should not be reported? If so, why not?

39. Should proposed Rule 901(d) also require reporting of the purpose of the SBS transaction (such as market making, directional trade, or asset hedge)? If so, what categories of purposes should be established, and why?

40. Is it possible that inconsistencies in pricing conventions among SBS market participants could result in uninformative prices being reported to a registered SDR? Could a reporting party use variation in pricing conventions to obscure pricing information? Do commenters believe that proposed Regulation SBSR should prescribe the specific pricing conventions that should be used?

41. Does proposed Rule 901(d) provide adequate guidance with respect to the information that must be reported?

42. Do commenters agree that the information described above regarding the material terms of a SBS would be useful for monitoring risk exposure and for other regulatory purposes? Why or why not?

43. Would it be difficult or cost prohibitive for reporting parties to report such information? If so, why?

44. Do SBS counterparties employ transaction-level collateral arrangements? If so, what specific information on transaction-level collateral information should be reported to a registered SDR?

45. Do commenters agree that the participant ID of each counterparty, and, as applicable, the broker ID, desk ID, and trader ID of the reporting party or its broker would be useful information to be reported? Why or why not? Would these identifiers be helpful for conducting regulatory oversight, including measuring risk exposure? How costly would it be for participants to report this information for each SBS?

46. Are there other entities that may play some part in the execution or reporting of a SBS transaction? If so, what are they? Should their identification information be reported to a registered SDR?

47. Are there additional subunits of a legal person, besides the desk, that should be identified by a UIC? If so, what are those subunits and how should they be defined?

48. Would the reporting party be in a position to know, in all cases, the participant ID of its counterparty? If a SBS is executed on a SB SEF, would the SB SEF be able to provide the reporting party the participant ID of the counterparty? If not, what alternative would be available to have this information reported?

49. Does an IRSB currently exist or will one exist in the near future that could carry out the functions envisioned by proposed Regulation SBSR? What additional steps would need to be taken for that entity to carry out these functions?

50. Who would own the intellectual property underlying the UICs assigned by or on behalf of an IRSB? Would a registered SDR have to pay fees to obtain UICs from an IRSB? If so, how much? What usage restrictions might the owners of the relevant intellectual property impose on registered SDRs or on consumers of the market data feed? Are any fees and usage restrictions imposed by an IRSB (or any entity that might become an

IRSB) fair and reasonable and not unreasonably discriminatory? If not, in what way are they not?

51. Are there any issues that could result from the Commission requiring that UICs only be assigned by or on behalf of an IRSB that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory? Would imposing such a standard allow for any activity that could undermine the ability of market participants to effectively obtain or use the UICs as anticipated? In the alternative, should the Commission require that there be no fees related to the use of UICs?

52. Would any end users of SBS market data disseminated by a registered SDR have to pay fees relating to an IRSB? If so, why? How much would these fees be?

53. How do data repositories currently identify participants and products? If UICs cannot be assigned by or on behalf of an IRSB, would the current methodologies of data repositories be adequate for assigning UICs pursuant to proposed Regulation SBSR? What would be the likely costs to a registered SDR of assigning such UICs itself?

54. What would be the potential impact on market participants and registered SDRs if no IRSB emerges and there are multiple SDRs per asset class assigning UICs?

55. What additional steps can or should the Commission take to promote internationally recognized standards for UICs?

56. Are there any other factors not already discussed that the Commission should take into account when considering voluntary consensus standards for UICs?

C. Reporting Timeframes for Regulatory Information

The Dodd-Frank Act does not specify the timeframes under which SBS transaction information, beyond that necessary to support real-time public dissemination for enhancing price discovery, must be reported to a registered SDR or to the Commission for regulatory purposes. However, the Commission preliminarily believes that, to further the objectives of the Dodd-Frank Act, SBS transaction information should be reported within a reasonable time following the time of execution – i.e., the point at which the counterparties to a SBS become irrevocably bound under applicable law – rather than waiting until the time a transaction is confirmed.[68] For purposes of proposed Regulation SBSR, the time a transaction is confirmed means the production of a confirmation that is agreed to by the parties to be definitive and complete and that has been manually, electronically, or, by some other legally equivalent means, signed.[69] Requiring reporting at or after the time a SBS transaction is confirmed, rather than at the time of execution, could encourage counterparties to delay confirming in order to delay the reporting of a transaction.

The Commission recognizes that the amount of time required for counterparties to report the data elements that would be required to be reported under proposed Rule 901(d)(1) could vary depending upon, among other things, the extent to which the SBS is customized and whether the SBS is executed or confirmed electronically or manually. The Commission believes that the extent to which a SBS is executed or confirmed electronically is an indication of the degree to which the SBS is or could be systematized, and thus could directly impact the amount of time needed to report such SBS. For example, the Commission believes, based on discussions with industry participants, that the required information would be available relatively quickly for

68 See proposed Rule 900 (defining "time of execution"); supra Section III.B.2.

69 See proposed Rule 900 (defining "confirm"). "Confirmation" refers to the specific documentation that evidences the legally binding agreement. Section 15F(i)(2) of the Exchange Act provides that SBS dealers and major SBS participants shall conform with such standards as may be prescribed by the Commission that relate, among other things, to timely and accurate confirmation of SBSs. Requirements for confirmations issued by SBS dealers and major SBS participants will be the subject of a separate Commission rulemaking.

a SBS that is executed and confirmed electronically because most of the information required to be reported would already be in an electronic format. On the other hand, the Commission recognizes that, for those SBSs that are not executed or confirmed electronically, additional time may be needed to systematize the information required to be reported under proposed Rule 901(d) and put it into an acceptable format. Accordingly, proposed Rule 901(d)(2) would obligate a reporting party to report the regulatory, non-real-time information required to be reported under proposed Rule 901(d)(1) promptly, but in no event later than:

- 15 minutes after the time of execution for a SBS that is executed and confirmed electronically;
- 30 minutes after the time of execution for a SBS that is confirmed electronically but not executed electronically; or
- 24 hours after execution for a SBS that is not executed or confirmed electronically.

The Commission preliminarily believes that requiring a SBS that is executed and confirmed electronically to be reported promptly, but in no event later than 15 minutes after the time of execution, is appropriate because such SBS could be easily systematized (if it is not already), thus allowing the SBS to be reported within a time period similar to that required for real-time reporting. The Commission further believes that, for a SBS that is confirmed electronically but not executed electronically, additional time would be needed to report such SBS. However, the Commission preliminarily believes that 30 minutes would be a sufficient amount of time because such SBS already would be put into electronic form for confirmation, and thus likely could be easily systematized and would not require a significant amount of manual handling.

Finally, since a SBS that is not executed or confirmed electronically would likely not already be systematized and could require a significant amount of manual intervention, the proposed rules would allow additional time for reporting. For this group of SBSs, the Commission seeks to balance the need to allow market participants sufficient time to determine the terms of their trade, with the need for regulators to have current and complete information about positions in the SBS market.

Request for Comment

The Commission requests general comments on the proposed reporting times and the basis for the proposed reporting times.

57. Do commenters believe that there should be different reporting times based on whether a SBS is executed or confirmed manually or electronically? If so, why? If not, what other basis should be used to distinguish reporting timeframes, and why? Should all SBSs be reported in the same time frame? If so, what should the timeframe be, and why?
58. Do commenters agree that the reporting time for a SBS that is executed and confirmed electronically should be 15 minutes after the time of execution? Should that period be shorter, for example, 30 seconds, one minute, or five minutes? Why or why not?
59. Do commenters agree that the reporting time for a SBS that is confirmed electronically but not executed electronically should be 30 minutes after the time of execution? Should that period be shorter, for example, one minute, five minutes, or 15 minutes? Why or why not?
60. Do commenters agree that the reporting time for a SBS that is not executed or confirmed electronically should be 24 hours? Should that period be shorter – perhaps eight hours? 12 hours? Should that period be longer – perhaps 36 hours? 48 hours? Why or why not?

If the time period were greater than 24 hours, how significant would be the risks that regulators would not know of SBS positions recently taken by counterparties engaging in SBSs that are not executed or confirmed electronically?

61. Do commenters agree with the proposed timeframes for reporting information required to be reported pursuant to proposed Rule 901(d)(1)? Would the timeframes in proposed Rule 901(d)(2) provide adequate time for reporting the information that would be required to be reported under proposed Rule 901(d)(1)? If not, why not? Should the time frame for reporting be shorter or longer? Why or why not?

62. Would public dissemination of information in the proposed timeframes materially reduce market liquidity? If so, for what types of SBSs? Why? What timeframe(s) would balance the concerns about market liquidity with the requirement for real-time reporting?

63. Are there customized SBSs for which it would be too difficult or burdensome to report within 24 hours? How long do those SBS transactions currently take to report to a SDR? What steps would have to be taken to accelerate reporting for such SBS transactions?

D. Reporting of Life Cycle Events

Proposed Rule 901(e) would require the reporting of certain "life cycle event" information. Proposed Rule 900 would define a "life cycle event" to mean, with respect to a SBS, any event that would result in a change in the information reported to a registered SDR pursuant to proposed Rule 901, including a counterparty change resulting from an assignment or novation; a partial or full termination of the SBS; a change in the cash flows originally reported; for a SBS that is not cleared, any change to the collateral agreement; or a corporate action affecting a security or securities on which the SBS is based (e.g., a merger, dividend, stock split, or bankruptcy). Notwithstanding the above, a life cycle event shall not include the scheduled expiration of the SBS, a previously described and anticipated interest rate adjustment (such as a quarterly interest rate adjustment), or other event that does not result in any change to the contractual terms of the SBS.

For any life cycle event that results in a change to information previously reported, proposed Rule 901(e) would require the reporting party to promptly provide updated information reflecting such change to the entity to which it reported the original transaction, using the transaction ID, except that:

(1) If a reporting party ceases to be a counterparty to a SBS due to an assignment or novation, the new counterparty would be the reporting party following such assignment or novation, if the new counterparty is a U.S. person; and

(2) If, following an assignment or novation, the new counterparty is not a U.S. person, the counterparty that is a U.S. person would be the reporting party following such assignment or novation.

As discussed in greater detail below, proposed Rule 907(a)(1) would require the policies and procedures of a registered SDR to specify the data elements of a life cycle event that a reporting party would be required to report, which would include, at a minimum, the data elements specified in proposed Rules 901(c) and (d). Proposed Rule 901(g) would require a registered SDR to assign a transaction ID to each SBS reported by a reporting party. The assignment of a transaction ID, which would be included in a life cycle event report, would facilitate the reporting of life cycle event information by identifying the particular SBS transaction to which the life cycle event pertained.[70]

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[70] See infra Section IV.E.2 (discussing proposed Rule 901(g)).

The reporting of life cycle event information would provide regulators with access to information about significant changes that occur over the duration of a SBS, including, for example, a counterparty change resulting from an assignment or novation, a change in the data elements necessary to calculate the value of the SBS, a partial or full termination of the SBS prior to the scheduled termination date of the SBS, or a modification of the periodic cash flows originally reported. The Commission preliminarily believes that the reporting of life cycle event information would help to assure that regulators have accurate and up-to-date information concerning outstanding SBSs and the current obligations and exposures of SBS counterparties.[71]

Request for Comment

The Commission requests comment on all aspects of the proposed life cycle event reporting requirements.

64. Do participants agree with the proposed definition of life cycle event? What life cycle event information should be reported? Should changes to all information that would be required to be reported under proposed Rules 901(c) and (d) be updated, or only specific items? If so, which items, and why?
65. Should a life cycle event report be formatted to include only the transaction ID and the updated information, or should it include the transaction ID, the updated information, and the other information that would be required to be reported under proposed Rules 901(c)

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71 In a separate rulemaking today, the Commission is proposing to require a registered SDR to establish, maintain, and enforce policies and procedures reasonably designed to calculate positions for all persons with open SBSs maintained by the registered SDR, and is requesting comment on whether a SDR should calculate (on at least a daily basis) the market value of each position in SBSs for which the registered SDR maintains transaction data. See SDR Registration Proposing Release, supra note 6 (proposing Rule 13n-5(b)(2) under the Exchange Act).

and (d)? Should the Commission prescribe the format of a life cycle event report, or allow a registered SDR to determine the format of the report?

66. Does the proposed rule provide adequate guidance concerning the life cycle events that would be required to be reported? If not, what areas require further guidance? Does the proposed rule provide adequate guidance regarding what information would be required to be reported for each life cycle event?

67. What benefits would result from the reporting of life cycle events? What would be the costs of such reporting?

68. Is it appropriate to require that life cycle events be reported promptly? If not, what should be the appropriate timeframe for reporting such events?

E. Additional Requirements Applicable to Registered SDRs or Participants

1. Time stamp for reported information

Proposed Rule 901(f) would require a registered SDR to time stamp, to the second, receipt of any information required to be submitted pursuant to proposed Rule 901(c), (d), or (e). The Commission believes that this requirement would help regulators to evaluate certain trading activity. For example, a reporting party's pattern of submitting late transaction reports could be an indicator of weaknesses in the reporting party's internal compliance processes. Accordingly, the Commission believes that the ability to compare the time of execution reported with the time of receipt of the report by the registered SDR could be an important component of surveillance activity conducted by regulators.

2. Transaction identifiers

Proposed Rule 901(g) would require a registered SDR to assign a transaction ID to each SBS transaction reported to it. Proposed Rule 900 would define "transaction ID" to mean the unique identification code assigned by a registered SDR to a specific SBS. The Commission preliminarily believes that, because each transaction is unique, it is not necessary or appropriate to look to an IRSB for assigning such identifiers. Accordingly, a registered SDR would be required to use its own methodology for assigning transaction IDs.[72]

The Commission preliminarily believes that a unique transaction ID would allow registered SDRs, regulators, and counterparties to more easily track a SBS over its duration and facilitate the reporting of life cycle events and the correction of errors in previously reported SBS information. The transaction ID of the original SBS would allow for the linking of the original report to a report of a life cycle event. Similarly, the transaction ID would be required to be included on an error report to identify the transaction to which the error report pertained.

3. Counterparty ID information

As discussed above, proposed Rule 901(d) would require the reporting of a participant ID of each counterparty and, as applicable, the broker ID, desk ID, and trader ID of the reporting party or its broker.[73] For regulators to monitor the SBS positions of market participants, evaluate trading activity, and conduct effective oversight and enforcement of the SBS market, it is important that the applicable UICs for both counterparties to a SBS be available to regulators.

Proposed Rule 901(d) would require the reporting party, for each SBS for which it is a reporting party, to report the participant ID of itself and its counterparty, and (as applicable) the reporting party's broker ID, desk ID, and trader ID. The reporting party would not be required to report the broker ID, desk ID, and trader ID for its counterparty. However, nothing in proposed Regulation SBSR would prevent a reporting party from reporting, or providing for the reporting

72 Cf. supra Section IV.B.1 (discussing participant IDs, broker IDs, desk IDs, and trader IDs, which could be used for multiple transactions across multiple asset classes).

73 See id.

to a registered SDR, of its counterparty's applicable UICs. For example, orders entered into an electronic trading system could be coded to include all relevant UICs. When the system matches two orders, it could bundle information about both orders (including the UICs) into a transaction report for the reporting party to report to a registered SDR, or the execution venue could provide the UICs directly to the registered SDR on behalf of the reporting party. Further, in a bilateral negotiated SBS, the counterparties could agree to have the non-reporting-party participant provide the applicable UICs to the reporting party for reporting to the registered SDR.

The Commission preliminarily believes that, to the extent that it is not feasible or desirable in a particular SBS transaction for the reporting party to report UICs, proposed Regulation SBSR should contain some means for the registered SDR to obtain the applicable UICs from the counterparty that is not the reporting party. Accordingly, proposed Rule 906(a) would set forth a procedure designed to ensure that a registered SDR obtains applicable UICs for both counterparties to a SBS, not just the reporting party. Proposed Rule 906(a) would require a registered SDR to identify any SBS reported to it for which the registered SDR did not have a participant ID and (if applicable), the broker ID, desk ID, and trader ID of each counterparty. Proposed Rule 906(a) would further require the registered SDR, once a day, to send a report to each participant identifying, for each SBS to which that participant is a counterparty, the SBS(s) for which the registered SDR lacks participant ID and (if applicable) broker ID, desk ID, and trader ID. Finally, under proposed Rule 906(a), a participant that receives such a report would be required to provide the missing UICs to the registered SDR within 24 hours of receipt of the report.

The Commission preliminarily believes that the registered SDR would be in the best position to know whether the reporting party had reported the UICs for its counterparty, and to request the missing UICs from any participant as necessary. In addition, the Commission recognizes that some reasonable period should be afforded to the registered SDR to determine what UICs have not been reported, to provide the report to each participant requesting such information, and for the participant to complete and return the report. The Commission preliminarily believes that it would be reasonable to require a registered SDR to produce only one such report per day, and to allow a participant up to 24 hours to complete and return the report with the requested information.

4. Parent and affiliate information

The Commission also preliminarily believes that, to be able to effectively report on participant positions to assist the Commission and other regulators in monitoring systemic risk, a registered SDR should be able to identify all SBS positions within the same ownership group. Therefore, the Commission is proposing Rule 906(b), which would require each participant of a registered SDR to provide to the registered SDR information sufficient to identify its ultimate parent(s)[74] and any affiliate(s)[75] of the participant that also are participants of the registered SDR.

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[74] See proposed Rule 900 (defining "parent" as a legal person that controls a participant); Rule 900 (defining "ultimate parent" as a legal person that controls a participant and that itself has no parent); Rule 900 (defining "control" for purposes of proposed Regulation SBSR as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise. A person would be presumed to control another person if the person: (1) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (2) directly or indirectly has the right to vote 25% or more of a class of voting securities or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (3) in the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25% or more of the capital). The proposed definitions of "parent" and "ultimate parent" are designed to identify particular categories of affiliated entities based on their ability to control a participant. Thus, a "parent" refers to a legal person that controls a participant, and the "ultimate parent" refers to an entity that controls a participant but that itself has no parent and thus is not controlled by another entity.

Proposed Rule 906(b) also would require a participant to promptly notify the registered SDR of any changes to that information. Under proposed Rule 906(b), a participant would be required to provide this ownership and affiliation information to a registered SDR immediately upon becoming a participant (in other words, as soon as a SBS for which it is a counterparty is required to be reported to the registered SDR). As with other UICs,[76] an ultimate parent ID would be the unique identification code assigned to an ultimate parent by or on behalf of an IRSB (or, if no standards-setting body meet the required criteria or the IRSB has not assigned a UIC to a particular person or unit thereof, by the registered SDR).

Request for Comment

The Commission requests comment on all aspects of the proposed time stamp and identifier requirements.

69. Would it be feasible for a registered SDR to time stamp, to the second, information that would be submitted pursuant to proposed Rule 901? Would some other time increment be appropriate? If so, why?
70. Would requiring a transaction ID for each reported SBS help facilitate reporting of all events related to that SBS? If not, what alternative method should be required to allow for tracking of all events related to a SBS throughout its life?
71. Would transaction IDs be helpful to counterparties? If so, how?
72. Should registered SDRs have the sole responsibility to assign transaction IDs? Would it be feasible for other registered entities (e.g., exchanges or SB SEFs) to assign transaction IDs?

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75 See proposed Rule 900 (defining "affiliate" as any person that, directly or indirectly, controls, is controlled by, or is under common control with, a person).

76 See supra Section IV.B.1.

73. Do existing SDRs that accept reports of SBSs assign transaction IDs or an equivalent identifier? If so, how?

74. Do commenters agree that the applicable UICs for both counterparties to a SBS would be useful to regulators? Why or why not?

75. Is the method set forth in proposed Rule 906(a) a practical way for the registered SDR to obtain the applicable UICs from the other counterparty if necessary? Why or why not? If not, what better mechanism should be required to ensure that a registered SDR has applicable UICs for both counterparties for any SBSs for which it acts as a repository?

76. Do commenters agree with the proposal to require participants to provide the required UICs within 24 hours? If not, why not? How long should the counterparty be given to complete the report?

77. Would it be more practicable and less burdensome to require a registered SDR to post on its website (in an area accessible only to participants) reports identifying missing UICs and requiring participants to check these reports daily, rather than requiring the registered SDR to send these reports to participants each day, as provided in proposed Rule 906(a)?

78. Would it be unduly burdensome to require a registered SDR to periodically obtain information from each participant that identifies the participant's ultimate parent(s) and any other participant(s) with which the counterparty is affiliated? If so, why? Would there be an easier method for assuring that such information is readily available to regulators? If so, what is it?

79. How much information about its counterparty should a reporting party be expected to obtain? Would it be practical to require the reporting party to report applicable UICs on behalf of its counterparty? If not, what alternative do commenters propose? For

example, should the Commission directly require each counterparty to report applicable UICs for each SBS?

80. For SBSs executed on a SB SEF or on a national securities exchange where a reporting party might not know the identity of its counterparty, how should the reporting of counterparty UICs be addressed? Should the Commission require the SB SEF or national securities exchange to report to the registered SDR, at a minimum, the participant ID of the counterparty?

81. Do commenters agree with the need for, and the goal of, having parent and affiliate information reported to a registered SDR?

82. What difficulties do commenters envision in establishing and implementing a UIC system for ultimate parents and affiliates of participants of a registered SDR?

6. Format of Reported Information

a. Data format

To develop a meaningful reporting and dissemination regime for SBSs, the Commission believes that it is essential that all required information for all SBS transactions be reported in a uniform electronic format.[77] Accordingly, proposed Rules 901(h) and 907(a)(2) together would mandate the use of a uniform reporting format for SBS information reported to a particular registered SDR. Specifically, proposed Rule 901(h) would require the reporting party to electronically transmit the information required to be reported by proposed Rule 901 in a format as required by the registered SDR. In addition, proposed Rule 907(a)(2) would require a registered SDR to have policies and procedures that specify the data format (which must be an

77 In a separate rulemaking today, the Commission is proposing various requirements for registered SDRs that would include, among other things, standards regarding data that registered SDRs would be required collect and maintain. See SDR Registration Proposing Release, supra note 6.

open-source structured data format that is widely used by participants), connectivity requirements, and other protocols for submitting information.[78]

The Commission recognizes that this likely would require some change in existing practice, particularly with respect to highly customized transactions that may not be electronically executed or confirmed currently. However, the Commission believes that such a requirement would provide significant benefits by allowing for more efficient use and analysis of the data. The Commission understands that, currently, information for certain SBSs is communicated using an open-source structured data format called Financial Products Markup Language ("FpML"), which is accepted and used industry-wide and has a sufficiently flexible structure to accommodate new products and asset classes.[79]

Request for Comment

The Commission requests comment on all aspects of the proposed rules regarding the electronic submission of information required under proposed Rule 901 and the formatting of information that would be required to be reported to a registered SDR.

83. Are there different standard data formats currently in use depending on the type or class of SBS?

84. Should the registered SDR have the flexibility to specify acceptable data formats, connectivity requirements, and other protocols for submitting information? Are there disadvantages to this approach? If so, what are they and how should they be addressed?

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78 See infra Section VI.

79 FpML is based on XML (eXtensible Markup Language), the standard meta-language for describing data shared between applications. The Commission preliminarily believes that FpML would be an appropriate format for data reporting, in part because it is already widely understood and used and can be used across multiple asset classes.

85. Are there concerns with a registered SDR requiring use of FpML to report SBSs? If so, what are they? Are there any licensing fees associated with use of FpML? If so, what actions should the Commission take, if any, to help ensure wide availability of a common data format by all participants?

86. Are commenters concerned that varying reporting formats would develop if there were more than one registered SDR in each asset class? If so, should there be a uniform reporting format across all registered SDRs? How would commenters recommend that the Commission achieve this goal? Should the Commission require all registered SDRs to use the same format and the same data elements?

b. Reference codes

The Commission understands that there are – or could be developed – industry conventions for identifying SBSs or reference entities on which SBS are based through readily available reference codes comparable to the CUSIP identifier used for debt, equity, and certain derivative securities.[80] Proposed Rule 903 would permit the use of codes in place of certain data elements for purposes of reporting and disseminating the information required under proposed Regulation SBSR, provided that the information needed to interpret such codes is widely available on a non-fee basis. Specifically, proposed Rule 903 would provide that a reporting party could provide information to a registered SDR pursuant to proposed Rule 901, and a registered SDR could publicly disseminate information pursuant to proposed Rule 902, using codes in place of certain data elements, provided that the information necessary to interpret such codes is widely available on a non-fee basis.

80 The CUSIP number for a security uniquely identifies a company or issuer, the type of security, and other information about the instrument. From the CUSIP number for a debt instrument, for example, market participants are able to determine the issuer, the date of maturity, the interest rate, the coupon structure, and other terms of the instrument.

The Commission preliminarily believes that it is appropriate for the information required to interpret any codes used for reporting SBSs be widely available on a non-fee basis. If the information necessary to interpret such codes were not widely available, or available only for a fee, SBS transaction and pricing data might not be meaningfully available to the public. In the absence of proposed Rule 903, a registered SDR potentially could use proprietary code information , thereby requiring all consumers of its SBS market data to purchase from the code creator information necessary to interpret the codes.

Request for Comment

The Commission requests comment on all aspects of the proposed rules regarding the use of reference codes.

87. Do commenters agree it would be useful to permit the use of codes in place of specific data elements? Why or why not?
88. Are such codes currently in use? How would proposed Rule 903 affect how market participants employ any existing codes? Should the Commission permit registered SDRs to publicly disseminate SBS information using existing codes? Are market participants able to understand the codes without having to pay licensing or other usage fees?
89. Who might in the future develop any codes to be used in place of specific data elements? Would it be costly to develop these codes?
90. Is it feasible for information necessary to interpret these codes to be widely available on a non-fee basis? If not, why not? Would codes be developed if developers were not able to charge fees for the information necessary to interpret the codes? How would permitting developers of codes to charge fees for information necessary to interpret the

codes affect SBS market participants? Would SBS market participants effectively be compelled to purchase this information?

91. If fees are necessary to protect the investment in intellectual property, what standards should be established to assure that such fees are fair and reasonable and not unreasonably discriminatory?

92. Do commenters believe a better approach would be to permit the use of fee-based codes for reporting information to a registered SDR, provided that SBS transaction reports are disseminated by the registered SDR without the codes, or with codes that are widely available on a non-fee basis? Should a registered SDR be expected to pay any fees or be subject to any usage restrictions imposed by the code creator? Would these fees and usage restrictions impact the public's access to the registered SDR's market data feed?

F. Reporting of Data for Historical SBSs

Section 3C(e)(1) of the Exchange Act requires the Commission, no later than 180 days after the effective date of Section 3C, to adopt rules providing for the reporting to a registered SDR or to the Commission of SBSs entered into before the date of enactment of Section 3C. Section 3C(e)(2) of the Exchange Act requires the Commission to adopt rules that provide for the reporting of SBSs entered into on or after the date of enactment of Section 3C no later than the later of (1) 90 days after the effective date of Section 3C, or (2) such other time after entering into the SBS as the Commission may prescribe by rule or regulation.

The statutory provision applicable to the reporting of SBSs entered into prior to the date of enactment does not limit the SBSs subject to the reporting. In contrast, the statutory provision requiring the Commission to adopt an interim final rule for the reporting of SBSs entered into prior to the effective date of the Dodd-Frank Act does limit the applicability of that rule to such

SBSs that had "not expired as of the date of enactment."[81] Indeed, the statutory language applicable in this proposal would not prohibit collection of SBS data on all SBSs entered into since the first SBS, whether or not those SBS positions remain open or have been closed. This would potentially capture a very large amount of data on SBSs going back many years. The Commission preliminarily believes that an attempt to collect many years' worth of transaction-level SBS data (including closed or expired SBSs) would not enhance the goal of price discovery, nor would it be particularly useful to regulators or market participants in implementing a forward-looking SBS reporting and dissemination regime. Furthermore, collecting, reporting, and processing all such data would involve substantial costs to market participants with little potential benefit. Accordingly, the Commission has proposed to limit the reporting of SBSs entered into prior to the date of enactment to those SBSs that had not expired as of that date ("pre-enactment SBSs").[82]

The Commission acknowledges that reporting parties will not necessarily possess all of the information required by proposed Rule 901(c) and (d) with respect to pre-enactment SBSs or SBSs executed on or after July 21, 2010, and before the effective reporting date[83] ("transitional SBSs") (and together with pre-enactment SBSs, "historical SBSs"). Thus, proposed Rule 901(i) would require a reporting party to report all of the information required by proposed Rules

81 15 U.S.C. 78m[A(a)(2)(A)].

82 See proposed Rule 900 (defining "pre-enactment security-based swap" to mean any SBS executed before July 21, 2010 – the date of enactment of the Dodd-Frank Act – the terms of which had not expired as of that date).

83 See proposed Rule 900 (defining "effective reporting date," with respect to a SDR, as the date six months after the registration date); proposed Rule 900 (defining "registration date," with respect to a SDR, as the date on which the Commission registers the SDR, or, if the Commission registers the SDR before the effective date of proposed Regulation SBSR, the effective date of proposed Regulation SBSR).

901(c) and (d) for any historical SBSs, to the extent such information is available.[84] For example, a reporting party would not have to report the time stamp of a historical SBS if a time stamp had not already been captured. In addition, if the terms of a SBS had been amended since the initial time of execution, only the most current version of the SBS would be considered the historical SBS that had to be reported pursuant to proposed Rules 901(i) and 910(a).

By requiring reporting of pre-enactment SBS transactions, proposed Rule 901(i) would provide the Commission with insight as to outstanding notional size, number of transactions, and number and type of participants in the SBS market. This would provide a starting benchmark against which to assess the development of the SBS market over time and, thus, represent a first step toward a more transparent and well regulated market for SBSs. The data reported pursuant to proposed Rule 901(i) also could help the Commission prepare the reports that it is required to provide to Congress. Further, proposed Rule 901(i) would require market participants to inventory their positions in SBS to determine what information needs to be reported, which could benefit market participants by encouraging management review of their internal procedures and controls.

The Commission notes that, especially with respect to CDSs, reporting parties may already have reported SBS information about historical SBSs to a data repository. Should such a data repository become registered with the Commission, the Commission would not require reporting parties to submit duplicate information to the registered SDR, except to the extent the

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84 Information concerning historical SBSs would be reported, but would not be publicly disseminated. <u>See</u> proposed Rules 901(i) and 910. This reporting is consistent with the requirements contained in Rule 13Aa-2T(b)(1) under the Exchange Act, as the Commission recognizes that such information may not be available. <u>See</u> Interim Rule Release, <u>supra</u> note 16. Furthermore, if a reporting party has reported a SBS to a registered SDR pursuant to proposed Rule 901(i), the reporting party would become obligated to report to the registered SDR any life cycle events pertaining to that SBS. <u>See</u> proposed Rule 901(e).

reporting party has information in its possession that satisfies the provisions of proposed Rules 901(c) and (d) that had not previously been reported to the registered SDR.

Request for Comment

The Commission requests comment on all aspects of the proposed rules relating to pre-enactment SBSs and transitional SBSs.

93. Do commenters agree with the proposed reporting requirements for historical SBSs? Should the Commission extend the reporting requirement to include SBSs that were entered into prior to the date of enactment of the Dodd-Frank Act that had expired as of that date? If so, what information should be reported with respect to these SBSs? Would this approach be feasible? What would be the benefits of such an approach? Who would use this information, and for what purpose(s)? What would be the costs of this approach?
94. Would data concerning expired SBSs be of use to anyone? If so, who would use this information, and for what purpose?
95. Should the proposed rule "grandfather" all SBSs previously reported to a SDR regardless of whether the reporting party has information in its possession that satisfies the provisions of proposed Rule 901(c) and (d) that had not previously been reported to the registered SDR?

V. Public Dissemination of Security-Based Swap Transaction Information

In seeking to carry out Congress's mandate to require real-time public reporting for all SBSs, the Commission is mindful of Congress's statement in Section 13(m)(1)(B) of the Exchange Act[85] that "[t]he purpose of [Section 13(m)] is to authorize the Commission to make security-based swap transaction and pricing data available to the public in such form and at such

85 15 U.S.C. 78m(m)(1)(B).

times as the Commission determines appropriate to enhance price discovery." Section 13(m)(1)(E)(iv) of the Exchange Act[86] further provides that the rule promulgated by the Commission to carry out the real-time reporting mandate shall contain provisions that take into account whether the public disclosure will materially reduce market liquidity.[87]

By reducing information asymmetries, post-trade transparency has the potential to lower transaction costs, improve confidence in the market, encourage participation by a larger number of market participants, and increase liquidity in the SBS market. The current market is opaque. Market participants, even dealers, lack an effective mechanism to learn the prices at which other market participants transact. In the absence of post-trade transparency, market participants do not know whether the prices they are paying or would pay are higher or lower than what others are paying for the same SBS instruments. Currently, market participants resort to "screen-scraping" e-mails containing indicative quotation information to develop a sense of the market. Supplementing that effort with prompt last-sale information would provide all market participants with more extensive and more accurate information on which to make trading and valuation determinations.

SBSs are complex derivative instruments, and there exists no single accepted way to model a SBS for pricing purposes. Post-trade pricing and volume information could allow valuation models to be adjusted to reflect how other market participants have valued a SBS instrument at a specific moment in time. Public, real-time dissemination of last-sale information also could aid dealers in deriving better quotations, because they would know the prices at which

86 15 U.S.C. 78m(m)(1)(E)(iv).

87 This provision applies only with regard to SBSs described in clauses (i) and (ii) of Section 13(m)(1)(C) of the Exchange Act, not SBSs described in clauses (iii) and (iv) of Section 13(m)(1)(C). See supra Section I.B.2 (describing which SBSs fall into each of these four categories).

on spreads for less active bonds" and that "[w]e do not find any effect (positive or negative) of transparency for very thinly traded bonds."[89]

It could be argued that post-trade transparency in the SBS market, particularly for large-sized trades, might even adversely impact liquidity by increasing the costs of dealers to hedge. In a typical SBS, one party (the "natural long") either has a risk position that it wishes to offset (because, for example, it is long the bonds of a reference company) or it wishes to establish a risk position. The natural long typically would approach one or more dealers to take the other side of the trade. If a dealer were to enter into a SBS with the natural long, the dealer typically would seek to lay off that risk as much as possible, perhaps with another dealer. Eventually, however, the risk would typically be assumed by a market participant (the "natural short") who is willing to assume the risk being laid off by the natural long. In the SBS market, dealers generally are not natural longs or natural shorts, because they do not seek to profit by taking long or short risk positions. Dealers profit, rather, by collecting spreads between the price at which they buy risk and the price at which they sell risk, and by charging commissions.

The larger the natural long's initial risk position, the more difficult it would likely be for a dealer that enters into an SBS with the natural long to lay off the risk. All other things being equal, it would likely be easier for the dealer to find another dealer or a natural short willing to take on a small risk than a larger one. This is the case even in an opaque market, such as the SBS market as it exists today. The difficulties in transferring the risk could be even greater if the transaction details of the initial SBS between the natural long and the dealer were publicly disseminated in real time. A dealer trying to engage in hedging transactions following an initial,

[89] Michael A. Goldstein, Edith S. Hotchkiss, & Erik R. Sirri, Transparency and Liquidity: A Controlled Experiment on Corporate Bonds, Rev. of Fin. Stud., Vol. 20, Issue 4, at 235-273 (2007), at 269, 270.

large SBS trade could be put in a weaker bargaining position relative to subsequent counterparties, who could anticipate the structure of the hedge.

In an opaque market, market participants have to rely primarily on their understanding of the market's fundamentals to arrive at a price at which they would be willing to assume risk. With immediate real-time public dissemination of a block trade, however, market participants who might be willing to offset that risk – i.e., other dealers and natural shorts – could extract rents from a dealer that takes the risk from the natural long. Because the initial dealer would not internalize those higher costs, it would most likely seek to pass those costs on to the natural long in the form of a higher price for the initial SBS up front. Alternatively, the initial dealer could choose not to enter into the initial SBS if the dealer's cost to hedge increased. In other words, increasing the dealer's initial cost to hedge could increase costs to those seeking to take a natural long position both in the form of less favorable SBS prices for the natural long and potentially fewer counterparties for a natural long to transact with, if certain dealers were to scale back their activity in the SBS market. This could lead to less liquidity in the SBS market, and thus lower trading volume and less ability for market participants to manage risk.[90] It also might be argued that increased post-trade transparency could drive large trades to other markets that offer the opacity desired by traders, creating fragmentation and harming price efficiency and liquidity. This possibility is consistent with the argument that large, informed traders may prefer a less transparent trading environment that allows them to minimize the price impact of their trades.[91]

Under this view of the SBS market, real-time public dissemination of SBS block trades could result in market inefficiencies, as evidenced by fewer transactions or less liquidity. If the

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[90] See N.Y. Naik, A. Neuberger, & S. Viswanathan, Trade Disclosure Regulation in Markets with Negotiated Trades, Rev. of Fin. Stud., Vol. 2, Issue 4, at 873-900 (1999).

[91] See Ananth Madhavan, Consolidation, Fragmentation, and the Disclosure of Trading Information, Rev. of Fin. Stud., Vol. 8, Issue 3, at 579-603 (1995).

natural long were unable or unwilling to assume higher costs for the initial SBS transaction, it might be left with an undesired level of risk, because the market has been unable to relocate the risk to others who are more willing or able to assume it. Furthermore, higher overall transaction costs could hurt dealers, even though they can pass on to the natural long the higher costs to hedge. This is because post-trade transparency could cause overall transaction volumes to decline, thereby reducing profits accruing to dealers, whether in the form of spreads or commissions. Furthermore, to the extent natural shorts are able under a post-trade transparency regime without a block trade exception to extract rents from natural longs (albeit indirectly), there could be a wealth transfer from natural longs to natural shorts. This could be viewed as inefficient, because the prices charged (and presumably obtained) by the natural shorts are not based solely on economic fundamentals, but also are impacted by the predicament of the natural longs (or dealers that have traded with the natural longs), where all market participants know that the natural longs (or the dealers) have a large risk position that they presumably will wish to offset in the near future.

On the other hand, fully and immediately disseminating SBS transactions to the public – even those of large notional size – could incentivize additional market participants to compete to purchase the risk that the natural long is trying to acquire or offset. In other words, the desire by natural shorts to extract rents from natural longs might be offset by more natural shorts competing to acquire the risk. In this view, greater post-trade transparency would result in lower rather than higher costs for natural longs to offset or acquire their risk positions. In the existing, opaque market for SBSs, any individual market participant possesses only incomplete knowledge of when transactions occur, and thus when opportunities arise to enter the market by offering to offset risk. Moreover, any individual market participant possesses only incomplete information about where others view the price of risk. Real-time public dissemination of both the price and full size of all SBS transactions, including block trades, could cause more market participants to bid to take on risk after seeing a report of the block trade. Moreover, full post-trade transparency of block trades would allow natural shorts to know the prices at which natural longs transacted, which would enable natural shorts to bid more efficiently to accept the risk, particularly if natural shorts used the post-trade information as an input to, rather than as a substitute for, their own independent valuation and pricing decisions. Currently, a natural short – without knowledge of the price at which the natural long transacted – could underprice its willingness to acquire the risk, resulting in a windfall profit for the dealer, who can capture a greater spread.

Discussed in greater detail below are the provisions in proposed Regulation SBSR relating to post-trade transparency. In particular, the Commission is proposing Rules 907(b) and 902(b) relating to block trades, and is thereby taking into account the possibility that public disclosure required under the Dodd-Frank Act could materially reduce market liquidity for SBSs of large notional size.[92] These proposed rules are designed to balance the benefits of post-trade transparency against the potential harm that could be done to dealers and natural longs that could face higher costs of transferring or hedging a large risk position after other market participants learn of the execution of a block trade.

The Commission acknowledges that it would be difficult at this stage to accurately predict how post-trade transparency in general, or the particular methods of post-trade transparency discussed in this release, would affect the SBS market. The Commission is mindful that there are similarities and differences between the SBS market and the other securities markets that the Commission regulates, and that these similarities and differences may impact

[92] See 15 U.S.C. 78m(m)(1)(E)(iv).

how post-trade transparency could affect the SBS market, in contrast to how post-trade transparency affects other securities markets. Moreover, the effects of immediate real-time dissemination could differ between the near term and the long term, particularly as the SBS market evolves in response to other regulatory actions. The Commission expects that, as post-trade transparency is implemented in the SBS market, new data will come to light that will inform the discussion and could cause subsequent revision of Regulation SBSR. Whatever approach is ultimately adopted, the Commission will study the development of the market closely, particularly with regard to block trades, and make subsequent revisions to the rules relating to post-trade transparency in the SBS market as necessary or appropriate.

Request for Comment

The Commission requests comment generally on how the Commission should address Congress's instruction in Section 13(m)(1)(E)(iv) of the Exchange Act that, with respect to certain SBSs, the rule promulgated by the Commission to carry out the real-time reporting mandate shall contain provisions that take into account whether the public disclosure will materially reduce market liquidity. In particular:

96. Would post-trade transparency have an effect on the SBS market similar to its effect in other securities markets? Why or why not?

97. Academic studies of other securities markets generally have found that post-trade transparency reduces transaction costs and has not reduced market liquidity. How do those markets differ or compare to the SBS market? How would those similarities or differences affect post-trade transparency in the SBS market?

98. The SBS market currently is almost wholly institutional. Would this characteristic impact the effect of post-trade transparency on the SBS market? If so, how and how

much? Are the needs of market participants in the SBS market for access to transaction information different than the needs of market participants in other securities markets for access to transaction information?

99. A significant amount of trading in the SBS market is currently carried out by only a limited number of market participants. Would this characteristic impact the effect of post-trade transparency on the SBS market? If so, how and how much? For example, is there a concern that it would be easier to determine the identity of the counterparties to a SBS transaction in certain instances based on the real-time transaction report? If so, what would be the harm, if any, of such knowledge? Would the answer differ depending upon the liquidity of the SBS instrument, or whether it was a customized SBS or not?

100. Overall, the SBS market is significantly more illiquid than other securities markets that have post-trade transparency regimes. How would this characteristic impact, if at all, the effect of post-trade transparency on the SBS market? Do commenters believe that post-trade transparency could materially reduce market liquidity in the SBS market, or particular subsets thereof? Why and how? Please be specific in your response and provide data to the extent possible.

101. In an illiquid market (such as the CDS market for smaller reference entities), there will likely be fewer last-sale prints than in a more liquid market (such as the CDS market for large corporate debt issuers). Would these few last-sale prints in the illiquid market have more, less, or the same value as prints in the more liquid market? Why or why not?

102. How would a post-trade transparency regime in SBSs affect the liquidity of the underlying securities? For example, how, if at all, would the post-trade transparency regime affect liquidity in the corporate bond market?

103. Should there be exceptions other than a block trading exception to post-trade transparency to avoid unnecessarily reducing market liquidity, e.g., for SBSs based on illiquid securities? Please be specific in your response and provide data to the extent possible.

104. As noted above, Section 13(m)(1)(E)(iv) of the Exchange Act provides that, with respect to real-time public dissemination of information about SBSs that are subject to mandatory clearing or that are not subject to mandatory clearing but are cleared regardless, the rule promulgated by the Commission regarding such dissemination shall contain provisions "that take into account whether the public disclosure will materially reduce market liquidity." Do commenters believe that there are circumstances under which real-time public dissemination of information about SBS transactions, as contemplated by proposed Regulation SBSR, whether or not the transactions are block trades, would materially reduce market liquidity? If so, how, why, and under what circumstances would real-time public dissemination affect market liquidity? If market liquidity would be materially reduced, how do commenters believe that the Commission should address that issue, given the general requirement in Section 13m(1)(C) of the Exchange Act that the Commission generally shall require real-time public reporting for all SBSs?

A. Registered SDRs as Entities With Duty to Disseminate

The Dodd-Frank Act identifies four types of SBSs and states, with respect to each, that the Commission shall require real-time public reporting for such transactions.[93] In implementing the requirements of the Dodd-Frank Act, the Commission preliminarily believes that the best

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93 See 15 U.S.C. 78m(m)(1)(C).

approach would be to require registered SDRs to disseminate SBS transaction information, and to require other market participants to report such information to a registered SDR in real time, so that the registered SDR can in turn provide transaction reports to the public in real time.[94] Under this approach, market participants would not have to obtain SBS market data from other potential sources of SBS transaction information – such as SB SEFs, clearing agencies, brokers, or the counterparties themselves – to obtain a comprehensive view of the SBS market. Requiring registered SDRs to be the registered entities with the duty to disseminate information would produce some degree of mandated consolidation of SBS transaction data and help to provide consistency in the form of the reported information. This approach is designed to limit the costs and difficulty to market participants of obtaining and assembling data feeds from multiple venues that might disseminate information using different formats.

Multiple uniquely formatted data feeds could impair the ability of market participants to receive, understand, or compare SBS transaction data and thus undermine its value. The Commission is cognizant of this potential and seeks public comment on means to address this issue. One way to address that issue would be to dictate the exact format and mode of providing required SBS transaction data to the public. Although this approach could promote consistency, the Commission preliminarily believes that such an approach could inhibit innovation and the development of best practices, and could inadvertently omit key elements to a successful SBS

94 One commenter has expressed support for this approach. See Benchmark Letter at 2 (arguing that trade reporting and dissemination, including the reference data and identifier system, "should be provided via a non-profit industry utility such as a SDR"). See also letter from Larry E. Thompson, General Counsel, DTCC, to Mary Schapiro, Chairman, Commission, and Gary Gensler, Chairman, CFTC, at 1 (November 15, 2010) (stating that a registered SDR "should be able to provide... a framework for real-time reporting from swap execution facilities and derivatives clearinghouses").

transaction reporting system. The Commission also preliminarily believes that such an approach may be difficult to administer over time.

The Commission understands that existing SDRs that accept SBS data do not currently have the functionality to publicly disseminate data in real time. The Commission notes that nothing in the proposal would prohibit a registered SDR from contracting with a vendor to carry out the dissemination function. Over time, as registered SDRs and SBS transaction reporting become more established, it is possible that alternative approaches for reporting and disseminating SBS transaction information could develop. Thus, the proposal would not prohibit registered SDRs that cover the same asset classes from acting together to create a central consolidator that would disseminate information for all SBSs in that asset class. Allowing registered SDRs to satisfy their dissemination obligation by providing information to a third party that would consolidate and disseminate information for all SBSs in an asset class might provide an economic incentive for registered SDRs to create, fund, and operate a single central consolidator.

The Commission is sensitive to the possibility that there could emerge multiple registered SDRs in an asset class. Should this occur, the Commission and the markets would be confronted with the possibility that different registered SDRs could adopt different dissemination protocols, potentially creating fragmentation in SBS market data. Based on conversations with market participants, however, the Commission preliminarily believes that the most likely outcome is for the market to have only a few registered SDRs (although nothing in the Dodd-Frank Act prevents more from being established). Furthermore, even if multiple registered SDRs were to be established in an asset class, it is unclear whether market participants would have an incentive to spread their business across those multiple registered SDRs. The Commission seeks comment on the likelihood of multiple registered SDRs per asset class emerging; how that would likely affect market participant behavior; and what steps, if any, that the Commission should take to address any attendant regulatory issues that could arise.

One step that the Commission could take would be to require one consolidated reporting entity to disseminate all SBS transaction data for that asset class, by requiring each registered SDR in an asset class to provide all of its SBS data to a "central processor" that would also be a registered SDR. There is substantial precedent for this approach in the equity markets, where market participants may access a consolidated quote for national markets system securities and a consolidated tape reporting executed transactions. A central processor could receive a data feed from each registered SDR, consolidate the information, and then publicly disseminate the consolidated data. However, this approach likely would take more time to implement and may not be warranted given the present SBS market structure. Furthermore, as noted above, the proposal would not prohibit registered SDRs that cover the same asset classes from determining on their own to act together to create a central processor.

Another approach would be to require public dissemination pursuant to a "first touch" or "modified first touch" approach. For a first touch approach, a SBS dealer or major SBS participant that is a party to the SBS would be responsible for dissemination, and for SBSs in which no SBS dealer or major SBS participant is a party, the SDR would be responsible for dissemination. Under a modified first touch approach, a SB SEF or national securities exchange would be required to disseminate the information for those SBSs executed on the SB SEF or national securities exchange. In connection with either of these approaches, the Commission could allow a party required to disseminate to satisfy its obligation if it provided the information to a third-party consolidator that would disseminate the information for all SBSs in that asset class. However, if that did not occur in a timely manner – if, for example, the reporting parties could not agree on the practicalities of such an undertaking, or if not all reporting parties wanted to join – it would result in less consolidation than the proposed approach to require registered SDRs to disseminate the SBS data.

Request for Comment

The Commission requests comment on all aspects of the proposed rules requiring registered SDRs to disseminate SBS information.

105. Would requiring registered SDRs to disseminate SBS information be an effective means of dissemination? Why or why not? Would another approach be more effective? What would be the advantages, or disadvantages, of requiring different registered entities, in addition to or instead of registered SDRs, to disseminate SBS information?

106. Would the presence of multiple disseminators increase the need for a consolidated data feed? Why or why not?

107. Should the Commission require consolidation of data feeds now? Or over time if multiple registered SDRs begin to operate in an asset class?

108. What are the costs and benefits of requiring registered SDRs to disseminate SBS data? Would this approach have an impact on an entity's desire to become a registered SDR? Are other entities, such as SB SEFs, better suited to disseminate SBS data? How should the Commission balance the costs to particular entities with the benefits of greater consolidation of publicly disseminated SBS data?

B. Dissemination in Real Time

Proposed Rule 902(a) would require a registered SDR to publicly disseminate a transaction report of a SBS, other than a block trade,[95] immediately upon (1) receipt of information about the SBS from a reporting party, or (2) re-opening following a period when the registered SDR was closed.[96] The Commission preliminarily believes that "immediately" as used in this context would require a wholly automated process to accept the incoming information, process the information to assure that only information required to be disseminated is disseminated, and disseminate a trade report through electronic means. The transaction report that is disseminated would be required to consist of all the information reported by the reporting party pursuant to proposed Rule 901(c),[97] along with any indicator or indicators contemplated by the registered SDR's policies and procedures.[98] In addition, the registered SDR would be required to have policies and procedures that specify the specific data elements that must be reported to it and the format for reporting this information,[99] which could help to provide greater uniformity in the disseminated transaction data.

The Commission recognizes that there may be circumstances when a registered SDR's systems might be unavailable for publicly disseminating transaction data. In such cases, as

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95 See infra Section V.C (discussing block trades).

96 The Commission notes that FINRA disseminates information on all transactions in TRACE-eligible securities immediately upon receipt of a transaction report. See FINRA Rule 6750(a). The Commission also notes that the Municipal Securities Rulemaking Board disseminates information on most transactions in municipal securities almost immediately. See http://emma.msrb.org/EducationCenter/FAQs.aspx?topic+AboutTrade.

97 See supra Section III.B (discussing the data elements required to be reported in real time by proposed Rule 901(c)).

98 See proposed Rule 907(a)(4).

99 See proposed Rules 907(a)(1) and (2).

provided in proposed Rule 902, the registered SDR would be required to disseminate the transaction data immediately upon its re-opening.[100]

C. Block Trades

The Commission proposes to establish criteria for what constitutes a block trade and for specifying a time delay for disseminating certain information about a block trade to the public, for all SBSs except those that are determined to be required to be cleared under Section 3C(b) of the Exchange Act but are not cleared.[101] Proposed Rule 907(b) would establish criteria for what constitutes a block trade, and proposed Rule 902(b) would specify the time delay for disseminating certain information about a block trade to the public.

1. Role of registered SDRs generally

Proposed Rule 900 would define "block trade" to mean a large notional SBS transaction that meets the criteria set forth in proposed Rule 907(b). Proposed Rule 907(b)(1) would require a registered SDR to establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all SBS instruments reported to the registered SDR in accordance with the criteria and formula for determining block size as specified by the Commission. In determining block trade thresholds, a registered SDR would be performing mechanical, non-subjective calculations.

The Commission preliminarily believes that requiring a registered SDR to calculate and publicize block trade thresholds pursuant to its written policies and procedures would allow for a more streamlined and accurate process, as registered SDRs would have more ready access to the

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100 See infra Section V.D (discussing proposed Rule 904, which deals with hours of operation of registered SDRs and related operational procedures).

101 See 15 U.S.C. 13m(m)(1)(C)(iv) (providing that, with respect to SBSs that are determined to be required to be cleared under Section 3C(b) but are not cleared, the Commission shall require real-time public reporting of such transactions).

data necessary to make block trade calculations. Further, placing the responsibility on registered SDRs rather than reporting parties would eliminate the burden on reporting parties for making block trade calculations, and should provide greater uniformity in what constitutes a block trade.

2. **Block trade threshold**

As noted above, Section 13m(1)(E)(ii) of the Exchange Act[102] requires the Commission rule for real-time public dissemination of SBS transactions "to specify the criteria for determining what constitutes a large notional security-based swap transaction (block trade)." In this release, the Commission is proposing general criteria that it would consider when setting specific block trade thresholds, but is not proposing specific thresholds at this time. The Commission believes that it would be appropriate to seek additional comment from the public, as well as to collect and analyze additional data on the SBS market, in the coming months. The Commission intends to propose specific block trade thresholds simultaneous with the adoption of Regulation SBSR (in whatever form it may ultimately take).

The Commission preliminarily believes that the general criteria for what constitutes a large notional SBS transaction must be specified in a way that takes into account whether public disclosure of such transactions would materially reduce market liquidity, but presumably should be balanced by the general mandate of Section 13(m)(1) of the Exchange Act, which provides that data on SBS transactions must be publicly disseminated in real time, and in a form that enhances price discovery. In considering criteria for what constitutes a large notional SBS, the Commission notes that there are mechanisms by which reporting data on any SBS might impact liquidity. If the intent to trade were publicly reported prior to a transaction taking place (i.e., if

102 15 U.S.C. 13m(m)(1)(E)(ii). This provision applies with respect to SBSs that are subject to mandatory clearing and SBSs that are not subject to mandatory clearing but are cleared at a registered clearing agency.

there were pre-trade transparency), it would be reasonable to suppose that the marketplace would have an opportunity to react to this information in a way that impacted the ability of such a transaction to be completed at the desired price, which might in turn impact the liquidity of such a market by causing participants to withdraw from trading or reduce the size of their trades.

However, this effect could not manifest itself directly via post-trade transparency, since the transaction has already taken place. For post-trade transparency to have a negative impact on liquidity, market participants would need to be affected in a way that either: (1) impacted their desire to engage in subsequent transactions unrelated to the first, or (2) impacted their ability to follow through with further actions after the reported transaction has been completed that they feel are a necessary consequence of the reported transaction. In instance (1), post-trade dissemination of transaction prices, without necessarily any reference to notional size, could impact the desire for certain market participants to trade if spreads narrowed, because price transparency led to an increased negotiating ability for market participants who otherwise would not have been privy to such information. But this same transparency also could lead to an increase in liquidity if other market participants increase their trading as a result of having access to new information or of narrower spreads. It may not be possible to estimate with any certainty which of these factors will outweigh the other as the SBS market continues to evolve. Analogs to other markets (such as fixed income or equities) may provide guidance; however, those markets each have structures and instruments that differ significantly from the SBS market.

In determining whether there should be a delay in the disclosure of prices of SBS block trades, without necessarily any reference to notional size, the Commission is guided by the general mandate of Section 13(m)(1) of the Exchange Act, which provides that transaction information should be disseminated in a form that enhances price discovery. Nonetheless, the

Commission recognizes that mandating disclosure of trades below a certain size would essentially signal to the market that a trade was at or above that size – that is to say, would signal that the trade was "of size" – even when there is no disclosure of the precise size of the trade if it is above some threshold size. The Commission preliminarily believes that even in very illiquid markets transaction prices form the foundation of price discovery. Past transactions may not be indicative of those in the future, and may not themselves accurately reflect fundamental value, but they provide an objective starting point for participants to consider. Moreover, in an illiquid market, the low frequency of transactions and potentially wide variation of past prices inform participants as to uncertainty in pricing that they may expect in the future, which may not only influence trading decisions, but could also play a role in mark-to-market valuations and risk management. There does not seem to be a reason that post-trade price disclosure for large notional SBS transactions would be less relevant for price discovery than similar disclosure for other SBSs. Therefore, as described further below, the Commission is proposing that prices for block trades be disseminated in the same fashion as prices for non-block-trade transactions.

In contrast, instance (2) above considers that disclosure that a block trade has taken place, with or without the exact size of the trade, may lead to a reduction in liquidity if one or both of the parties engaged in such a transaction need to take further actions in the marketplace after the reported transaction was completed and disseminated, and dissemination would inhibit their ability to take such action. In this situation, one or both of the parties might choose not to have participated in the original transaction.

One reason a SBS counterparty might desire to take further action after an initial transaction is completed would be for hedging purposes. This hedge may take the form of re-entering the SBS market on the contra side, or hedging the exposure underlying the initial SBS by taking a contra position in the cash security market. Whether or not one or more parties to a transaction will be subsequently hedging its exposure after the transaction is complete cannot be discerned from data about the transaction. However, if a transaction is to be hedged, the size of the transaction would be a factor in how readily the hedge can be executed.

For transactions that are sufficiently small, disseminating the exact size of the transaction would likely not provide other market participants with information that could be used to the detriment of the hedging party, since the hedging transaction would be indistinguishable from other market activity. However, for transactions that are sufficiently large, it may be the case that disseminating the size of such a transaction would provide a signal to other market participants that there is the potential, though not certainty, that a large transaction could take place in a SBS or a related security. Market participants might be able to use this information to their advantage in a way that disadvantages the hedging party and disincents that party from engaging in such types of SBS transactions. In this fashion, post-trade transparency for one transaction is transformed into pre-trade signaling for another.

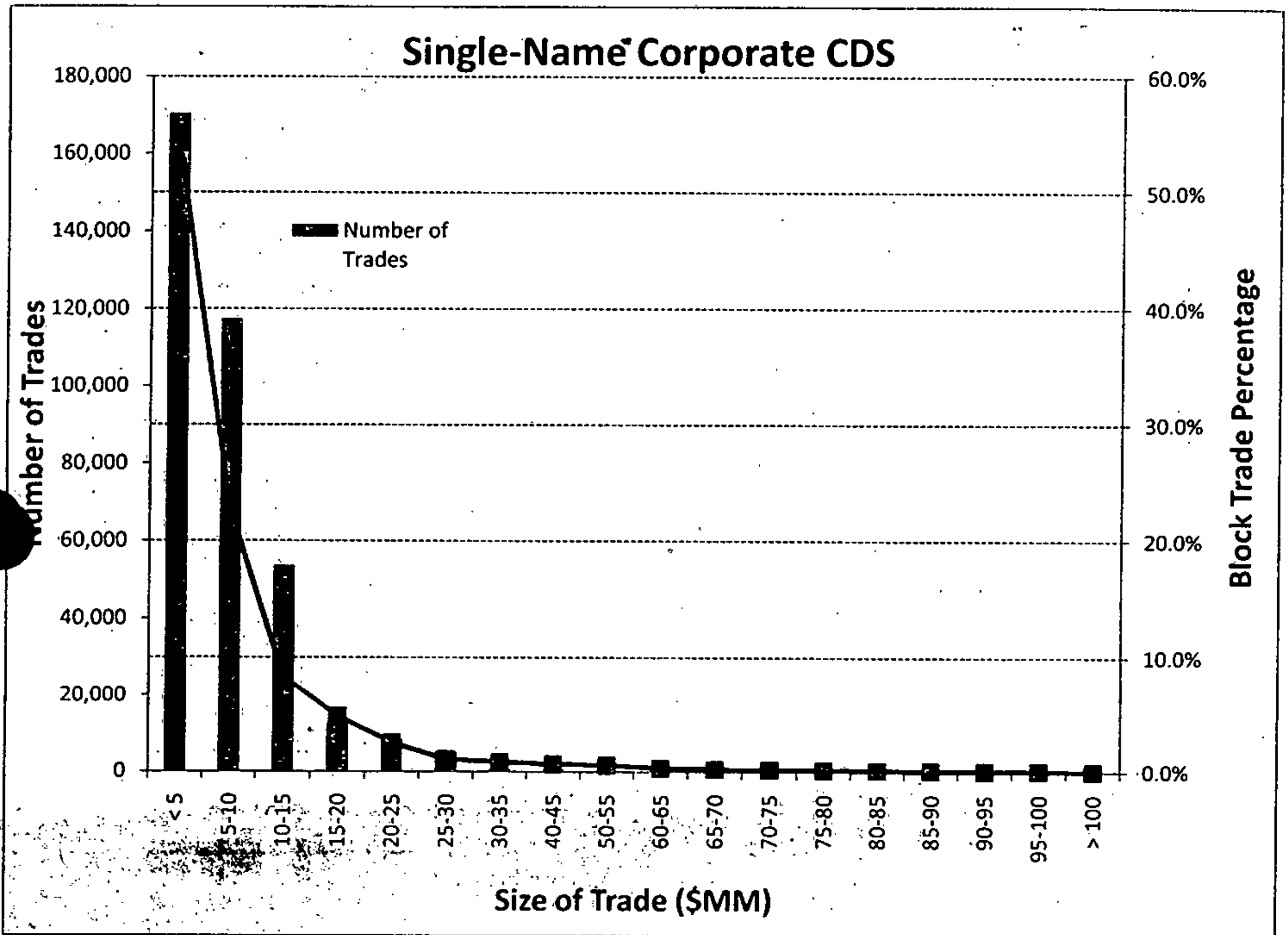
To address this issue, the Commission preliminary believes that the size of a SBS transaction that is sufficiently large to signal other market participants that there is the potential for a subsequent outsized transaction, should itself be suppressed to provide time for those subsequent transactions, if any, to be absorbed by the market. Moreover, the Commission recognizes that mandating disclosure of trades below a certain size would essentially signal to the market that a trade was at or above that size – that is to say, would signal that a trade was "of size" – even when there is no disclosure of the precise size of the trade, if it is above some threshold size.

There are a variety of metrics that can be used to determine the criteria for whether or not a SBS transaction should be considered a block trade. These include the absolute size of the transaction, the size of the transaction relative to other similar transactions, the size of the transaction relative to some measure of overall volume for that SBS instrument, and the size of the transaction relative to some measure of overall volume for the security or securities underlying the SBS. The most relevant metric would depend of the specific nature and timing of the hedging, which cannot be discerned from data about the transaction. However, if the goal of not publicly disseminating the size of a large notional SBS transaction is to prevent inadvertent signaling to the market of potential large subsequent transactions, then criteria should be chosen in a way that minimizes such signaling.

This suggests the use of one or more metrics that can help distinguish ordinary transaction sizes from extraordinary transaction sizes. An ordinary transaction size would be one in which the size of subsequent hedging transactions (if any) would be indistinguishable from the rest of the market. Extraordinary transaction sizes would be those in which subsequent transactions could be distinguished from the rest of the market.

One possibility could be to order the sizes of all transactions for a given SBS instrument and identify the top N-percent as large. However, it is not a priori obvious what percent should be used. Also, using a simple percentile threshold would not account for the distribution of trade sizes that could be widely dispersed or narrowly clustered. In addition, the distribution of the trade sizes could change over time.

A second possibility would be to examine trade size data to determine if the distribution of trade sizes suggests thresholds that could be used to discern ordinary versus extraordinary trade size. The figure below plots the distribution of trade sizes, bucketed in bins of $5 million, for over 370,000 single name corporate CDS transactions.[103] Almost half of all trades have sizes of less than $5 million, and over 90% have sizes less than $15 million. There is a small cluster of trades between $15 million and $30 million, followed by a long tail beginning at $30 million and extending to over $100 million.



These data would suggest two possible thresholds – $15 million or $30 million. A cutoff of $15 million would have resulted in about 8% of trades executed over this time period being considered large notional, and a cutoff of $30 million would have resulted in about 1% of trades being considered large notional.

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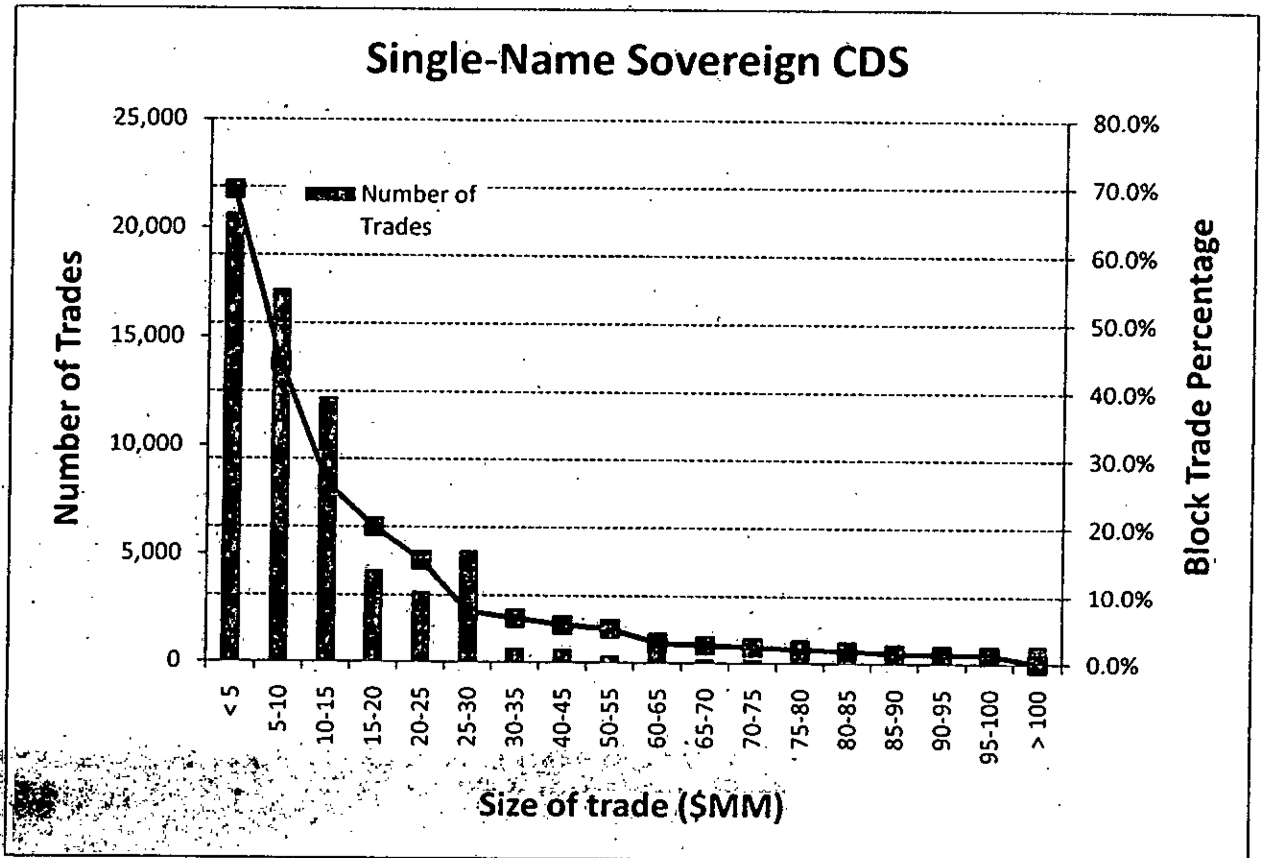
103 See supra note 11.

The second figure below presents similar data for over 20,000 sovereign CDS transactions from the same source over the same time period. The plot suggests similar cutoff points, although there are notably many more transactions in the tail for sovereign CDS than there were for single-name corporate CDS. A cutoff of $15 million would result in about 26% of all trades being considered large notional, and a cutoff of $30 million would result in about 7.5% of all trades being considered large notional.



Splitting the universe of transactions into single-name corporate CDS and sovereign CDS would not provide for potential differences between individual corporates or sovereigns that may have unique distributions or liquidity profiles. As a further consideration, the Commission notes that some SBSs may trade very infrequently, such as only a few times per month. Under these conditions, it would not be obvious how to distinguish an ordinary sized transaction from an extraordinary size. However, if a market were that illiquid it would most likely not be the case that subsequent hedging would be done in that same market. In such case, it is somewhat harder to see how the post-trade reporting of size would <u>further</u> impact the ability for one or more market participants to affect subsequent hedging transactions, since in such an illiquid market it may not be possible to hedge at all.

The Commission also notes that this criterion considers only typical trade sizes within the CDS market without regard to overall daily, weekly, or monthly volume. This criterion also does not consider liquidity or volume in the underlying cash markets. Inclusion of volume metrics may be helpful in defining the criteria for what constitutes a block trade. For example, a single trade that is equivalent in size to a full- or half-day's average volume may be considered out-sized. On the other hand, if a particular SBS trades only once or twice per day then every trade would be equivalent to a full or half-day's average size. The Commission invites comment on if and how volume considerations should be included in the criteria for setting block trade thresholds.

For the reasons discussed above, a simple metric based on recent trade sizes of SBSs designed to help distinguish ordinary from extraordinary trade sizes could address the issue of inadvertently signaling market participants that a potential large transaction in a specific SBS or underlying security may be forthcoming as the result of one or more participants hedging a just-completed large notional transaction. On the other hand, the Commission recognizes that requiring disclosure of the fact that a block trade took place may raise some of the same concerns as requiring disclosure of the exact size of the large trade, and that to mandate disclosure of trades below a certain size is tantamount to mandating disclosure that a large trade occurred, even if the precise size of the trade is not disclosed. The Commission is interested in and invites comment on whether there are other means by which the dissemination protocol for block trades could effectively not reveal the size of a block trade or mitigate the potential effects of revealing that a block trade took place, while still offering the price component in real time. For example, could the block trade be disseminated with a "proxy" size, such as the size of the block trade threshold or a randomized size, with no identifier showing that the trade is a block trade?

Finally, the Commission preliminarily believes that it would not be appropriate to establish different block trade thresholds for similar instruments with different maturities. This is reflected in the proposed definition of "security-based swap instrument," which would mean "each security-based swap in the same asset class, with the same underlying reference asset, reference issuer, or reference index."[104] The proposed definition would not include any distinction based on tenor or date until expiration. The Commission is proposing this approach for three reasons. First, the larger the number of distinctions between SBS instruments that are created by the proposed rule, the larger the number of potentially illogical categorizations at the margins. For example, there would be little economic rationale to draw a distinction between SBSs alike in all respects except that they had maturities one day apart. Second, the Commission understands that SBSs in the same asset class, with the same underlying reference asset, reference issuer, or reference index have pricing impacts on each other, regardless of their maturities. This is because market participants typically price SBSs based on the same reference issuer or index along a curve, whereby prices at points along the curve where no hard data exist may be interpolated or extrapolated from different points along the curve where harder data (such as publicly disseminated last-sale prints) may exist. Thus, even if a SBS of an unusual maturity were traded only infrequently, the market in that SBS would likely be affected more by

104 See proposed Rule 900.

the characteristics of other SBSs based in the same asset class, with the same underlying reference asset, reference issuer, or reference index, rather than the fact that there is low liquidity in SBSs having that specific maturity. Third, a regime that differentiated SBSs based on maturities could invite market participants to fragment the market by creating SBSs with non-standard maturities in an effort to gain more favorable block trade treatment.

3. Exclusions from block trade definition

Proposed Rule 907(b)(2)(i) would provide that a registered SDR shall not designate as a block trade any SBS that is an equity total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the security-based swap is based.[105] A SBS can be designed as a synthetic substitute for a position in the underlying equity security or securities. There is no delay in the reporting of block trade transactions for equity securities in the United States. Proposed Rule 907(b)(2)(i) is designed to discourage SBS market participants from evading post-trade transparency in the equity securities markets by using synthetic substitutes in the SBS market.[106]

Proposed Rule 907(b)(2)(ii) would provide that a registered SDR shall not designate as a block trade any SBS contemplated by Section 13(m)(1)(C)(iv) of the Exchange Act, i.e., any SBS that is determined to be required to be cleared under Section 3C(b) of the Exchange Act, but

105 Proposed Rule 901(c)(1) would require the reporting party to report, in real time, the asset class of the SBS and, if the SBS is an equity derivative, whether it is a total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the SBS is based.

106 As an example: Bank DEF wants to purchase ten million shares of Company XYZ and would like to avoid real-time public reporting of the purchase. If Bank DEF purchased those shares on a national securities exchange, the purchase would be reported in real time. However, Bank DEF could instead enter into a total return swap with ten million shares of XYZ as a reference asset and create an economically similar position. If the total return swap, but not the equity security transaction, were afforded a block trade exception under proposed Regulation SBSR, this disparate regulatory treatment might influence market participants' investment choices.

that is not cleared. The Dodd-Frank Act expressly requires the Commission to mandate real-time public dissemination for SBSs that are determined to be required to be cleared but are not cleared.

4. Public dissemination of block trades

Proposed Rule 902(b) would provide that a registered SDR shall publicly disseminate a transaction report of a SBS that constitutes a block trade immediately upon receipt of information about the block trade from the reporting party. The transaction report would be required to consist of all the information reported by the reporting party pursuant to proposed Rule 901(c), except for the notional size, plus the transaction ID and an indicator that the report represents a block trade. The Commission proposes that the registered SDR would be required to publicly disseminate a complete transaction report for such block trade (including the transaction ID and the full notional size) as follows:

- Proposed Rule 902(b)(1) would provide that, if the SBS was executed on or after 05:00 UTC and before 23:00 UTC of the same day (which corresponds to 12:00 midnight and 6:00 p.m. EST), the transaction report (including the transaction ID and the full notional size) shall be disseminated at 07:00 UTC of the following day (which corresponds to 2:00 a.m. EST of the following day).
- Proposed Rule 902(b)(2) would provide that, if the SBS was executed on or after 23:00 UTC and up to 05:00 UTC of the following day (which corresponds to 6:00 p.m. until midnight EST), the transaction report (including the transaction ID and the full notional size) shall be disseminated at 13:00 UTC of that following day (which corresponds to 8:00 a.m. EST of the following day).

Under proposed Rule 902(b), market participants would learn the price of a SBS block trade in real time, although not the notional size. The Commission preliminarily believes that this approach promotes the public's interest in price discovery without subjecting the block trade counterparties to undue risk of a significant change in the price necessary to hedge the market risk created by entering into the block trade. Other market participants would know the SBS transaction was above a certain size, and it may be possible to infer the size or direction of a large trade before the size is publicly disseminated, based on the liquidity premium inferred from the reported trade price. The Commission recognizes that the disclosure that a block trade took place, even without disclosure of the exact size, can still implicate some of the concerns regarding subsequent hedging that were previously discussed. On the other hand, there would still be substantial risk for any other market participant that seeks to take long or short market positions solely to profit from the information that a block trade occurred, due to the uncertainty regarding the true size of the trade. Moreover, disseminating the price in real time could allow all market participants to obtain useful information about the block trade for valuation purposes, even though they would not learn about the full size of the block trade until later.[107] The

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107 SBS market participants typically value their holdings at the end of the business day. If no information about a block trade were made public until after the end of the business day (for example, if the block trade occurred at 15:00 UTC/noon EST but no public trade report were required until eight hours later, i.e., at 23:00 UTC/8:00 p.m. EST), all market participants would lose a potentially significant input into their valuation methodologies. This could be the case in particular for infrequently traded SBS instruments, where there are few last-sale prints. This would also likely be the case for market participants that hold SBS instruments in notional sizes similar to the undisseminated SBS block trade. A large position might be valued less on a per-unit basis than a smaller position, due to an illiquidity premium. Seeing the price of the block trade in real time could be useful for market participants that must value a larger SBS position, because the price of the reported block trade (even if the exact size is unknown) would also likely reflect an illiquidity premium to some extent.

Commission notes that the approach that it is proposing here is similar to TRACE's handling of block trades.[108]

Unlike TRACE, however, the Commission is proposing a second wave of transaction reporting, which would include the full notional size of the block trade, after an appropriate delay. Under proposed Rules 907(b)(1) and (2), all block trades would have at least an eight-hour delay before the full notional size would be disseminated. Proposed Rule 907(b) would establish a cut-off time of 23:00 UTC, which correspond to 6:00 p.m. EST. Block trades executed on or after 05:00 UTC (which corresponds to midnight EST) and up to 23:00 UTC (6:00 p.m. EST) would have to have their full notional size disseminated by 07:00 UTC, which corresponds to 2:00 a.m. EST. Thus, most block trades executed on a given U.S. day would have their full notional sizes disseminated overnight. However, block trades executed on or after 23:00 UTC (6:00 p.m. EST) and before 05:00 UTC (midnight EST) would instead have their full notional sizes disseminated at 13:00 UTC, which corresponds to 8:00 a.m. EST of the following U.S. day. If there were only one point in the day when a registered SDR were required to disseminate the full notional sizes, block trades executed a short time before the second wave of dissemination would not benefit from the proposed delay in the dissemination of the notional size. Under the proposed approach, block trades executed during a period that runs roughly from the close of the U.S. business day to midnight EST would have their full sizes disseminated by a registered SDR at a time that corresponds to the opening of business on the next U.S. day.

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108 FINRA rules requires member broker-dealers to report transactions in corporate and agency debt securities to TRACE within 15 minutes. FINRA publicly disseminates a transaction report immediately upon receipt of the information. If the par value of the trade exceeds $5 million (in the case of investment grade bonds) or $1 million (in the case of non-investment-grade bonds) the quantity disseminated by TRACE will be either "5 million+" or "1 million+". At no time will TRACE subsequently disseminate the full size of the trade. <u>See</u> TRACE User Guide, version 2.4 (last update March 31, 2010), at 50.

The Commission preliminarily believes that disseminating the full size of a block trade, albeit with a delay, would further promote price transparency while having only minimal costs. The ability to view the full notional size, although with a delay of between eight and 26 hours,[109] would allow market participants to understand the full scope of activity in the market. At the same time, market participants that execute block trades would have at minimum eight hours to hedge or take other action to minimize their risks before the full size of their trades was disseminated. Based on preliminary discussions with market participants, the Commission believes that the proposed delay of between eight and 26 hours, which in most cases would represent the better part of a business day, would allow sufficient time for the counterparties to the transaction to take follow-up action as needed. The Commission preliminarily believes, therefore, that these time periods strike a reasonable balance between the goals of post-trade transparency and of providing market participants that trade in large size a reasonable opportunity to mitigate their risks.

Finally, proposed Rule 907(b)(3) would provide that, if a registered SDR is in normal closing hours or special closing hours[110] at a time when it would be required to disseminate information about a block trade pursuant to this section, the registered SDR shall instead disseminate information about the block trade immediately upon re-opening. Under proposed

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109 Market participants would be able to view the full notional size of a SBS transaction no sooner than eight hours and no more than 26 hours after the time of execution. A SBS block trade executed at 05:00 UTC would have its full size disseminated by a registered SDR at 07:00 UTC of the next day, which is 26 hours later. Any other SBS block trade would be disseminated after a shorter delay. For example, a SBS block trade executed at 17:00 UTC also would be disseminated with its full size at 07:00 UTC of the next day, which is 14 hours later. A SBS block trade executed at 04:59:59 would have its full size disseminated by a registered SDR at 13:00 UTC of that same day, just over eight hours later.

110 See infra Section V.E (discussing hours of operation of registered SDRs).

Rules 907(b)(1) and (2), a registered SDR could otherwise be required to disseminate the full report of a block trade, including the notional size, at a time when it is closed.

5. No delay in reporting block trades to registered SDR

Because the registered SDR, rather than the reporting party, would have the responsibility to determine whether a transaction qualifies as a block trade, the reporting party would be required to report a SBS to a registered SDR or the Commission pursuant to the time frames set forth in Rules 901(c) and (d), regardless of whether the reporting party believes the transaction qualifies for block trade treatment.

6. Block trade policies and procedures

Proposed Rule 907(b)(1) would provide that a registered SDR shall establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all SBS instruments reported to the registered SDR. At a minimum, a registered SDR would be required to establish written policies and procedures reasonably designed to: (1) immediately determine whether a SBS reported to the registered SDR constitutes a block trade and, if so, (2) disseminate information about the block trade in a manner consistent with proposed Rule 902(b).

As noted above, the specific threshold that a registered SDR would have to apply to make the block trade calculations will be established in a future Commission rulemaking.

Request for Comment

The Commission requests comment generally on all aspects of the proposed rules regarding block trades, including the proposed criteria and the proposed exclusions. In particular, the Commission specifically requests comment on the following issues:

109. Do commenters agree with the approach of having a registered SDR calculate and publicize block size thresholds, in accordance with the criteria established by the Commission? Why or why not? If not, what would be an alternative approach?

110. If there is more than one registered SDR for an asset class, how would the Commission ensure that all registered SDRs calculated the same block trade thresholds for the same SBS instrument? How should the Commission address this issue? Is it feasible to expect multiple registered SDRs in the same asset class to obtain each others' market data feeds to obtain the data with which to calculate block trade thresholds?

111. If commenters believe that there would be adverse price impact for traders if all information on block trades was made available in real time, do commenters have any studies or empirical evidence to support that assertion? What would be the long-term effects on the market if all market participants knew the full transaction details of all SBSs in real time? Would this impact liquidity? If so, how?

112. Some participants in the Market Data Roundtable referred to the likelihood of "front running" if all information on block trades were made available in real time. How would front running occur in the SBS market if all the details of block trades were disseminated in real time?

113. How do counterparties hedge large SBS trades? At what notional trade size does it become difficult to hedge a SBS such that a dissemination delay is necessary? How does this vary by asset class? How long does it take to complete a hedge? What characteristics of a SBS instrument or asset class affect the length of time needed to deploy the hedge?

114. Does a counterparty's ability to hedge a trade increase or decrease depending on market characteristics such as trading volume and trading frequency? Does this depend on asset class, and within an asset class does it depend on maturity or other contract characteristics?

115. Do commenters agree that the criteria for determining whether or not a SBS transaction is considered a block trade should be based on a distribution of past trade sizes? Should overall volume also be considered? Should volume or trade sizes in the cash market be considered?

116. Should block trade thresholds be determined with more granularity, such as on a SBS instrument by instrument basis?

117. How often should thresholds be updated? What should be the appropriate look back period for data used to determine thresholds?

118. Is there a preferred formulaic way of computing the thresholds from trade size or other distributions? Should a simple percentile cut-off be chosen? If so, how? Would a standard deviation metric be appropriate?

119. How might trading change as a result of the chosen threshold? Could these provisions be gamed? Would market participants change their trading patterns to purposely skew the distribution to alter the threshold when they are next updated?

120. For any criterion that takes into account trading activity in the SBS instrument, should inter-affiliate transactions or trades resulting from portfolio compressions be excluded? If so, why? Are there other types of SBSs that should be excluded? If so, why? How could those exclusions be defined so as to prevent market participants from inappropriately deeming a SBS as qualifying for an exclusion?

121. Should there be a fixed minimum notional size threshold below which no SBS could be considered a block trade? If so, what should that threshold be and why? Should there be a different fixed minimum threshold for different asset classes or SBS instruments? If so, why? What would those different thresholds be?

122. Do commenters agree with the proposed exclusions from the block trade determination? If so, why or why not? Should other kinds of transactions be prevented from having a block trade exception?

123. Do commenters believe that block trades (however defined) should be treated differently from other trades for purposes of public dissemination? If so, why? If not, why not?

124. What would be the effect of having no or only a short dissemination delay for a block trade report that includes the full notional size? Would it enhance or slow the speed of price discovery and the level of price efficiency in the market? Would it increase or decrease competition among market participants in general, or SBS dealers in particular? Would any short-term increases in the cost of hedging be offset by reductions in the cost of hedging in the longer term?

125. Do commenters agree with the proposed two-step process for public dissemination of a block trade?

126. How likely is it that market participants would be able to infer the size or direction of a large trade before the size is publicly disseminated, based on the liquidity premium inferred from the reported traded price? Is it feasible to remove the liquidity premium component from the price of a large trade, leaving only a normalized price for a standard (non-block) size trade to be reported in real time, with the actual price including

the liquidity premium component being reported only at the time that actual trade size is revealed?

127. Would it be preferable to have a single transaction report for a block trade that contains all transaction details, including the notional size, but with a delay in dissemination of the complete trade report? If so, why? What should that delay be? Five minutes? Ten minutes? An hour? Three hours? At the end of the day? Why would this length of time be appropriate?

128. Are there other means by which the dissemination protocol for block trades could effectively not reveal the size of the block trade while still offering the price component in real time? For example, could the block trade be disseminated with a "proxy" size, such as the size of the block trade threshold or a randomized size, with no identifier showing that the trade is a block trade? Even if that approach were to effectively not reveal the true size of the block, would it do so at the cost of creating misinformation in the market?

129. Do commenters believe it is important for market participants to have pricing information from block trades to set end-of-day marks? When are these marks typically set? How valuable would it be in setting end-of-day marks to know the price of a SBS block trade, even without the full size?

130. If the Commission were to adopt a requirement that the price and size of a block trade must be publicly disseminated before the time that market participants typically set marks, would that cause SBS counterparties to avoid executing block trades near that time? For example, assume the Commission were to require that the full transaction details of block trades had to be publicly disseminated by a registered SDR at 21:00

UTC/4:00 p.m. EST, and that even a block trade executed at 3:55 p.m. EST had to be disseminated at 4:00 p.m. EST. Would this cause market participants to shift block trading earlier or later in the day? If so, would there be any harm in such movement?

131. Do commenters agree with the Commission's proposed times for disseminating the full notional size of block trades? If not, what other times would be appropriate, and why? Would counterparties be able to effectively hedge large SBSs executed toward the end of the day during the time allowed by the proposed rules (i.e., between 6:00 p.m. and midnight EST)?

132. Do commenters believe it would be more appropriate for a registered SDR to disseminate the notional size of each block trade after a fixed period after the trade report for that SBS transaction is disseminated without the notional size, rather than requiring the registered SDR to disseminate the full trade reports in two "batches" during the day? If so, what would be an appropriate delay for disseminate the full notional size, and why?

133. Under the Commission's proposal, there would be at least an eight-hour delay between the time of execution of a block trade and when the full notional size is required to be disseminated by a registered SDR. Is an eight-hour minimum appropriate? Should that period be longer or shorter? Why?

134. Would the Commission's proposed times for disseminating block trade information with the full notional size included cause any disruptive change in trading patterns or activity for large SBS trades, for example by providing market participants the incentive to move block trading toward the very beginning of the day, or by prompting market participants to avoid trading around the release of block trade information at 07:00 UTC/2:00 a.m. EST and 13:00 UTC/8:00 a.m. EST?

135. Would the public dissemination of block trades as proposed allow some market participants to infer the identity of the parties to the transaction or materially reduce market liquidity? If so, how? Can or should there be another means of suppressing the exact size of a block trade?

D. SBS information that will not be disseminated

The Commission is proposing Rule 902(c)(1), which would prohibit a registered SDR from disseminating the identity of either counterparty to a SBS, and Rule 902(c)(2), which would prohibit a registered SDR from disseminating, with respect to a SBS that is not cleared at a registered clearing agency and that is reported to a registered SDR, any information disclosing the business transactions and market positions of any person.[111]

In addition, proposed Rule 902(c)(3) would prohibit a registered SDR from publicly disseminating any information regarding a SBS reported pursuant to proposed Rule 901(i), which would require participants to report pre-enactment and transitional SBSs.[112] The Commission preliminarily believes that price discovery would not be enhanced by publicly disseminating information about historical SBSs.[113]

111 See 15 U.S.C. 13m(m)(1)(C)(iii) ("With respect to security-based swaps that are not cleared…and which are reported to a security-based swap data repository or the Commission under section 3C(a)(6), the Commission shall require real-time public reporting…in a manner that does not disclose the business transactions and market positions of any person."); 15 U.S.C. 13m(m)(1)(E)(i) (requiring that the Commission's rules governing the dissemination of SBS transaction and pricing information "does not identify the participants"). The Commission does not believe that the information that would be disseminated pursuant to proposed Regulation SBSR would disclose the business transactions, identities, or market positions of any person.

112 See proposed Rule 900 (defining "pre-enactment security based swap" and "transactional security-based swap").

113 See supra Section IV.F.

Request for Comment

136. Do commenters believe that information that would be disseminated pursuant to proposed Regulation SBSR would disclose the business transactions, identities, or market positions of any person?

137. If so, what revisions to proposed Regulation SBSR do commenters believe would be necessary to avoid disclosing the business transactions, identities, or market positions of any person?

E. Operating Hours of Registered SDRs

1. Continuous operation

The Dodd-Frank Act does not explicitly address or prescribe the hours of operation of the real-time reporting and dissemination regime. However, to serve the goals of transparency and price discovery, the Commission believes that it is appropriate to implement a system of real-time reporting and dissemination that, in general, operates continuously.[114] Accordingly, proposed Rule 904 would require a registered SDR to design its systems to allow for continuous receipt and dissemination of SBS data, except that a registered SDR would be permitted to establish "normal closing hours." Such normal closing hours may occur only when, in the estimation of the registered SDR, the U.S. markets and other major markets are inactive. In addition, a registered SDR would be permitted to declare, on an ad hoc basis, special closing hours to perform routine system maintenance, subject to certain requirements.

The Commission believes there are compelling reasons to adopt this approach. First, the market for SBSs is global, and the Commission believes the public interest is served by requiring continuous real-time dissemination of any SBS transactions that would be required to be reported

[114] The Commission is aware that one current data repository, Warehouse Trust Company LLC, a subsidiary of DTCC, operates 24 hours a day for six days a week.

to a registered SDR, no matter when they are executed. Second, a continuous dissemination regime would reduce the incentive for market participants to defer execution of SBS transactions until after regular business hours to avoid real-time post-trade transparency. Third, the Commission believes that this continuous dissemination regime would be "technologically practicable," and thus consistent with the Dodd-Frank definition of what constitutes real-time dissemination.[115]

2. Normal closing hours and special closing hours

Although the Commission believes that continuous operation of a real-time reporting and dissemination regime should be the goal, the Commission recognizes the potential need for a registered SDR to establish normal closing hours to perform necessary system maintenance. Such normal closing hours should occur only when, in the estimation of the registered SDR, the U.S. markets and major foreign markets are inactive. Consequently, proposed Rule 904(a) would allow a registered SDR to establish normal closing hours during periods when, in its estimation, the U.S. market and major foreign markets are inactive. A registered SDR would be required to provide reasonable advance notice to participants and to the public of its normal closing hours.[116]

Further, the Commission recognizes that unexpected circumstances could arise that would require a registered SDR to temporarily make unavailable its systems for processing transaction reports and publicly disseminating transaction data. Consequently, proposed Rule 904(b) would permit a registered SDR to declare, on an ad hoc basis, special closing hours to perform system maintenance that cannot wait until normal closing hours. A registered SDR

115 See 15 U.S.C. 78m(m)(1)(A).

116 For example, a registered SDR could provide notices to its participants or publicize its normal closing hours in a conspicuous place on its website.

would be required, to the extent reasonably possible under the circumstances, to avoid scheduling special closing hours during when, in its estimation, the U.S. market and major foreign markets are most active, and to provide reasonable advance notice of its special closing hours to participants and to the public.

Paragraphs (c) to (e) of proposed Rule 904 would specify requirements for handling and disseminating reported data during a registered SDR's normal and special closing hours. During normal closing hours and, to the extent reasonably practicable, during special closing hours, a registered SDR would be required to have the capability to receive and hold in queue transaction data it receives. Immediately upon system re-opening following normal closing hours (or opening following special closing hours, if it were able to hold incoming data in queue), the registered SDR would be required to publicly disseminate any transaction data required to be reported under proposed Rule 901(c) that it received and held in queue. If the registered SDR could not, while it was closed, receive and hold in queue information required to be reported, it would be required, immediately upon resuming normal operations, to send a notice to all participants that it had resumed normal operations but could not, while closed, receive and hold in queue such transaction information. Thereafter, any participant that had an obligation to report information, but was unable to do so because of the registered SDR's inability to receive and hold data in queue, would be required to immediately report the information to the registered SDR.

Regardless of the current operating status of a registered SDR, reporting parties would be required to submit information to the registered SDR under the same standards and permissible timing detailed in proposed Rule 901. If a party that has an obligation to report the transaction data is unable to do so because the registered SDR's system is unable to receive and hold in queue such data, the reporting party would be required to report any information that it was obligated to report immediately after it received a notice that it was possible to do so.

Request for Comment

The Commission requests comment on all aspects of the proposed operating hours for registered SDRs.

138. Do commenters agree with the provisions that would allow registered SDRs to have normal and special closing hours and the proposed process for receipt and dissemination of data during and after such hours?

139. Is it reasonable for the Commission to provide registered SDRs with flexibility to set specific closing times, or should the Commission adopt a rule that specifies hours of operation?

140. Are there alternatives to allowing registered SDRs to close during normal and special closing hours? Would it be feasible for registered SDRs to operate without normal and special closing hours?

F. Procedures for Correcting Errors

Proposed Rule 905 would establish procedures to correct errors in reported and disseminated SBS information. The Commission recognizes that any system for transaction reporting must accommodate the possibility that certain data elements may be incorrectly reported. Proposed Rule 905 would establish error reporting procedures for counterparties and for registered SDRs.

1. Counterparty reporting error

Proposed Rule 905(a) would apply where a counterparty discovers an error after a SBS transaction has been reported. A counterparty that was not the reporting party would be required to promptly notify the reporting party of the error. A reporting party that discovers an error or receives notification of an error from its counterparty would be required to promptly submit to the entity to which it provided the original transaction report an amended report pertaining to the original transaction report. If the reporting party reported the initial transaction to a registered SDR, the reporting party must submit an amended report to the registered SDR in a manner consistent with the policies and procedures contemplated by proposed Rule 907(a)(3).[117] The Commission preliminarily believes that it is reasonable to place the duty to submit a correction report on the reporting party, because the reporting party was responsible for submitting the initial transaction report. This approach should establish a clear duty and help to avoid the submission of duplicative error reports.

2. Responsibility of registered SDR to correct

Proposed Rule 905(b) outlines the duties of registered SDRs in correcting information and re-disseminating corrected information.[118] If the registered SDR either discovers an error in the SBS information contained in its system or receives notice of an error from a counterparty, the registered SDR would be required to verify the accuracy of the terms of the SBS and, following such verification, promptly correct the information in its system.[119] Proposed Rule 905 would further require that, if the erroneous information contains any information that falls into the categories enumerated in proposed Rule 901(c) as information required to be reported

117 See proposed Rule 905(a)(2).

118 See also SDR Registration Proposing Release, supra note 6 (proposing Rule 13n-5 under the Exchange Act).

119 See proposed Rule 905(b)(1). The Commission is also proposing to require the registered SDR to establish and maintain written policies and procedures that, among other things, specify how reporting parties are to report corrections to previously submitted information and how information in the records of the SDR, upon being discovered to be erroneous, is to be corrected. See proposed Rule 907(a)(3); infra Section VI.A (discussing the policies and procedures of registered SDRs).

and disseminated in real time, the registered SDR would be required to publicly disseminate a corrected transaction report of the SBS promptly following verification of the trade by the parties to the SBS, with an indication that the report relates to a previously disseminated transaction.[120]

Proposed Rule 907(a)(3) would require a registered SDR to, among other things, establish and maintain written policies and procedures for determining how participants would be required to report corrections of prior reports. The registered SDR would have flexibility to specify the modifiers or indicators to allow reporting parties to submit reports distinguishing corrected trades from new trades and indicating the actual execution date and time.

For example: Counterparty B (the reporting party) notices that there is an error in the reported notional amount of a SBS transaction. Counterparty B then would be required under proposed Rule 905(a) to promptly notify the registered SDR to which it originally reported the trade of the error in the notional amount. Because the notional amount is one of the data elements that must be reported in real time under proposed Rule 901(c), the registered SDR would be required to immediately disseminate a corrected transaction report to the public, with a notation indicating that it is a corrected trade report.

Request for Comment

The Commission requests comment on all aspects of the proposed rules relating to procedures for correcting errors in reported and disseminated SBS information.

141. Are the proposed obligations for submitting error reports sufficiently clear?

142. Are additional requirements necessary? Are the proposed requirements adequate to assure that errors are corrected promptly and corrections are promptly disseminated as appropriate? If not, what additional procedures should be required?

120 See proposed Rule 905(b)(2).

143. Do commenters agree with the proposed approach? Why or why not?

144. Do commenters agree that error reports should be publicly disseminated? Why or why not?

VI. Policies and Procedures of Registered SDRs

In designing a comprehensive system of transaction reporting and post-trade transparency for all SBS – involving a constantly evolving market, thousands of participants, and potentially millions of transactions – the Commission preliminarily believes that it is not necessary or appropriate for it to specify by rule every detail of how this system should operate. On some matters, there may not be a single correct approach for maximizing transparency and price discovery; rather, it might be more important that there be a coordinated approach that all market participants understand and adhere to.

The Commission believes that registered SDRs could play an important role in developing, operating, and improving the system for transaction reporting and post-trade transparency in SBS, as laid out by Congress in the Dodd-Frank Act. Registered SDRs are placed at the center of the market infrastructure, as the Dodd-Frank Act requires all SBSs, whether cleared or uncleared, to be reported to them.[121] The Commission preliminarily believes that some reasonable flexibility should be given to registered SDRs to carry out their functions – by, for example, being able to specify data formats, connectivity requirements, and other protocols for submitting information to them. The Commission's intent is to set out broad principles that registered SDRs and their participants would be required to follow, while providing registered SDRs with flexibility in determining the precise means of doing so.

121 See 15 U.S.C. 13m(m)(1)(G).

As discussed more fully below, a registered SDR would be required to establish and maintain certain policies and procedures, including policies and procedures to: (1) enumerate the specific data elements of SBS or life cycle event that a reporting party must report; (2) specify one or more acceptable data formats, connectivity requirements, and other protocols for submitting information; (3) promptly correct information in its records that is discovered to be erroneous; (4) determine whether and how life cycle events and other SBSs that may not accurately reflect the market should be disseminated; (5) assign or obtain certain unique identifiers; (6) receive information concerning a participant's ultimate parent and affiliated entities; and (7) handle block trades.

A registered SDR also would be required to make its policies and procedures required by proposed Regulation SBSR publicly available on its website.[122] This would allow all interested parties to understand how the registered SDR is utilizing the flexibility it has in operating the transaction reporting and dissemination system.[123] The Commission anticipates that participants might make suggestions to the registered SDR for altering and improving that system, or developing new policies and procedures to address new products or circumstances, consistent with the principles set out in proposed Regulation SBSR. In conclusion, the Commission preliminarily believes that requiring registered SDRs to adopt and maintain policies and procedures, as required under proposed Rule 907, would improve compliance with proposed Regulation SBSR.

A. Elements of Policies and Procedures

122 See proposed Rule 907(c).

123 See SDR Registration Proposing Release, supra note 6, proposed Rule 13n-10. Furthermore, proposed Form SDR would require all of the policies and procedures required by proposed Regulation SBSR be submitted by a data repository registering with the Commission. See SDR Registration Proposing Release, supra note 6, Exhibit GG to proposed Form SDR.

Proposed Rule 907(a)(1) of Regulation SBSR would require a registered SDR to establish and maintain written policies and procedures that enumerate the specific data elements of a SBS or a life cycle event that a reporting party must report. These data elements would be required to include, at a minimum, those specified in proposed Rules 901(c) and (d). The Commission expects that the policies and procedures adopted under proposed Rule 907(a)(1) would explain to reporting parties how to report if all the SBS transaction data required by Rules 901(c) and (d) is being reported simultaneously, and how to report if responsive data are being provided at separate times.[124]

Proposed Rule 907(a)(2) would require a registered SDR to establish and maintain written policies and procedures that specify one or more acceptable data formats (each of which must be an open-source structured data format that is widely used by participants), connectivity requirements, and other protocols for submitting information. The Commission preliminarily believes that a registered SDR should have reasonable flexibility to design its systems and develop ways for participants to input information into those systems.

Proposed Rule 907(a)(3) would require a registered SDR to establish and maintain written policies and procedures for specifying how reporting parties are to report corrections to previously submitted information, making corrections to information in its records that is subsequently discovered to be erroneous, and applying an appropriate indicator to any report required to be disseminated by proposed Rule 905(b)(2), which would denote that the report relates to a previously disseminated transaction. There could be a number of acceptable ways to

124 In the latter case, the Commission expects that the registered SDR would provide the reporting party the transaction ID after the reporting party reports the information required by proposed Rule 901(c). The reporting party would then include the transaction ID with its submission of data required by proposed Rule 901(d), thereby allowing the registered SDR to match the real-time report and the subsequent regulatory report.

carry out the general directive to correct erroneous information, and reasonable flexibility should be afforded a registered SDR in this regard. Use of transaction IDs assigned by the registered SDR would facilitate this process, as this would offer a clear way for participants and the registered SDR to refer to an earlier transaction.[125] The Commission preliminarily believes that a registered SDR should be required to have an appropriate means to confirm that the information provided by the reporting party is indeed correct.

Finally, the policies and procedures required by proposed Rule 907(a)(3) would have to address applying an appropriate indicator to any new transaction report required by proposed Rule 905(b)(2) that the report relates to a previously disseminated transaction. It is essential that market observers understand that the transaction report triggered by proposed Rule 905 does not represent a new transaction, but merely a correction to a previous transaction. Without some kind of indication to that effect, market observers could misunderstand the true state of the market. Therefore, the Commission preliminarily believes that the registered SDR must apply an appropriate indication to the publicly disseminated transaction report.

Proposed Rule 907(a)(4) would require a registered SDR to establish and maintain written policies and procedures describing how reporting parties shall report – and, consistent with the enhancement of price discovery, how the registered SDR shall publicly disseminate – reports of, and adjustments due to, life cycle events; SBS transactions that do not involve an opportunity to negotiate any material terms, other than the counterparty; and any other SBS transactions that, in the estimation of the registered SDR, do not accurately reflect the market. As noted above, all SBS transactions must be reported to a registered SDR, pursuant to proposed Rules 901(c) and (d). However, some SBSs might not involve arm's-length negotiations that

125 See supra Section IV.E.2.

reflect competitive price discovery.[126] Similarly, there might be no price discovery in the case of an assignment where the new counterparty to which a SBS is assigned has no opportunity to negotiate a different price. Proposed Rule 907(a)(4) would provide some flexibility to a registered SDR regarding how to publicly disseminate transaction reports for such SBSs. The registered SDR could determine in some cases that an indication should be provided that explains the circumstances. Publicly disclosed policies and procedures would permit market observers to understand which indicators applied to which circumstances. The Commission expects that the policies and procedures would direct reporting parties to provide additional information to the registered SDR about the existence of such circumstances. Furthermore, the Commission preliminarily believes that all transactions reported late (i.e., over 15 minutes after time of execution) should bear an indicator so that market participants know that the transaction was reported late. While there is likely to be value in disseminating the transaction report, all market participants should understand that the report is no longer timely and thus would not reflect the current market at the time of dissemination.

Finally, the policies and procedures required by proposed Rule 907(a)(4) would be required to address applying an appropriate indicator to reports of, and adjustments due to, life cycle events. As with corrected transaction reports, it is essential that market observers understand that the transaction report triggered by a life cycle event does not represent a new transaction, but merely a change to the terms of a previously executed SBS. Without an indicator to that effect, market observers could misunderstand the true state of the market. Therefore, the Commission preliminarily believes that the registered SDR must apply an appropriate indicator to the publicly disseminated transaction report.

126 This could be the case, for example, with an inter-affiliate transfer.

Proposed Rule 907(a)(5) would require a registered SDR to establish and maintain written policies and procedures for assigning: (1) A transaction ID to each SBS that is reported to it; and (2) UICs established by or on behalf of an IRSB (or, if such UICs are not yet able to be so assigned, for assigning UICs in a consistent manner using its own methodology). Proposed Rule 907(a)(6) would require a registered SDR to establish and maintain written policies and procedures for periodically obtaining from each participant information that identifies the participant's ultimate parent(s) and any other participant(s) with which the counterparty is affiliated, using ultimate parent IDs and participant IDs. The Commission expects that the registered SDR's policies and procedures would address the relationship between itself and an IRSB, and how UICs could be obtained from the IRSB or an agent or other person acting on its behalf. Furthermore, the Commission expects that, if an IRSB exists and the registered SDR is using UICs assigned by that IRSB or on its behalf, the registered SDR's policies and procedures should explain how a participant could obtain applicable UICs from the IRSB. To the extent that the IRSB cannot provide certain UICs required of a participant by proposed Regulation SBSR, the registered SDR's policies and procedures would be required to explain the process by which a participant could obtain such UICs from the registered SDR.

Proposed Rule 907(d) would require a registered SDR to review and, as necessary, update its policies and procedures required by proposed Regulation SBSR at least annually, and to indicate the date on which they were last reviewed. Periodic review should help ensure that a registered SDR's policies and procedures remain well-functioning over time. Indicating the date on which the policies and procedures were last reviewed would allow regulators and market participants to understand which version of the policies and procedures are current. The Commission is proposing recordkeeping and retention rules for registered SDRs in a separate rulemaking.[127] Prior versions of a registered SDR's policies and procedures would be records under that proposed rule, and thus would be required to be retained in accordance with those rules. Access to these records would permit the Commission, when conducting a review of past actions, to understand what policies and procedures were in force at the time.

Proposed Rule 907(e) would require a registered SDR to have the capacity to provide to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to proposed Regulation SBSR and the registered SDR's policies and procedures thereunder.[128] Under Title VII of the Dodd-Frank Act, the Commission is responsible for regulating and overseeing the SBS market. The Commission preliminarily believes that, to carry out this responsibility, it could be valuable to obtain information from each registered SDR related to the timeliness, accuracy, and completeness of data reported to it. Required data submissions that are untimely, inaccurate, or incomplete could compromise the regulatory data that the Commission would utilize to carry out its oversight responsibilities. Furthermore, required data submissions that are untimely, inaccurate, or incomplete could diminish the value of publicly disseminated reports that promote transparency and price discovery. Information or reports provided to the Commission by a registered SDR related to the timeliness, accuracy, and completeness of data could assist the Commission in examining for compliance with proposed Regulation SBS and in bringing enforcement or other administrative actions as necessary and appropriate.

Request for Comment

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[127] See SDR Registration Proposing Release, supra note 6, proposed Rule 13n-7 under the Exchange Act.

[128] See id., proposed Rule 13n-8 under the Exchange Act (requiring every registered SDR to promptly report to the Commission, in a form and manner acceptable to the Commission, such information as the Commission determines to be necessary or appropriate for the Commission its duties under the Exchange Act and the rules and regulations thereunder).

The Commission requests comment on all aspects of the proposed policies and procedures for registered SDRs.

145. Do commenters agree, overall, with the proposed policies and procedures for registered SDRs? Why or why not?

146. Should proposed Rule 907 specify more detailed elements to be included in the required policies and procedures? If so, what should those elements be? Or, are the proposed policies and procedures too prescriptive? If so, in what way(s)?

147. Should a registered SDR have flexibility to specify acceptable data formats, connectivity requirements, and other protocols for submitting information? Why or why not? Are there disadvantages to this approach? If so, how should they be addressed?

148. Should all acceptable data formats be open-source structured data formats? What data formats are currently in use by SDRs? Would they qualify as open-source structured data formats?

149. Assuming special indicators on certain publicly disseminated trade reports may be necessary, do commenters agree that a registered SDR should have the flexibility to determine and apply those indicators? If not, can commenters suggest another system for assigning relevant indicators?

150. What kinds of special circumstances would warrant indicators for public dissemination? What should those indicators be? How should they be reflected on the publicly disseminated trade report?

151. Should inter-affiliate transactions be publicly disseminated with an indicator? Should they be disseminated at all? Why or why not?

152. Should portfolio compressions and terminations be publicly disseminated with an indicator? Should they be disseminated at all? Why or why not?

153. Should a registered SDR have the flexibility to determine whether a SBS transaction does not accurately reflect the market or would not enhance price discovery if disseminated? If so, how should the registered SDR exercise such flexibility? What criteria should it use? What are examples of transactions that commenters believe should be reported to a registered SDR but should not be publicly disseminated? Why should they not be publicly disseminated?

154. Multi-lateral netting and portfolio compression are post-trade processes designed to reduce gross exposure and leave only net exposure. These processes typically entail the termination of open contracts and the establishment of new contracts representing only the net position. How, if at all, should SBSs related to multi-lateral netting and portfolio compression be reported to and disseminated by a registered SDR? What if the netting involves a payment that is determined by market value?

155. How should a registered SDR's policies and procedures address the use of UICs assigned under the auspices of a voluntary consensus standards body?

156. What are the costs for registered SDRs to adopt and implement the proposed policies and procedures? What are the benefits of requiring registered SDRs to adopt and implement these policies and procedures?

157. Should a data repository seeking to register with the Commission be required to provide the policies and procedures required by proposed Rule 907 as part of its Form SDR submission?

VII. Policies and Procedures of SBS Dealers and Major SBS Participants

For the proposed SBS reporting requirements established by the Dodd-Frank Act to achieve the objective of enhancing price transparency and providing regulators with access to data to help carry out their oversight responsibilities, the information that participants provide to registered SDRs must be reliable. Accordingly, proposed Rule 906(c) would require a participant that is a SBS dealer or major SBS participant to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with the SBS transaction reporting obligations set forth in proposed Regulation SBSR and the policies and procedures of any registered SDR in which it is a participant. Such policies and procedures are intended to provide a system of controls that facilitate complete and accurate reporting of SBS information by these participants, consistent with their obligations under the Dodd-Frank Act and proposed Regulation SBSR.

The Commission believes that proposed Rule 906(c) should result in greater accuracy and completeness of reported SBS transaction data. Without written policies and procedures, compliance with reporting obligations may depend too heavily on key individuals or unreliable processes. The Commission believes that requiring participants that are SBS dealers or major SBS participants to establish written policies and procedures should promote clear, reliable reporting that can continue independent of any specific individuals. The Commission further believes that requiring such participants to adopt and maintain policies and procedures relevant to their reporting responsibilities, as required under proposed Rule 906(c), would help to improve the degree and quality of overall compliance with the reporting requirements set out in proposed Regulation SBSR.

The policies and procedures required by proposed Rule 906(c) should be designed to foster compliance with the real-time reporting requirements specified in proposed Rule 901(c), as well as the additional reporting requirements specified in proposed Rules 901(d) and (e). These policies and procedures, among other things, should address: (1) the reporting process and designation of responsibility for reporting SBS transactions; (2) the process for systematizing orally negotiated SBS transactions; (3) OMS outages or malfunctions, and when and how backup systems are to be used in connection with required reporting; (4) verification and validation of all information relating to SBS transactions reported to a registered SDR; (5) a training program for employees responsible for SBS transaction reporting; (6) control procedures relating to SBS transaction reporting and designation of personnel responsible for testing and verifying such policies and procedures; and (7) reviewing and assessing the performance and operational capability of any third party that carries out any duty required by proposed Regulation SBSR on behalf of the entity.[129]

Each participant that is a SBS dealer or major SBS participant also would be required to review and, as needed, update its policies and procedures at least annually.[130] Periodic review should help ensure that a participant's policies and procedures remain well functioning over time.

The value of requiring policies and procedures in promoting regulatory compliance is well-established. For example, internal control systems have long been used to strengthen the integrity of financial reporting. Congress recognized the importance of internal control systems in the Foreign Corrupt Practices Act, which requires public companies to maintain a system of internal accounting controls.[131] Broker-dealers also must maintain policies and procedures for

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129 See supra Section II.B (noting that proposed Rule 901 would not prohibit a reporting party from having a third-party agent carry out reporting duties on its behalf).

130 See proposed Rule 906(c).

131 See 15 U.S.C. 78m(b)(2)(B).

various purposes.[132] The Commission preliminarily believes that requiring participants that are SBS dealers or major SBS participants to adopt and maintain policies and procedures designed to promote compliance with proposed Regulation SBSR and the policies and procedures of any registered SDR of which it is a participant would be consistent with Congress's goals in adopting the Dodd-Frank Act.

Request for Comment

The Commission requests comment on all aspects of the proposed requirement that participants that are SBS dealers or major SBS participants establish policies and procedures.

158. Do commenters think proposed Rule 906(c) is necessary? Would SBS dealers and major SBS participants otherwise implement written policies and procedures to ensure compliance with the reporting obligations in proposed Regulation SBSR?

159. Should proposed Rule 906(c) specify elements to be included in the required policies and procedures, such as those discussed above? If so, what elements should be included in the proposed rule, and why?

VIII. Jurisdictional Matters

Proposed Rule 908 is designed to clarify the application of proposed Regulation SBSR to cross-border SBS transactions and to non-U.S. persons.[133]

A. When Is a SBS Subject to Regulation SBSR?

[132] See, e.g., FINRA Conduct Rule 3010(b) (requiring FINRA member broker-dealers to establish and maintain written procedures "that are reasonably designed to achieve compliance with applicable securities laws and regulations, and the applicable Rules of [the NASD]"; FINRA Conduct Rule 3012 (requiring FINRA member broker-dealers to establish and maintain written supervisory procedures to ensure that internal policies and procedures are followed and achieve their intended objectives).

[133] See proposed Rule 900 (defining "U.S. person" to mean a natural person that is a U.S. citizen or U.S. resident or a legal person that is organized under the corporate laws of any part of the United States or has its principal place of business in the United States).

Proposed Rule 908(a) would require a SBS to be reported if the SBS: (1) has at least one counterparty that is a U.S. person; (2) was executed in the United States or through any means of interstate commerce; or (3) was cleared through a registered clearing agency having its principal place of business in the United States. In addition, any SBS that is required to be reported to a registered SDR pursuant to proposed Rule 908(a) also would be required to be publicly disseminated by the registered SDR. The Commission preliminarily believes that, if there are sufficient jurisdictional ties to the United States to warrant reporting of the SBS, other market participants should have knowledge of the SBS transaction.

The Commission preliminarily believes that, if a U.S. person executes a SBS anywhere in the world, that SBS should be reported to a registered SDR, pursuant to proposed Regulation SBSR. Because the U.S. person is assuming risk, U.S. regulators have an interest in ensuring that they have appropriate knowledge of the transaction. The Commission notes that it is proposing to define "U.S. person" in proposed Rule 900 to mean "a natural person that is a U.S. citizen or U.S. resident or a legal person that is organized under the corporate laws of any part of the United States or has its principal place of business in the United States." The Commission intends for this proposed definition to include branches and offices of U.S. persons. Because a branch or office has no separate legal existence under corporate law, the branch or office would be an integral part of the U.S. person itself.

A SBS also would have to be reported if the SBS were executed in the United States or through any means of interstate commerce. For example, even if both counterparties are not U.S. persons, U.S. regulators have a strong interest in having knowledge of and being able to regulate any activity conducted within the United States or through any means of interstate commerce.

Under proposed Rule 908(a)(3), a SBS would have to be reported pursuant to proposed Regulation SBSR – even if both counterparties are not U.S. persons – if the SBS were cleared through a clearing agency having its principal place of business in the United States. It is possible that two counterparties, neither of whom is a U.S. person, could execute a SBS outside the United States, but clear the SBS through a clearing agency having its principal place of business in the United States. The Commission preliminarily believes that such SBS should be reported to a registered SDR. If a SBS is cleared by a clearing agency having its principal place of business in the United States, U.S. regulators should have access to information regarding the SBS through a registered SDR.[134] Moreover, if non-U.S. persons determined to clear a SBS through a clearing agency having its principal place of business in the United States, this suggests that the clearing agency has made the SBS eligible for clearing because at least some U.S. counterparties might wish to trade the SBS as well. Requiring the SBS to be reported to a registered SDR also would cause a transaction report of the SBS to be publicly disseminated, thus promoting price discovery for market participants in the United States and elsewhere.

It is possible that there could be a clearing agency registered with the Commission under Section 17A of the Exchange Act[135] but having its principal place of business outside the United States. Although that clearing agency might service U.S. persons, it also would likely provide clearing services to many non-U.S. persons. The Commission does not intend for proposed Regulation SBSR to apply to such non-U.S. persons solely because they clear a SBS through a clearing agency registered with the Commission but not having its principal place of business in

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134 While U.S. regulators also would have access to information about the SBS through the U.S. clearing agency, requiring the SBS to be reported to a registered SDR would reduce the fragmentation of the regulatory data.

135 15 U.S.C. 78q-1.

the United States.[136] However, proposed Regulation SBSR would apply with respect to that SBS if either counterparty were a U.S. person, or if the SBS had been executed in the United States or through any means of interstate commerce (including by clearing through a clearing agency having its principal place of business in the United States).

It should be noted that a registered SDR could receive reports of foreign SBS transactions that are not required to be reported pursuant to proposed Rule 908(a). The registered SDR may determine to publicly disseminate reports of such foreign SBS transactions, but would not be required to do so by proposed Regulation SBSR.

B. When Is a Counterparty to a SBS Subject to Regulation SBSR?

Proposed Rule 908(b) would provide that, notwithstanding any other provision of Regulation SBSR, no counterparty to a SBS would incur any obligation under Regulation SBSR unless it is: (1) a U.S. person; (2) a counterparty to a SBS executed in the United States or through any means of interstate commerce; or (3) a counterparty to a SBS cleared through a clearing agency having its principal place of business in the United States. For the reasons discussed above, the Commission preliminarily believes that, if a U.S. person executes a SBS anywhere in the world, that U.S. person should become subject to Regulation SBSR.

Non-U.S. persons who are counterparties to U.S. persons could, therefore, have SBSs to which they are counterparties reported to and held by a registered SDR. If none of these SBSs

136 For example, assume that Clearing Agency A has its principal place of business in an E.U. member state, but is also registered as a clearing agency in the United States under Section 17A of the Exchange Act because it has sufficient contacts with U.S. participants to require registration under Section 17A. Assume further that Counterparty X executes a SBS with Counterparty Y, both X and Y are each domiciled in an E.U. member state, the SBS is executed in an E.U. member state and does not involve any means of interstate commerce in the United States. Under proposed Rule 908, this SBS would not be required to be reported to a registered SDR solely because it was cleared by a clearing agency registered under Section 17A.

were executed in the United States or through any means of interstate commerce, however, the non-U.S. person would not become a "participant" of the registered SDR and would not become subject to proposed Regulation SBSR.[137] Thus, the non-U.S. person would not have to provide any UICs pursuant to proposed Rule 906(a) or parent and affiliate information to a registered SDR pursuant to proposed Rule 906(b).

C. An Example

Assume that X (a U.S. bank) enters into a SBS with a Y (a Japanese bank). The SBS is effected in Japan, involves no means of interstate commerce, and is not cleared by a clearing agency having its principal place of business in the United States. Because the SBS has at least one counterparty that is a U.S. person, proposed Rule 908(a) – which describes when a SBS is not required to be reported because it is outside the jurisdiction of the Exchange Act – would not apply. Therefore, the SBS must be reported to a registered SDR. X would be the reporting party, as proposed Rule 901(a)(1) provides that, where only one counterparty to a SBS is a U.S. person, the U.S. person shall be the reporting party. X also would be a participant because it is a U.S. person that is a counterparty to a SBS that is required to be reported to a registered SDR. However, Y would not be a participant under proposed Rule 900, and would incur no obligations under proposed Regulation SBSR. Although the SBS is required to be reported to a registered SDR, the SBS was not executed in the United States or through any means of interstate commerce, or cleared through a clearing agency having its principal place of business in the

137 See proposed Rule 900 (defining "participant" as (1) A U.S. person that is a counterparty to a SBS that is required to be reported to a registered SDR; or (2) A non-U.S. person that is a counterparty to a SBS that is (i) required to be reported to a registered SDR; and (ii) that is executed in the United States or through any means of interstate commerce, or cleared through a clearing agency having its principal place of business in the United States).

United States. Thus, the Commission anticipates that there would be some SBSs reported to and captured by a registered SDR where only one counterparty of the SBS is a participant.

IX. Fair and Non-Discriminatory Access to SBS Market Data

A. SBS Market Data Disseminated by Registered SDRs

As noted above, the Commission preliminarily believes that post-trade transparency could spur significant improvements in the SBS market. Some of the benefits could include greater price competition, lower transaction costs, enhanced liquidity, and improved ability of market participants to value their positions. Therefore, fair access to last-sale data appears critical – particularly since registered SDRs would collectively have data on all SBSs executed in the market. The Commission preliminarily believes that market observers should not be forced to pay excessive fees or be subject to unfair usage restrictions imposed by registered SDRs. The Commission therefore seeks to ensure that these data feeds would be available to all market observers on terms that are fair and reasonable and not unreasonably discriminatory.

In a separate rulemaking proposal regarding the registration and regulation of SDRs being issued today, the Commission is proposing rules that would require SDRs to comply with certain core principles. To comply with these core principles, a SDR would be required, among other things, to establish and enforce clearly stated and objective criteria that would permit fair, open, and not unreasonably discriminatory access to services offered and data that would be disseminated by the SDR, as well as fair, open, and not unreasonably discriminatory participation by market participants, market infrastructures, venues from which data could be submitted to the SDR, and third-party service providers that seek to connect or link with the SDR.[138] In addition, a SDR would be required to establish policies and procedures for reviewing

138 See proposed Rule 13n-4(c)(1)(iv) under the Exchange Act.

any prohibition or limitation of any person's access to services offered, directly or indirectly, or data maintained and disseminated by the SDR, and – if it finds that the person has been discriminated against unfairly – granting to such person access to its services or data.[139]

A registered SDR also would become subject to certain provisions of Section 11A of the Exchange Act[140] because it would be a SIP, as defined by Section 3(a)(22)(A) of the Exchange Act.[141] Section 11A(c)(1) of the Exchange Act[142] provides that the Commission may prescribe rules applying to SIPs (among other entities) that would require them (among other things) to assure "the fairness and usefulness of the form and content" of the information that they disseminate,[143] and to assure "all other persons may obtain on terms which are not unreasonably discriminatory" the transaction information published or distributed by SIPs.[144] Section 11A(c)(1) applies regardless of whether a SIP is registered with the Commission as such.

Section 11A(b)(1) of the Exchange Act[145] provides that a SIP not acting as the "exclusive

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139 See proposed Rule 13n-4(c)(1)(v) under the Exchange Act.

140 15 U.S.C. 78k-1.

141 15 U.S.C. 78c(a)(22)(A) (defining SIP as "any person engaged in the business of (i) collecting, processing, or preparing for distribution or publication, or assisting, participating in, or coordinating the distribution or publication of information with respect to transactions in or quotations for any security (other than an exempted security) or (ii) distributing or publishing (whether by means of a ticker tape, a communications network, a terminal display device, or otherwise) on a current and continuing basis, information with respect to such transactions or quotations"). SBSs are securities under the Exchange Act. See 15 U.S.C. 78c(a)(10). Further, pursuant to proposed Regulation SBSR, a registered SDR would collect SBS transaction reports from participants and participate in the distribution of such reports and, thus, would be a SIP for purposes of the Exchange Act.

142 15 U.S.C. 78k-1(c)(1).

143 15 U.S.C. 78k-1(c)(1)(B).

144 15 U.S.C. 78k-1(c)(1)(D).

145 15 U.S.C. 78k-1(b)(1).

processor"[146] of any information with respect to quotations for or transactions in securities is exempt from the requirement to register with the Commission as a SIP unless the Commission, by rule or order, determines that the registration of such SIP "is necessary or appropriate in the public interest, for the protection of investors, or for the achievement of the purposes of [Section 11A]." Requiring a registered SDR to register with the Commission as a SIP would subject that entity to Section 11A(b)(5) of the Exchange Act,[147] which provides that a registered SIP must notify the Commission whenever it prohibits or limits any person's access to its services. Upon its own motion or upon application by any aggrieved person, the Commission could review the registered SIP's action.[148] If the Commission finds that the person has been discriminated against unfairly, it could require the SIP to provide access to that person.[149] Section 11A(b)(6) of the Exchange Act also provides the Commission authority to take certain regulatory action as may be necessary or appropriate against a registered SIP.[150]

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146 15 U.S.C. 78c(a)(22)(B) (defining "exclusive processor" as any securities information processor or self-regulatory organization which, directly or indirectly, engages on an exclusive basis on behalf of any national securities exchange or registered securities association, or any national securities exchange or registered securities association which engages on an exclusive basis on its own behalf, in collecting, processing, or preparing for distribution or publication any information with respect to (1) transactions or quotations on or effected or made by means of any facility of such exchange or (2) quotations distributed or published by means of any electronic system operated or controlled by such association).

147 15 U.S.C. 78k-1(b)(5).

148 See 15 U.S.C. 78k-1(b)(5)(A).

149 See 15 U.S.C. 78k-1(b)(5)(B).

150 See 15 U.S.C. 78k-1(b)(6) (providing that the Commission, by order, may censure or place limitations upon the activities, functions, or operations of any registered SIP or suspend for a period not exceeding 12 months or revoke the registration of any such processor, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest, necessary or appropriate for the protection of investors or to assure the prompt, accurate, or reliable performance of the functions of such SIP, and that such SIP

The Commission preliminarily believes that the additional authority over a registered SDR/SIP provided by Sections 11A(b)(5) and 11A(b)(6) of the Exchange Act would help ensure that these entities offer their SBS market data on terms that the Commission believes would be fair and reasonable and not unreasonably discriminatory. Therefore, the Commission preliminarily believes that the registration of SDRs as SIPs would be necessary or appropriate in the public interest, for the protection of investors, or for the achievement of the purposes of Section 11A of the Exchange Act. Section 11A of the Exchange Act establishes broad goals for the development of the securities markets and charges the Commission with establishing rules and policies that are designed to further these objectives. Section 11A(a) states, among other things, that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure economically efficient execution of securities transactions; the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities; and an opportunity for investors' orders to be executed without the participation of a dealer. SIP registration could assist in achieving these objectives in the still-developing SBS market. Therefore, the Commission preliminarily believes that the registration of SDRs as SIPs would be necessary or appropriate in the public interest, for the protection of investors, or for the achievement of the purposes of Section 11A. Accordingly, the Commission is proposing Rule 909, which would require a registered SDR to register with the Commission as a SIP.[151]

B. SBS Market Data Disseminated by Other Market Participants

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has violated or is unable to comply with any provision of this title or the rules or regulations thereunder).

151 A registered SDR would register as a SIP by filing (existing) Form SIP with the Commission.

The measures described above are designed to ensure that SBS market data disseminated by registered SDRs is available to the public on terms that are fair and reasonable and not unreasonably discriminatory. This is particularly important since all SBS must be reported to a registered SDR,[152] and registered SDRs exclusively would have the responsibility under proposed Regulation SBSR to publicly disseminate SBS transaction data to the public.

Nevertheless, other private sources of market data reflecting subsets of the SBS market could arise.[153] Differences in access to that market data – for example, if some market participants could obtain the data sooner than others – could create an unfair competitive landscape. Therefore, the Commission is proposing Rule 902(d), which would impose a partial and temporary restriction on sources of SBS market data other than registered SDRs. Proposed Rule 902(d) would provide that no person (other than a registered SDR) shall make available to one or more persons (other than a counterparty) a transaction report of a SBS before the earlier of: (1) 15 minutes after execution of the SBS; or (2) the time that a registered SDR publicly disseminates a report of that SBS.

Under proposed Rule 902(d), the temporary restriction on other market participants that may wish to disseminate information relating to a SBS transaction would last no longer than 15 minutes. Under proposed Regulation SBSR, a transaction report of a SBS would be expected to be publicly disseminated within 15 minutes of execution. The Commission preliminarily believes that it is not necessary or appropriate to require other sources of market data to withhold dissemination of a transaction report beyond 15 minutes if a registered SDR is not able to do so in a timely fashion. Proposed Rule 902(d) would, however, permit the transfer of information of

152 See 15 U.S.C. 78m(m)(1)(G).

153 For example, a SB SEF would have information about SBSs executed on its systems and could find that commercial opportunities exist to sell such information.

a SBS before dissemination by a registered SDR to a counterparty to that SBS. Therefore, one counterparty would be permitted to pass details of the SBS to the other counterparty, or a SB SEF on which the SBS was executed could pass details of the SBS to either or both of the counterparties.

By proposing Rule 902(d), the Commission seeks to balance the goal of promoting robust and fair competition among all market participants – by allowing them to view the same comprehensive source of SBS market data at the same time – with that of allowing market participants to devise new value-added market data products.

Request for Comment

The Commission requests comment on all aspects of its proposal relating to fair and non-discriminatory access to SBS market data. In particular:

160. Do commenters have any potential concerns with market participants' access to data disseminated by registered SDRs? If so, what steps should the Commission do to address them?

161. Do commenters agree with the proposal to require registered SDRs to register with the Commission as SIPs? Why or why not?

162. Would SIP registration entail costs and burdens that are unreasonable or unnecessary in light of the requirements associated with SDR registration? What additional burdens, if any, would be associated with SIP registration?

163. In the SDR Registration Proposing Release, the Commission is proposing a Form SDR that is similar to but separate from existing Form SIP. Should the Commission combine Forms SIP and Form SDR such that an SDR would register as a SIP and SDR using only one form? Or should the elements necessary for registration as an SDR be a

supplement to Form SIP? Are there any specific items on Form SIP that should be added to Form SDR that would help to facilitate the registration process?

164. Would it be beneficial for aggrieved persons to have the ability to request that the Commission review a registered SDR's prohibition or limitation on access its services, as contemplated by Section 11A(b)(5) of the Exchange Act? Are there any concerns with applying Section 11A(b)(5) to registered SDRs?

165. Are there additional means by which the Commission can or should attempt to ensure that the market data fees and usage restrictions imposed by registered SDRs are fair and reasonable and not unreasonably discriminatory? If so, please describe.

166. Should market participants other than a registered SDR be prohibited from distributing their SBS market data before transactions are disseminated by a registered SDR? Why or why not?

167. Do commenters anticipate that market participants other than registered SDRs will seek to sell SBS market data? Do commenters have a view as to whether those additional market data products would compete with or complement the required market data feed from registered SDRs?

168. Would proposed Rule 902(d) unnecessarily inhibit competition and innovation in the provision of value-added market data services or products? Please be specific in your response.

169. Are there alternative means to better ensure that all market participants have full and fair access to SBS market data other than placing a restriction on sources other than the registered SDRs? If so, what are they and why would they be preferable to the proposal?

170. Would competitive forces act to ensure that all market participants have full and fair access to SBS market data?

171. If commenters agree with proposed Rule 902(d), is 15 minutes an appropriate length to restrict market participants other than registered SDRs from disseminating SBS transaction data? Do commenters think that period is too long or too short? Please be specific in your response.

172. Should market participants other than registered SDRs that publicly disseminate SBS transaction information be subject to the same requirements regarding dissemination of block trades as registered SDRs?

X. Implementation Timeframes

Proposed Rule 910 is designed to provide clarity as to SBS reporting and dissemination timelines and to establish a phased-in compliance schedule for those subject to proposed Regulation SBSR. The Commission acknowledges that the system for reporting and dissemination described in proposed Regulation SBSR would take a significant amount of time and resources to implement effectively. While the Commission is committed to fully implementing Congress's directive to require real-time public reporting of all SBSs, market participants will need a reasonable period in which to acquire or configure the necessary systems, engage and train the necessary staff, and develop and implement the necessary policies and procedures to implement the proposed rules. The Commission preliminarily believes that the proposed compliance timeframes described below should provide sufficient time for reporting parties and SDRs to make the necessary technological and other preparations needed to begin reporting and disseminating SBS information, respectively, as required under proposed Regulation SBSR.

The Commission is proposing a phased-in compliance schedule, with respect to a SDR that registers with the Commission, as follows:

- Reporting of pre-enactment SBSs, no later than January 12, 2012.

Proposed Rule 910(a) would require reporting parties to report to a registered SDR any pre-enactment SBSs subject to reporting under proposed Rule 901(i) no later than January 12, 2012 (180 days after the effective date of the Dodd-Frank Act).[154] Proposed Rule 900 would define pre-enactment SBS to mean any SBS executed before July 21, 2010 (the date of enactment of the Dodd-Frank Act), the terms of which had not expired as of that date. The Commission notes that Section 3C(e)(1) of the Exchange Act[155] requires SBSs entered into before the date of enactment of Section 3C to be reported to a registered SDR or the Commission no later than 180 days after the effective date of Section 3C (i.e., no later than January 12, 2012). The proposed timeframe would help the Commission obtain relevant information about SBS transactions necessary to prepare reports required by the Dodd-Frank Act. Further, proposed Rule 910 would help promote timely implementation of Regulation SBSR, and thereby facilitate achievement of the goals articulated in the Dodd-Frank Act.

- Phase 1, six months after the registration date (i.e., the effective reporting date):[156] Reporting parties shall begin reporting, pursuant to proposed Rule 901, all SBS transactions executed on or after the effective reporting date; reporting parties also shall

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154 See supra Section IV.F (discussing reporting requirements for pre-enactment SBSs).

155 15 U.S.C. 78c-3(e)(1).

156 See proposed Rule 900 (defining "registration date," with respect to a SDR, as the date on which the Commission registers the SDR, or, if the Commission registers the SDR before the effective date of proposed Regulation SBSR, the effective date of proposed Regulation SBSR; and "effective reporting date," with respect to a SDR, as the date six months after the registration date).

report to the registered SDR any transitional SBSs;[157] SBS dealers and major SBS participants shall comply with proposed Rule 906(c);[158] participants and the registered SDR must comply with proposed Rule 905[159] (except with respect to dissemination) and proposed Rules 906(a) and (b).[160]

The Commission preliminarily believes that, before reporting parties and other participants could be expected to comply with proposed Regulation SBSR, they must first know the policies and procedures of the registered SDR that would receive and hold transaction information regarding their SBSs.[161] Phase 1 would provide time for SBS dealers and major SBS participants to establish their own policies and procedures, and implement necessary systems changes, for complying with proposed Regulation SBSR and the policies and procedures of the registered SDR. On the effective reporting date, participants would be required to begin reporting SBSs to the registered SDR in a manner consistent with proposed Rule 901, including providing the real-time reports required by proposed Rule 901(c) and the additional, regulatory

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157 See supra Section IV.F (discussing reporting requirements for transitional SBSs).

158 Proposed Rule 906(c) would require each SBS dealer and major SBS participant to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure that it complies with any reporting obligations under proposed Regulation SBSR.

159 Proposed Rule 905, among other things, would require a registered SDR to correct erroneous information with respect to SBSs.

160 Proposed Rule 906(a) would require a registered SDR to notify participants at least once a day of SBSs for which the registered SDR lacks a participant ID, broker ID, desk ID, or trader ID. Proposed Rule 906(b) would require participants to provide to the registered SDR information sufficient to identify its ultimate parent(s) and any affiliate(s) of the participant that also are participants of the registered SDR.

161 As discussed in the SDR Registration Proposing Release, a data repository seeking to register with the Commission would have to provide the policies and procedures required by proposed Rule 907 as part of its application for registration. See SDR Registration Proposing Release, supra note 6.

SBS information required by proposed Rule 901(d). At that time, however, the registered SDR would not yet publicly disseminate any transaction reports.

Also on the effective reporting date, the registered SDR would be required to begin preparing reports to each participant of any missing UICs, and any participant receiving such a report would have to begin providing the missing UICs to the registered SDR. The registered SDR and its participants also would become subject to the error correction requirements of proposed Rule 905 at this time, except that the registered SDR would not yet be required to publicly disseminate any corrected transaction reports (since it would not have disseminated a report of the initial transaction).

Finally, the Commission notes that proposed Rules 901(i) (establishing reporting requirements for pre-enactment and transitional SBSs), 910(a) (requiring the reporting of pre-enactment SBSs by January 12, 2012), and 910(b)(2)(i) (requiring the reporting of transitional SBSs by the effective reporting date) are together designed to assure that a registered SDR would obtain a complete view of each participant's open SBS positions by the time that the registered SDR is about to both receive and publicly disseminate transaction reports of SBSs.

- Phase 2, nine months after the registration date: Wave 1 of public dissemination; the registered SDR would be required to comply with proposed Rules 902 and 905 (with respect to dissemination of corrected transaction reports) for 50 SBS instruments.

Nine months after the registration date and three months after the effective reporting date, the registered SDR would be required to begin disseminating transaction reports as follows: The registered SDR, in consultation with the Commission's staff, would select 50 SBS instruments for which it receives and holds transaction data. Beginning on the date nine months after the registration date and continuing every day thereafter, the registered SDR would be required to publicly disseminate transaction reports in real time for those 50 SBS instruments, including with respect to block trades. The three-month period between the beginning of Phase 2 and the beginning of Phase 3 would allow the registered SDR a sufficient number of days to calculate and publish the block trade levels for those 50 SBS instruments. Also in Phase 2, the registered SDR would be required to begin disseminating any corrected reports required by proposed Rule 905 for those 50 SBS instruments. The Commission preliminarily believes, based on its experience implementing aspects of Regulation NMS, that the public dissemination of transaction reports for 50 SBS instruments is appropriate in Phase 2.

- Phase 3, 12 months after the registration date: Wave 2 of public dissemination; the registered SDR must comply with proposed Rules 902 and 905 (with respect to dissemination of corrected transaction reports) for an additional 200 SBS instruments.

Twelve months after the registration date and six months after the effective reporting date, the registered SDR would be required, in consultation with the Commission's staff, to select an additional 200 SBS instruments for which to publicly disseminate transaction reports in real time, apply the block trade exception with respect to those 250 SBS instruments, and disseminate any corrected transaction reports required by proposed Rule 905 for those 250 SBS instruments. The Commission preliminarily believes, based on its experience implementing aspects of Regulation NMS, that the public dissemination of transaction reports for 250 SBS instruments is appropriate in Phase 3.

- Phase 4, 18 months after the registration date: Wave 3 of public dissemination; All SBSs reported to the registered SDR shall be subject to real-time public dissemination as specified in Rule 902.

Eighteen months after the registration date, proposed Regulation SBSR would become operative with respect to every SBS transaction reported to and held by the registered SDR. The Commission preliminarily believes, based on its experience implementing aspects of Regulation NMS, that requiring public dissemination of all SBSs reported to the registered SDR is appropriate in Phase 4.

C. Prohibition During Phase-In Period

Proposed Rule 911 is designed to prevent evasion of the post-trade transparency rules. The rule would provide that a reporting party shall not report a SBS to a registered SDR in a phase-in period described in proposed Rule 910 during which the registered SDR is not yet required to publicly disseminate transaction reports for that SBS instrument unless: (1) the SBS also is reported to a registered SDR that is disseminating transaction reports for that SBS instrument, consistent with proposed Rule 902; or (2) no other registered SDR is able to receive, hold, and publicly disseminate transaction reports regarding that SBS instrument.

The Commission is concerned that the development of new SDRs not be used to undermine the goal of post-trade transparency for SBSs. This could occur, for example, if a SDR were registered with the Commission, and – pursuant to proposed Rule 910 – the SDR were in a phase-in period when it was not yet required to publicly disseminate transactions. Participants in an existing registered SDR could seek to report their SBSs to the second instead of the first registered SDR during the former's phase-in period, to avoid having their SBS transactions publicly disseminated in real time.

Under proposed Rule 911, counterparties would be permitted to report any SBS to the first registered SDR, even though the first registered SDR was in a phase-in period and not yet publicly disseminating transaction reports, because no other registered SDR could do so, either.

However, if a later SDR registers and enters a phase-in period, participants would not be permitted to report SBSs exclusively to the subsequent registered SDR before it is required or able under proposed Rule 910 to disseminate transaction reports, if an earlier registered SDR could receive, hold, and publicly disseminate transaction reports for that SBS. Thus, a participant could report the SBS to both registered SDRs: to the newer one, to assist with operational testing; and to the operating one, to ensure that a trade report for that SBS was publicly disseminated in real time.

Request for Comment

The Commission requests comment on all aspects of the proposed rules relating to the proposed implementation of proposed Regulation SBSR, as provided in proposed Rules 910 and 911.

173. Are the proposed timeframes for reporting with respect to pre-enactment SBSs sufficiently clear?

174. Are the obligations applicable to registered SDRs, counterparties, and participants in each phase of the proposed phase-in schedule sufficiently clear? If not, what obligations are unclear? Please be specific in your response.

175. Do commenters generally agree with the proposed phase-in approach to implementation of the reporting timeframes contained in proposed Rule 910? Is the proposed phase-in schedule generally appropriate to allow reporting parties and registered SDRs sufficient time to implement the requirements of proposed Regulation SBSR? If not, why not? What period of time would be sufficient?

176. Do commenters believe that registered SDRs would be able to meet the requirements of proposed Phase 1? Why or why not? If three months after the SDR's

registration date is not a sufficient amount of time to comply with proposed Rule 907, what amount of time would be sufficient? Do commenters believe that registered SDRs would need additional time to develop and implement certain policies and procedures that would be required under proposed Rule 907? If so, why, and which policies and procedures would require additional time to develop and implement?

177. Do commenters believe that registered SDRs, reporting parties, and participants would be able to satisfy their respective obligations under proposed Phase 2 within the proposed time frame? Why or why not? Would SBS counterparties and participants be able to comply, respectively, with proposed Rules 901 and 906(b) and (c) within the time frame specified in Phase 2? Why or why not? If not, what amount of time would be sufficient? Would counterparties or participants require additional time to comply with certain requirements in proposed Phase 2? If so, which requirement(s), and what additional amount of time would be necessary? Would counterparties and participants have adequate time to make any necessary systems changes to comply with the requirements in proposed Phase 2?

178. Would registered SDRs be able to correct erroneous information and notify counterparties of missing UICs within the time frame specified in Phase 2? Why or why not? If not, what amount of time would be adequate?

179. Do commenters believe that registered SDRs would be able to begin publicly disseminating SBS information, including corrected reports, and publicizing block trade levels, as would be required in proposed Phase 3? Why or why not? Would any specific requirement in proposed Phase 3 require additional time to implement? If so, which requirement(s), and what amount of time would be sufficient?

180. Do commenters believe that real-time public dissemination of SBS transaction reports should be required to commence for 50 SBS instruments nine months after the registration date? Should that period be longer or shorter? For example, should it be 12 months after the registration date? If so, why? Should the first wave of public dissemination be for more SBS instruments – perhaps 100? 200? Why or why not?

181. Do commenters generally agree with the proposed implementation schedule that would require public dissemination of SBSs in three Waves, as provided in proposed Phases 3, 4, and 5? Why or why not? If not, what approach would be more appropriate?

182. Should there be longer periods between Waves? If so, how long?

183. Is 50 SBSs an appropriate number of SBSs to include in proposed Phase 3? Why or why not? If not, what number would be appropriate?

184. Is it appropriate to require public dissemination of an additional 200 SBSs in proposed Phase 4? Why or why not?

185. What criteria should be used to choose the first 50 and second 200 SBSs be publically disseminated?

186. Do commenters believe that registered SDRs would be able to begin publicly disseminating all SBSs reported to the SDR 18 months after registration, as would be required under proposed Phase 5? Why or why not? If 18 months is not a sufficient amount of time, what amount of time would be sufficient?

187. Do commenters agree with the objective of proposed Rule 911? Why or why not?

188. Do commenters agree with the requirements of proposed Rule 911? Why or why not? Please be specific in your response. Do commenters believe that the Commission should take a different approach to preventing potential evasions of the post-trade

transparency rules? If so, what approach would be more appropriate? Please be specific in your response.

189. Under proposed Rule 910, the Commission would require a newly registered SDR to begin publicly disseminating trade reports for 50 SBS instruments beginning nine months after its registration date, and for an additional 200 SBS instruments beginning 12 months after its registration date. The registered SDR would be required at those times to calculate block trade thresholds in accordance with proposed Rule 907(b) and to disseminate reports of block trades in accordance with proposed Rule 902(b) with respect to those initial 50 and subsequent 200 instruments. Under proposed Rule 902(b), the registered SDR would be required to publicly disseminate a transaction report of the block trade with all transaction details other than notional size, and to disseminate the full trade report (including the notional size) at a later time. Should the Commission instead, during the phase-in period, provide for different approaches to publicly disseminating block trades in order to measure their associated cost to market participants? The Commission could require – at least for the phase-in period, but perhaps beyond – that different SBS instruments or transactions be subject to different block trade dissemination rules, to provide the Commission and market participants the opportunity to assess the relative costs and benefits of different approaches. For example, one group of SBS instruments or transactions could be subject to block trade dissemination mechanism described in proposed Rule 902(b). A second group could be subject to a regime where the full details of the transaction (including notional size) were disseminated, but with a one-hour delay, a third group could be subject to a regime where the full details were disseminated with a three-hour delay, and so on. Would

commentators support or oppose such an approach? Why? Are there other approaches that should be considered in order to evaluate the impact of different post-trade transparency regimes for block trades on market quality? How long should each portion of the phase-in continue and what variation in the number and type of SBS instruments or transactions would be needed in each group to support a statistical analysis to distinguish between the potentially different effects on the markets resulting from distinct post-trade dissemination requirements?

XI. Section 31 Fees

Section 31(c) of the Exchange Act[162] provides that a national securities association must pay fees based on the "aggregate dollar amount of sales transacted by or through any member of such association otherwise than on a national securities exchange of securities . . . registered on a national securities exchange or subject to prompt last sale reporting pursuant to the rules of the Commission or a registered national securities association." Pursuant to Section 761(a) of the Dodd-Frank Act,[163] SBSs are securities.[164] When proposed Regulation SBSR becomes effective, SBSs will be subject to prompt last-sale reporting pursuant to the rules of the Commission because they will be subject to real-time public dissemination. Therefore, a national securities association the members of which effect SBS sales other than on an exchange (including on a SB SEF) would be liable for Section 31 fees for any such sales.[165] A national securities association typically obtains funds to pay its Section 31 fees by imposing on its members an offsetting fee on covered sales, and would likely take the same approach with respect to SBSs.

162 15 U.S.C. 78ee(c).

163 15 U.S.C. 78c(a)

164 See 15 U.S.C. 78c(a)(10).

165 National securities exchanges also would be liable for fees in connection with transactions in SBSs that they execute. See 15 U.S.C. 78ee(b).

Under the Exchange Act, brokers and dealers are required to join a national securities association.[166] The Dodd-Frank Act also provides for the registration of SBS dealers[167] and correspondingly amends the definition of "dealer" under the Exchange Act to exempt from the definition of dealer any person engaged in the business of buying and selling SBSs, other than SBSs with or for persons that are not eligible contract participants.[168] Under the new definition of "dealer," a SBS dealer that buys and sells SBSs – other than with or for persons that are not eligible contract participants – would not be required to register as a dealer under the Exchange Act and thus would not be required to join a national securities association.

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166 See 15 U.S.C. 78o(b)(8) ("It shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than or [sic] commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to section 78o-3 of this title or effects transactions in securities solely on a national securities exchange of which it is a member."). In addition, Rule 15b9-1(a) under the Exchange Act, 17 CFR 240.15b9-1(a), provides that any broker or dealer required by Section 15(b)(8) of the Exchange Act to become a member of a registered national securities association shall be exempt from such requirement if it (1) is a member of a national securities exchange, (2) carries no customer accounts, and (3) has annual gross income derived from purchases and sales of securities otherwise than on a national exchange of which it is a member in an amount no greater than $1,000. The gross income limitation does not apply to income derived from transactions (1) for the dealer's own account with or through another registered broker or dealer, or (2) through the Intermarket Trading System. See 17 CFR 240.15b9-1(b).

167 See 15 U.S.C. 78o-8 ("The term 'dealer' means any person engaged in the business of buying and selling securities (not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants) for such person's own account through a broker or otherwise"); 15 U.S.C. 78c(71) (defining a security-based swap dealer "any person who — (i) holds themself out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps").

168 See 15 U.S.C. 78c(a)(5).

Because the Dodd-Frank Act did not make corresponding changes for SBS brokers, a SBS broker would be considered a broker for purposes of the Exchange Act.[169] Thus, brokers that buy or sell SBSs, SBS dealers that buy and sell SBSs with or for persons that are not eligible contract participants, and SBS dealers that buy and sell securities other than SBSs would be required to join a national securities association. However, SBS dealers that buy and sell only securities that are SBSs would not be required to register as dealers under the Exchange Act and thus would not be required to join a national securities association.

The Commission is proposing to exempt SBSs from the calculation of Section 31 fees.[170] This exemption is designed to provide a more level playing field among SBS market participants. A national securities association would be able to collect funds to pay its Section 31 fees only from SBS market participants that are required to register with it. It would be unable to collect such member fees from SBS dealers that are not required to register with it. Thus, absent an exemption for all SBSs, the burden of indirectly paying the Section 31 fees would fall on some SBS market participants but not others.

In addition, the Commission proposes to revise Rule 31(a)(10)(ii) under the Exchange Act[171] to conform the definition of "due date" in that rule to Section 31(e)(2) of the Exchange Act, as amended by Section 991 of the Dodd-Frank Act. This amendment provides that certain fees and assessments required under Section 31 will be required to be paid by September 25,

169 See 15 U.S.C. 78c(a)(4).

170 15 U.S.C. 78ee(f) ("The Commission, by rule, may exempt any sale of securities or any class of sales of securities from any fee or assessment imposed by this section, if the Commission finds that such exemption is consistent with the public interest, the equal regulation of markets and brokers and dealers, and the development of a national market system.").

171 17 CFR 240.31(a)(10)(ii).

rather than September 30.[172] The Commission proposes to make a corresponding amendment to the definition of "due date" in Rule 31(a)(10)(ii) under the Exchange Act by replacing the reference to "September 30" in that rule with a reference to "September 25."

Request for Comment

190. Do commenters agree with the proposal to exempt SBSs from Section 31 fees? Why or why not?

191. How much transaction volume in SBSs would the Commission be exempting from Section 31 fees on an annual basis?

192. If the Commission did not exempt SBSs from Section 31 fees, how would a national securities association obtain funds to pay the fees? Would the offsetting fees imposed on members of the national securities association be fairly distributed?

193. Do commenters agree that the proposed exemption would create a more level playing field among SBS market participants? Why or why not?

194. Absent the proposed exemption from Section 31 fees for SBSs, would there be difficulties in collecting Section 31 fees for mixed swaps (which are included with the definition of "security-based swap" and are thus securities)?

XII. General Request for Comment

Title VII of the Dodd-Frank Act requires the SEC to consult and coordinate to the extent possible with the CFTC for the purposes of assuring regulatory consistency and comparability, to

172 Section 991 of the Dodd Frank Act provides, in relevant part: "(1) AMENDMENTS.— Section 31 of the Securities Exchange Act of 1934 (15 U.S.C. 78ee) is amended . . . in subsection (e)(2), by striking 'September 30' and inserting 'September 25'."

the extent possible,[173] and states that in adopting rules, the CFTC and SEC shall treat functionally or economically similar products or entities in a similar manner.[174]

The CFTC is adopting rules related to the reporting of swaps and the public dissemination of swap transaction, pricing, and volume data, as required under Sections 723, 727, and 729 of the Dodd-Frank Act. Understanding that the Commission and the CFTC regulate different products and markets and, as such, appropriately may be proposing alternative regulatory requirements, the Commission requests comment on the impact of any differences between the Commission and CFTC approaches to the regulation of the reporting of swaps and SBSs and the public dissemination of swap and SBS transaction, pricing, and volume information.

In addition, legislatures and regulators in other jurisdictions are undertaking efforts to improve regulation in the market for OTC derivatives, including security-based swaps. The Commission requests comment generally on the impact of any differences between the Commission's proposed approach to the reporting and public dissemination of SBSs and that of any relevant foreign jurisdictions.

195. Would the regulatory approaches under the Commission's proposed rulemaking pursuant to Sections 763 and 766 of the Dodd-Frank Act and the CFTC's proposed rulemaking pursuant to Sections 723, 727, and 729 of the Dodd-Frank Act result in duplicative or inconsistent efforts on the part of market participants subject to both regulatory regimes or result in gaps between those regimes? If so, in what ways do commenters believe that such duplication, inconsistencies, or gaps should be minimized?

173 See Section 712(a)(2) of the Dodd-Frank Act.

174 See Section 712(a)(7) of the Dodd-Frank Act.

196. Do commenters believe the approaches proposed by the Commission and the CFTC to regulate the reporting of swaps and SBSs, and the public dissemination of swap and SBS transaction, volume, and pricing information, are comparable? If not, why not?

197. Do commenters believe there are approaches that would make the regulation of swap and SBS reporting and the public dissemination of swap and SBS transaction, volume, and pricing information more comparable? If so, what?

198. Do commenters believe that it would be appropriate for the Commission to adopt an approach proposed by the CFTC that differs from our proposal? Is so, which one(s)? We request commenters to provide data, to the extent possible, supporting any such suggested approaches.

199. If registered SDRs would also be assuming real-time reporting obligations under the CEA, should the phase-in schedules for reporting obligations for swaps and SBSs be coordinated?

200. How will proposed Regulation SBSR interact with reporting and public dissemination regimes in other jurisdictions? Will there be significant differences? If so, would those differences result in regulatory arbitrage? If so, what steps, if any, should the Commission take to minimize opportunities for regulatory arbitrage?

XIII. Paperwork Reduction Act

Certain provisions of the proposed reporting rules proposed in this release contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[175] The Commission is therefore submitting relevant information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR

[175] 44 U.S.C. 3501 et seq.

1320.11. Compliance with the collection of information requirements would be mandatory. 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. Specific collections of information are discussed further below.

A. Definitions – Rule 900

Proposed Rule 900 of Regulation SBSR contains only definitions of relevant terms and, thus, would not be a "collection of information" within the meaning of the PRA.

B. Reporting Obligations – Rule 901 of Regulation SBSR

Proposed Rule 901 of Regulation SBSR contains "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 901 – Reporting Obligations."

1. Summary of Collection of Information

The Dodd-Frank Act amended the Exchange Act to require the reporting of SBS transactions. Accordingly, the Commission is proposing Rule 901 under the Exchange Act to implement this requirement. Proposed Rule 901 would specify who reports SBS transactions, where such transactions are to be reported, what information is to be reported, and in what format. Counterparties to a SBS would be responsible for reporting the SBS to a registered SDR, or, if there is no registered SDR that would accept the SBS, to the Commission. Proposed Rule 901 generally would divide the SBS information that must be reported into three categories: (1) information that must be reported in real time pursuant to proposed Rule 901(c);[176] (2) additional

176 Proposed Rule 901(c) would provide that, for each SBS for which it is the reporting party, the reporting party shall report the following information in real time: (1) the asset class of the SBS and, if the SBS is an equity derivative whether it is a total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the SBS is based; (2) information that identifies the SBS

information that must be reported pursuant to proposed Rule 901(d) within specified timeframes;[177] and (3) life cycle events that must be reported pursuant to proposed Rule 901(e).[178]

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instrument and the specific asset(s) or issuer of a security on which the SBS is based; (3) the notional amount(s), and the currenc(ies) in which the notional amount(s) is expressed; (4) the date and time, to the second, of execution, expressed using UTC; (5) the effective date; (6) the scheduled termination date; (7) the price; (8) the terms of any fixed or floating rate payments, and the frequency of any payments; (9) whether or not the SBS will be cleared by a clearing agency; (10) if both counterparties to a SBS are SBS dealers, an indication to that effect; (11) if applicable, an indication that the transaction does not accurately reflect the market; and (12) if the SBS is customized to the extent that the information provided in items (1) through (11) does not provide all of the material information necessary to identify such customized SBS or does not contain the data elements necessary to calculate the price, an indication to that effect. See supra Section III.B.

177 Proposed Rule 901(d)(1) would provide that, in addition to the information required under proposed Rule 901(c), for each SBS for which it is the reporting party, the reporting party shall report: (1) the participant ID of each counterparty; (2) as applicable, the broker ID, desk ID, and trader ID of the reporting party; (3) the amount(s) and currenc(ies) of any up-front payment(s) and a description of the payment streams of each counterparty; (4) the title of any master agreement, or any other agreement governing the transaction (including the title of any document governing the satisfaction of margin obligations), incorporated by reference and the date of any such agreement; (5) the data elements necessary for a person to determine the market value of the transaction; (6) if the SBS will be cleared, the name of the clearing agency; (7) if the SBS is not cleared, whether the exception in Section 3C(g) of the Exchange Act was invoked; (8) if the SBS is not cleared, a description of the settlement terms, including whether the SBS is cash-settled or physically settled, and the method for determining the settlement value; and (9) the venue where the SBS was executed. Under proposed Rule 901(d)(2), any information required to be reported pursuant to paragraph (d)(1) must be reported promptly, but in no event later than: (1) 15 minutes after the time of execution for a SBS that is traded and confirmed electronically; (2) 30 minutes after the time of execution for a SBS that is confirmed electronically but not traded electronically; or (3) 24 hours after execution for a SBS that is not executed or confirmed electronically. See supra Sections IV.B. and C.

178 Proposed Rule 901(e) would require that, for any life cycle event, and any adjustment due to a life cycle event, that results in a change to information previously reported pursuant to proposed Rule 901(c) or (d), the reporting party shall promptly provide updated information reflecting such change to the entity to which it reported the original transaction, using the transaction ID, subject to two enumerated exceptions. However, if a reporting party ceases to be a counterparty to a SBS due to an assignment or novation, the new counterparty shall be the reporting party following such assignment or novation, if the new counterparty is a U.S. person. If, following an assignment or novation, the

Proposed Rule 901(i) would require the reporting of all of the information required by proposed Rules 901(c) and (d) for any pre-enactment SBSs or transitional SBSs, to the extent such information is available.

Proposed Rule 901 also would impose certain duties on a registered SDR that receives SBS transaction data. Proposed Rule 901(f) would require a registered SDR to time stamp, to the second, its receipt of any information submitted to it pursuant to proposed Rule 901(c), (d), or (e). Proposed Rule 901(g) would require a registered SDR to assign a transaction ID to each SBS reported by a reporting party.

2. Proposed Use of Information

The SBS transaction information required to be reported pursuant to proposed Rule 901 would be used by registered SDRs, market participants, the Commission, and other regulators. The information reported by reporting parties pursuant to proposed Rule 901 would be used by registered SDRs to publicly disseminate real-time reports of SBS transactions, as well as to offer a resource for regulators to obtain detailed information about the SBS market. Market participants would use the public market data feed to assess the current market for SBSs and for valuation purposes. The Commission and other regulators would use information about SBS transactions reported to and held by registered SDRs for prudential oversight and to monitor potential systemic risks, as well as to examine for improper behavior and to take enforcement actions, as appropriate.

The transaction ID would be used on any subsequent transaction report or information submitted by a reporting party regarding that SBS (e.g., on an error report to identify the original transaction to which the error report pertains).

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new counterparty is not a U.S. person, the counterparty that is a U.S. person shall be the reporting party. See supra Section IV.D.

3. Respondents

Proposed Rule 901 would apply to reporting parties.[179] The Commission preliminarily believes that up to 1,000 entities could be reporting parties under proposed Rule 901(a), and that it is reasonable to use the figure of 1,000 respondents for estimating collection of information burdens under the PRA. The Commission preliminarily believes, based on information currently available to it, that there are and would continue to be approximately 1,000 entities regularly engaged in the CDS marketplace, and that most of these entities are likely to regularly participate in other SBS markets.[180] Accordingly, the Commission preliminarily believes that an estimate of 1,000 respondents (i.e., reporting parties) is appropriate.

Proposed Rule 901 also would impose certain duties on registered SDRs. Pursuant to Section 13(n) of the Exchange Act, an SDR must register with the Commission.[181] The Commission preliminarily believes that the number of SDRs seeking to register would not exceed ten. Accordingly, for purposes of estimating collection of information burdens under proposed Regulation SBSR, including proposed Rule 901, the Commission believes that it is reasonable to use ten as an estimate of the number of registered SDRs.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

a. For Reporting Parties

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179 See proposed Rule 900 (defining "reporting party" as the counterparty to a SBS with the duty to report information in accordance with proposed Regulation SBSR to a registered SDR, or if there is no registered SDR that would receive the information, to the Commission).

180 The Commission includes in its estimate of reporting parties clearing agencies, which under proposed Rule 901(e)(i) could become the reporting parties for SBS transactions where the original reporting party ceases to be a counterparty to the SBS following a novation of the transaction. See supra Section IV.D.

181 See 15 U.S.C. 78m(n). The Commission today is separately proposing several rules to implement this requirement. See SDR Registration Proposing Release, supra note 6.

Pursuant to proposed Rule 901, all SBS transactions must be reported to a registered SDR or to the Commission. Together, sections (a), (b), (c), (d), (e) and (h) of proposed Rule 901 set forth the parameters that market participants must follow to report SBS transactions. Proposed Rule 901(i) addresses the reporting of pre-enactment SBSs. The proposed SBS reporting requirements would impose initial and ongoing burdens on reporting parties. The Commission preliminarily believes that these burdens would be a function of, among other things, the number of reportable SBS transactions and the data elements required to be reported for each SBS transaction.

Based on publicly available information and consultation with industry sources, the Commission preliminarily believes that even the most active participants in the SBS market do not enter into a large number of new SBSs on a daily basis. Rather, most regularly active SBS market participants enter into only a small number of new SBSs during any given time period, while a few larger dealers participate in the majority of SBS transactions. The Commission has sought available information in an effort to quantify the number of aggregate SBS transactions on an annual basis. According to publicly available data from DTCC, recently, there have been an average of approximately 36,000 CDS transactions per day,[182] corresponding to a total number of CDS transactions of approximately 13,140,000 per year. The Commission preliminarily believes that CDSs represent 85% of all SBS transactions.[183] Accordingly, and to the extent that historical market activity is a reasonable predictor of future activity,[184] the

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182 See, e.g., http://www.dtcc.com/products/derivserv/data_table_iii.php (weekly data as updated by DTCC).

183 The Commission's estimate is based on internal analysis of available SBS market data. The Commission is seeking comment about the overall size of the SBS market.

184 The Commission notes that regulation of the SBS markets, including by means of proposed Regulation SBSR, could impact market participant behavior.

Commission preliminarily estimates that the total number of SBS transactions that would be subject to proposed Rule 901 on an annual basis would be approximately 15,460,000, which is an average of approximately 42 per reporting party per day.[185]

The Commission believes that reporting parties would face three categories of burdens to comply with proposed Rule 901 of Regulation SBSR. First, each reporting party would likely need to develop an internal order and trade management system ("OMS") capable of capturing relevant SBS transaction information. The OMS would have to include or be connected to a system designed to store SBS transaction information. The Commission understands that it is current industry practice, in many cases, to add SBS transaction details to the transaction record post-execution in a process known as "enrichment." Accordingly, the OMS would likely need to link both to the trade desk – to permit real-time transaction reporting under proposed Rule 901(c) – and to the back office – to facilitate reporting of complete transactions as required under proposed Rule 901(d).

Second, each reporting party would have to implement a reporting mechanism. This would include a system that "packages" SBS transaction information from the reporting party's OMS, sends such information, and tracks it. The reporting mechanism would also include necessary data transmission lines to the appropriate registered SDR.

Third, each reporting party would have to establish an appropriate compliance program and support for the operation of the OMS and reporting mechanism. Relevant elements of the compliance program would include transaction verification and validation protocols; the ability

185 These figures are based on the following: [13,140,000 / 0.85] = 15,458,824. [((15,458,824 estimated SBS transactions) / (1,000 estimated reporting parties)) / (365 days/year)] = 42.35, or approximately 42 transactions per day. The Commission understands that many of these transactions may arise from previously executed SBS transactions.

to identify and correct erroneous transaction reports; and necessary technical, administrative, and legal support. Additional operational support would include new product development, systems upgrades, and ongoing maintenance.

Internal Order Management. To comply with their reporting obligations, reporting parties would likely need to develop and maintain an internal OMS that can capture relevant SBS data. The Commission preliminarily estimates that capturing SBS data in a manner sufficient to comply with proposed Rule 901 would impose an initial one-time aggregate burden of approximately 355,000 burden hours, which corresponds to a burden of 355 hours for each reporting party.[186] This estimate includes an estimate of the number of potential burden hours required to amend internal procedures, design or reprogram systems, and implement processes to ensure that SBS transaction data are captured and preserved. The Commission further preliminarily estimates that capturing SBS data in a manner sufficient to comply with proposed Rule 901 would impose an annual aggregate burden of approximately 436,000 burden hours, 436 burden hours for each reporting party.[187] This figure would include day-to-day support of the OMS, as well as an estimate of the amortized annual burden associated with system upgrades and periodic "re-platforming" (i.e., implementing significant updates based on new technology).

186 This figure is based on discussions of Commission staff with various market participants and is calculated as follows: [((Sr. Programmer at 160 hours) + (Sr. Systems Analyst at 160 hours) + (Compliance Manager at 10 hours) + (Director of Compliance at 5 hours) + (Compliance Attorney at 20 hours)) x (1,000 reporting parties)] = 355,000 burden hours, which is 355 hours per reporting party (assuming 1,000 reporting parties). The Commission preliminarily believes that information on SBS transactions is currently being retained by many market participants in the ordinary course of business. This may result in lesser burdens for those parties.

187 This figure is based on discussions of Commission staff with various market participants and is calculated as follows: [((Sr. Programmer at 32 hours) + (Sr. Systems Analyst at 32 hours) + (Compliance Manager at 60 hours) + (Compliance Clerk at 240 hours) + (Director of Compliance at 24 hours) + (Compliance Attorney at 48 hours)) x (1,000 reporting parties)] = 436,000 burden hours, which is 436 hours per reporting party.

The Commission preliminarily estimates that, to capture and maintain relevant information and documents, reporting parties could incur aggregate annual dollar cost burden (first-year and ongoing) of $1,000,000, which corresponds to $1,000 for each participant.[188] The figure is an estimate of the hardware and associated maintenance costs for sufficient memory to capture and store SBS transactions, including redundant back-up systems.

Summing these burdens, the Commission preliminarily estimates the initial (i.e., first-year) aggregate annualized burden on reporting parties for internal order management under proposed Rule 901 would be 791,000 burden hours, which corresponds to 791 burden hours for each reporting party.[189] The Commission preliminarily estimates that the initial aggregate annualized dollar cost burden would be $1,000,000, which would correspond to $1,000 for each reporting party.[190] The Commission further preliminarily estimates that the ongoing aggregate annualized burden on reporting parties for internal order management under proposed Rule 901 would be 436,000 burden hours, which corresponds to 436 burden hours for each reporting

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188 This estimate is based on discussions of Commission staff with various market participants and is calculated as follows: [($250/gigabyte of storage capacity) x (4 gigabytes of storage) x (1,000 reporting parties)] = $1,000,000. The Commission preliminarily believes that storage costs associated with saving relevant SBS information and documents would not vary significantly between the first year and subsequent years. Accordingly, the Commission has preliminarily estimated the initial and ongoing storage costs to be the same. Moreover, the per-entity annual data storage figure of $1,000 is an average. Some parties may face higher costs, while others would simply use existing storage resources.

189 This estimate is based on the following: [((355 one-time burden hours for systems development) + (436 burden hours for annual costs)) x (1,000 reporting parties)] = 791,000 burden hours, which corresponds to 791 burden hours per reporting party.

190 See supra note 188.

party.[191] The Commission preliminarily estimates that the ongoing aggregate annualized dollar cost burden would be $1,000,000, which corresponds to $1,000 for each reporting party.[192]

SBS Reporting Mechanism. Reporting parties would be required to incur initial one-time costs to establish connectivity to a registered SDR to report SBS transactions. Depending on the number of SBS asset classes that a reporting party transacts in, and which registered SDRs accept the resulting SBS transaction reports, multiple connections to different registered SDRs could be necessary. For purposes of estimating relevant burdens, the Commission preliminarily estimates that, on average, each reporting party would require connections to two registered SDRs. The Commission bases this estimate on discussions with market participants. We recognize that, in light of the developing SBS market and regulatory structure, the actual average number of SDR connections maintained by each reporting party may be different.

This estimate is based on the following factors. First, based on discussions with SBS market participants, the Commission understands that the majority of SBSs are comprised of CDS and equity-based swaps. Accordingly, the Commission preliminarily believes that transactions in these two asset classes would predominate. Moreover, the Commission preliminarily believes that SBS market participants may not all transact in each asset class. Thus, even if each registered SDR accepted transaction reports only for a single SBS asset class, the total number of connections needed by many reporting parties would likely be limited. Next, the Commission also preliminarily believes that, for operational efficiency, a reporting party would seek to use only one registered SDR per asset class for repository services. Accordingly, to the extent that a single registered SDR accepted SBSs in multiple asset classes, a reporting party would need fewer connections. Finally, a reporting party that required a significant

191 See supra note 187.

192 See supra note 188.

number of connections to registered SDRs could engage a third party – for example, a dealer or connectivity services provider – instead of independently establishing its own connections. Accordingly, the Commission preliminarily believes that one connection may suffice for many reporting parties.

On this basis, the Commission preliminarily estimates that the cost to establish and maintain connectivity to a registered SDR to facilitate the reporting required by proposed Rule 901 would impose an annual dollar cost burden of approximately $200,000,000, which corresponds to a dollar cost burden of $200,000 for each reporting party.[193]

Moreover, the Commission believes that establishing a reporting mechanism for SBS transactions would impose internal burdens on each reporting party, including the development of systems necessary to capture and send information from the entity's OMS to the relevant registered SDR, as well as corresponding testing and support. The Commission preliminarily estimates an initial one-time aggregate burden of 172,000 burden hours, which corresponds to a burden of 172 burden hours for each reporting party.[194] In addition, the Commission

193 This estimate is based on discussions of Commission staff with various market participants, as well as the Commission's experience regarding connectivity between securities market participants for data reporting purposes. The Commission derived the total estimated expense from the following: [($100,000 hardware- and software-related expenses, including necessary back-up and redundancy, per SDR connection) x (2 SDR connections per reporting party) x (1,000 reporting parties)] = $200,000,000. The Commission understands that many reporting parties already have established linkages to entities that may register as SDRs, which could significantly reduce the out-of-pocket costs associated with this establishing the reporting function contemplated by proposed Rule 901.

194 This figure is based on discussions with various market participants as follows: [((Sr. Programmer at 80 hours) + (Sr. Systems Analyst at 80 hours) + (Compliance Manager at 5 hours) + (Director of Compliance at 2 hours) + (Compliance Attorney at 5 hours)) x (1,000 reporting parties)] = 172,000 burden hours, which is 172 hours per reporting party. The Commission preliminarily believes that many dealers and major market participants already are reporting SBS data to some extent in the ordinary course of business. Thus, as a practical matter, these parties may face substantially lower burdens.

preliminarily estimates that reporting specific SBS transactions to a registered SDR as required by proposed Rule 901 would impose an ongoing aggregate burden of 77,300 burden hours, which corresponds to a burden of approximately 80 burden hours for each reporting party.[195]

Thus, the Commission preliminarily estimates the initial (first-year) aggregate annualized burden on reporting parties for reporting under proposed Rule 901 would be 249,300 burden hours, which corresponds to approximately 250 burden hours for each reporting party.[196] The Commission preliminarily estimates that the initial aggregate annualized dollar cost burden would be $200,000,000, which corresponds to $200,000 for each reporting party.[197] In addition, the Commission preliminarily estimates that the ongoing aggregate annualized burden on reporting parties under proposed Rule 901 would be 77,300 burden hours, which corresponds to approximately 80 burden hours for each reporting party.[198] The Commission preliminarily estimates that the ongoing aggregate annualized dollar cost burden would be $200,000,000, which corresponds to $200,000 for each reporting party.[199]

Compliance and Ongoing Support. As stated above, in complying with proposed Rule 901, each reporting party also would need to establish and maintain an appropriate compliance

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195 This figure is based on discussions of Commission staff with various market participants, as well as the Commission's experience regarding connectivity between securities market participants, including alternative trading systems and self-regulatory organizations for data reporting purposes. The Commission derived the total estimated initial burden from the following: [(15,460,000 estimated total annual SBS transactions) x (0.005 hours/transaction)] = 77,300 burden hours, which is 77.3 burden hours per reporting party.

196 This estimate is based on the following: [((172 one-time burden hours) + (77.3 burden hours for ongoing costs)) x (1,000 reporting parties)] = 249,300 burden hours, which corresponds to 249.3 burden hours per reporting party.

197 See supra note 193.

198 See supra note 195.

199 See supra note 193.

program and support for the operation of the OMS and reporting mechanism, which would include transaction verification and validation protocols, and necessary technical, administrative, and legal support. Additional operational support would include new product development, systems upgrades, and ongoing maintenance. The Commission preliminarily believes that initial burdens associated with this aspect of proposed Rule 901 – i.e., the establishment of relevant compliance capability – would in significant part involve the development of appropriate policies and procedures, which, for those participants who are SBS dealers or major SBS participants, is addressed in connection with proposed Rule 906(c).[200] A reporting party also would need to design its OMS to include tools to ensure accurate, complete reporting. On an ongoing basis, a reporting party would need to employ appropriate technical and compliance staff to maintain and support the operation of its order management and reporting systems over time.

The Commission preliminarily estimates that designing and implementing an appropriate compliance and support program would impose an initial, one-time aggregate burden of approximately 180,000 burden hours, which corresponds to a burden of 180 burden hours for each reporting party.[201]

The Commission further preliminarily estimates that maintaining a reporting party's compliance and support program would impose an ongoing aggregate burden of approximately 218,000 burden hours, which corresponds to a burden of 218 burden hours for each reporting

200 See infra Section XIII.G.

201 This figure is based on discussions with various market participants and is calculated as follows: [((Sr. Programmer at 100 hours) + (Sr. Systems Analyst at 40 hours) + (Compliance Manager at 20 hours) + (Director of Compliance at 10 hours) + (Compliance Attorney at 10 hours)) x (1,000 reporting parties)] = 180,000 burden hours, which corresponds to 180 hours per reporting party.

party.[202] This figure includes day-to-day support of the OMS, as well as an estimate of the amortized annual burden associated with system upgrades and periodic re-platforming (i.e., implementing significant updates based on new technology).

Therefore, the Commission preliminarily estimates the initial aggregate annualized burden on reporting parties for compliance and ongoing support under proposed Rule 901 would be 398,000 burden hours, which corresponds to 398 burden hours for each reporting party.[203] The Commission further preliminarily estimates that the ongoing aggregate annualized burden on reporting parties for compliance and ongoing support under proposed Rule 901 would be 218,000 burden hours, which corresponds to 218 burden hours for each reporting party.[204]

Aggregate Burdens. Thus, the Commission estimates that the total first-year burden – the initial aggregate annualized burden – on reporting parties associated with proposed Rule 901 would be 1,438,300 burden hours, which corresponds to approximately 1,438 burden hours per reporting party.[205] In addition, the Commission preliminarily estimates that the initial aggregate annualized dollar cost burden on reporting parties associated with proposed Rule 901 would be $301,000,000, which corresponds to a dollar cost burden of $301,000 per reporting party.[206]

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202 This figure is based on discussions with various market participants and is calculated as follows: [((Sr. Programmer at 16 hours) + (Sr. Systems Analyst at 16 hours) + (Compliance Manager at 30 hours) + (Compliance Clerk at 120 hours) + (Director of Compliance at 12 hours) + (Compliance Attorney at 24 hours)) x (1,000 reporting parties)] = 218,000 burden hours, which is 218 hours per reporting party.

203 This estimate is based on the following: [((180 one-time burden hours) + (218 annual burden hours)) x (1,000 reporting parties)] = 398,000 burden hours, which corresponds to 398 burden hours per reporting party.

204 See supra note 202.

205 This figure is based on summing the initial aggregate annualized burdens for reporting parties under proposed Rule 901: [(791,000) + (249,300) + (398,000)] = 1,438,300 burden hours.

206 This figure is based on summing the estimated first-year aggregate annualized dollar cost burdens as follows: [($300,000,000) + ($1,000,000)] = $301,000,000.

Likewise, the Commission estimates that the ongoing aggregate annual burdens on reporting parties associated with proposed Rule 901 would be 731,300 burden hours, which corresponds to 731 burden hours per reporting party.[207] In addition, the Commission preliminarily estimates that the ongoing, aggregate annualized dollar cost burden on reporting parties associated with proposed Rule 901 would be $301,000,000, which corresponds to a dollar cost burden of $301,000 per reporting party.[208]

b. For Registered SDRs

Proposed Rule 901(f) would require a registered SDR to time-stamp information that it receives. Proposed Rule 901(g) would require a registered SDR to assign a unique transaction ID to each SBS it receives. The Commission preliminarily believes that a registered SDR would need to design its systems to include these capabilities, but that such design elements would not pose additional significant burdens to incorporate in the context of designing and building the technological framework that would be required of a SDR to become registered.[209] Therefore, the Commission preliminarily estimates that proposed Rules 901(f) and (g) would impose an initial one-time aggregate burden of 1,200 burden hours, which corresponds to 120 burden hours per registered SDR.[210] This figure is based on an estimate of ten registered SDRs. Once

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207 This figure is based on summing estimated ongoing annual aggregate burdens as follows: [(436,000) + (77,300) + (218,000)] = 731,300 burden hours.

208 This figure is based on summing the estimated first-year aggregate annualized dollar cost burdens as follows: [($300,000,000) + ($1,000,000)] = $301,000,000.

209 The Commission is proposing Rules 13n-4(b), 13n-5, and 13n-6 under the Exchange Act, which would relate to the duties, data collection and maintenance, and automated systems requirements for SDRs. <u>See</u> SDR Registration Proposing Release, <u>supra</u> note 6.

210 This figure is based on discussions with various market participants and is calculated as follows: [((Sr. Programmer at 80 hours) + (Sr. Systems Analyst at 20 hours) + (Compliance Manager at 8 hours) + (Director of Compliance at 4 hours) + (Compliance Attorney at 8 hours)) x (10 registered SDRs)] = 1,200 burden hours, which is 120 hours per registered SDR.

operational, these elements of each registered SDR's system would have to be supported and maintained. Accordingly, the Commission estimates that proposed Rule 901(f) and (g) would impose an annual aggregate burden of 1,520 burden hours, which corresponds to 152 burden hours per registered SDR.[211] This figure represents an estimate of the burden for a registered SDR for support and maintenance costs for the registered SDR's systems to time stamp incoming submissions and assign transaction IDs.

Thus, the Commission preliminarily estimates that the first-year aggregate annualized burden associated with proposed Rules 901(f) and (g) would be 2,820 burden hours, which corresponds to 282 burden hours per registered SDR.[212] Correspondingly, the Commission preliminarily estimates that the ongoing aggregate annualized burden associated with proposed Rules 901(f) and (g) would be 1,520 burden hours, which corresponds to 152 burden hours per registered SDR.[213]

5. Recordkeeping Requirements

Concurrently with proposed Regulation SBSR, the Commission is issuing the SDR Registration Proposing Release, which includes recordkeeping requirements for SBS transaction data received by a registered SDR pursuant to proposed Regulation SBSR. Specifically, proposed Rule 13n-5(b)(4) would require a registered SDR to maintain the transaction data that it collects for not less than five years after the applicable SBS expires, and historical positions and

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211 This figure is based on discussions with various market participants as follows: [((Sr. Programmer at 60 hours) + (Sr. Systems Analyst at 48 hours) + (Compliance Manager at 24 hours) + (Director of Compliance at 12 hours) + (Compliance Attorney at 8 hours)) x (10 SDRs)] = 1,520 burden hours, which is 152 hours per registered SDR.

212 This figure is based on the following: [(1,200) + (1,520)] = 2,720 burden hours, which corresponds to 272 burden hours per registered SDR.

213 See supra note 211.

historical market values for not less than five years.[214] Accordingly, SBS transaction reports received by a registered SDR pursuant to proposed Rule 901 would be required to be retained by the SDR for not less than five years.

6. Collection of Information is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

7. Confidentiality of Responses to Collection of Information

Information collected pursuant to proposed Rule 901(c) would be widely available to the public to the extent it is incorporated into SBS transaction reports that are publicly disseminated by a registered SDR pursuant to proposed Rule 902. A registered SDR would be under an obligation to maintain the confidentiality of any information collected pursuant to proposed Rule 901(d), pursuant to Sections 13(n)(5) of the Exchange Act and proposed Rule 13n-9 thereunder.[215] To the extent that the Commission receives confidential information pursuant this collection of information, such information would be kept confidential, subject to the provisions of the Freedom of Information Act.

8. Request for Comment

The Commission requests public comment on its burden estimates. The Commission also solicits comment as follows:

201. Is the proposed collection of information necessary for the performance of the functions of the agency? Would the information have practical utility?

202. How accurate are the Commission's preliminary estimates of the burdens of the proposed collection of information associated with proposed Rule 901? In particular,

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214 See SDR Registration Proposing Release, supra note 6.

215 See id.

how many entities would incur collection of information burdens pursuant to proposed Rule 901?

203. Would covered entities incur any initial burdens associated with systems design, programming, expanding systems capacity, and establishing compliance programs pursuant to proposed Rule 901?

204. Would there be different or additional burdens associated with the collection of information under proposed Rule 901 that a covered entity would not undertake in the ordinary course of business?

205. Are there additional burdens that the Commission has not addressed in its preliminary burden estimates?

206. Can you suggest any ways to enhance the quality, utility, and clarity of the information to be collected?

207. Can you suggest any ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?

208. What entities may be subject to proposed Rule 901, whether specific classes of entities may be impacted, how many entities may be impacted, and will any such entity or class of entities be impacted differently than others? In addition, the Commission seeks comment on the accuracy of its estimates as to the number of participants in the SBS market that would be required to report information pursuant to proposed Rule 901.

C. Public Dissemination of Transaction Reports – Rule 902 of Regulation SBSR

Certain provisions of proposed Rule 902 of Regulation SBSR contain "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 902 – Public Dissemination of Transaction Reports."

1. Summary of Collection of Information

Proposed Rule 902(a) generally would require that a registered SDR publicly disseminate a transaction report for each SBS transaction immediately upon receipt of information about the SBS submitted by a reporting party pursuant to proposed Rule 901(c), along with any indicator(s) contemplated by the registered SDR's policies and procedures.[216] If its systems are unavailable for publicly disseminating transaction data immediately upon receipt, the registered SDR would be required to disseminate the transaction data immediately upon re-opening.

Pursuant to Rule 902(b), a registered SDR would be required to publicly disseminate a transaction report of a SBS that constitutes a block trade immediately upon receipt of information about the block trade from the reporting party. The transaction report would consist of all the information reported by the reporting party pursuant to proposed Rule 901(c), except for the notional size, plus the transaction ID and an indicator that the report represents a block trade. The registered SDR would be required to publicly disseminate a complete transaction report for such block trade (including the transaction ID and the full notional size) at a later time.

Proposed Rule 902(c) would prohibit a registered SDR from disseminating: (1) the identity of either counterparty to a SBS; (2) with respect to a SBS that is not cleared at a registered clearing agency and that is reported to a registered SDR, any information disclosing the business transactions and market positions of any person; (3) any information regarding a SBS reported pursuant to proposed Rule 901(i).

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216 See proposed Rule 907(a)(4).

2. Proposed Use of Information

The real-time public dissemination requirement contained in proposed Rule 902 would provide post-trade transparency for SBS transactions, as required by the Dodd-Frank Act. Publicly disseminated reports of SBS transactions that are not block trades would include the full notional size. Publicly disseminated reports of SBS transactions that are block trades would occur pursuant to a two-step process. First, a real-time report would be disseminated without the notional size, but with an indication that the trade is a block trade as well as a transaction ID. At a later time, a follow-on report would be disseminated, including the notional size, with the transaction ID used to connect the second report to the first report.

3. Respondents

The collection of information associated with the proposed Rule 902 would apply to registered SDRs. As noted above, the Commission preliminarily believes that an estimate of ten registered SDRs is reasonable for purposes of its analysis of potential burdens under the PRA.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

Although proposed Rule 902 would not prescribe a manner of public dissemination, the Commission anticipates that a registered SDR would establish a mechanism functionally similar to one established by TRACE, which is a system operated by FINRA for collecting and disseminating to the public reports of trades in corporate and agency debt securities.

Simultaneously with this proposal, the Commission is proposing new Rules 13n-1 through 13n-11 under the Exchange Act relating to the SDR registration process, the duties of SDRs, and their core principles.[217] The SDR Registration Proposing Release covers anticipated collections of information with respect to various aspects of establishing and operating an SDR,

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217 See SDR Registration Proposing Release, supra note 6.

including its start-up and ongoing operations. Proposed Rule 13n-5(b)(1) would set forth parameters each registered SDR would be required to follow with regard to collecting and maintaining transaction data. Every SDR would be required to (i) establish, maintain, and enforce written policies and procedures for the reporting of transaction data to the SDR and shall accept all transaction data that is reported in accordance with such policies and procedures; (ii) accept all SBSs in any asset class that are reported to it in accordance with its policies and procedures to the extent that it accepts any SBS in a particular asset class; (iii) establish, maintain, and enforce written policies and procedures to verify the accuracy of the transaction data that has been submitted to the SDR, including clearly identifying the source for each trade side and the pairing method (if any) for each transaction in order to identify the level of quality of the transaction data; and (iv) promptly record the transaction data it receives. The SDR Registration Proposing Release describes the relevant burdens and costs that complying with proposed Rule 13n-5(b)(1) would entail.

The Commission preliminarily believes that a registered SDR would be able to integrate the capability to publicly disseminate real-time SBS transaction reports required under proposed Rule 902 as part of its overall system development for transaction data. Accordingly, the Commission believes that the burdens associated with enabling and maintaining compliance with proposed Rule 902 would, as a practical matter, represent a portion of a registered SDR's overall systems development budget and process. Based on discussions with industry participants, the Commission preliminarily estimates that to implement and comply with the real-time public dissemination requirement of proposed Rule 902, each registered SDR would incur a burden equal to an additional 20% of the first-year and ongoing burdens discussed in the SDR Registration Proposing Release.[218]

On this basis, the Commission preliminarily estimates that the initial one-time aggregate burden imposed by the proposed Rule 902 for development and implementation of the systems needed to disseminate the required transaction information, including the necessary software and hardware, would be approximately 84,000 hours and a dollar cost of $20 million, which would correspond to a burden of 8,400 hours and a dollar cost of $2 million for each registered SDR.[219] In addition, the Commission preliminarily estimates that annual aggregate burden (initial and ongoing) imposed by the proposed Rule 902 would constitute approximately 50,400 hours and a dollar cost of $12 million, which would correspond to a burden of 5,040 hours and a dollar cost of $1.2 million for each registered SDR.[220] Thus, the Commission preliminarily estimates that the total first-year (initial) aggregate annualized burden on registered SDRs associated with real-

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218 See Section IV.D.2 (SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access) of the SDR Registration Proposing Release. This estimate is based on discussions with industry members and market participants, including potential SDRs who would be required to register as SDRs under the Dodd-Frank Act, and includes time necessary to design and program a registered SDR's system to calculate and disseminate initial and subsequent trade reports as well as annual costs associated with systems testing and maintenance necessary for the special handling of block trades. These figures do not include the development of policies and procedures necessary to calculate block trade levels pursuant to proposed Rule 907(b).

219 See SDR Registration Proposing Release, supra note 6 for the total burden associated with establishing SDR technology systems. The Commission derived this estimated burden from the following: [((Attorney at 1,400 hours) + (Compliance Manager at 1,600 hours) + (Programmer Analyst at 4,000 hours) + (Senior Business Analyst at 1,400 hours)) x (10 registered SDRs)] = 84,000 burden hours, which corresponds to 8,400 hours per registered SDR.

220 See SDR Registration Proposing Release, supra note 6 for the total ongoing annual burdens associated with operating and maintaining SDR technology systems. The Commission derived this estimated burden from the following: [((Attorney at 840 hours) + (Compliance Manager at 960 hours) + (Programmer Analyst at 2,400 hours) + (Senior Business Analyst at 840 hours)) x (10 registered SDRs)] = 50,400 burden hours, which corresponds to 5,040 hours per registered SDR.

time public dissemination requirement under proposed Rule 902 would be approximately 134,400 hours and a dollar cost of $32 million, which would correspond to a burden of 13,440 hours and a dollar cost of $3.2 million for each registered SDR.[221]

5. Recordkeeping Requirements

Pursuant to proposed Rule 13n-7(b) under the Exchange Act,[222] a registered SDR would be required to keep and preserve at least one copy of all documents, including all documents and policies and procedures required by the Exchange Act and the rules or regulations thereunder, for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination. This requirement would encompass real-time SBS transaction reports disseminated by the registered SDR. Accordingly, SBS transaction reports disseminated by a registered SDR pursuant to proposed Rule 902 would be required to be retained for not less than five years.

6. Collection of Information is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

7. Confidentiality of Responses to Collection of Information

Information collected pursuant to proposed Rule 902 would be widely available to the extent that it is incorporated into SBS transaction reports that are publicly disseminated by a registered SDR pursuant to proposed Rules 902(a) and (b). However, a registered SDR would be under an obligation to maintain the confidentiality of any information that is not subject to public

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221 These estimates are based on the following: [(84,000 one-time burden hours) + (50,400 annual burden hours)] = 134,400 burden hours, which corresponds to 13,440 hours per registered SDR; [($20 million one-time dollar cost burden) + ([$12] million annual dollar cost burden) = $32 million cost burden, which corresponds to $3.2 million per registered SDR.

222 See SDR Registration Proposing Release, supra note 6.

dissemination. To the extent that the Commission receives confidential information pursuant this collection of information, such information would be kept confidential, subject to the provisions of the Freedom of Information Act.

8. Request for Comment

The Commission requests public comment on its burden estimates. The Commission also solicits comment as follows:

209. Is the proposed collection of information necessary for the performance of the functions of the agency? Would the information have practical utility?

210. How accurate are the Commission's preliminary estimates of the burdens of the proposed collection of information associated with proposed Rule 902? In particular, how many entities would incur collection of information burdens pursuant to proposed Rule 902?

211. Would registered SDRs incur any initial burdens associated with systems design, programming, expanding systems capacity, and establishing compliance programs pursuant to proposed Rule 902?

212. Would there be different or additional burdens associated with the collection of information under proposed Rule 902 that a registered SDR would not undertake in the ordinary course of business?

213. Are there additional burdens that the Commission has not addressed in its preliminary burden estimates?

214. Can you suggest any ways to enhance the quality, utility, and clarity of the information to be collected?

215. Can you suggest any ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?

D. Coded Information – Rule 903 of Regulation SBSR

The Commission does not believe that proposed Rule 903 would be a "collection of information" within the meaning of the PRA because the rule would merely permit reporting parties and registered SDRs to use codes in place of certain data elements, subject to certain conditions. The rule would offer subject entities greater flexibility in meeting the obligations specified elsewhere in proposed Regulation SBSR related to the reporting of SBS transactions.

E. Operating Hours of Registered Security-Based Swap Data Repositories – Rule 904 of Regulation SBSR

Certain provisions of proposed Rule 904 contain "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 904 – Operating Hours of Registered Security-Based Swap Data Repositories."

1. Summary of Collection of Information

Proposed Rule 904 would require a registered SDR to operate continuously, subject to two exceptions. First, a registered SDR could establish normal closing hours during periods when, in its estimation, the U.S. market and major foreign markets are inactive. A registered SDR would be required to provide reasonable advance notice to participants and to the public of its normal closing hours. Second, a registered SDR could declare, on an ad hoc basis, special closing hours to perform system maintenance that cannot wait until normal closing hours. A registered SDR would, to the extent reasonably possible under the circumstances, be required to avoid scheduling special closing hours during when, in its estimation, the U.S. market and major foreign markets are most active; and provide reasonable advance notice of its special closing hours to participants and to the public.

Paragraphs (c) and (e) of proposed Rule 904 would specify requirements for handling and disseminating reported data during a registered SDR's normal and special closing hours. First, during normal closing hours and, to the extent reasonably practicable, during special closing hours, a registered SDR would be required to have the capability to receive and hold in queue transaction data it receives.[223] Second, if a registered SDR could not hold in queue transaction data to be reported, it would be required, immediately upon resuming normal operations, to send a notice to all participants that it has resumed normal operations and to immediately disseminate the transaction data required to be reported under proposed Rule 901(c) and received from the participants following the notice.[224]

Two of the requirements contained in Rule 904 constitute requirements already contained in other proposed rules. First, the requirement in Rule 904(d) that, immediately upon system re-opening, a registered SDR would be required to publicly disseminate any transaction data required to be reported under proposed Rule 901(c) and held in queue, is also contained in the proposed Rule 902(a). Second, the requirement in proposed Rule 904(e) that, if a reporting party that has an obligation to report transaction data could not to do so because a registered SDR's system was unavailable, it would be required to submit that information immediately after it receives a notice that it is possible to do so, is already implicitly contained in proposed Rule 901.

2. Proposed Use of Information

The information that would be provided pursuant to proposed Rule 904 is necessary to allow participants and the public to know the normal and special closing hours of the registered

223 See proposed Rule 904(c).

224 See proposed Rule 904(e).

SDR, and to allow participants to take appropriate action in the event that the registered SDR cannot accept SBS transaction reports from participants.

3. Respondents

Proposed Rule 904 would apply to all registered SDRs. As noted above, the Commission preliminarily estimates that there would be ten registered SDRs.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

The Commission preliminarily estimates that that the one-time, initial burden, as well as ongoing annualized burden for each registered SDR associated with proposed Rule 904 would be minimal, because registered SDRs would already have undertaken necessary steps in compliance with other proposed rules. First, simultaneously with this proposal, the Commission is proposing the SDR Registration Proposed Rules, including proposed Rules 13n-1 through 240-13n-11.[225] The SDR Registration Proposed Rules cover collections of information with respect to various aspects of establishing and operating a registered SDR, including, implicitly, its hours of operation.[226]

The Commission preliminarily believes that the requirements for a registered SDR to provide reasonable advance notice to participants and to the public of its normal and special closing hours, as well as to provide a notice to participants that it is possible to report transaction data to a registered SDR after its system was unavailable, would entail a minor burden. On this basis, the Commission preliminarily estimates that the annual aggregate burden (first-year and

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225 See SDR Registration Proposing Release, supra note 6.

226 The requirement in proposed Rule 904(e) for the participants to report information to the registered SDR upon receiving a notice that the registered SDR resumed its normal operations is already part of the participant's reporting obligations under proposed Rule 901 and is already contained in the burden estimate for the proposed Rule 901.

ongoing) imposed by proposed Rule 904 would be 360 hours, which corresponds to 36 hours per registered SDR.[227]

5. Recordkeeping Requirements

Concurrently with proposed Regulation SBSR, the Commission is proposing the SDR Registration Proposed Rules.[228] Proposed Rule 13n-7(b) would require a registered SDR to keep and preserve at least one copy of all documents, including all documents and policies and procedures required by the Exchange Act and the rules or regulations thereunder, for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination.[229] This requirement would encompass notices issued by a registered SDR to participants under proposed Rule 904.

6. Collection of Information is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

7. Confidentiality of Responses to Collection of Information

The Commission anticipates that any notices issued to by a registered SDR to its participants would be publicly available.

8. Request for Comment

The Commission requests public comment on its burden estimates. The Commission also solicits comment as follows:

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227 This figure is based on the Commission's experience as follows: [(Operations Specialist at 3 hours/month) x (12 months/year) x (10 registered SDRs)] = 360 burden hours.

228 See SDR Registration Proposing Release, supra note 6.

229 See id., proposed Rule 13n-7(b) under the Exchange Act.

216. Is the proposed collection of information necessary for the performance of the functions of the agency? Would the information have practical utility?

217. How accurate are the Commission's preliminary estimates of the burdens of the proposed collection of information associated with proposed Rule 904? In particular, how many entities would incur collection of information burdens pursuant to proposed Rule 904?

218. Would the burdens imposed under proposed Rule 904 be different or additional to those that a registered SDR would undertake in the ordinary course of business?

219. Are there additional burdens that the Commission has not addressed in its preliminary burden estimates?

220. Can you suggest any ways to enhance the quality, utility, and clarity of the information to be collected?

221. Can you suggest any ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?

F. Correction of Errors in Security-Based Swap Information – Rule 905 of Regulation SBSR

Certain provisions of proposed Rule 905 of Regulation SBSR contain "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 905 – Correction of Errors in Security-Based Swap Information."

1. Summary of Collection of Information

Proposed Rule 905 would establish duties for SBS counterparties and registered SDRs to correct errors in information that previously has been reported.

Counterparty Reporting Error. Under proposed Rule 905(a)(1), where a counterparty that was not the reporting party for a SBS discovers an error in the information reported with respect to such SBS, the counterparty shall promptly notify the reporting party of the error. Under proposed Rule 905(a)(2), where a reporting party for a SBS transaction discovers an error in the information reported with respect to a SBS, or receives notification from its counterparty of an error, the reporting party shall promptly submit to the entity to which the SBS was originally reported an amended report pertaining to the original transaction report. The reporting party would submit an amended report to the registered SDR in a manner consistent with the policies and procedures of the registered SDR required pursuant to proposed Rule 907(a)(3).

Duty of Registered SDR to Correct. Proposed Rule 905(b) would set forth the duties of a registered SDR relating to corrections. If the registered SDR either discovers an error in a transaction on its system or receives notice of an error from a counterparty, proposed Rule 905(b)(1) would require the registered SDR to verify the accuracy of the terms of the SBS and, following such verification, promptly correct the erroneous information contained in its system. Proposed Rule 905(b)(2) would further require that, if the erroneous transaction information contained any data that fall into the categories enumerated in proposed Rule 901(c) as information required to be reported in real time, the registered SDR would be required to publicly disseminate a corrected transaction report of the SBS promptly following verification of the SBS by the counterparties to the SBS, with an indication that the report relates to a previously disseminated transaction.

2. Proposed Use of Information

The SBS transaction information required to be reported pursuant to proposed Rule 905 would be used by registered SDRs, participants, the Commission, and other regulators.

Participants would be able to use such information to evaluate and manage their own risk positions and satisfy their duties to report corrected information to a registered SDR. A registered SDR would need the required information to correct its own records, in order to maintain an accurate record of a participant's positions as well as to disseminate corrected information. The Commission and other regulators would need the corrected information to have an accurate understanding of the market for surveillance and oversight purposes.

3. Respondents

Proposed Rule 905 would apply to participants of a registered SDR. As noted above, the Commission has estimated that there may be 1,000 entities regularly engaged in the CDS marketplace. In addition, the Commission estimates that there may be up to 4,000 SBS counterparties that transact SBSs much less frequently. The Commission preliminarily believes that these SBS counterparties would not be reporting parties. However, these additional 4,000 counterparties would be "participants" as defined by proposed Rule 900. Accordingly, with respect to burdens applicable to all SBS counterparties, the Commission preliminarily believes that it is reasonable to use the estimate of 5,000 respondents for purposes of estimating collection of information burdens under the PRA.

Proposed Rule 905 also would apply to registered SDRs. As noted above, the Commission preliminarily estimates there would be ten registered SDRs.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

The Commission preliminarily believes that promptly submitting an amended transaction report to the appropriate registered SDR after discovery of an error as required under proposed Rule 905(a)(2) would impose a burden on reporting parties. Likewise, the Commission preliminarily believes that promptly notifying the relevant reporting party after discovery of an error as required under proposed Rule 905(a)(1) would impose a burden on non-reporting-party participants.

With respect to reporting parties, the Commission preliminarily believes that proposed Rule 905(a) would impose an initial, one-time burden associated with designing and building the reporting party's reporting system to be capable of submitting amended SBS transactions to a registered SDR. In addition, reporting parties would be required to support and maintain the error reporting function.[230]

The Commission preliminarily believes that designing and building appropriate reporting system functionality to comply with proposed Rule 905(a)(2) would be a component of, and represent an incremental "add-on" to, the cost to build a reporting system and develop a compliance function as required under proposed Rule 901. Based on discussions with industry participants, the Commission preliminarily estimates this incremental burden to be equal to 5% of the one-time and annual burdens associated with designing and building a reporting system that is in compliance with proposed Rule 901,[231] plus 10% of the corresponding one-time and annual burdens associated with developing the reporting party's overall compliance program required under proposed Rule 901.[232] Thus, for reporting parties, the Commission preliminarily estimates that proposed Rule 905(a) would impose an initial (first-year) aggregate burden of

230 The Commission preliminarily believes that the actual submission of amended transaction reports required under proposed Rule 905(a)(2) would not result in a material burden because this would be done electronically though the reporting system that the reporting party must develop and maintain to comply with proposed Rule 901. The burdens associated with such a reporting system are addressed in the Commission's analysis of proposed Rule 901. See supra Section XIII.B.4.a and notes 193-195.

231 See supra notes 194 and 198.

232 See supra notes 201 and 202.

52,400 hours, which is 52.4 burden hours per reporting party,[233] and an ongoing aggregate annualized burden of 25,800 hours, which is 25.8 burden hours per reporting party.[234]

With regard to non-reporting-party participants, the Commission preliminarily believes that proposed Rule 905(a) would impose an initial and ongoing burden associated with promptly notifying the relevant reporting party after discovery of an error as required under proposed Rule 905(a)(1). The Commission preliminarily estimates that the annual burden would be 2,920,000 hours, which corresponds to 730 burden hours per non-reporting-party participant.[235] This figure is based on the Commission's preliminary estimates of (1) 4,000 non-reporting-party participants; (2) 11 transactions per day per non-reporting-party participant;[236] and (3) an error

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233 This figure is calculated as follows: [(((172 burden hours one-time development of reporting system) x (0.05)) + ((80 burden hours annual maintenance of reporting system) x (0.05)) + ((180 burden hours one-time compliance program development) x (0.1)) + ((218 burden hours annual support of compliance program) x (0.1))) x (1,000 reporting parties)] = 52,400 burden hours, which is 52.4 burden hours per reporting party.

234 This figure is calculated as follows: [(((80 burden hours annual maintenance of reporting system) x (0.05)) + ((218 burden hours annual support of compliance program) x (0.1))) x (1,000 reporting parties)] = 25,800 burden hours, which is 25.8 burden hours per reporting party.

235 This figure is based on the following: [(4 error notifications per non-reporting-party participant per day) x (365 days/year) x (Compliance Clerk at 0.5 hours/report) x (4,000 non-reporting-party participants)] = 2,920,000 burden hours, which corresponds to 730 burden hours per non-reporting-party participant. The Commission preliminarily believes that participants already monitor their SBS transactions and positions in the ordinary course of business. Thus, the Commission preliminary believes that, as a practical matter, proposed Rule 905 would not result in any significant new burdens for these participants.

236 This figure is based on the following: [((15,458,824 estimated annual SBS transactions) / (4,000 estimated non-reporting-party participants)) / (365 days/year)] = 10.58, or approximately 11 transactions per day. See supra note 185. The Commission understands that many of these transactions may arise from previously executed SBS transactions.

rate of one-third (33%),[237] or approximately 4 transactions per day per non-reporting-party participant.

Proposed Rule 905(b) would require a registered SDR to develop protocols regarding the reporting and correction of erroneous information. The Commission preliminarily believes, however, that this duty would represent only a minor extension of other duties for which the Commission is estimating burdens, and consequently, would not impose substantial additional burdens on a registered SDR. A registered SDR would be required to have the ability to collect and maintain SBS transaction reports and update relevant records under the SDR Registration Proposing Release.[238] Likewise, a registered SDR would have the capacity to disseminate additional, corrected SBS transaction reports under proposed Rule 902. The Commission preliminarily believes that the burdens associated with proposed Rule 905 – including systems development, support, and maintenance – are addressed in the Commission's analysis of those other rules. Thus, the Commission preliminarily believes that proposed Rule 905(b) would impose only an incremental additional burden on registered SDRs. The Commission preliminarily estimates that to develop and publicly provide the necessary protocols would impose on each registered SDR an initial one-time burden of approximately 730 burden hours.[239]

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237 In other words, the Commission is estimating that one-third of all SBS transactions will require an amended report to be submitted to the registered SDR pursuant to proposed Rule 905(a). For purposes of its PRA analysis, the Commission is further assuming that the both the non-reporting-party participant and the reporting party discover all errors. The Commission recognizes that, as a practical matter, there may be instances where one party fails to detect an error.

238 See supra note 6.

239 This figure is based on the following: [(Sr. Programmer at 80 hours) + (Compliance Manager at 160 hours) + (Compliance Attorney at 250 hours) + (Compliance Clerk at 120 hours) + (Sr. System Analyst at 80 hours) + (Director of Compliance at 40 hours)] = 730 burden hours.

The Commission estimates that to review and update such protocols on an ongoing basis would impose an annual burden on each SDR of approximately 1,460 burden hours.[240]

Accordingly, the Commission preliminarily estimates that the initial (first-year) aggregate annualized burden on registered SDRs under proposed Rule 905 would be 21,900 burden hours, which corresponds to 2,190 burden hours for each registered SDR.[241] The Commission further preliminarily estimates that the ongoing aggregate annualized burden on registered SDRs under proposed Rule 905 would be 14,600 burden hours, which corresponds to 1,460 burden hours for each registered SDR.[242]

5. Recordkeeping Requirements

Concurrently with proposed Regulation SBSR, the Commission is proposing the SDR Registration Proposed Rules, which would include recordkeeping requirements for SBS transaction data received by a registered SDR pursuant to proposed Regulation SBSR.[243] Specifically, proposed Rule 13n-5(b)(5) under the Exchange Act would require a registered SDR to maintain the transaction data for not less than five years after the applicable SBS expires and historical positions and historical market values for not less than five years. Accordingly, SBS transaction reports received by a registered SDR pursuant to proposed Rule 905 would be required to be retained for not less than five years.

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240 This figure is based on the following: [(Sr. Programmer at 160 hours) + (Compliance Manager at 320 hours) + (Compliance Attorney at 500 hours) + (Compliance Clerk at 240 hours) + (Sr. System Analyst at 160 hours) + (Director of Compliance at 80 hours)] = 1,460 burden hours.

241 This figure is based on the following: [(730 burden hours to develop protocols) + (1,460 burden hours annual support)) x (10 registered SDRs)] = 21,900 burden hours, which corresponds to 2,190 burden hours per registered SDR.

242 This figure is based on the following: [(1,460 burden hours annual support) x (10 registered SDRs)] = 14,600 burden hours, which corresponds to 1,460 burden hours per registered SDR.

243 See SDR Registration Proposing Release, supra note 6.

With respect to information disseminated by a registered SDR in compliance with proposed Rule 905(b)(2), proposed Rule 13n-7(b) under the Exchange Act would require a registered SDR to keep and preserve at least one copy of all documents, including all policies and procedures required by the Exchange Act and the rules or regulations thereunder for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination.[244] This requirement would encompass amended real-time SBS transaction reports disseminated by the registered SDR. Accordingly, SBS transaction reports disseminated by a registered SDR pursuant to proposed Rule 905(b)(2) would be required to be retained for not less than five years.

6. Collection of Information is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

7. Confidentiality of Responses to Collection of Information

Information collected pursuant to proposed Rule 905 would be widely available to the extent that it corrects information previously reported pursuant to proposed Rule 901(c) and incorporated into SBS transaction reports that are publicly disseminated by a registered SDR pursuant to proposed Rule 902. Generally, however, a registered SDR would be under an obligation to maintain the confidentiality of any information collected pursuant to proposed Rule 901, pursuant to Sections 13(n)(5) of the Exchange Act and proposed Rule 13n-9 thereunder.[245] To the extent that the Commission receives confidential information pursuant this collection of information, such information would be kept confidential, subject to the provisions of the Freedom of Information Act.

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244 See id.

245 See SDR Registration Proposing Release, supra note 6.

8. Request for Comment

The Commission requests public comment on its burden estimates. The Commission also solicits comment as follows:

222. Is the proposed collection of information necessary for the performance of the functions of the agency? Would the information have practical utility?

223. How accurate are the Commission's preliminary estimates of the burdens of the proposed collection of information associated with proposed Rule 905? In particular, how many entities would incur collection of information burdens pursuant to proposed Rule 905?

224. Would covered entities incur any initial burdens associated with systems design, programming, expanding systems capacity, and establishing compliance programs pursuant to proposed Rule 905?

225. What entities may be subject to proposed Rule 905? In what ways would these entities be impacted? Would any such entity or class of entities be impacted differently than others?

226. How many entities might be impacted by proposed Rule 905? Are the Commission's preliminary estimates as to the number of participants in the SBS market that would be required to report and retain information pursuant to the proposed rule accurate?

227. Are there additional burdens that the Commission has not addressed in its preliminary burden estimates?

228. Can you suggest any ways to enhance the quality, utility, and clarity of the information to be collected?

229. Can you suggest any ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?

G. Other Duties of Participants – Rule 906 of Regulation SBSR

Certain provisions of proposed Rule 906 of Regulation SBSR contain "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 906 – Duties of All Participants."

1. Summary of Collection of Information

Proposed Rule 906(a) would set forth a procedure designed to ensure that a registered SDR obtains relevant ID information for both counterparties to a SBS, not just the IDs of the reporting party. Proposed Rule 906(a) would require a registered SDR to identify any SBS reported to it for which it does not have participant ID and (if applicable) broker ID, desk ID, and trader ID of each counterparty. Proposed Rule 906(a) would further require the registered SDR, once a day, to send a report to each participant identifying, for each SBS to which that participant is a counterparty, the SBS(s) for which the registered SDR lacks participant ID and (if applicable) broker ID, desk ID, and trader ID. Additionally, under proposed Rule 906(a), a participant that receives such a report would be required to provide the missing ID information to the registered SDR within 24 hours.

Proposed Rule 906(b) would require a participant to provide a registered SDR with information identifying the participant's ultimate parent(s) and affiliate(s) that may also be participants of the registered SDR. Additionally, under proposed Rule 906(b), the participant would be required to promptly notify the registered SDR of any changes to the information provided.

Proposed Rule 906(c) would require each participant that is a SBS dealer or major SBS participant to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with any SBS transaction reporting obligations in a manner consistent with proposed Regulation SBSR and the registered SDR's applicable policies and procedures. In addition, proposed Rule 906(c) would require each such participant to review and update its policies and procedures at least annually.

2. Proposed Use of Information

The information required to be provided by participants pursuant to proposed Rule 906(a) would complete missing elements of SBS transaction reports so that the registered SDR would have, and could make available to regulators, accurate and complete records for reported SBS.

Similarly, proposed Rule 906(b) would be used to ensure that the registered SDR would have, and could make available to regulators, accurate and complete records for reported SBS regarding participant parents and affiliates. The Commission would use this information in its ongoing efforts to monitor and enforce compliance with the federal securities laws, including proposed Regulation SBSR.

The policies and procedures required under proposed Rule 906(c) would be used by participants to aid in their compliance with proposed Regulation SBSR, and also used by the Commission as part of its ongoing efforts to monitor and enforce compliance with the federal securities laws, including proposed Regulation SBSR.

3. Respondents

Proposed Rules 906(a) and (b) would apply to all participants of registered SDRs. Based on the information currently available to the Commission, the Commission preliminarily estimates that there may be up to 5,000 participants. Proposed Rule 906(c) would apply to participants that are SBS dealers or major SBS participants. The Commission believes that such entities would constitute the majority of reporting parties, so that it is reasonable to use the figure of 1,000 respondents for purposes of estimating collection of information burdens under the PRA.

Proposed Rule 906 also imposes certain duties on registered SDRs. As noted above, the Commission is preliminarily estimating that there would be ten registered SDRs.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

Proposed Rule 906(a) would require a registered SDR, once a day, to send a report to each participant identifying, for each SBS to which that participant is a counterparty, the SBS(s) for which the registered SDR lacks participant ID and (if applicable) broker ID, desk ID, and trader ID. The Commission preliminarily estimates that there would be a one-time, initial burden of 112 burden hours for a registered SDR to create a report template and develop the necessary systems and processes to produce a daily report required by proposed Rule 906(a).[246] Further, the Commission preliminarily estimates that there would be an ongoing annualized burden of 308 burden hours for a registered SDR to generate and issue the daily reports, and to enter into its systems the ID information supplied by participants in response to the daily reports.[247]

Accordingly, the Commission preliminarily estimates that the initial aggregate annualized burden for registered SDRs under proposed Rule 906(a) would be 4,200 burden hours, which

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246 The Commission has derived the total estimated burdens based on the following estimates, which are based on the information provided to the Commission: (Senior Systems Analyst at 40 hours) + (Sr. Programmer at 40 hours) + (Compliance Manager at 16 hours) + (Director of Compliance at 8 hours) + (Compliance Attorney at 8 hours) = 112 burden hours.

247 The Commission has derived the total estimated burdens based on the following estimates, which are based on the information provided to the Commission: (Senior Systems Analyst at 24 hours) + (Sr. Programmer at 24 hours) + (Compliance Clerk at 260 hours) = 308 burden hours.

corresponds to 420 burden hours per registered SDR.[248] The Commission preliminarily estimates that the ongoing aggregate annualized burden for registered SDRs under proposed Rule 906(a) would be 3,080 burden hours, which corresponds to 308 burden hours per registered SDR.[249]

In addition, proposed Rule 906(a) would require any participant that receives a daily report from a registered SDR to provide the missing UICs to the registered SDR within 24 hours. The Commission preliminarily estimates participants that are reporting parties would bear no initial or ongoing burdens under proposed Rule 906(a). This estimate is based on the Commission's preliminary belief that a reporting party would structure its reporting program to be in compliance with proposed Regulation SBSR, and consequently, would send complete information as relates to itself for each SBS transaction submitted to a registered SDR. The Commission further preliminarily estimates that the initial and ongoing annualized burden under proposed Rule 906(a) to participants that are not reporting parties would be 1,277,500 burden hours, which corresponds to 255.5 burden hours per participant.[250] This figure is based on the Commission's preliminary estimates of (1) 5,000 participants; (2) 9 transactions per day per

248 The Commission derived its estimate from the following: [(112 + 308 burden hours) x (10 registered SDRs)] = 4,200 burden hours, which corresponds to 420 burden hours per registered SDR.

249 The Commission derived its estimate from the following: [(308 burden hours) x (10 registered SDRs)] = 3,080 burden hours, which corresponds to 308 burden hours per registered SDR.

250 This figure is based on the following: [(7 missing information reports per non-reporting-party participant per day) x (365 days/year) x (Compliance Clerk at 0.1 hours/report) x (5,000 participants)] = 1,277,500 burden hours, which corresponds to 255.5 burden hours per participant.

participant;[251] and (3) a missing information rate of 80%,[252] or approximately 7 transactions per day per participant.

Proposed Rule 906(b) would require every participant to provide the registered SDR an initial parent/affiliate report and subsequent reports, as needed. The Commission preliminarily estimates that each participant would submit two reports each year.[253] In addition, the Commission preliminarily estimates that there would be 5,000 participants and that each one may connect to two registered SDRs. Accordingly, the Commission preliminarily estimates that the initial and ongoing aggregate annualized burden associated with proposed Rule 906(b) would be 10,000 burden hours, which corresponds to 2 burden hours per participant.[254]

Proposed Rule 906(c) would require each participant that is a SBS dealer or major SBS participant to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with any SBS transaction reporting obligations in a manner consistent with proposed Regulation SBSR and the registered SDR's applicable policies and procedures. Proposed Rule 906(c) would also require the review and updating of such policies and procedures at least annually. The Commission preliminary estimates that the one-time,

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[251] This figure is based on the following: [((15,458,824 estimated annual SBS transactions) / 5,000 estimated participants)) / (365 days/year)] = 8.47, or approximately 9 transactions per day. See supra note 185. The Commission understands that many of these transactions may arise from previously executed SBS transactions.

[252] In other words, the Commission is estimating that 80% of the time the reporting party would not know and thus would not be able to report the necessary UICs of its counterparty. Therefore, a registered SDR would have to obtain the missing UICs through the process described in proposed Rule 906(a).

[253] During the first year, the Commission preliminarily estimates each participant would submit its initial report and one update report. In subsequent years, the Commission preliminarily estimates that each participant would submit two update reports.

[254] This figure is based on the following: [(Compliance Clerk at 0.5 hours per report) x (2 reports/year/SDR connection) x (2 SDR connections/participant) x (5,000 participants)] = 10,000 burden hours, which corresponds to 2 burden hours per participant.

initial burden for each covered participant to adopt written policies and procedures as required under proposed Rule 906(c) would be approximately 216 burden hours.[255] Drawing on the Commission's experience with other rules that require entities to establish and maintain policies and procedures,[256] this figure is based on the estimated number of hours to develop a set of written policies and procedures, program systems, implement internal controls and oversight, train relevant employees, and perform necessary testing.

In addition, the Commission preliminarily estimates the burden of maintaining such policies and procedures, including a full review at least annually, as required by proposed Rule 906(c), would be approximately 120 burden hours for each covered participant.[257] This figure includes an estimate of hours related to reviewing existing policies and procedures, making necessary updates, conducting ongoing training, maintaining internal controls systems, and performing necessary testing. Accordingly, the Commission preliminarily estimates that the initial aggregate annualized burden associated with proposed Rule 906(c) would be 336,000 burden hours, which corresponds to 336 burden hours per covered participant.[258] The Commission preliminarily estimates that the ongoing aggregate annualized burden associated

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255 This figure is based on the following: [(Sr. Programmer at 40 hours) + (Compliance Manager at 40 hours) + (Compliance Attorney at 40 hours) + (Compliance Clerk at 40 hours) + (Sr. Systems Analyst at 32 hours) + (Director of Compliance at 24 hours)] = 216 burden hours per covered participant.

256 See Securities Exchange Act Release Nos. 62174 (May 26, 2010), 75 FR 32556 (June 8, 2010) (proposing Rule 613 of Regulation NMS); 61908 (April 14, 2010), 75 FR 21456 (proposing large trader reporting system).

257 This figure is based on the following: [(Sr. Programmer at 8 hours) + (Compliance Manager at 24 hours) + (Compliance Attorney at 24 hours) + (Compliance Clerk at 24 hours) + (Sr. Systems Analyst at 16 hours) + (Director of Compliance at 24 hours)] = 120 burden hours per covered participant.

258 This figure is based on the following: [(216 + 120 burden hours) x (1,000 covered participants)] = 336,000 burden hours.

with proposed Rule 906(c) would be 120,000 burden hours, which corresponds to 120 burden hours per covered participant.[259]

Therefore, the Commission preliminarily estimates that the initial aggregate annualized burden associated with proposed Rule 906 would be 1,518,200 burden hours,[260] and the ongoing aggregate annualized burden would be 1,301,080 burden hours for all covered entities.[261]

5. Recordkeeping Requirements

Concurrently with proposed Regulation SBSR, the Commission is issuing the SDR Registration Proposing Release, which would include recordkeeping requirements for SBS transaction data received by a registered SDR pursuant to proposed Regulation SBSR.[262] Specifically, proposed Rule 13n-5(b)(5) under the Exchange Act would require a registered SDR to maintain the transaction data for not less than five years after the applicable SBS expires and historical positions and historical market values for not less than five years.

With regard to other information that a registered SDR may receive from participants pursuant to proposed Rule 906, proposed Rule 13n-7(b) would require a registered SDR to keep and preserve at least one copy of all documents, including all documents and policies and procedures required by the Exchange Act and the rules or regulations thereunder for a period of

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259 This figure is based on the following: [(120 burden hours) x (1,000 covered participants)] = 120,000 burden hours.

260 This figure is based on the following: [(4,200 burden hours for registered SDRs under proposed Rule 906(a)) + (1,277,500 burden hours for non-reporting-party participants under proposed Rule 906(a)) + (10,000 burden hours for participants under proposed Rule 906(b)) + (336,000 burden hours for covered participants under proposed Rule 906(c))] = 1,627,700 burden hours.

261 This figure is based on the following: [(3,080 burden hours for registered SDRs under proposed Rule 906(a)) + (1,277,500 burden hours for non-reporting-party participants under proposed Rule 906(a)) + (10,000 burden hours for participants under proposed Rule 906(b)) + (120,000 burden hours for covered participants under proposed Rule 906(c))] = 1,410,580 burden hours.

262 See supra note 6.

not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination.[263] This requirement would encompass materials received by a registered SDR from participants pursuant to proposed Rule 906.

6. Collection of Information is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

7. Confidentiality of Responses to Collection of Information

A registered SDR would be under an obligation to maintain the confidentiality of any information collected pursuant to proposed Rule 906. To the extent that the Commission receives confidential information pursuant this collection of information, such information would be kept confidential, subject to the provisions of the Freedom of Information Act.

8. Request for Comment

The Commission requests public comment on its burden estimates. The Commission also solicits comment as follows:

230. Is the proposed collection of information necessary for the performance of the functions of the agency? Would the information have practical utility?

231. In what ways would entities covered by Rule 906 be impacted? Would any such entity or class of entities be impacted differently than others?

232. What would be the burdens on participants to provide to a registered SDR and keep updated information about their ultimate parents and affiliates that are also participants?

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263 See id.

233. How many entities might be impacted by proposed Rule 906? Are the Commission's preliminary estimates as to the number of participants in the SBS market that would be required to report and retain information pursuant to the proposed rule accurate?

234. Can you suggest any ways to enhance the quality, utility, and clarity of the information to be collected?

235. Can you suggest any ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?

236. Would proposed Rule 906 create any additional burdens not discussed here? If so, please identify and quantify these burdens.

H. Policies and Procedures of Registered Security-Based Swap Data Repositories – Rule 907 of Regulation SBSR

Certain provisions of proposed Rule 907 of Regulation SBSR contain "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 907 – Policies and Procedures of Registered Security-Based Swap Data Repositories." The Commission is applying for a new OMB Control Number for this collection in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13.

1. Summary of Collection of Information

Proposed Rule 907 would require a registered SDR to establish and maintain compliance with written policies and procedures: (1) that enumerate the specific data elements of a SBS or a life cycle event that a reporting party would report; (2) that specify data formats, connectivity requirements, and other protocols for submitting information; (3) for specifying how reporting parties are to report corrections to previously submitted information, making corrections to information in its records that is subsequently discovered to be erroneous, and applying an appropriate indicator to any transaction report required to be disseminated by proposed Rule 905(b)(2), which would denote that the report relates to a previously disseminated transaction; (4) describing how reporting parties shall report and, consistent with the enhancement of price discovery, how the registered SDR shall publicly disseminate, reports of, and adjustments due to, life cycle events; SBS transactions that do not involve an opportunity to negotiate any material terms, other than the counterparty; and any other SBS transactions that, in the estimation of the registered SDR, do not accurately reflect the market; (5) for assigning transaction IDs and UICs related to its participants; and (6) for periodically obtaining from each participant information that identifies the participant's ultimate parent(s) and any other participant(s) with which the counterparty is affiliated, using applicable UICs.

In addition, proposed Rule 907(b)(1) would require a registered SDR to establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all SBS instruments reported to the registered SDR in accordance with the criteria and formula for determining block size as specified by the Commission.

Under proposed Rules 907(c) and (d), a registered SDR would be required to make its policies and procedures publicly available on its website, and review, and update as necessary, its policies and procedures at least annually, indicating the date on which they were last reviewed. Finally, proposed Rule 907(e) would require a registered SDR to have the capacity to providé to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to proposed Regulation SBSR and the registered SDR's policies and procedures thereunder.

2. Proposed Use of Information

The policies and procedures required under proposed Rule 907 would be used by registered SDRs to aid in their compliance with Regulation SBSR, and also used by the Commission as part of its ongoing efforts to monitor and enforce compliance with the federal securities laws, including proposed Regulation SBSR. These policies and procedures also would be used by participants of a registered SDR to understand the specific data elements of SBS transactions that they must report, the specific data formats they would be required to use, and for understanding what constitutes a block trade in a SBS instrument. Furthermore, market participants would use the information about block trades calculated and publicized by a registered SDR to understand the block trade thresholds for specific SBS instruments, and for understanding the registered SDR's dissemination protocols generally. Finally, any information or reports provided to the Commission pursuant to proposed Rule 907(e) would be used by the Commission to assess the timeliness, accuracy, and completeness of data reported pursuant to proposed Regulation SBSR and as part of its general oversight of the SBS markets.

3. Respondents

As noted above, the Commission preliminarily estimates that ten registered SDRs would be subject to proposed Rule 907.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

The Commission preliminarily estimates that the one-time, initial burden for a registered SDR to adopt written policies and procedures as required under proposed Rule 907 would be approximately 15,000 hours.[264] Drawing on the Commission's experience with other rules that

264 This figure is based on the following: [(Sr. Programmer at 1,667 hours) + (Compliance Manager at 3,333 hours) + (Compliance Attorney at 5,000 hours) + (Compliance Clerk at 2,500 hours) + (Sr. System Analyst at 1,667 hours) + (Director of Compliance at 833 hours)] = 15,000 burden hours per registered SDR.

require entities to establish and maintain policies and procedures,[265] this figure is based on the estimated number of hours to develop a set of written policies and procedures, program systems, implement internal controls and oversight, train relevant employees, and perform necessary testing.[266] In addition, the Commission preliminarily estimates the annual burden of maintaining such policies and procedures, including a full review at least annually, making available its policies and procedures on the registered SDR's website, and compiling statistics on non-compliance, as required under proposed Rule 907, would be approximately 30,000 hours for each registered SDR.[267] This figure includes an estimate of hours related to reviewing existing policies and procedures, making necessary updates, conducting ongoing training, maintaining relevant systems and internal controls systems, calculating and publishing block trade thresholds, performing necessary testing, monitoring participants, and compiling data.

The Commission preliminarily believes that, as part of its core functions, a registered SDR would have the capacity to provide to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to proposed Regulation SBSR and the registered SDR's policies and procedures. Proposed Rule 13n-5(b) would require a registered SDR to establish, maintain, and enforce written policies and

265 See infra at note 256.

266 This figure includes time necessary to design and program systems and implement policies and procedures to calculate and publish block trade thresholds for all SBS instruments reported to the registered SDR, as would be required by proposed Rule 907(b). It also includes time necessary to design and program systems and implement policies and procedures to determine which reported trades would not be considered block trades. This figure also includes time necessary to design and program systems and implement policies and procedures to assign certain IDs, as would be required by proposed Rule 907(a)(5).

267 This figure is based on the following: [(Sr. Programmer at 3,333 hours) + (Compliance Manager at 6,667 hours) + (Compliance Attorney at 10,000 hours) + (Compliance Clerk at 5,000 hours) + (Sr. System Analyst at 3,333 hours) + (Director of Compliance at 1,667 hours)] = 30,000 burden hours per registered SDR.

procedures to satisfy itself by reasonable means that the transaction data that has been submitted to the security-based swap data repository is accurate, and also to ensure that the transaction data and positions that it maintains are accurate.[268] The Commission preliminarily believes that these capabilities would enable a registered SDR to provide the Commission information or reports as may be requested pursuant to proposed Rule 907(e). Thus, the Commission does not believe that proposed Rule 907(e) would impose any additional burdens on a registered SDR.

Based on the Commission's experience and input from self-regulatory organizations, the Commission preliminarily believes that a registered SDR would need to hire 15 full-time staff to fulfill the obligations outlined in proposed Rule 907. Accordingly, the Commission preliminarily estimates that the initial annualized burden associated with proposed Rule 907 would be approximately 45,000 hours per registered SDR, which corresponds to an initial annualized aggregate burden of approximately 450,000 hours.[269] The Commission preliminarily estimates that the ongoing annualized burden associated with proposed Rule 907 would be approximately 30,000 hours per registered SDR,[270] which corresponds to an ongoing annualized aggregate burden of approximately 300,000 hours.[271]

5. Recordkeeping Requirements

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268 See SDR Registration Proposing Release, supra note 6, proposed Rules 13n-5(b)(1)(iii) and 13n-5(b)(3) under the Exchange Act.

269 This figure is based on the following: [((15,000 burden hours per registered SDR) + (30,000 burden hours per registered SDR)) x (10 registered SDRs)] = 450,000 initial annualized aggregate burden hours during the first year.

270 This figure is based on the following: [(Sr. Programmer at 3,333 hours) + (Compliance Manager at 6,667 hours) + (Compliance Attorney at 10,000 hours) + (Compliance Clerk at 5,000 hours) + (Sr. System Analyst at 3,333 hours) + (Director of Compliance at 1,667 hours)] = 30,000 burden hours per registered SDR.

271 This figure is based on the following: [(30,000 burden hours per registered SDR) x (10 registered SDRs)] = 300,000 ongoing, annualized aggregate burden hours.

Concurrently with proposed Regulation SBSR, the Commission is proposing the SDR Proposed Rules.[272] Specifically, proposed Rule 13n-7(b) would require a registered SDR to keep and preserve at least one copy of all documents, including all documents and policies and procedures required by the Exchange Act and the rules or regulations thereunder, for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination.[273] This requirement would encompass policies and procedures established by a registered SDR pursuant to proposed Rule 907. This requirement would also encompass any information or reports provided to the Commission pursuant to proposed Rule 907(e).

6. Collection of Information is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

7. Confidentiality of Responses to Collection of Information

All of the policies and procedures required by proposed Rule 907 would have to be made available by a registered SDR on its website and would not, therefore, be confidential. Any information obtained by the Commission from a registered SDR pursuant to proposed Rule 907(e) relating to the timeliness, accuracy, and completeness of data reported to the registered SDR would be for regulatory purposes and would be kept confidential.

8. Request for Comment

The Commission requests public comment on its burden estimates. The Commission also solicits comment as follows:

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272 See SDR Registration Proposing Release, supra note 6.

273 See id., proposed Rule 13n-7(b) under the Exchange Act.

235. Is the proposed collection of information necessary for the performance of the functions of the agency? Would the information have practical utility?

236. How many entities might be impacted by proposed Rule 907? Are the Commission's preliminary estimates as to the number of registered SDRs that would be subject to proposed Rule 907 accurate?

237. How accurate are the Commission's preliminary estimates of the burdens of the proposed collection of information associated with proposed Rule 907?

238. Can you suggest any ways to enhance the quality, utility, and clarity of the information to be collected?

239. Does the Commission's proposed Rule 907 minimize burdens by reserving to registered SDRs the flexibility to develop and implement tailored policies and procedures, or would more specificity in the rule text better minimize associated burdens?

240. Can you suggest any ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?

241. Would proposed Rule 907 create any additional burdens not discussed here? If so, please identify and quantify these burdens.

I. Jurisdictional Matters – Rule 908 of Regulation SBSR

The Commission preliminarily does not believe that proposed Rule 908 would be a collection of information" within the meaning of the PRA, as the rule would merely describe the jurisdictional reach of proposed Regulation SBSR. The Commission requests comment on this preliminary assessment of proposed Rule 908. Would proposed Rule 908 impose any collection of information requirements that the Commission has not considered?

J. Registration of Security-Based Swap Data Repository as Securities Information Processor – Rule 909 of Regulation SBSR

Certain provisions of proposed Rule 909 contain "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 909 – Registration of Security-Based Swap Data Repository as Securities Information Processor."

1. Summary of Collection of Information

Proposed Rule 909 would require a registered SDR to register with the Commission as a SIP. To comply with this requirement, a registered SDR would need to submit a Form SIP.[274] As a registered SIP, a registered SDR would be required to keep its Form SIP current, and submit amendments as required by Rule 609(b) of Regulation NMS under the Exchange Act.[275]

2. Proposed Use of Information

The information required by proposed Rule 909 would permit the Commission to register a registered SDR as a SIP, and to maintain updated information about the registered SDR/SIP over time.

3. Respondents

The Commission preliminarily estimates that there would be ten registered SDRs. Thus, the Commission preliminarily estimates that ten entities would have to register as SIPs as required by proposed Rule 909.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

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[274] 17 CFR 249.1001.

[275] 17 CFR 242.609(b).

As described in the SDR Registration Proposing Release,[276] an entity wishing to register with the Commission as a registered SDR would have to submit proposed Form SDR, which is modeled after existing Form SIP. The Commission has estimated the burden for completing Form SIP to be 400 hours. Therefore, the Commission also has estimated the burden for completing proposed Form SDR to be 400 hours (specifically, 150 hours of legal compliance work and 250 hours of clerical compliance work).[277] Any entity that is required to complete proposed Form SDR also would have to complete Form SIP. Because of the substantial overlap in the forms, much of the burden for completing Form SIP would be subsumed in completing proposed Form SDR. Therefore, the Commission preliminarily estimates that, having completed a proposed Form SDR, an entity would need only one-quarter of the time to then complete Form SIP, or 100 hours (specifically, 37.5 hours of legal compliance work and 62.5 hours of clerical compliance work). Accordingly, the Commission is preliminarily estimating that the one-time initial registration burden for all registered SDR/SIPs would be 1,000 hours.[278]

With regard to ongoing burdens, the Commission preliminarily estimates that the aggregate annualized burden for providing amendments to Form SIP would be one-tenth of the burden to complete the initial form or 400 burden hours, which corresponds to 40 burden hours for each registered SDR. This figure is based on a preliminary estimate that each of ten registered SDRs would submit one amendment on Form SIP each year. SIP registration also would require a registered SDR to provide notice to the Commission of prohibitions or

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276 See supra note 6.

277 This figure is based on the following: [(Compliance Attorney at 150 hours) + (Compliance Clerk at 250 hours)] = 400 burden hours per SDR. See SDR Registration Proposing Release, supra note 6 at notes 183 and 234.

278 This figure is based on the following: [(Compliance Attorney at 37.5 hours) + (Compliance Clerk at 62.5 hours) x (10 registrants)] = 400 burden hours.

limitations on access to its services. The Commission preliminarily believes that the notice would be a simple form, and that prohibitions or limitations on access to information provided by a registered SDR would be not be prevalent. Thus, the Commission does not believe that

providing such notice would result in any material burden. The Commission solicits comments as to the accuracy of these estimates.

5. Recordkeeping Requirements

Pursuant to proposed Rule 13n-7(b) under the Exchange Act,[279] a registered SDR would be required to keep and preserve at least one copy of all documents, including all documents and policies and procedures required by the Exchange Act and the rules or regulations thereunder, for a period of not less than five years, the first two years in a place that is immediately available to the staff of the Commission for inspection and examination. This requirement would encompass any regulatory documents and related work papers completed by the registered SDR as part of its business, including Form SIP as required by proposed Rule 909.

6. Collection of Information is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

7. Confidentiality of Responses to Collection of Information

Form SIP is not confidential.

8. Request for Comment

The Commission requests public comment on its burden estimates. The Commission also solicits comment as follows:

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[279] See SDR Registration Proposing Release, supra note 6.

242. How many entities might be impacted by proposed Rule 909? Are the Commission's preliminary estimates as to the number of registered SDRs that would be subject to proposed Rule 909 accurate?

243. How accurate are the Commission's preliminary estimates of the burdens of the proposed collection of information associated with proposed Rule 909? Given that a SDR would be required to complete Form SDR to register with the Commission, how long would it take to also complete Form SIP?

244. How many amendments per year would a registered SDR/SIP have to file to Form SIP? What would be the average burden per amendment?

245. Can you suggest any ways to enhance the quality, utility, and clarity of the information to be collected?

246. Can you suggest any ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?

247. Would proposed Rule 909 or SIP registration create burdens for registered SDRs or other entities not contemplated here? If so, please identify and quantify these burdens.

K. Phase-In Period – Rule 910 of Regulation SBSR

The Commission preliminarily does not believe that proposed Rule 910 would be a "collection of information" within the meaning of the PRA. Proposed Rule 910 merely describes when a registered SDR and its participants would be required to comply with the various parts of proposed Regulation SBSR, and would not create any additional collection of information requirements. The Commission requests public comment on its burden estimates. The Commission also solicits comment whether proposed Rule 910 imposes any collection of information requirements that the Commission has not considered.

L. Prohibition During Phase-In Period – Rule 911 of Regulation SBSR

The Commission preliminarily does not believe that proposed Rule 911 would be a collection of information" within the meaning of the PRA. Proposed Rule 911 would restrict the ability of a reporting party to report a SBS to one registered SDR rather than another, but would not otherwise create any duties or impose any collection of information requirements beyond those already required by proposed Rule 901. The Commission requests public comment on its burden estimates. The Commission also solicits comment whether proposed Rule 911 imposes any collection of information requirements that the Commission has not considered.

M. Amendments to Rule 31

The proposed amendments to Rule 31 under the Exchange Act do not contain any "collection of information requirements" within the meaning of the PRA. Rule 31(a)(11) sets forth a list of "exempt sales" to which Section 31 fees do not apply. The proposed amendment of Rule 31 would add "security-based swaps" to the list of "exempt sales," and thereby exempt SBSs from Section 31 fees. The proposed amendment would require no collection of information, nor would it impose any burden on parties to SBS transactions. The Commission requests public comment on its burden estimates. The Commission also solicits comment whether the proposed amendment to Rule 31 imposes any collection of information requirements that the Commission has not considered.

XIV. Cost-Benefit Analysis

On July 21, 2010, the President signed the Dodd-Frank Act into law. The Dodd-Frank Act was enacted to, among other things, promote the financial stability of the United States by improving accountability and transparency in the financial system.[280] Subtitle B of Title VII

280 See Pub. L. No. 111-203 Preamble.

designates the Commission to oversee the SBS markets and develop appropriate regulations.

The OTC derivatives markets, which have been described as opaque,[281] have grown exponentially in recent years[282] and are capable of affecting significant sectors of the U.S. economy. One of the primary goals of Title VII is to increase the transparency and efficiency of the OTC derivatives market and to reduce the potential for counterparty and systemic risk.[283]

The Dodd-Frank Act amends the Exchange Act to require the Commission to adopt rules providing for, among other things: (1) the reporting of SBS to a registered SDR or to the Commission; and (2) real-time public dissemination of SBS transaction, volume, and pricing information. To accomplish this mandate, the Commission today is proposing Regulation SBSR, a set of reporting and related rules for SBS transactions.

In general, proposed Regulation SBSR would provide for the reporting of SBS information that falls into three broad categories: (1) information that must be reported in real time pursuant to proposed Rule 901(c); (2) additional information that must be reported pursuant

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281 With respect to CDSs, for example, the Government Accountability Office found that "comprehensive and consistent data on the overall market have not been readily available," that "authoritative information about the actual size of the CDS market is generally not available," and that regulators currently are unable "to monitor activities across the market." Government Accountability Office, "Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps," GAO-09-397T (March 2009), at 2, 5, 27. See Robert E. Litan, "The Derivatives Dealers' Club and Derivatives Market Reform," Brookings Institution (April 7, 2010) at 15-20; Michael Mackenzie, Era of an opaque swaps market ends, FIN. TIMES (June 25, 2010).

282 The BIS semi-annual reports on the swap markets summarizes developments in the OTC derivatives markets. The report breaks down trading volumes and other statistics for various classes of derivatives, including CDS, interest rate and foreign exchange derivatives, and equity and commodity derivatives. The report covers derivatives trading within the G10 countries. The most recent report, available at http://www.bis.org/statistics/derstats.htm, covers the period through the last quarter of 2009.

283 See "Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation," U.S. Department of the Treasury, at 47-48 (June 17, 2009).

to proposed Rule 901(d) within specified timeframes, depending on whether the transaction is traded or confirmed electronically or manually; and (3) life cycle events that must be reported pursuant to proposed Rule 901(e). Proposed Regulation SBSR would require registered SDRs to publicly disseminate certain SBS information in real time. Proposed Regulation SBSR would identify the SBS information that would be required to be reported, establish reporting obligations, and specify the timeframes for reporting and disseminating information. Proposed Regulation SBSR would require SBS market participants and registered SDRs to establish appropriate policies and procedures governing the transaction reporting process. In addition, proposed Regulation SBSR would require each registered SDR to register with the Commission as a SIP. Together, Regulation SBSR is designed to provide a more transparent market for SBSs.

Broadly, the Commission anticipates that Regulation SBSR may have several overarching benefits to the SBS markets. These include the following:

Improvements in Market Quality. The Commission's rules on reporting and public dissemination of SBS transaction data could have very significant benefits to the SBS market. Comprehensive, timely, and accurate reporting should allow for better regulation of the SBS market, which should promote greater confidence and participation in the market. Post-trade transparency could result in lower transaction costs, greater price competition, and greater participation in the market. These benefits could extend beyond the SBS market to the securities markets more generally, which are increasingly interconnected.

Improved Risk Management. As SBS market participants implement transaction reporting programs, they would be required to review their current positions in SBSs and report those open positions to a registered SDR. Incorporating all positions into an OMS sufficient to permit ongoing reporting as required under proposed Regulation SBSR could result in a direct and immediate benefit to market participants by potentially reducing the risk associated with current open positions. Further, because proposed Regulation SBSR would require market participants to inventory their positions in SBS to determine what needs to be reported, the proposal should enable more robust risk monitoring and management going forward.

Economies and Greater Efficiency. Automation and systems development associated with SBS transaction reporting required by proposed Regulation SBSR could provide market participants new tools to process transactions at a lower expense per transaction. Such increased efficiency would enable participants to handle increased volumes of SBSs with less marginal expense, or existing volumes of SBSs with greater efficiency. In addition, proposed Regulation SBSR is designed to further the development of internationally recognized standards for establishing reference identifiers in the financial services industry. A common set of reference identifiers for participants and products could yield significant efficiencies in both the public and private sectors. Information about financial firms operating in different functional areas and different jurisdictions could more readily be identified by regulators. In addition, financial firms could eliminate the use of multiple proprietary reference systems and move to a single, widely accepted system.

Improved Commission Oversight. SBS transaction reporting under proposed Regulation SBSR would provide a means for the Commission to gain a better understanding of the SBS market – including aggregate positions both in specific SBS instruments and positions taken by individual entities or groups – by requiring transaction data both on newly executed SBS and unexpired pre-enactment SBS to be reported to a registered SDR. The reporting of SBS transactions should thus provide the Commission and other regulators a better understanding of the current risks in the SBS market. For example, having such data available would help Commission staff to analyze the SBS market as a whole in a manner that is not possible currently. In this way, Regulation SBSR would support the Commission's supervisory function over the SBS market, as required by Congress in the Dodd-Frank Act.

Further, proposed Regulation SBSR should facilitate completing the reports the Commission is required to provide to Congress on SBSs and the SBS marketplace.[284]

While the Commission believes that proposed Regulation SBSR would result in significant benefits to SBS market participants, the Commission is cognizant that the proposed rules would entail costs, as more fully discussed below. The proposed rules could, for example, require market participants to begin retaining additional data related to SBS transactions. The rules also could require market participants to modify existing internal processes and systems. The Commission estimates that the rules comprising proposed Regulation SBSR could affect 5,000 participants, including 1,000 reporting parties, and several million SBSs annually.

The Commission is sensitive to the costs and benefits associated with proposed Regulation SBSR. The Commission requests comment on the costs and benefits associated with the individual rules, and its cost-benefit analysis thereof, including identification and assessments of any costs and benefits not discussed in this analysis. The Commission also seeks comment on the accuracy of any of the benefits identified and also welcomes comments on the accuracy of any of the cost estimates. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits.

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[284] See Section 719 of the Dodd-Frank Act.

A. Definitions – Rule 900 of Regulation SBSR

1. Benefits

By defining key terms, proposed Rule 900 would provide increased clarity about the scope and application of proposed Regulation SBSR. This should help market participants subject to the proposal understand their obligations and make appropriate compliance plans. Clearly defined terms should also help the Commission in its oversight responsibilities.

2. Costs

The Commission preliminarily believes that proposed Rule 900 would not entail any material costs to market participants. Proposed Rule 900 would define terms used in Regulation SBSR. The rule would not impose any obligation or duty.

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 900 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

248. How can the Commission more accurately estimate the costs and benefits of proposed Rule 900?

249. Would proposed Rule 900 create any additional costs or benefits not discussed here?

B. Reporting Obligations – Rule 901 of Regulation SBSR

Pursuant to proposed Rule 901, all SBS transactions must be reported. Together, sections (a), (b), (c), (d), (e), (h), and (i) of proposed Rule 901 set forth the parameters that SBS counterparties must follow to report SBS transactions to a registered SDR or, if there is no registered SDR that would accept the information, to the Commission. Proposed Rule 901(a) would specify which counterparty would be the "reporting party" for a SBS transaction. Proposed Rule 901(b) would require a reporting party to report the information required under proposed Rule 901 to a registered SDR or, if there is no registered SDR that would accept the information, to the Commission. Proposed Rule 901 divides the SBS information that would be required to be reported into three broad categories: (1) information that would be required to be reported in real time pursuant to proposed Rule 901(c) and publicly disseminated pursuant to proposed Rule 902; (2) additional information that would be required to be reported pursuant to proposed Rule 901(d)(1) within the timeframes specified in proposed Rule 901(d)(2); and (3) life cycle events that must be reported pursuant to proposed Rule 901(e), the timeframes for which would vary depending on whether the transaction was executed and confirmed electronically or manually. The information that would be reported under proposed Rule 901(d)(1) would not be publicly disseminated. Proposed Rule 901(i) would require the reporting of the information detailed in proposed Rules 901(c) and (d), to the extent such information is available, for pre-enactment SBSs and transitional SBSs.

Proposed Rule 901(f) would require a registered SDR to time stamp, to the second, its receipt of any information submitted to it pursuant to proposed Rules 901(c), (d), or (e). Proposed Rule 901(g) would require a registered SDR to assign a transaction ID to each SBS reported by a reporting party.

1. Benefits

The SBS transaction information required to be reported pursuant to proposed Rule 901 would benefit market participants and the SBS marketplace. First, the Commission preliminarily believes that, by setting out the requirements for the reporting of each SBS transaction to a registered SDR, proposed Rule 901 would provide the registered SDR with the SBS transaction information necessary to support public dissemination, as required by proposed Rule 902. Additionally, by requiring real-time reporting of certain SBS transaction data, proposed Rule 901, together with proposed Rule 902, would provide the necessary framework to enable public dissemination of SBS transactions in real time as required under proposed Rule 902. Together, proposed Rules 901 and 902 will enable market participants and regulatory authorities to know the current state of the SBS markets and track it over time.

To comply with proposed Rule 901, reporting parties – which are the largest and most actively engaged participants in the SBS market – would likely need to establish and maintain OMSs capable of supporting real-time and additional reporting. The Commission anticipates that proposed Rule 901 would have the effect of promoting efforts by reporting parties to inventory their positions in SBSs, as each determines what information needs to be reported. This effect could encourage management review of internal procedures and controls by these reporting parties.

In addition, proposed Rule 901 would provide a means for the Commission to gain a better understanding of the SBS market, including the size and scope of that market, as the Commission would have access to data held by a registered SDR.[285] Having such data available should help Commission staff to analyze the SBS market as a whole and identify risks. In this way, proposed Rule 901 would support the Commission's supervisory function over the SBS market as required by Congress in the Dodd-Frank Act. Proposed Rule 901 also could facilitate

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285 See, e.g., 15 U.S.C. 78m(n)(5)(D) (requiring a registered SDR to provide the Commission with direct electronic access to its data).

the reports the Commission is required to provide to Congress on SBS and the SBS marketplace.[286]

The information reported by reporting parties pursuant to proposed Rule 901 would be used by registered SDRs to publicly disseminate real-time reports of SBS transactions, and to retain SBS transaction and position information for use by regulators. The reporting requirements of proposed Rule 901 are designed to ensure that important information about SBSs is reported and, ultimately available to market participants, through the market data feed disseminated by a registered SDR.

The Commission further preliminarily believes that the time stamp and transaction ID required to be added by the registered SDR under proposed Rules 901(f) and (g) would facilitate data management by the registered SDR, as well as market supervision and oversight by the Commission and other regulatory authorities.

Generally, the availability of additional market information, along with the ability of the Commission and other regulators to use information about SBS transactions reported to and held by registered SDRs, would result in more robust prudential and systemic regulation. The Commission and other regulators would use information about SBS transactions reported to and held by registered SDRs to conduct both prudential and systemic regulation, as well as to examine for improper behavior and to take enforcement actions, as appropriate. Specifying general types of information to be reported and publicly disseminated could increase the efficiency and level of standardization in the SBS market.

Proposed Rule 901 would prescribe only broad categories of SBS data to be reported. However, proposed Rule 907(a)(1) would require each registered SDR to enumerate specific

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286 See Section 719 of the Dodd-Frank Act.

data elements to be reported, and to specify acceptable data formats. This approach would provide for the efficient accommodation of evolving industry conventions in the reporting of SBS data. The requirement that all trades be reported to a registered SDR for public dissemination, regardless of trading venue, would reduce the coordination costs that would exist if numerous parties were independently disseminating SBS data. In this way, proposed Rule 901 would increase the uniformity in the SBS data that is disseminated under proposed Rule 902.

Proposed Rule 901(i) would also provide important benefits. By requiring reporting of pre-enactment and transitional SBS transactions, proposed Rule 901(i) would provide the Commission with insight as to outstanding notional size, number of transactions, and number and type of participants in the SBS market. This would provide a starting benchmark against which to assess the development of the SBS market over time and, thus, represents a first step toward a more transparent and well regulated market for SBSs. The data reported pursuant to proposed Rule 901(i) also could help the Commission prepare the reports that it is required to provide to Congress. Further, proposed Rule 901(i) would require market participants to inventory their positions in SBS to determine what information needs to be reported, which could benefit market participants by encouraging management review of their internal procedures and controls.

The transaction ID required by proposed Rule 901(g) also would provide an important benefit by facilitating the reporting of subsequent, related SBS transactions that may be submitted to a registered SDR (e.g., a transaction report regarding a SBS life cycle event, or report to correct an error in a previously submitted report). Regulators also would benefit by having an easy way to refer to specific prior transactions.

Proposed Rule 901 would require reporting parties, to the extent they do not already possess systems for electronically capturing and transmitting data about their SBS transactions, to build or otherwise obtain such systems. Such systems would be necessary to report data within the timeframes set forth in proposed Rules 901(c) and (d), because it is unlikely that manual processes could capture and report in real time the numerous data elements relating to a SBSs. There could be substantial benefits in the form of reduced operational risk in requiring all reporting parties to have such capability. Systematizing all SBS transaction information more quickly would support effective risk management, as counterparties, registered SDRs, clearing agencies (in some cases), and regulators would obtain accurate knowledge of new SBS transactions more quickly. Reporting parties that obtain such systems could see additional benefits in being able to process and risk manage their existing positions more effectively, or use their expanded capability to participate further in the SBS market.

Finally, proposed Rule 901 could result in significant benefits by encouraging the creation and widespread use of generally accepted standards for reference information. Proposed Rule 901 would require the reporting of a participant ID of each counterparty and, as applicable, the broker ID, desk ID, and trader ID of the reporting party or its broker. The Commission preliminarily believes that reporting of this information would help ensure effective oversight, enforcement, and surveillance of the SBS market by the Commission and other regulators. For example, activity could be tracked by a particular participant, a particular desk, or a particular trader. Regulators could observe patterns and connections in trading activity, or examine whether a trader had engaged in questionable trading activity across different SBS instruments. These identifiers also would facilitate aggregation and monitoring of the positions of SBS counterparties, which could be of significant benefit for prudential oversight and systemic risk management.

The Commission understands that some efforts have been undertaken – in both the private and public sectors, both domestically and internationally – to establish a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally. Such a system would be of significant benefit to regulators worldwide, as each market participant could readily be identified using a single reference code regardless of the jurisdiction or product market in which the market participant was engaging. Such a system also could be of significant benefit to the private sector, as market participants would have a common identification system for all counterparties and reference entities, and would no longer have to use multiple proprietary nomenclature systems. The enactment of the Dodd-Frank Act and the establishment of a comprehensive system for reporting and dissemination of SBSs – and for reporting and dissemination of swaps, under jurisdiction of the CFTC – offer a unique opportunity to facilitate the establishment of a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally.

2. Costs

a. For Reporting Parties

The proposed SBS reporting requirements would impose initial and ongoing costs on reporting parties. The Commission preliminarily believes that these costs would be a function of, among other things, the number of reportable SBS transactions and the data elements required to be collected for each SBS transaction.

The Commission obtained information from publicly available sources and consulted with industry participants in an effort to quantify the number of aggregate SBS transactions on an annual basis. According to publicly available data from DTCC, recently, there have been an average of approximately 36,000 CDS transactions per day,[287] corresponding to a total number of CDS transactions of approximately 13,140,000 per year. The Commission preliminarily believes that CDSs represent 85% of all SBS transactions.[288] Accordingly, and to the extent that historical market activity is a reasonable predictor of future activity,[289] the Commission preliminarily estimates that the total number of SBS transactions that would be subject to proposed Rule 901 on an annual basis would be approximately 15,460,000, which is an average of approximately 42 per reporting party per day.[290]

The Commission believes that SBS market participants would face three categories of costs to comply with proposed Rule 901. First, each market participant would have to develop an internal OMS capable of capturing relevant SBS transaction information so that it can be reported. The Commission understands that, because of the manner in which participants transact certain SBSs with certain transaction details being added post-execution, an OMS would likely need to link both to a market participant's trade desk – to permit real-time transaction reporting – and to the market participant's back office – to facilitate reporting of complete

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287 See, e.g., http://www.dtcc.com/products/derivserv/data_table_iii.php (weekly data as updated by DTCC).

288 The Commission's estimate is based on internal analysis of available SBS market data. The Commission is seeking comment about the overall size of the SBS market.

289 The Commission notes that regulation of the SBS markets, including by means of proposed Regulation SBSR, could impact market participant behavior.

290 These figures are based on the following: [13,140,000 / 0.85] = 15,458,824. [((15,458,824 estimated SBS transactions) / (1,000 estimated reporting parties)) / (365 days/year)] = 42.35, or approximately 42 transactions per day. The Commission understands that many of these transactions may arise from previously executed SBS transactions.

transactions as required under proposed Rule 901. The OMS would also have to include or be connected to a system designed to store SBS transaction information.

Second, each reporting party would have to implement a reporting mechanism. This would include a system that "packages" SBS transaction information from the entity's OMS, sends the information, and tracks it. The reporting mechanism would also include necessary data transmission lines to the appropriate registered SDR.

Third, each reporting party would have to establish an appropriate compliance program and support for the operation of the OMS and reporting mechanism. Relevant elements of the compliance program would include transaction verification and validation protocols, the ability to identify and correct erroneous transaction reports, necessary technical, administrative, and legal support. Additional operational support would include new product development, systems upgrades, and ongoing maintenance.

Based on conversations with industry participants, the Commission preliminarily believes that the reporting timeframes mandated by proposed Rules 901(c), (d), and (e) may be costly to achieve for reporting parties that do not currently have the capabilities to perform those functions in those time frames, requiring additional expenditure of resources to satisfy these requirements. For example, reporting parties that do not currently have the capability to capture SBS trade information and provide it to a registered SDR in real time would be required by proposed Regulation SBSR to obtain such capability.

Proposed Rule 901 would not provide an explicit list of data elements. Instead, proposed Regulation SBS would provide a registered SDR with flexibility to determine the specifics of the form and format for data to be reported under proposed Rule 901. Thus, to the extent reported and disseminated SBS transaction data are not uniform, market participants and regulators could face a cost to standardize and interpret them.

Internal Order Management. To comply with their reporting obligations, reporting parties would be required to develop and maintain an internal OMS that can capture relevant SBS data. The Commission preliminarily estimates that, to capture SBS data in a manner sufficient to facilitate reporting under proposed Rule 901 would impose an initial one-time aggregate cost of approximately $96,650,000, which corresponds to $96,650 for each reporting party.[291] This estimate includes an estimate of the costs required to amend internal procedures, design or reprogram systems, and implement processes to ensure that SBS transaction data are captured and preserved. The Commission further preliminarily estimates that capturing SBS data in a manner sufficient to facilitate reporting under proposed Rule 901 would impose an ongoing annual aggregate cost of approximately $73,144,000, which corresponds to $73,144 for each reporting party.[292] This figure would include day-to-day support of the OMS, as well as an estimate of the amortized annual cost associated with system upgrades and periodic "re-platforming" (i.e., implementing significant updates based on new technology). In addition, to capture and maintain relevant information and documents, the Commission preliminarily estimates that all reporting parties could incur an initial and ongoing aggregate annualized cost of

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291 This estimate is based on the following: [((Sr. Programmer (160 hours) at $285 per hour) + (Sr. Systems Analyst (160 hours) at $251 per hour) + (Compliance Manager (10 hours) at $294 per hour) + (Director of Compliance (5 hours) at $426 per hour) + (Compliance Attorney (20 hours) at $291 per hour) x (1,000 reporting parties)] = $96,650,000.. The Commission preliminarily believes that information on SBS transactions is currently being retained by counterparties in the ordinary course of business, and as a practical matter should not result in any significant new burdens.

292 This estimate is based on the following: [((Sr. Programmer (32 hours) at $285 per hour) + (Sr. Systems Analyst (32 hours) at $251 per hour) + (Compliance Manager (60 hours) at $294 per hour) + (Compliance Clerk (240 hours) at $59 per hour) + (Director of Compliance (24 hours) at $426 per hour + (Compliance Attorney (48 hours) at $291 per hour) x (1,000 reporting parties)] = $73,144,000.

$1,000,000, which corresponds to $1,000 for each reporting party.[293] The figure is an estimate of the hardware and associated maintenance costs for sufficient memory to capture and store SBS transactions, including redundant back-up systems.

Summing these costs, the Commission preliminarily estimates the initial aggregate annualized cost for reporting parties for internal order management under proposed Rule 901 would be $170,794,000, which corresponds to $170,794 for each reporting party.[294] The Commission further preliminarily estimates that the ongoing aggregate annualized costs on reporting parties for internal order management under proposed Rule 901 would be $74,144,000, which corresponds to $74,144 for each reporting party.[295]

SBS Reporting Mechanism. Each reporting party would incur initial one-time costs to establish connectivity with and report SBS transactions to a registered SDR. Depending on the number of SBS asset classes that a reporting party transacts in and which registered SDRs accept the resulting SBS transaction reports; multiple connections to different registered SDRs could be

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293 This estimate is based on discussions of Commission staff with various market participants and is calculated as follows: [$250/gigabyte of storage capacity x (4 gigabytes of storage) x (1,000 participants)] = $1,000,000. The Commission preliminarily believes that storage costs associated with saving relevant SBS information and documents would not vary significantly between the first year and subsequent years. Accordingly, the Commission has preliminarily estimated the initial and ongoing storage costs to be the same. Moreover, the Commission believes the per-entity annual data storage figure of $1,000 to be a reasonable average. Some reporting parties may face higher costs, while others would simply use existing storage resources.

294 This estimate is based on the following: [(($96,650 + $73,144 + $1,000) x (1,000 reporting parties)] = $170,794,000, which corresponds to $170,794 burden hours per reporting party.

295 This is estimate is based on the following: (($73,144 + $1,000) x 1,000 reporting parties) = $74,144,000.

necessary. For purposes of estimating relevant costs, the Commission preliminarily estimates that, on average, each reporting party would require connections to two registered SDRs.[296]

On this basis, the Commission preliminarily estimates that the cost to establish and maintain connectivity to a registered SDR to facilitate the reporting required by proposed Rule 901 would impose an annual (first-year and ongoing) aggregate cost of approximately \$200,000,000, which corresponds to \$200,000 for each reporting party.[297] The Commission understands that many reporting parties already have established linkages to entities that may register as SDRs, which could significantly reduce the out-of-pocket costs associated with this establishing the reporting function contemplated by proposed Rule 901.

Moreover, the Commission believes that establishing a reporting mechanism for SBS transactions would impose internal costs on each reporting party, including the development of systems necessary to capture and send information from the entity's OMS to the relevant registered SDR, as well as corresponding testing and support. The Commission preliminarily estimates an initial one-time aggregate cost of \$46,657,000, which corresponds to an initial one-

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296 The Commission derived this estimate as follows. First, the Commission believes that initially there would be only a limited number of registered SDRs, and that the number would not exceed ten. Many reporting parties might transact in only some classes of SBSs. Thus, even if each registered SDR accepted transaction reports only for a single SBS asset class, the total number of connections needed by many reporting parties would likely be limited. The Commission also preliminarily believes that, for operational efficiency, a participant would seek to use only one registered SDR per asset class to obtain repository services. Next, reporting parties that required a significant number of connections to registered SDRs could engage a third party – a dealer or connectivity services provider – instead of independently establishing their own connections. Accordingly, the Commission preliminarily believes that one connection may suffice for many reporting parties.

297 This estimate is based on discussions of Commission staff with various market participants, as well as the Commission's experience regarding connectivity between securities market participants for data reporting purposes. The Commission derived the total estimated expense from the following: (\$100,000 hardware- and software-related expenses, including necessary backup and redundancy, per SDR connection) x (2 SDR connections per reporting party) x (1,000 reporting parties) = \$200,000,000.

time cost of $46,657 for each reporting party.[298] In addition, Commission preliminarily estimates that reporting specific SBS transactions to a registered SDR as required by proposed Rule 901 would impose an annual aggregate cost (first-year and ongoing) of approximately $5,400,000, which corresponds to approximately $5,400 for each reporting party.[299]

Thus, the Commission preliminarily estimates the initial, aggregate annualized cost for reporting parties submitting SBS transaction reports under proposed Rule 901 would be $252,057,000, which corresponds to $252,057 for each reporting party.[300] The Commission further preliminarily estimates that the ongoing, aggregate annualized cost on reporting parties for submitting SBS transaction reports under proposed Rule 901 would be $205,400,000, which corresponds to $205,400 for each reporting party.[301]

Compliance and Ongoing Support. As stated above, in complying with proposed Rule 901, each reporting party also would need to establish and maintain an appropriate compliance

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298 This figure is based on discussions with various market participants and is calculated as follows: [((Sr. Programmer (80 hours) at $285 per hour) + (Sr. Systems Analyst (80 hours) at $251 per hour) + (Compliance Manager (5 hours) at $294 per hour) + (Director of Compliance (2 hours) at $426 per hour) + (Compliance Attorney (5 hours) at $291 per hour) x (1,000 reporting parties)] = $46,657,000. The Commission preliminarily believes that information on SBS transactions is currently being retained by market participants in the ordinary course of business, and as a practical matter should not result in any significant new costs.

299 The Commission preliminarily believes that the costs of having an operational reporting system capable of effectively processing these transactions are covered in the cost estimates for a compliance and ongoing support system. See infra notes 302 to 305. The Commission preliminarily believes that the actual reporting of transactions represents an incremental additional cost. The referenced figure is based on discussions with various market participants and is calculated as follows: [(Compliance Clerk (40 hours) at $59 per hour) + (Sr. Computer Operator (40 hours) at $76 per hour)) x (1,000 reporting parties)] = $5,400,000.

300 This estimate is based on the following: (($46,657 + $5,400 + $200,000) x (1,000 reporting parties)) = $252,057,000, which corresponds to $252,057 per reporting party.

301 This estimate is based on the following: (($5,400 + $200,000) x (1,000 reporting parties)) = $205,400,000, which corresponds to $205,400 per reporting party.

program and support for the operation of the OMS and reporting mechanism, which would include transaction verification and validation protocols and necessary technical, administrative, and legal support. Additional operational support would include new product development, systems upgrades, and ongoing maintenance. The Commission preliminarily believes that initial costs associated with this aspect of proposed Rule 901 – i.e., the establishment of relevant compliance capability – would also involve in significant part the development of appropriate policies and procedures, which, for those participants who are SBS dealers or major SBS participants, is addressed in connection with proposed Rule 906(c). A reporting party would need to design its OMS to include tools to ensure accurate, complete reporting and employ appropriate technical and compliance staff to maintain and support the operation of its OMS on an ongoing basis.

The Commission preliminarily estimates that designing and implementing an appropriate compliance and support program would impose an initial one-time aggregate cost of approximately $51,590,000, which corresponds to a cost of $51,590 for each reporting party.[302] The Commission further preliminarily estimates that maintaining its compliance and support program would impose an ongoing annual aggregate cost of approximately $36,572,000, which corresponds to a cost of $36,572 for each reporting party.[303] This figure includes day-to-day

302 This figure is based on discussions with various market participants and is calculated as follows: [((Sr. Programmer (100 hours) at $285 per hour) + (Sr. Systems Analyst (40 hours) at $251 per hour) + (Compliance Manager (20 hours) at $294 per hour) + (Director of Compliance (10 hours) at $426 per hour) + (Compliance Attorney (10 hours) at $291 per hour) x (1,000 reporting parties)] = $51,590,000.

303 This figure is based on discussions with various market participants and is calculated as follows: [((Sr. Programmer (16 hours) at $285 per hour) + (Sr. Systems Analyst (16 hours) at $251 per hour) + (Compliance Manager (30 hours) at $294 per hour) + (Compliance Clerk (120 hours) at $59 per hour) + (Director of Compliance (12 hours) at $426 per hour) + (Compliance Attorney (24 hours) at $291 per hour) x (1,000 reporting parties)] = $36,572,000.

support of the OMS, as well as an estimate of the amortized annual cost associated with system upgrades and periodic "re-platforming."

Therefore, the Commission preliminarily estimates the initial aggregate annualized costs to reporting parties for compliance and ongoing support under proposed Rule 901 would be \$88,162,000, which corresponds to \$88,162 for each reporting party.[304] The Commission further preliminarily estimates that the ongoing aggregate annualized cost on reporting parties for compliance and ongoing support under proposed Rule 901 would be \$36,572,000, which corresponds to \$36,572 for each reporting party.[305]

Summing these costs, the Commission preliminarily estimates that the initial, aggregate annualized costs associated with proposed Rule 901 would be \$511,013,000, which corresponds to \$511,013 per reporting party.[306] The Commission preliminarily estimates that the ongoing aggregate annualized costs associated with proposed Rule 901 would be \$316,116,000, which corresponds to \$316,116 per reporting party.[307]

Finally, the Commission notes that it is possible that the costs associated with required reporting pursuant to proposed Regulation SBSR could represent a barrier to entry for new, smaller firms that might not have the ability or desire to comply with these reporting requirements. To the extent that proposed Regulation SBSR causes new firms not to enter the SBS market, this would be a cost of the proposal. Nevertheless, the Commission preliminarily believes that firms would be able to contract with third-party service providers, which could

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304 This estimate is based on the following: ((\$51,590 + \$36,572) x (1,000 reporting parties)] = \$88,162,000, which corresponds to \$88,162 per reporting party.

305 See supra note 303.

306 This estimate is based on the following: ((\$170,794 + \$252,057 + \$88,162) x (1,000 reporting parties)) = \$511,013,000, which corresponds to \$511,013 per reporting party.

307 This estimate is based on the following: ((\$74,144 + \$205,400 + \$36,572) x (1,000 reporting parties)) = \$316,116,000, which corresponds to \$316,116 per reporting party.

facilitate their compliance with proposed Regulation SBSR. Accordingly, the Commission preliminarily does not believe it likely that proposed Rule 901 would, as a practical matter, act as a barrier to new entrants. The Commission requests comment on this issue.

Reference information. The Commission, in proposed Regulation SBSR, is not requiring the development of internationally recognized standards for reference information that could be used across the financial services industry. Therefore, the Commission believes that the costs of developing and sustaining such a system should not be considered costs of proposed Regulation SBSR. However, proposed Regulation SBSR would require a registered SDR and its participants to use UICs generated by such a system, if such system is able to generate such UICs. Although the Commission believes there would be long-term benefits for using UICs generated by such a system, there could be short-term costs imposed on reporting parties to convert to such a system. In addition, under these internationally recognized standards, users of the reference information could have to pay reasonable fees to support the system. These fees also would represent costs of proposed Rule 901. The Commission requests comment on this issue and any potential costs associated with the potential future use of internationally recognized standards.

b. For Registered SDRs

Proposed Rule 901(f) would require a registered SDR to time stamp, to the second, its receipt of any information submitted to it pursuant to proposed Rules 901(c), (d), or (e). Proposed Rule 901(g) would require a registered SDR to assign a transaction ID to each SBS reported by a reporting party. The Commission preliminarily believes that these requirements would not be significant in the context of designing and building the technological framework that would be required of an SDR to become registered.[308] Therefore, the Commission preliminarily estimates that proposed Rules 901(f) and (g) would impose an initial aggregate one-time cost of $342,040, which corresponds to $34,204 per registered SDR.[309] This figure is based on an estimate of ten registered SDRs. With regard to ongoing costs, the Commission preliminarily estimates that proposed Rules 901(f) and (g) would impose an ongoing aggregate annual cost of $436,440, which corresponds to $43,644 per registered SDR.[310] This figure represents an estimate of the support and maintenance costs for the time stamp and transaction ID assignment elements of a registered SDR's systems.

Thus, the Commission preliminarily estimates that the initial aggregate annualized cost associated with proposed Rules 901(f) and (g) would be $778,480, which corresponds to $77,848 per registered SDR.[311] Correspondingly, the Commission preliminarily estimates that the ongoing aggregate annualized cost associated with proposed Rules 901(f) and (g) would be $436,440, which corresponds to $43,644 per registered SDR.[312]

3. Request for Comment

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308 See SDR Registration Proposing Release, supra note 6.

309 This figure is based on discussions with various market participants and is calculated follows: [((Sr. Programmer (80 hours) at $285 per hour) + (Sr. Systems Analyst (20 hours) at $251 per hour) + (Compliance Manager (8 hours) at $294 per hour) + (Director of Compliance (4 hours) at $426 per hour) + (Compliance Attorney (8 hours) at $291 per hour) x (10 registered SDRs)] = $342,040.

310 This figure is based on discussions with various market participants and is calculated as follows: [((Sr. Programmer (60 hours) at $285 per hour) + (Sr. Systems Analyst (48 hours) at $251 per hour) + (Compliance Manager (24 hours) at $294 per hour) + (Director of Compliance (12 hours) at $426 per hour) + (Compliance Attorney (8 hours) at $291 per hour) x (10 registered SDRs)] = $436,440.

311 This figure is based on the following: (($34,016 + $42,240) x (10 registered SDRs) = $778,480, which corresponds to $77,848 per registered SDR.

312 See supra note 310.

The Commission requests comment on the costs and benefits of proposed Rule 901 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

250. How can the Commission more accurately estimate the costs and benefits?

251. What are the costs currently borne by entities covered by proposed Rule 901 with respect to the retention of records of SBS transactions?

252. How many entities would be affected by the proposed rule? How many transactions would be subject to the proposed rule?

253. Are there additional costs involved in complying with the rule that have not been identified? What are the types, and amounts, of the costs?

254. Would the obligations imposed on reporting parties by proposed Rule 901 be a significant enough barrier to entry to cause some firms not to enter the SBS market? If so, how many firms might decline to enter the market? How can the cost of their not entering the market be tabulated? How should the Commission weigh such costs, if any, against the anticipated benefits from increased transparency to the SBS market from the proposal, as discussed above?

255. Can commenters assess the benefits of having comprehensive and accurate reporting of SBS transactions to registered SDRs, which would provide access to such information to the Commission and other regulators? What would have been the benefits to the SBS market if such regulatory oversight had been in place sooner?

256. What benefits and costs would there be to converting to a reference identification system established by or on behalf of an IRSB? What fees might be charged to support such a system? How much would those fees be? Who would have to pay them?

257. Would there be additional benefits from the proposed rule that have not been identified?

C. Public Dissemination of Transaction Reports – Rule 902 of Regulation SBSR

Generally, proposed Rule 902 would require the public dissemination of SBS transaction information. Proposed Rule 902(a) would set out the core requirement that a registered SDR, immediately upon receipt of a SBS transaction report of a SBS, must publicly disseminate information about the SBS, except in the case of a block trade, that must consist of all the information reported by the reporting party pursuant to proposed Rule 901, plus any indicator or indicators contemplated by the registered SDR's policies and procedures that are required by proposed Rule 907.[313]

Proposed Rule 902(b) would require a registered SDR to publicly disseminate a transaction report of a block trade immediately upon receipt of information about the block trade from the reporting party. The transaction report would consist of all the information reported by the reporting party pursuant to proposed Rule 901(c), except for the notional size, plus the transaction ID and an indicator that the report represents a block trade. The registered SDR would be required to publicly disseminate a complete transaction report for such block trade (including the transaction ID and the full notional size) at a later time.

313 In the circumstances necessitating a registered SDR's systems to be unavailable for publicly disseminating transaction data, the registered SDR would have to disseminate the transaction data immediately upon its re-opening. Proposed Rule 902(c) would prohibit the dissemination of certain information. See supra note 100 and accompanying text.

1. Benefits

By reducing information asymmetries, post-trade transparency has the potential to lower transaction costs, improve confidence in the market, encourage participation by a larger number of market participants, and increase liquidity in the SBS market. The current market is opaque. Market participants, even dealers, lack an effective mechanism to learn the prices at which other market participants transact. In the absence of post-trade transparency, market participants do not know whether the prices they are paying or would pay are higher or lower than what others are paying for the same SBS instruments. Currently, market participants resort to "screen-scraping" e-mails containing indicative quotation information to develop a sense of the market. Supplementing that effort with prompt last-sale information would provide all market participants with more extensive and more accurate information on which to make trading and valuation determinations.

SBSs are complex derivative instruments, and there exists no single accepted way to model a SBS for pricing purposes. Post-trade pricing and volume information could allow valuation models to be adjusted to reflect how SBS counterparties have valued a SBS instrument at a specific moment in time. Public, real-time dissemination of last-sale information also could aid dealers in deriving better quotations, because they would know the prices at which other market participants have recently traded. This information could aid end users in evaluating current quotations, because they could inquire from dealers why the quotations that the dealers are providing them differ from the prices of recently executed transactions. Furthermore, end users would be afforded the means of testing whether quotations offered by dealers before the last sale were close to the price at which the last sale was executed. In this manner, post-trade transparency could promote price competition and more efficient price discovery, and ultimately lower transaction costs in the SBS market.

Post-trade transparency of SBSs, as required by proposed Rule 902, could benefit the financial markets generally by improving market participants' ability to value SBSs, particularly if the trade information is used as an input to, rather than as a substitute for, independent valuations and pricing decisions by other market participants. In transparent markets with sufficient liquidity, valuations generally can be derived from recent quotations and/or last-sale prices. However, in opaque markets or markets with low liquidity, recent quotations or last-sale prices may not exist or, if they do exist, may not be widely available. Therefore, market participants holding assets that trade in opaque markets or markets with low liquidity frequently rely instead on pricing models. These models might be based on assumptions subject to the evaluator's discretion, and can be imprecise. Thus, market participants holding the same asset but using different valuation models might arrive at significantly different values for the same asset.

Valuation models could be improved to the extent that they consider last-sale reports of the asset to be valued, reports of related assets, or reports of benchmark products that include the asset to be valued or closely related assets, even if those reports are dated. There is evidence to suggest that post-trade transparency helps reduce the range of valuations of assets that trade in illiquid markets.[314] Thus, post-trade transparency in the SBS market could result in more accurate valuations of SBSs generally – particularly if trade information is used as an input to, rather than a substitute for, independent valuations by other market participants – as it would

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314 See Gjergji Cici, Scott Gibson, John J. Merrick, Jr., "Missing the Marks? Dispersion in Corporate Bond Valuations Across Mutual Funds," draft paper available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1104508.

allow all market participants to know how SBS counterparties priced the SBS at a specific point in time. Especially with complex instruments, investment decisions generally are predicated a significant amount of due diligence to value the instruments properly. A post-trade transparency system permits other market participants to derive at least some informational benefit from obtaining the views of the two counterparties who did a particular trade.

Furthermore, better valuations could create a benefit in the form of more efficient capital allocation, which is premised on accurate knowledge of asset prices. Asset prices that are too high could result in a misallocation of capital, as investors demand more of an asset that cannot deliver an economic risk-adjusted return. By the same token, assets that are inappropriately undervalued could represent investment opportunities that will likely not receive enough capital because investors do not realize that a good risk-adjusted return is available. To the extent that post-trade transparency of SBS transactions enables asset valuations to move closer to their fundamental value, capital could be more efficiently allocated.

Better valuations resulting from post-trade transparency of SBSs also could reduce prudential and systemic risks. Some financial institutions, including many of the most systemically important financial institutions, have large portfolios of SBSs. The financial system could benefit if the portfolios of these institutions were more accurately valued. To the extent that post-trade transparency affirms the valuation of an institution's portfolio, regulators, the individual firm, and the market as a whole could be more certain as to whether the firm would or would not pose prudential or systemic risks. In some cases, however, post-trade transparency in the SBS market might cause an individual firm to revalue its positions and lower the overall value of its portfolio. The sooner that accurate valuations can be made, the more quickly that regulators and the individual firm could take appropriate steps to minimize the firm's prudential risk profile, and the more quickly that regulators and other market participants could take appropriate steps to address any systemic risk concerns raised by that firm.

In addition, proposed Rule 902 is designed to maximize the availability of information regarding SBS transactions to all market participants in a way that the Commission preliminarily believes "take[s] into account whether the public disclosure will materially reduce market liquidity."[315] Post-trade transparency, as contemplated by proposed Rule 902, could reduce information asymmetries among SBS market participants and thereby benefit market liquidity in at least two ways. First, it could reduce the informational asymmetries between market participants, allowing dealers to set quotes using information beyond their own order flow. This could help smaller dealers or other market participants to enter the market by reducing the informational advantage and bargaining power of large dealers. Second, investors with hedging needs who are at an informational disadvantage to dealers and would have more information as to trade prices. Such investors also could more accurately price the trade, which would encourage their participation in the SBS market. Better informed market participation by both dealers and investors – through greater fairness in access to relevant pricing information – could result in benefits in the form of an increase in overall market liquidity.

Finally, real-time public dissemination of SBS transaction reports could have effects on the overall volume of the SBS market, which could have certain benefits. Greater transparency could result in greater confidence in the SBS market, resulting in more market participants being willing to trade, or the same number of market participants being willing to trade more often. These additional transactions could result in better allocation of risk across the financial system. On the other hand, there could be a benefit even if fewer SBS transactions occur because of

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315 15 U.S.C. 78m(m)(1)(E)(iv).

proposed Regulation SBSR. This could be the case if market participants that are unable or unwilling to properly manage the attendant risks of participation in the SBS market are deterred from participating, or if there were a reduction in the number of SBS transactions where there is a significant information asymmetry between the counterparties. In the latter case, there could be a benefit if uninformed parties are deterred from unwittingly taking on imprudent positions in SBSs.

2. Costs

A potential cost of post-trade transparency that is often cited by market participants, particularly dealers, is that it increases inventory risks. Dealers often enter trades with their customers as a liquidity supplier. A potential consequence of post-trade transparency is that dealers trying to hedge inventory following a trade are put in a weaker bargaining position relative to subsequent counterparties, and will either raise the liquidity fee charged to their clients or refuse to accommodate such trades. Such behavior could lead to lower trading volume and reduce the ability of market participants to manage risk, both of which could have a negative welfare effect on all market participants.

In an opaque market, market participants have to rely primarily on their understanding of the market's fundamentals to arrive at a price at which they would be willing to assume risk. With immediate real-time public dissemination of a block trade, however, market participants who might be willing to offset that risk – i.e., other dealers and natural shorts – could extract rents from a dealer that takes a large risk position from a counterparty. Because the initial dealer would not internalize those higher costs, it would most likely seek to pass those costs on to the counterparty in the form of a higher price for the initial SBS. This could lead to less liquidity in the SBS market, and thus lower trading volume and less ability for market participants to manage risk. It also might be argued that increased post-trade transparency could drive large trades to other markets that offer the opacity desired by traders, creating fragmentation and harming price efficiency and liquidity. This possibility is consistent with the argument that large, informed traders may prefer a less transparent trading environment that allows them to minimize the price impact of their trades. Real-time public dissemination of SBS transaction information, therefore, could cause certain market participants to trade less frequently or to exit the market completely. It would be difficult at this stage to estimate the likelihood of this occurring and, if does occur, what the costs would be. The Commission invites comment on this issue.

Another potential cost of post-trade transparency in the SBS market, as contemplated by proposed Rule 902, is that last-sale prints, particularly in infrequently traded products, could be the result of unusual conditions that do not reflect the economic fundamentals of the SBS instrument. For instance, if a large market participant failed resulting in the liquidation of its portfolio, fire sale prices could have the effect of requiring other market participants to unduly mark down the value of their portfolios. This could cause additional market stress, particularly through the triggering of additional margin calls. In these circumstances, independent evaluations and decision-making that incorporates post-trade information can be important to stabilizing the markets.

Simultaneously with this proposal, the Commission is proposing new Rules 13n-1 through 13n-11 under the Exchange Act relating to the SDR registration process, the duties of SDRs, and their core principles.[316] The SDR Registration Proposing Release covers anticipated collections of information with respect to various aspects of establishing and operating an SDR,

316 See SDR Registration Proposing Release, supra note 6.

including its start-up and ongoing operations, and describes the costs that complying with the proposed rules would entail. The Commission preliminarily believes that a registered SDR would be able to integrate the functions outlined in new Rules 13n-1 through 13n-11 with the capability to publicly disseminate real-time SBS transaction reports required under proposed Rule 902 as part of its overall system development. Accordingly, the Commission believes that the costs associated with enabling and maintaining compliance with proposed Rule 902 would, as a practical matter, represent a portion of the SDR's overall systems development budget and process. For purposes of the PRA, the Commission preliminarily estimated that implementing and complying with the real-time public dissemination requirement of proposed Rule 902 would add an additional 20% to the start-up and ongoing operational expenses that would otherwise be required of a registered SDR.[317]

On this basis, the Commission preliminarily estimates that the initial one-time aggregate costs associated with real-time public dissemination for development and implementation of the systems needed to disseminate the required transaction information and for necessary software and hardware would be $40,004,000 million, which corresponds to $4,000,400 per registered SDR.[318] In addition, the Commission preliminarily estimates that aggregate annual costs for

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317 See Section V.D.2 (SDR Duties, Data Collection and Maintenance, Automated Systems, and Direct Electronic Access) of the SDR Registration Proposing Release. This estimate is based on the input from potential SDRs and includes time necessary to design and program a registered SDR's system to calculate and disseminate initial and end of day block trade reports as well as annual costs associated with systems testing and maintenance necessary for the special handling of block trades. These figures do not include the development of policies and procedures necessary to calculate block trade thresholds pursuant to proposed Rule 907(b).

318 The Commission derived this estimate from the following: [((Attorney (1,400 hours) at $316 per hour) + (Compliance Manager (1,600 hours) at $294 per hour) + (Programmer Analyst (4,000 hours) at $190 per hour) + (Senior Business Analyst (1,400 hours) at $234 per hour) x (10 registered SDRs)) + ($2,000,000 for necessary hardware and software)] =

systems and connectivity upgrades associated with real-time public dissemination would be $24,002,400 million, which corresponds to $2,400,240 per registered SDR.[319] Thus, the initial aggregate costs associated with proposed Rule 902 would be $64,006,400, which corresponds to $6,400,640 per registered SDR.[320]

The SDR Registration Proposed Rules also address additional costs on registered SDRs that are not included here.[321]

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 902 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

258. What would be the costs and benefits of post-trade transparency in the SBS market, both in the long and the short term? How would post-trade transparency alter the existing market structure?

259. How would post-trade transparency in the SBS market affect the ability to hedge? Would hedging become more costly or less costly over time? Why?

$40,004,000. See SDR Registration Proposing Release, supra note 6 at Section VI.B.2 (estimating the total cost associated with establishing SDR technology systems).

319 The Commission derived this estimate from the following: [((Attorney (840 hours) at $316 per hour) + (Compliance Manager (960 hours) at $294 per hour) + (Programmer Analyst (2,400 hours) at $190 per hour) + (Senior Business Analyst (840 hours) at $234 per hour) x (10 registered SDRs)) + ($1,200,000 for necessary hardware and software upgrades)] = $24,002,400. See SDR Registration Proposing Release, supra note 6, at Section VI.B.2 (estimating the annual ongoing cost associated with operating and maintaining SDR technology systems).

320 This estimate is based on the following: [(($4,000,400) + ($2,400,240)) x (10 registered SDRs)] = $64,006,400, which corresponds to $6,400,640 per registered SDR.

321 See SDR Registration Proposing Release, supra at note 6.

260. Would post-trade transparency have the same costs and benefits on the SBS market similar as on other securities markets? Why or why not?

261. The SBS market is currently almost wholly institutional. Would this characteristic impact the costs and benefits of post-trade transparency on the SBS market? If so, how and how much? Are the needs of market participants in the SBS market for access to transaction information different than the needs of market participants in other securities markets for access to transaction information?

262. A significant amount of trading in the SBS market is currently carried out by only a limited number of market participants. Would this characteristic impact the costs and benefits of post-trade transparency on the SBS market? If so, how and how much? For example, is there a concern that it would be easier to determine the identity of the counterparties to a SBS transaction in certain instances based on the real-time transaction report? If so, what would be the harm, if any, of such knowledge? Would the answer differ depending upon the liquidity of the SBS instrument, or whether it was a customized SBS or not?

263. The SBS market is generally more illiquid than other securities markets that have post-trade transparency regimes. How would this characteristic impact, if at all, the effect the costs and benefits of post-trade transparency on the SBS market? Do commenters believe that post-trade transparency could materially reduce market liquidity in the SBS market, or particular subsets thereof? Why and how? Please be specific in your response and provide data to the extent possible.

264. How would a post-trade transparency regime in SBSs affect the costs of trading in the underlying securities? For example, how, if at all, would the post-trade transparency regime affect liquidity in the corporate bond market?

265. Academic studies of other securities markets generally have found that post-trade transparency reduces transaction costs and has not reduced market liquidity. How do those markets differ or compare to the SBS market? How would those similarities or differences affect post-trade transparency in the SBS market?

266. Do commenters believe that post-trade transparency could materially reduce market liquidity in the SBS market, or particular subsets thereof? Why and how?

267. Would proposed Rule 902 create any additional costs or benefits not discussed here?

268. Are there any ways that the Commission can study the costs and benefits of the dissemination delay for the size of a block trade by creating different initial requirements by entities or assets classes as part of the phase-in of the rule?

D. Coded Information – Rule 903 of Regulation SBSR

To facilitate the reporting and dissemination of SBS transactions, as would be required under proposed Rules 901 and 902, the Commission understands that there may – or could be developed – industry conventions for identifying SBSs or reference entities on which SBS are based through readily available reference codes. Proposed Rule 903 addresses this possibility. Specifically, proposed Rule 903 would provide that a reporting party could provide information to a registered SDR pursuant to proposed Rule 901, and a registered SDR could publicly disseminate information pursuant to proposed Rule 902, using codes in place of certain data elements, provided that the information necessary to interpret such codes is widely available on a non-fee basis.

1. Benefits

The use of such codes by a registered SDR and its participants could give rise to significant potential benefits. First, the use of codes could greatly improve the efficiency and accuracy of the trade reporting system by streamlining the provision of data to the registered SDR. Reporting just the code could replace several data elements that otherwise would have to be reported separately. Second, the development of a public coding system could also support greater transparency. Coded transaction reports with key identifying information for SBS transactions could facilitate the aggregation of market transactions, particularly when the records are dispersed across different registered SDRs. Third, the aggregation of SBS transaction data through codes would also facilitate more efficient market analysis studies, surveillance activities, and system risk monitoring by regulators by streamlining the presentation of the SBS transaction data. Without robust, common identifying information, the process of aggregating market data across asset classes and entities could be impaired, increasing the effort required for market analysis activities.

2. Costs

Proposed Rule 903 could impose certain costs on current SBS market participants. Some SBS market participants have developed private coding systems.[322] To the extent that these systems are not widely available, proposed Rule 903 would prohibit their adoption for use by registered SDRs and their participants in connection with the reporting and dissemination of SBS

322 The Commission is aware of one such product identification system that involves six-digit reference entity identifiers and three-digit reference obligations identifiers as well as a standard three-digit maturity identifier.

transactions required under proposed Regulation SBSR. Consequently, the owners of these systems may no longer be able to market and generate income (i.e., licensing fees) from these systems, or recover development costs associated with their systems.

The Commission preliminarily believes that proposed Rule 903 would not impose any material costs on registered SDRs or their participants. The development and use of a coding system that is widely available on a non-fee basis would instead likely reduce the costs associated with reporting and disseminating SBS transactions as required under proposed Rules 901 and 902, as market participants would not have to incur any fees to use codes.

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 903 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

269. How can the Commission more accurately estimate the costs and benefits?

270. Would proposed Rule 903 entail any benefits or costs not considered by the Commission?

271. Are there costs the Commission has not considered with respect to the use of coding systems that are widely available on a non-fee basis? Would the use of these coding systems in fact reduce the costs associated with the obligations under proposed Rules 901 and 902?

272. Are there coding systems that are widely available on a non-fee basis? What, if any, costs may be associated with requiring the use of a coding system that is widely available on a non-fee basis?

273. What would be the costs and benefits of permitting the use of codes that are available for a fee? Could allowing the use of such codes create a regulatory monopoly in favor of the owner of the code's intellectual property?

E. Operating Hours of Registered SDRs – Rule 904 of Regulation SBSR

Proposed Rule 904 would require a registered SDR to design its systems to allow for continuous receipt and dissemination of SBS data, except that a registered SDR would be permitted to establish "normal closing hours." Such normal closing hours may occur only when, in the estimation of the registered SDR, the U.S. markets and other major markets are inactive. In addition, a registered SDR would be permitted to declare, on an ad hoc basis, special closing hours to perform routine system maintenance, subject to certain requirements.

1. Benefits

The Commission preliminarily believes that it would be beneficial to require a registered SDR to continuously receive and disseminate SBS transaction information. The market for SBS is global, and the Commission believes the public interest would be served by requiring continuous real-time dissemination of any SBS transactions (with a sufficient nexus to the United States to require reporting into a registered SDR), no matter when they are executed. Thus, if U.S. participants execute SBSs in Japan while the U.S. markets are closed, market participants around the word would still be able to view real-time reports of such transactions. Further, the Commission believes a continuous dissemination regime would eliminate the temptation for market participants to defer execution of SBS transactions until after regular business hours to avoid real-time post-trade transparency.

Paragraphs (c) to (e) of proposed Rule 904 would specify requirements for handling and disseminating reported data during a registered SDR's normal and special closing hours. The

Commission believes that these provisions would provide benefits in that they clarify how SBSs executed while a registered SDR is in normal or special closing hours would be reported and disseminated.

2. Costs

The Commission believes that a registered SDR would not incur significant costs in connection with proposed Rule 904. The Commission today is also proposing Rules 13n-1 through 13n-11 under the Exchange Act that would deal with SDR registration, duties, data collection and maintenance, automated systems and other issues.[323] That proposal covers expenses with respect to many aspects of establishing and operating an SDR, including, implicitly, its hours of operation.

The requirement for a registered SDR to provide reasonable advance notice to participants and to the public of its normal and special closing hours, and to provide notice to participants that the SDR is available to accept transaction data after its system was unavailable would likely entail a only a modest annual cost. The Commission preliminarily estimates that the initial and ongoing aggregate annual cost would be $27,360, which corresponds to $2,736 per registered SDR.[324]

There would be additional costs, but these costs are subsumed in the costs associated with proposed Rules 901 and 902. For example, the requirement for reporting parties to report information to the registered SDR upon receiving a notice that the registered SDR has resumed its normal operations would be part of the reporting parties' reporting obligations under proposed

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[323] See SDR Registration Proposing Release, supra note 6.

[324] The Commission derived this number as follows: [(Operations Specialist (24 hours) at $114 per hour) x (10 potential registered SDRs)] = $27,360, which corresponds to $2,736 per registered SDR.

Rule 901. The requirement to disseminate transaction reports held in queue should not present any costs in addition to those already contained in proposed Rule 902.

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 904 discussed above, as well as any costs and benefits not already described. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

274. How can the Commission more accurately estimate the costs and benefits for handling and disseminating reported SBS transaction data during a registered SDR's normal and special closing hours?

275. Would proposed Rule 904 create any additional costs or benefits not discussed here?

F. Correction of Errors in Security-Based Swap Information – Rule 905 of Regulation SBSR

Proposed Rule 905(a) would establish procedures for correcting errors in reported and disseminated SBS information, recognizing that that any system for transaction reporting must accommodate for the possibility that certain data elements may be incorrectly reported. Proposed Rule 905(b) would set forth the duties of a registered SDR to verify disputed information and make necessary corrections. If the registered SDR either discovers an error in a transaction on its system or receives notice of an error from a counterparty, proposed Rule 905(b)(1) would require the registered SDR to verify the accuracy of the terms of the SBS and, following such verification, promptly correct the erroneous information contained in its system. Proposed Rule 905(b)(2) would further require that, if the erroneous transaction information contained any data that fall into the categories enumerated in proposed Rule 901(c) as information required to be reported in real time, the registered SDR would be required to publicly disseminate a corrected transaction report of the SBS promptly following verification of the trade by the counterparties to the SBS.

1. Benefits

The Commission preliminarily believes that proposed Rule 905 would enhance the overall reliability of SBS transaction data that would be required to be reported. Requiring participants to promptly correct erroneous transaction information should help ensure the timeliness, accuracy, and completeness of reported transaction information. Providing more accurate SBS transaction data to a registered SDR could benefit participants by helping them ensure that their books are marked accurately and reduce operational risks that arise when counterparties do not have the same understanding of the details of a SBS transaction. Furthermore, requiring corrected SBS transaction information be reported to a registered SDR helps ensure that the Commission and other regulars have an accurate view of the prudential and systemic risks in the SBS market.

2. Costs

The Commission preliminarily believes that promptly submitting an amended transaction report to the appropriate registered SDR after discovery of an error as required under proposed Rule 905(a)(2) would impose costs on reporting parties. Likewise, the Commission preliminarily believes that promptly notifying the relevant reporting party after discovery of an error as required under proposed Rule 905(a)(1) would impose costs on non-reporting-party participants.

With respect to reporting parties, the Commission preliminarily believes that proposed Rule 905(a) would impose an initial, one-time cost associated with designing and building the reporting party's reporting system to be capable of submitting amended SBS transactions to a registered SDR. In addition, reporting parties would face ongoing costs associated with supporting and maintaining the error reporting function.[325]

The Commission preliminarily believes that designing and building appropriate reporting system functionality to comply with proposed Rule 905(a)(2) would be a component of, and represent an incremental "add-on" to, the cost to build a reporting system and develop a compliance function as required under proposed Rule 901.

Based on discussions with industry participants, the Commission preliminarily estimates this incremental burden to be equal to 5% of the one-time and annual costs associated with designing and building a reporting system that is in compliance with proposed Rule 901,[326] plus 10% of the corresponding one-time and annual costs associated with developing the reporting party's overall compliance program required under proposed Rule 901.[327] Thus, for reporting parties, the Commission preliminarily estimates that proposed Rule 905(a) would impose an

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325 The Commission preliminarily believes that the actual submission of amended transaction reports required under proposed Rule 905(a)(2) would not result in material, independent costs because this would be done electronically though the reporting system that the reporting party must develop and maintain to comply with proposed Rule 901. The costs associated with such a reporting system are addressed in the Commission's analysis of proposed Rule 901. See supra Section XIV.B.2 and notes 298-301.

326 See supra notes 298 and 299.

327 See supra notes 302 and 303.

initial (first-year) aggregate cost of $11,419,000, which is $11,419 per reporting party,[328] and an ongoing aggregate annualized burden of $3,927,000, which is $3,927 per reporting party.[329]

With regard to non-reporting-party participants, the Commission preliminarily believes that proposed Rule 905(a) would impose an initial and ongoing cost associated with promptly notifying the relevant reporting party after discovery of an error as required under proposed Rule 905(a)(1). The Commission preliminarily estimates that such annual cost would be $172,280,000, which corresponds to $43,070 per non-reporting-party participant.[330] This figure is based on the Commission's preliminary estimates of (1) 4,000 non-reporting-party participants; (2) 11 transactions per day per non-reporting-party participant;[331] and (3) an error rate of one-third (33%),[332] or approximately 4 transactions per day per non-reporting-party participant.

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328 This figure is calculated as follows: [((($46,657 one-time development of reporting system) x (0.05)) + (($5,400 annual maintenance of reporting system) x (0.05)) + (($51,590 one-time compliance program development) x (0.1)) + (($36,572 annual support of compliance program) x (0.1))) x (1,000 reporting parties)] = $11,419,000, which is $11,419 per reporting party.

329 This figure is calculated as follows: [((($5,400 annual maintenance of reporting system) x (0.05)) + (($36,572 annual support of compliance program) x (0.1))) x (1,000 reporting parties)] = $3,927,000, which is $3,927 per reporting party.

330 This figure is based on the following: [(4 error notifications per non-reporting-party participant per day) x (365 days/year) x (Compliance Clerk (0.5 hours/report) at $59 per hour) x (4,000 non-reporting-party participants)] = $172,280,000, which corresponds to $43,070 per non-reporting-party participant. The Commission preliminarily believes that participants already monitor their SBS transactions and positions in the ordinary course of business. Thus, the Commission preliminary believes that, as a practical matter, proposed Rule 905 would not result in any significant new burdens for these participants.

331 This figure is based on the following: [((15,458,824 estimated annual SBS transactions) / (4,000 estimated non-reporting-party participants)) / (365 days/year)] = 10.58, or approximately 11 transactions per day. See supra note 185. The Commission understands that many of these transactions may arise from previously executed SBS transactions.

332 In other words, the Commission is estimating that one-third of all SBS transactions will require an amended report to be submitted to the registered SDR pursuant to proposed

For registered SDRs, the ability to verify disputed information, process a transaction report cancellation, accept a new SBS transaction report, and update relevant records are all capabilities that the registered SDR would have to implement to comply with its obligations under proposed Regulation SDR.[333] Likewise, a registered SDR would be required to have the capacity to re-disseminate SBS transaction reports pursuant to proposed Rule 902. The Commission preliminarily believes that the costs associated with establishing these capabilities, including systems development, support, and maintenance, are largely addressed in the Commission's analysis of those rules.[334] The Commission preliminarily estimates that to develop and publicly provide the necessary protocols for carrying out these functions would impose on each registered SDR a cost of $186,790.[335] The Commission estimates that to review and update such protocols would impose an annualized cost on each registered SDR of $373,580.[336]

Accordingly, the Commission preliminarily estimates that the initial aggregate annualized cost on registered SDRs under proposed Rule 905 would be $5,603,700, which corresponds to

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Rule 905(a). For purposes of its PRA analysis, the Commission is further assuming that both the non-reporting-party participant and the reporting party discover all errors. The Commission recognizes that, as a practical matter, there may be instances where one party fails to detect an error.

333 See SDR Registration Proposing Release, supra note 6.

334 See id.

335 This figure is based on the following: [(Sr. Programmer (80 hours) at $285 per hour) + (Compliance Manager (160 hours) at $294 per hour) + (Compliance Attorney (250 hours) at $291 per hour) + (Compliance Clerk (120 hours) at $59 per hour) + (Sr. Systems Analyst (80 hours) at $251 per hour) + (Director of Compliance (40 hours) at $426 per hour) = $186,790.

336 This figure is based on the following: [(Sr. Programmer (160 hours) at $285 per hour) + (Compliance Manager (320 hours) at $294 per hour) + (Compliance Attorney (500 hours) at $291 per hour) + (Compliance Clerk (240 hours) at $59 per hour) + (Sr. Systems Analyst (160 hours) at $251 per hour) + (Director of Compliance (80 hours) at $426 per hour)] = $373,580.

$560,370 for each registered SDR.[337] The Commission further preliminarily estimates that the ongoing aggregate annualized cost on registered SDRs under proposed Rule 905 would be $3,735,800, which corresponds to $373,580 for each registered SDR.[338]

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 905 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

276. How can the Commission more accurately estimate the costs and benefits related to correcting errors in reported and disseminated SBS information?

277. Would proposed Rule 905 create any additional costs or benefits not discussed here?

G. Other Duties of Participants – Rule 906 of Regulation SBSR

Proposed Rule 906(a) would set forth a procedure designed to ensure that a registered SDR obtains relevant ID information for both counterparties to a SBS, not just the IDs of the reporting party. Proposed Rule 906(a) would require a registered SDR to identify any SBS reported to it for which it does not have participant ID and (if applicable) broker ID, desk ID, and trader ID of each counterparty. For such transactions, the registered SDR would be required to send a report, once a day, to each participant seeking the missing information. Under proposed

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337 This figure is based on the following: [($186,790 to develop protocols) + ($373,580 for annual support)) x (10 registered SDRs)] = $5,603,700, which corresponds to $560,370 per registered SDR.

338 This figure is based on the following: [($373,580 for annual support per registered SDR) x (10 registered SDRs)] = $3,735,800, which corresponds to $373,580 per registered SDR.

Rule 906(a), a participant that receives such a report would be required to provide the missing ID information to the registered SDR within 24 hours.

Proposed Rule 906(b) would require participants to provide a registered SDR with information identifying the participant's affiliate(s) that may also be participants of the registered SDR, as well as its ultimate parent(s). Additionally, under proposed Rule 906(b) participants would be required to promptly notify the registered SDR of any changes to the information previously provided.

Proposed Rule 906(c) would require a participant that is a SBS dealer or major SBS participant to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with any SBS transaction reporting obligations in a manner consistent with proposed Regulation SBSR and the registered SDR's applicable policies and procedures. In addition, proposed Rule 906(c) would require each such participant to review and update its policies and procedures at least annually.

1. Benefits

The Commission preliminarily believes that proposed Rule 906(a) would enable each registered SDR to obtain more complete records, consistent with the goals of the Dodd-Frank Act. Also, proposed Rule 906(a) would provide regulators with a more comprehensive picture of SBS transactions, thus enabling more robust surveillance and supervision of the SBS markets. More complete SBS records would provide the Commission necessary information to investigate specific transactions and respond effectively when issues arise in the SBS markets.

Proposed Rule 906(b) is designed to enhance the Commission's ability to monitor and surveil the SBS markets. Obtaining this ultimate parent(s) and affiliate(s) information would be helpful for understanding the risk profile of not only individual counterparties, but for large financial groups. The Commission further preliminarily believes that it is important that the participants promptly notify the registered SDR of any changes to the information regarding ultimate parent(s) and affiliate(s), as this would impact the value of the data that the registered SDR would be retaining for regulatory purposes.

Furthermore, proposed Rule 906(b) could result in significant benefits by encouraging the creation and widespread use of generally accepted standards for reference information. The Commission understands that some efforts have been undertaken – in both the private and public sectors, both domestically and internationally – to establish a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally. Such a system would be of significant benefit to regulators worldwide, as each market participant could readily be identified using a single reference code regardless of the jurisdiction or product market in which the market participant was engaging. Such a system also could be of significant benefit to the private sector, as market participants would have a common identification system for all counterparties and reference entities, and would no longer have to use multiple proprietary nomenclature systems. The enactment of the Dodd-Frank Act and the establishment of a comprehensive system for reporting and dissemination of SBSs – and for reporting and dissemination of swaps, under jurisdiction of the CFTC – offer a unique opportunity to facilitate the establishment of a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally.

The Commission preliminarily believes that proposed Rule 906(c) could provide benefits to SBS market participants and the market as a whole. Proposed Rule 906(c) would enhance the overall reliability SBS transaction data that is required to be reported to a registered SDR pursuant to proposed Rule 901. Requiring SBS dealers and major SBS participants to adopt and maintain written policies and procedures addressing compliance with proposed Regulations SBSR should result in more reliable reporting of SBS transaction data. More reliable reporting would benefit counterparties to SBS transactions, and the market more generally, by increasing the usefulness of the disseminated data, and would benefit regulators using and analyzing the reported data. In addition, requiring participants that are SBS dealers or major SBS participants – the entities that engage in the most SBS transactions – to implement policies and procedures could reduce the incidence of outages, reporting system malfunctions, or interruptions by addressing how they may be prevented and, in the event one occurs, how it could be resolved with the least negative impact.

The Commission preliminarily believes that requiring each participant that is a SBS dealer or major SBS participant to adopt and maintain written policies and procedures related to the reporting of SBS transactions may have additional benefits. Proposed Rule 906(c) should foster compliance efforts more generally among participants. With written policies and procedures, a participant's compliance with its reporting obligations would not be overly dependent on any specific individual. Higher quality reporting of SBS transaction data should generate greater confidence among SBS market participants and benefit the market as a whole. Over time, participants and the Commission also would be able to compare different approaches and develop best practices for the reporting of SBS transactions. Best practices would be valuable to the participants, the Commission, and market as a whole by supporting more complete and accurate SBS transaction reporting. Comparing the written policies and procedures adopted and maintained by covered participants would also support Commission supervision and oversight of SBS transaction reporting. For example, the failure of a SBS dealer or major SBS participant to adopt and maintain appropriate policies and procedures as required under proposed Rule 906(c) could serve as an important indicator of other compliance issues. Proposed Rule 906(c) could thus provide the Commission a means to address such concerns proactively.

2. Costs

Proposed Rule 906(a) would require a registered SDR, once a day, to send a report to each participant identifying, for each SBS to which that participant is a counterparty, the SBS(s) for which the registered SDR lacks participant ID and (if applicable) broker ID, desk ID, and trader ID. The Commission preliminarily estimates that each registered SDR would face a one-time, initial cost of $30,832 to create a report template and develop the necessary systems and processes to produce a daily report required by proposed Rule 906(a).[339] The Commission further preliminarily believes that there would be an ongoing annual cost for a registered SDR to generate and issue the daily reports, and to enter into its systems the ID information supplied by participants in response to the daily reports, of approximately $29,244.[340]

Accordingly, the Commission preliminarily estimates that the initial aggregate annualized cost for registered SDRs associated with proposed Rule 906(a) would be approximately $600,760, which corresponds to $60,076 per registered SDR.[341] The Commission preliminarily estimates that the ongoing aggregate annualized cost for registered SDRs associated with

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339 The Commission derived its estimate from the following: [(Senior Systems Analyst (40 hours) at $251 per hour) + (Sr. Programmer (40 hours) at $285 per hour) + (Compliance Manager (16 hours) at $294 per hour) + (Director of Compliance (8 hours) at $426 per hour) + (Compliance Attorney (8 hours) at $291)] = $30,832.

340 The Commission derived its estimate from the following: [(Senior Systems Analyst (24 hours) at $251 per hour) + (Sr. Programmer (24 hours) at $285 per hour) + (Compliance Clerk (260 hours) at $59 per hour)] = $29,244.

341 The Commission derived its estimate from the following: [($30,832 + $29,244) x (10 registered SDRs)] = $600,760, which corresponds to $60,076 per registered SDR.

proposed Rule 906(a) would be approximately $292,440, which corresponds to $29,244 per for registered SDR.[342]

Proposed Rule 906(a) would require a participant that receives a daily report from a registered SDR to provide the missing UICs to the registered SDR within 24 hours. Proposed Rule 906(a) would impose initial and ongoing costs on participants to complete and return the reports received from a registered SDR. The Commission preliminarily estimates that proposed Rule 906(a) would not result in any initial or ongoing costs for participants that are reporting parties. This estimate is based on the Commission's preliminary belief that a reporting party would structure its reporting program to be in compliance with proposed Regulation SBSR, and consequently, would send complete information as relates to itself for each SBS transaction submitted to a registered SDR. The Commission further preliminarily estimates that proposed Rule 906(a) would result in an initial and ongoing aggregate annualized cost for participants of approximately $75,372,500, which corresponds to a cost of approximately $15,100 per participant.[343] This figure is based on the Commission's preliminary estimates of (1) 5,000 participants; (2) 9 transactions per day per participant;[344] and (3) a missing information rate of 80%,[345] or approximately 7 transactions per day per participant.

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342 The Commission derived its estimate from the following: [($29,244) x (10 registered SDRs)] = $292,440, which corresponds to $29,244 per registered SDR.

343 This figure is based on the following: [(7 missing information reports per participant per day) x (365 days/year) x (Compliance Clerk (0.1 hours) at $59 per hour) x (5,000 participants)] = $75,372,500, which corresponds to $15,074.50 per participant.

344 This figure is based on the following: [((15,458,824 estimated annual SBS transactions) / (5,000 estimated participants)) / (365 days/year)] = 8.47, or approximately 9 transactions per day. See supra note 290. The Commission understands that many of these transactions may arise from previously executed SBS transactions.

345 In other words, the Commission is estimating that 80% of the time the reporting party would not know and thus would not be able to report the necessary UICs of its

Proposed Rule 906(b) would require every participant to provide a registered SDR an initial parent/affiliate report, using ultimate parent IDs and participant IDs, and updating that information, as necessary. The Commission preliminarily estimates that the cost for each participant to submit an initial or update report would be $29.50.[346] The Commission preliminarily estimates that each participant would submit two reports each year.[347] In addition, the Commission preliminarily estimates that there may be 5,000 SBS participants and that each one may connect to two registered SDRs. Accordingly, the Commission preliminarily estimates that the initial and ongoing aggregate annualized cost associated with proposed Rule 906(b) would be $590,000, which corresponds to $118 per participant.[348]

The Commission, in proposed Regulation SBSR, is not requiring the development of internationally recognized standards for reference information (such participant IDs or ultimate parent IDs) that could be used across the financial service industry. Therefore, the Commission believes that the costs of developing and sustaining such a system should not be considered costs of proposed Regulation SBSR. However, proposed Regulation SBSR would require a registered SDR and its participants to use UICs generated by such a system, if such system were able to generate such UICs. Although the Commission believes there would be long-term benefits for using UICs generated by such a system, there could be short-term costs imposed on reporting

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counterparty. Therefore, a registered SDR would have to obtain the missing UICs through the process described in proposed Rule 906(a).

346 This figure is based on the following: [(Compliance Clerk (0.5 hours) at $59 per hour) x (1 report)] = $29.50.

347 During the first year, the Commission preliminarily believes each participant would submit its initial report and one update report. In subsequent years, the Commission preliminarily estimates that each participant would submit two update reports.

348 This figure is based on the following: [($29.50/report) x (2 reports/year/SDR connection) x (2 SDR connections/participant) x (5,000 participants)] = $590,000, which corresponds to $118 per participant.

parties to convert to such a system. In addition, under these internationally recognized standards, users of the reference information could have to pay reasonable fees to support the system. These fees also would represent costs of proposed Rule 901. The Commission requests comment on this issue and any potential costs associated with the potential future use of internationally recognized standards.

Proposed Rule 906(c) would require each participant that is a SBS dealer or major SBS participant to establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure compliance with any SBS transaction reporting obligations in a manner consistent with proposed Regulation SBSR and the registered SDR's applicable policies and procedures. Proposed Rule 906(c) would also require the review and updating of such policies and procedures at least annually. The Commission preliminarily estimates that developing and implementing written policies and procedures as required under the proposed rule could result in a one-time initial cost to each covered participant of approximately $52,440.[349] Drawing on the Commission's experience with other rules that require entities to establish and maintain policies and procedures,[350] this figure includes the estimated cost to develop a set of written policies and procedures, program systems, implement internal controls and oversight, train relevant employees, and perform necessary testing. In addition, the Commission preliminarily estimates that the annualized cost to maintain such policies and procedures, including a full review at least annually, as required under the proposed rule, would be approximately $29,736 for each covered

349 The Commission derived its estimate from the following: [(Sr. Programmer (40 hours) at $285 per hour) + (Compliance Manager (40 hours) at $294 per hour) + (Compliance Attorney (40 hours) at $291 per hour) + (Compliance Clerk (40 hours) at $59 per hour) + (Sr. Systems Analyst (32 hours) at $251 per hour) + (Director of Compliance (24 hours) at $426 per hour)] = $52,440 per covered participant.

350 See supra note 256.

participant.[351] This figure is based on an estimate of the cost to review existing policies and procedures, make any necessary updates, conduct ongoing training, maintain relevant systems and internal controls systems, and perform necessary testing.

Accordingly, the Commission preliminarily estimates that the initial aggregate annualized cost associated with proposed Rule 906(c) would be approximately $82,176,000, which corresponds to $82,176 per covered participant.[352] The Commission preliminarily estimates that the ongoing aggregate annualized cost associated with proposed Rule 906(c) would be approximately $29,736,000, which corresponds to $29,736 per covered participant.[353]

In total, the Commission preliminarily believes that proposed Rule 906 would result in an initial, aggregate annualized cost of $159,094,260,[354] and an ongoing, aggregate annualized cost of $106,350,860 for all covered entities.[355]

3. Request for Comment

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351 The Commission derived its estimate from the following: [(Sr. Programmer (8 hours) at $285 per hour) + (Compliance Manager (24 hours) at $294 per hour) + (Compliance Attorney (24 hours) at $291 per hour) + (Compliance Clerk (24 hours) at $59 per hour) + (Sr. Systems Analyst (16 hours) at $251 per hour) + (Director of Compliance (24 hours) at $426 per hour)] = $29,736 per participant.

352 The Commission derived its estimate from the following: [($52,440 + $29,736) x (1,000 covered participants)] = $82,176,000.

353 The Commission derived its estimate from the following: [($29,736) x (1,000 covered participants)] = $29,736,000.

354 This figure is based on the following: [($600,760 for registered SDRs under proposed Rule 906(a)) + ($75,372,500 for non-reporting-party participants under proposed Rule 906(a)) + ($945,000 for participants under proposed Rule 906(b)) + ($82,176,000 for covered participants under proposed Rule 906(c))] = $159,094,260.

355 This figure is based on the following: [($297,360 for registered SDRs under proposed Rule 906(a)) + ($75,372,500 for non-reporting-party participants under proposed Rule 906(a)) + ($945,000 for participants under proposed Rule 906(b)) + ($29,736,000 for covered participants under proposed Rule 906(c))] = $106,350,860.

The Commission requests comment on the costs and benefits of proposed Rule 906 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

278. How can the Commission more accurately estimate the costs and benefits?

279. Would proposed Rule 906 create any additional costs or benefits not discussed here?

280. What would be the costs and benefits of having reference identifiers established under the auspices of an IRSB – for participants? For registered SDRs? What fees might be charged to support such a system? How much would those fees be? Who would have to pay them?

281. What would be the costs to verify ultimate parent and affiliate information under the auspices of an IRSB and maintain it over time? What would be the benefits of having such information verified and maintained?

282. To what extent do participants already have policies and procedures in place for reporting information to an SDR? To what extent would proposed Rule 906(c) impose costs on covered participants that they have not already incurred?

H. Policies and Procedures of Registered SDRs – Rule 907 of Regulation SBSR

Proposed Rule 907 would require a registered SDR to establish and maintain compliance with written policies and procedures: (1) that enumerate the specific data elements of a SBS or a life cycle event that a reporting party would report; (2) that specify data formats, connectivity requirements, and other protocols for submitting information; (3) for specifying how reporting parties are to report corrections to previously submitted information, making corrections to information in its records that is subsequently discovered to be erroneous, and applying an appropriate indicator to any transaction report required to be disseminated by proposed Rule 905(b)(2), which would denote that the report relates to a previously disseminated transaction; (4) describing how reporting parties shall report and, consistent with the enhancement of price discovery, how the registered SDR shall publicly disseminate, reports of, and adjustments due to, life cycle events; SBS transactions that do not involve an opportunity to negotiate any material terms, other than the counterparty; and any other SBS transactions that, in the estimation of the registered SDR, do not accurately reflect the market; (5) for assigning transaction IDs and UICs related to its participants; and (6) for periodically obtaining from each participant information that identifies the participant's ultimate parent(s) and any other participant(s) with which the counterparty is affiliated, using applicable UICs.

In addition, proposed Rule 907(b) would require a registered SDR to establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all SBS instruments reported to the registered SDR in accordance with the criteria and formula for determining block size as specified by the Commission.

Under proposed Rules 907(c) and (d), a registered SDR would be required to make its policies and procedures publicly available on its website, and review, and update as necessary, its policies and procedures at least annually, indicating the date on which they were last reviewed. Finally, proposed Rule 907(e) would require a registered SDR to have the capacity to provide to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to proposed Regulation SBSR and the registered SDR's policies and procedures thereunder.

1. Benefits

In proposed Regulation SBSR, the Commission is establishing a number of broad policy goals for implementing Title VII of the Dodd-Frank Act. Proposed Rule 907 would permit a registered SDR some flexibility regarding how to meet those goals. In many cases, there could be many ways that that these goals could be carried out effectively, and it may not be necessary or appropriate in all cases to establish one particular way by rule. By requiring a registered SDR, in proposed Rule 907, to develop policies and procedures for completing many of the details of a SBS transaction reporting and dissemination system, the Commission seeks to harness the knowledge and experience of registered SDRs and harness market incentives to develop the policies and procedures that are most effective in meeting the policy goals in an efficient manner. The Commission expects that, over time, registered SDRs, participants, and the Commission could identify best practices for the reporting and dissemination of SBS transactions.

Proposed Rules 907(a)(1) and (2) would require a registered SDR to develop and maintain policies and procedures to specify the data elements of a SBS or a life cycle event that a reporting party must report, as well as the data formats, connectivity requirements, and other protocols for submitting information. The Commission preliminarily believes that assigning this responsibility to a registered SDR would provide a level of flexibility and transparency that is necessary in this developing market. Furthermore, this approach would allow registered SDRs (perhaps, but not necessarily, after consultation with their participants) to quickly identify and address potential weaknesses in the SBS transaction reporting process as set out under proposed Regulation SBSR.

Proposed Rule 907(a)(3) would require a registered SDR to establish and maintain compliance with policies and procedures for specifying how reporting parties are to report corrections to previously submitted information, making corrections to information in its records that is subsequently discovered to be erroneous, and applying an appropriate indicator to any transaction report required to be disseminated by proposed Rule 905(b)(2), which would denote that the report relates to a previously disseminated transaction. The Commission preliminarily believes that a registered SDR is in the best position to determine how these corrections are submitted, and believes that a consistent regime for the submission of correction by participants would benefit all market participants.

Proposed Rule 907(a)(4) would require a registered SDR to develop and maintain policies and procedures that describe how reporting parties would report and, consistent with the enhancement of price discovery, how the registered SDR would publicly disseminate reports of, and adjustments to, life cycle events; SBS transactions that do not involve an opportunity to negotiate any material terms, other than the counterparty; and any other SBS transactions that, in the estimation of the registered SDR, do not accurately reflect the market. The Commission believes that the entire SBS market could benefit if a registered SDR, using its knowledge of the market, would develop consistent and transparent standards when certain SBS might have characteristics that reduce or eliminate entirely their price discovery value. For example, while an inter-affiliate SBS transaction would be required to be reported (so that the registered SDR obtains information about the legal owner), it could be disseminated with indication that the transaction was not at arm's length.

Proposed Rule 907(a)(5) would require a registered SDR to establish and maintain compliance with policies and procedures for assigning a transaction ID to each SBS that is reported to it, and for assigning UICs, including participant IDs, ultimate parent IDs, desk IDs, broker IDs, and trader IDs. As noted above, all such UICs would have to be assigned by or on behalf of an IRSB (or, if no standards-setting body meet the required criteria or the IRSB has not assigned a UIC to a particular person or unit thereof, by the registered SDR). Proposed Rule 906 could result in significant benefits by encouraging the creation and widespread use of internationally recognized standards for reference information. The Commission preliminarily believes that reporting of information using UICs would promote effective oversight, enforcement, and surveillance of the SBS market by the Commission and other regulators. For example, activity could be tracked by a particular participant, a particular desk, or a particular trader. Regulators could observe patterns and connections in trading activity, or examine whether a trader had engaged in questionable trading activity across different SBS instruments. UICs also could facilitate aggregation and monitoring of the positions of SBS counterparties, which could be of significant benefit for prudential and systemic risk management.

The Commission understands that some efforts have been undertaken – in both the private and public sectors, both domestically and internationally – to establish a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally. Such a system would be of significant benefit to regulators worldwide, as each market participant could readily be identified using a single reference code regardless of the jurisdiction or product market in which the market participant was engaging. Such a system also could be of significant benefit to the private sector, as market participants would have a common identification system for all counterparties and reference entities, and would no longer have to use multiple identification systems. The enactment of the Dodd-Frank Act and the establishment of a comprehensive system for reporting and dissemination of SBSs – and for reporting and dissemination of swaps, under the jurisdiction of the CFTC – offer a unique opportunity to facilitate the establishment of a comprehensive and widely accepted system for identifying entities that participate not just in the SBS market, but in the financial markets generally.

Furthermore, requiring a registered SDR to establish and maintain compliance with written policies and procedures could result in more accurate reporting by reporting parties, and thus more reliable dissemination of SBS transaction data. Higher quality reporting and dissemination of SBS transaction data should generate greater confidence among registered SDRs, market participants, and regulators, thus strengthening the SBS market the market as a whole.

The Commission preliminarily believes that requiring a registered SDR to calculate and publish block trade thresholds pursuant to proposed Rule 907(b) should help market participants, the Commission, and other regulators monitor block trade thresholds and track changes in the market for particular SBS instruments over time. The Commission preliminarily believes that a registered SDR is best placed to deliver these benefits, because an SDR has access to the necessary data and the ability to calculate and publicize the block trade thresholds efficiently.

The Commission preliminarily believes that requiring a registered SDR to make publicly available on its website the policies and procedures required by proposed Regulation SBSR, pursuant to proposed Rule 907(c), would promote greater understanding of and compliance with such policies and procedures. Periodic review of the policies and procedures would also ensure that they are up-to-date.

Finally, proposed Rule 907(e) would require a registered SDR to have the capacity to provide to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to proposed Regulation SBSR and the registered SDR's policies and procedures thereunder. There could be benefits in obtaining information from each registered SDR related to the timeliness, accuracy, and completeness of data reported to the registered SDR. Required data submissions that are untimely, inaccurate, or incomplete could compromise the regulatory data that the Commission would utilize to carry out its oversight responsibilities. Furthermore, required data submissions that are untimely, inaccurate, or incomplete could diminish the value of publicly disseminated reports that promote transparency and price discovery. Information or reports provided to the Commission by a registered SDR related to the timeliness, accuracy, and completeness of data could assist the Commission in examining for compliance with proposed Regulation SBS and in bringing enforcement or other administrative actions as necessary and appropriate.

2. Costs

The Commission preliminarily estimates that ten registered SDRs would be subject to proposed Rule 907, and that developing and implementing written policies and procedures as required under proposed Rule 907 could result in an initial, one-time cost to each registered SDR of approximately \$3,831,000.[356] This figure includes the estimated cost to develop a set of written policies and procedures, program systems, implement internal controls and oversight, train relevant employees, perform necessary testing, monitor participants, and compile data.[357]

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356 The Commission derived its estimate from the following: [(Sr. Programmer (1,667 hours) at \$285 per hour) + (Compliance Manager (3,333 hours) at \$294 per hour) + (Compliance Attorney (5,000 hours) at \$291 per hour) + (Compliance Clerk (2500 hours) at \$59 per hour) + (Sr. Systems Analyst (1,667 hours) at \$251 per hour) + (Director of Compliance (833 hours) at \$426 per hour)] = \$3,830,722 per SDR. The Commission preliminarily believes that potential SDRs that have similar policies and procedures in place may find that these costs would be lower, while potential SDRs that do not have similar policies and procedures in place may find that the potential costs would be higher.

357 This figure includes time necessary to design and program systems and implement policies and procedures to calculate and publish block trade thresholds for all SBS instruments reported to the registered SDR as required by proposed Rule 907(b). It also includes time necessary to design and program systems and implement policies and procedures to determine which reported trades would not be considered block trades

In addition, the Commission preliminarily estimates that the annualized cost to maintain such policies and procedures, including a full review at least annually; making its policies and procedures publicly available on its website; and developing the capacity to provide the Commission information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to proposed Regulation SBSR and the registered SDR's policies and procedures would be approximately $7,662,000 for each registered SDR.[358] This figure is based on an estimate of the cost to review existing policies and procedures, make necessary updates, conduct ongoing training, maintain relevant systems and internal controls systems, calculate and publish block trade thresholds, perform necessary testing, monitor participants, and collect data. Accordingly, the Commission preliminarily estimates that the initial annualized cost associated with proposed Rule 907 would be approximately $11,492,500 per registered SDR, which corresponds to an initial annualized aggregate cost of approximately $114,924,500.[359] The Commission preliminarily estimates that the ongoing annualized cost associated with proposed Rule 907 would be approximately $7,662,000 per registered SDR, which corresponds to an

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pursuant to proposed Rule 907(b). This figure also includes time necessary to design and program systems and implement policies and procedures to assign certain IDs, as required by proposed Rule 907(a)(5).

358 The Commission derived its estimate from the following: [Sr. Programmer (3,333 hours) at $285 per hour) + (Compliance Manager (6,667 hours) at $294 per hour) + (Compliance Attorney (10,000 hours) at $291 per hour) + (Compliance Clerk (5,000 hours) at $59 per hour) + (Sr. Systems Analyst (3,333 hours) at $251 per hour) + (Director of Compliance (1,667 hours) at $426 per hour)] = $7,661,728 per registered SDR. The Commission preliminarily believes that potential SDRs that have similar policies and procedures in place may find that these costs would be lower, while potential SDRs that do not have similar policies and procedures in place may find that the potential costs would be higher.

359 The Commission derived its estimate from the following: [((3,830,722) + ($7,661,728)) x (10 registered SDRs)] = $114,924,500.

ongoing annualized aggregate cost of approximately $76,617,000.[360] These figures are based, in part, on the Commission's experience with other rules that require entities to establish and maintain compliance with policies and procedures.[361]

In addition, proposed Rule 907(a)(5) could impose certain costs on registered SDRs in connection with the use of internationally recognized standards for reference information. The Commission, in proposed Regulation SBSR, is not requiring the development of such standards that could be used across the financial service industry. Therefore, the Commission believes that the costs of developing and sustaining such a system should not be considered costs of proposed Regulation SBSR. However, proposed Regulation SBSR would require a registered SDR to use UICs generated by such a system, if such system is able to generate such UICs. Although the Commission believes there would be long-term benefits for using UICs generated by such a system, there could be short-term costs imposed on registered SDRs to convert to such a system. In addition, under these internationally recognized standards, users of the reference information could have to pay reasonable fees to support the system. These fees also would represent costs of proposed Rule 901. The Commission requests comment on this issue and any potential costs associated with the potential future use of internationally recognized standards.

There could be a potential cost of proposed Rule 907 in that registered SDRs would retain flexibility to shape the details of a SBS trade reporting and dissemination system. It could be that such flexibility could result in varying approaches by each registered SDR and, thus, complicate the reporting of SBS transactions, impede the use of SBS transaction information that is publicly disseminated, or make market oversight more difficult. These potential costs could be

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360 The Commission derived its estimate from the following: [($7,661,728) x (10 registered SDRs)] = $76,617,280.

361 See supra note 256.

avoided were the Commission to implement more of the details through rulemaking. The Commission requests comment on the costs, if any, associated with providing a registered SDR a certain amount of flexibility, and how those costs should be balance with the potential benefits as discussed above of providing the registered SDRS with flexibility.

Finally, with respect to proposed Rule 907(e), the Commission preliminarily believes that, as part of its core functions, a registered SDR would have the capacity to provide to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to proposed Regulation SBSR and the registered SDR's policies and procedures. Proposed Rule 13n-5(b) would require a registered SDR to establish, maintain, and enforce written policies and procedures to satisfy itself by reasonable means that the transaction data that has been submitted to the security-based swap data repository is accurate, and also to ensure that the transaction data and positions that it maintains are accurate.[362] The Commission preliminarily believes that these capabilities would enable a registered SDR to provide the Commission information or reports as may be requested pursuant to proposed Rule 907(e). Thus, the Commission does not believe that proposed Rule 907(e) would impose any additional costs on a registered SDR.

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 907 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

283. How can the Commission more accurately estimate the costs and benefits?

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[362] See SDR Registration Proposing Release, supra note 6, proposed Rules 13n-5(b)(1)(iii) and 13n-5(b)(3) under the Exchange Act.

284. Would proposed Rule 907 create any additional costs or benefits not discussed here?

285. Is it a potential cost that the policies and procedures sufficiently detailed such that participants would be able to know what is required of them?

286. What are the costs and benefits of allowing a registered SDR some flexibility to determine whether certain SBSs may not have price discovery value and to use certain indicators to that effect in the publicly disseminated transaction reports?

287. What costs would be imposed on a registered SDR to use UICs that had been established by or on behalf of an IRSB? Would the registered SDR have to pay fees to support the system? To whom? How much would the fees be? What would be the costs of transitioning to such a system? How would these overall costs compare to the costs that would be incurred by a registered SDR to assign UICs using its own methodology?

288. What are the costs of allowing registered SDRs flexibility to shape many of the details of a SBS trade reporting and dissemination system? What are the benefits?

I. Jurisdictional Matters - Rule 908 of Regulation SBSR

1. Benefits

The Commission believes that, in proposing Rule 908, the Commission has no discretion about which entities or SBSs are subject to the Exchange Act, as amended by the Dodd-Frank Act. A federal agency does not have the power to expand or circumscribe the reach of U.S. law. Therefore, because the Commission has no discretion in the matter, there are no benefits to proposed Rule 908 other than those inherent in the Exchange Act, as amended by the Dodd-Frank Act.

2. Costs

Similarly, because the Commission has no discretion in the matter, there are no costs to proposed Rule 908 other than those inherent in the Exchange Act, as amended by the Dodd-Frank Act.

J. Registration of Security-Based Swap Data Repository as Securities Information Processor – Rule 909 of Regulation SBSR

Proposed Rule 909 would require each registered SDR also to register with the Commission as a SIP on existing Form SIP.

1. Benefits

The Commission preliminarily believes that SIP registration of a registered SDR would help ensure fair access to important SBS transaction data reported to and publicly disseminated by the registered SDR. Requiring a registered SDR to register with the Commission as a SIP would subject it to Section 11A(b)(5) of the Exchange Act,[363] which provides that a registered SIP must notify the Commission whenever it prohibits or limits any person's access to its services. Upon its own motion or upon application by any aggrieved person, the Commission could review the SIP's action.[364] If the Commission finds that the person has been discriminated against unfairly, it could require the SIP to provide access to that person.[365] Section 11A(b)(6) of the Exchange Act[366] also provides the Commission authority to take certain regulatory action as may be necessary or appropriate against a registered SIP.[367] The Commission preliminarily

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363 15 U.S.C. 78k-1(b)(5).

364 See 15 U.S.C. 78k-1(b)(5)(A).

365 See 15 U.S.C. 78k-1(b)(5)(B).

366 15 U.S.C. 78k-1(b)(6).

367 Section 11A(b)(6) of the Exchange Act provides that the Commission, by order, may censure or place limitations upon the activities, functions, or operations of any registered SIP or suspend for a period not exceeding 12 months or revoke the registration of any such processor, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the

believes that potential consumers of SBS market data would benefit from the Commission having the additional authority over a registered SDR/SIP provided by Sections 11A(b)(5) and 11A(b)(6) of the Exchange Act to help ensure that these entities offer their SBS market data on terms that are fair and reasonable and not unreasonably discriminatory.

2. Costs

The Commission preliminarily believes that the costs of proposed Rule 909 would be minimal. As noted above, proposed Rule 909 would impose an initial one-time cost on each registered SDR associated with the submission of Form SIP.[368] The Commission notes that Form SDR, which all SDRs would be required to complete and submit to the Commission pursuant to proposed Rule 13n-1 under the Exchange Act,[369] and Form SIP are similar in many respects. Thus, the Commission preliminarily believes that a registered SDR, which must complete Form SDR, would be able to complete Form SIP more easily and with less cost than otherwise would be the case. The Commission preliminarily estimates that the one-time cost to each SDR to complete Form SIP would be about one-quarter the cost of completing proposed Form SDR, or approximately $14,600.[370] In addition, the Commission preliminarily estimates that each SDR would incur approximately one half of the ongoing annual costs – corresponding to an average of six months of operations – during the first year. The Commission preliminarily

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public interest, necessary or appropriate for the protection of investors, or to assure the prompt, accurate, or reliable performance of the functions of such SIP, and that such SIP has violated or is unable to comply with any provision of this title or the rules or regulations thereunder.

368 See supra Section XII.J.

369 See SDR Registration Proposing Release, supra note 6.

370 The Commission derived its estimate from the following: [(Compliance Attorney (37.5 hours) at $291 per hour) + (Compliance Clerk (62.5 hours) at $59 per hour)] = $14,600. See Section XII(J) supra; SDR Registration Proposing Release, supra note 6.

estimates this cost would be approximately $730 per SDR/SIP.[371]

With regard to ongoing costs, the Commission preliminarily estimates that the aggregate annualized cost for providing amendments to Form SIP would be one-tenth of the cost to complete the initial Form SIP, or approximately $1,460 per SDR/SIP.[372] This figure is based on a preliminary estimate that each registered SDR would submit one amendment on Form SIP each year. SIP registration also would require a registered SDR to provide notice to the Commission of prohibitions or limitations on access to its services. The Commission preliminarily believes that the notice would be a simple form, and that prohibitions or limitations on access to information provided by a registered SDR would be not be prevalent. Thus, the Commission does not believe that providing such notice would result in economically significant costs.

Accordingly, the Commission preliminarily estimates that the initial aggregate annualized costs associated with proposed Rule 909 would be approximately $153,300, which corresponds to $15,330 per registered SDR.[373] The Commission further preliminary estimates that the ongoing aggregate annualized costs associated with proposed Rule 909 would be approximately $14,600, or an ongoing annual cost of approximately $1,460 for each registered SDR/SIP.[374] The Commission solicits comments as to the accuracy of these estimates.

3. Request for Comment

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371 The Commission derived its estimate from the following: [($1,460/2)] = $730. See infra note 372.

372 The Commission derived its estimate from the following: [($14,600) x (0.1)] = $1,460. See supra note 370.

373 The Commission derived its estimate from the following: [(($14,600) + ($730)) x (10 registered SDRs)] = $153,300. See supra notes 370 and 371.

374 The Commission derived its estimate from the following: [($1,460) x (10 registered SDRs)] = $14,600. See supra notes 372.

The Commission requests comment on the costs and benefits of proposed Rule 909 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

289. How can the Commission more accurately estimate the costs and benefits?

290. Would proposed Rule 909 create any additional costs or benefits not discussed here?

291. Are the Commission's preliminary estimates reasonable?

292. Is SIP registration likely to impose costs not addressed? If so, what are they?

K. Implementation of Security-Based Swap Reporting and Dissemination – Rule 910 of Regulation SBSR

1. Benefits

Proposed Rule 910 addresses implementation of the obligations imposed by proposed Regulation SBSR. Proposed Rule 910(a) would require a reporting party to report to a registered SDR any pre-enactment SBSs subject to reporting under proposed Rule 901(i) no later than January 12, 2012 (180 days after the effective date of the Dodd-Frank Act). The proposed timeframe would help ensure that the Commission has relevant information about SBS transactions necessary to prepare reports required by the Dodd-Frank Act.[375] Further, proposed Rule 910 would help ensure timely implementation of Regulation SBSR, and thereby facilitate achievement of the goals articulated in the Dodd-Frank Act.

Proposed Rule 910(b) would establish a phase-in period for each SDR that registers with the Commission, as well as its participants. The phase-in period would give both the registered SDR and its participants a reasonable period in which to acquire or configure the necessary

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[375] See Section 719 of the Dodd-Frank Act.

systems, engage and train the necessary staff, and develop and implement the necessary policies and procedures to implement the proposed rules. In the absence of the measured and incremental approach specified in proposed Rule 910(b), market participants might not evaluate and develop their systems, processes, and procedures with sufficient care and analysis. Furthermore, without the phase-in period afforded by proposed Rule 910(b), registered SDRs and their participants could be forced to devote an undue amount of capital and resources to becoming compliant with proposed Regulation SBSR, thus diverting capital and resources from other productive endeavors.

2. Costs

The Commission preliminarily believes that proposed Rule 910(a) would not require reporting parties to materially change their current practices or operations with respect to recordkeeping for the pre-enactment SBSs or transitional SBSs. Any reporting party, as part of its regular business operations, would already maintain records covering most if not all of the data elements associated with a SBS. Furthermore, proposed Rule 910(a) would not require reporting parties to report any data elements (such as the time of execution) that were not already available. Therefore, proposed Rule 910(a) would not require reporting parties to search for or reconstruct any missing data elements.

To comply with the reporting obligations of proposed Rule 910(a), reporting parties likely would incur many of the costs that they otherwise would incur in order to comply with proposed Rule 901.[376] Because of the substantial overlap between the costs necessitated by proposed Rule 910 and proposed Rule 901 (for reporting parties) and proposed Rule 902, the

[376] See supra Section XIV.B.2.

Commission preliminarily estimates that that the initial annualized, cost for each reporting party associated with proposed Rule 910 would be de minimis.

The Commission preliminarily estimates two types of costs associated with proposed Rule 910(b): one stemming from the possibility that the phase-in period is too long and the other stemming from the possibility that the phase-in period is too short. If the phase-in period were too long, the benefits from better recordkeeping and regulatory information, as well as from post-trade transparency in the SBS market, would be inappropriately delayed. However, if the phase-in period were too short, market participants might not have enough time to develop appropriate systems and procedures to effectively implement proposed Regulation SBSR. In proposing Rule 910(b), the Commission seeks an appropriate balance between these two considerations.

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 910 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

293. How can the Commission more accurately estimate the costs and benefits?

294. Would proposed Rule 910 create any additional costs or benefits not discussed here?

295. How many entities would be affected by the rule?

296. Are there additional costs involved in complying with the proposed rule that have not been identified? What are the types, and amounts, of the costs?

297. Are there additional benefits from the rule that have not been identified? If so, please identify and quantify to the extent feasible.

L. Prohibition During Phase-In Period – Rule 911 of Regulation SBSR

Proposed Rule 911 would provide that a reporting party to a SBS would not report a SBS to a registered SDR in a phase-in period described in proposed Rule 910 during which the registered SDR is not yet required to publicly disseminate transaction reports for that SBS instrument unless: (1) The SBS is also reported to an registered SDR that is disseminating transaction reports for that SBS instrument consistent with proposed Rule 902; or (b) No other registered SDR is able to receive, hold, and publicly disseminate transaction reports regarding that SBS instrument.

1. Benefits

The Commission preliminarily believes that proposed Rule 911 would have two clear benefits to the marketplace. First, it is meant to preserve the goal of post-trade transparency for SBSs, as codified in the Dodd-Frank Act, even as new SDRs are phased in, as specified in proposed Rule 910, during which time they may have no obligation or only a limited obligation to publicly disseminate SBS data. Second, the proposed rule would prevent reporting parties from engaging in regulatory arbitrage by avoiding reporting SBS data to an existing registered SDR that is publicly disseminating SBS transaction reports and instead reporting only to a new SDR subject to a phase-in period, in an effort to avoid having their SBS transactions publicly disseminated in real time. Proposed Rule 911 would prohibit such conduct.

2. Costs

The Commission believes that the costs imposed by proposed Rule 911 on reporting parties and registered SDRs would be minimal, as the rule would restrict the ability of a reporting party to report a SBS to one registered SDR rather than another, but would not otherwise create any quantifiable costs beyond those already required by proposed Rule 901. To the extent there are costs, they may include the following. First, proposed Rule 911 potentially could dampen competition among those entities considering registering as SDRs. Potential SDR registrants could perceive the proposed rule as a barrier to entry to the marketplace insofar as their business may be limited during the phase-in period. Second, as a result of proposed Rule 911, there may be some costs associated with double-reporting of SBS information – both to an existing SDR as well as to a new SDR in a phase-in period. Indeed, proposed Rule 911 contemplates the potential of such double-reporting. This could result require regulators to incur costs to accurately identify double-counted transactions, where the same SBS transaction is captured by two different registered SDRs.

3. Request for Comment

The Commission requests comment on the costs and benefits of proposed Rule 911 discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

298. How can the Commission more accurately estimate the costs and benefits?

299. Would proposed Rule 911 create any additional costs or benefits not discussed here?

M. Amendments to Rule 31

Rule 31 under the Exchange Act[377] sets forth a procedure for the calculation and collection of fees payable under Section 31 of the Exchange Act.[378] The Dodd-Frank Act classifies SBSs as securities,[379] thereby subjecting them to Section 31 fees. The proposed

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377 17 CFR 240.31.

378 15 U.S.C. 78ee.

379 See 15 U.S.C. 78c(a)(10).

amendment to Rule 31 would add "security-based swaps" to the list of "exempt sales," and thereby exempt SBSs from Section 31 fees.[380]

The Commission preliminarily believes that the proposed amendments to Rule 31 would have a neutral effect on existing costs and benefits. It would not impose any additional costs or impact the transaction fees currently paid on other securities transactions. Likewise, because market participants have never monitored or collected fees on SBS transactions, there would be no benefit to exempting these transactions from Section 31 fees other than that affected entities would not have to take any steps to pay fees on SBS transactions.

However, eliminating Section 31 fee for SBS transactions theoretically could result in slightly higher fees on transactions in other securities that would not benefit from a Section 31 exemption. Section 31 requires the Commission to adjust Section 31 fees so that such rates are reasonably likely to produce aggregate fee collections that equal amounts prescribed under Section 31.[381] Thus, although the Commission may exempt certain securities from Section 31, it cannot reduce the total amount of fees that it is required to collect under Section 31. An exemption granted to certain securities could, therefore, result in a higher rate paid on transactions in the other, non-exempted securities.

The Commission requests comment on the costs and benefits of the proposed amendments to Rule 31, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits.

N. Aggregate Total Costs

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380 The Commission is also proposing to make a technical correction to Rule 31(a)(10)(ii), to correct a date (from "September 30" to "September 25"), as required by the Dodd-Frank Act. The Commission does not believe there are any material costs or benefits to this change.

381 See 15 U.S.C. 78ee(j).

Based on the foregoing, the Commission preliminarily estimates that proposed Regulation SBSR would impose an aggregate total first-year cost of approximately $1,038,947,500 on all covered entities.[382] This amount includes an estimated total first-year cost of approximately $852,850,500 on participants (reporting parties and non-reporting parties), and approximately $186,097,000 on registered SDRs. The Commission preliminarily estimates that proposed Regulation SBSR would impose a total ongoing annualized aggregate cost of approximately $703,147,540 for all covered entities.[383] This amount includes an estimated total ongoing annualized cost of approximately $598,021,500 on participants (reporting parties and non-reporting parties), and approximately $105,126,040 on registered SDRs.

With regard to registered SDRs, the Commission preliminarily estimates that proposed Regulation SBSR would impose an initial aggregate one-time cost of approximately

382 The Commission derived its estimate from the following: [($511,013,000 proposed Rule 901 first-year costs on reporting parties) + ($778,480 proposed Rule 901 first-year costs on registered SDRs) + ($64,006,400 proposed Rule 902 first-year costs on registered SDRs) + ($27,360 proposed Rule 904 first-year costs on registered SDRs) + ($11,419,000 proposed Rule 905 first-year costs on reporting parties) + ($5,603,700 proposed Rule 905 first-year costs on registered SDRs) + ($172,280,000 proposed Rule 905 first-year costs on non-reporting parties) + ($82,176,000 proposed Rule 906 first-year costs on reporting parties) + ($600,760 proposed Rule 906 first-year costs on registered SDRs) + ($75,962,500 proposed Rule 906 first-year costs on all SDR participants) + ($114,927,000 proposed Rule 907 first-year costs on registered SDRs) + ($153,300 proposed Rule 909 first-year costs on registered SDRs)] = $1,038,947,500.

383 The Commission derived its estimate from the following: [($316,116,000 proposed Rule 901 ongoing annual costs on reporting parties) + ($436,440 proposed Rule 901 ongoing annual costs on registered SDRs) + ($24,002,400 proposed Rule 902 ongoing annual costs on registered SDRs) + ($27,360 proposed Rule 904 ongoing annual costs on registered SDRs) + ($3,927,000 proposed Rule 905 ongoing annual costs on reporting parties) + ($3,735,800 proposed Rule 905 ongoing annual costs on registered SDRs) + ($172,280,000 proposed Rule 905 ongoing annual costs on non-reporting parties) + ($29,736,000 proposed Rule 906 ongoing annual costs on reporting parties) + ($292,440 proposed Rule 906 ongoing annual costs on registered SDRs) + ($75,962,500 proposed Rule 906 ongoing annual costs on all SDR participants) + ($76,617,000 proposed Rule 907 ongoing annual costs on registered SDRs) + ($14,600 proposed Rule 909 ongoing annual costs on registered SDRs)] = $703,147,540.

$80,978,260,[384] and an ongoing aggregate annual cost of $105,126,400.[385] The Commission further preliminarily estimates that the proposed SDR registration rules would impose an initial aggregate one-time cost of approximately $214,913,592,[386] and an ongoing aggregate annual cost of approximately $140,302,120 on registered SDRs.[387] Summing these estimates, proposed Regulation SBSR and the proposed SDR registration rules would impose initial costs on registered SDRs of approximately $295,891,852,[388] and ongoing annualized costs on registered SDRs of approximately $245,428,520.[389]

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

Section 3(f) of the Exchange Act[390] 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,

384 The Commission derived its estimate from the following: [($342,040 proposed Rule 901 one-time costs on registered SDRs) + ($40,004,000 proposed Rule 902 one-time costs on registered SDRs) + ($1,867,900 proposed Rule 905 one-time costs on registered SDRs) + ($308,320 proposed Rule 906 one-time costs on registered SDRs) + ($38,310,000 proposed Rule 907 one-time costs on registered SDRs) + ($146,000 proposed Rule 909 one-time costs on registered SDRs)] = $80,978,260.

385 The Commission derived its estimate from the following: [($436,440 proposed Rule 901 ongoing annual costs on registered SDRs) + ($24,002,400 proposed Rule 902 ongoing annual costs on registered SDRs) + ($27,360 proposed Rule 904 ongoing annual costs on registered SDRs) + ($3,735,800 proposed Rule 905 ongoing annual costs on registered SDRs) + ($292,440 proposed Rule 906 ongoing annual costs on registered SDRs) + ($76,617,000 proposed Rule 907 ongoing annual costs on registered SDRs) + ($14,600 proposed Rule 909 ongoing annual costs on registered SDRs)] = $105,126,400.

386 See SDR Registration Proposing Release, supra note 6.

387 See id.

388 The Commission derived its estimate from the following: [($80,978,260) + ($214,913,592)] = $295,891,852.

389 The Commission derived its estimate from the following: [($105,126,400) + ($140,302,120)] = $245,428,520.

390 15 U.S.C. 78c(f).

competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act[391] 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 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. Analysis of Proposed Regulation SBSR

The Commission preliminarily believes that public availability of transaction and pricing data for SBSs, as required by the Dodd-Frank Act and implemented by proposed Regulation SBSR, would promote efficiency, competition, and capital formation by reducing information asymmetries, lowering transaction costs, and encouraging market participation from a larger number of firms. Public, real-time dissemination of last-sale information aids dealers in deriving appropriate quotations, and aids investors in evaluating current quotations – thus furthering efficient price discovery. Increased transparency ultimately should provide the opportunity for increased competition among market participants and thus contribute to a more efficient market. The Commission believes that knowledge that all market participants are subject to the same reporting rules and can see the same price information creates certainty, fosters investor confidence, and promotes participation in the markets.

The Commission's experience with other asset classes is that post-trade transparency reduces transaction costs. For example, a number of studies have found that post-trade transparency in the corporate bond market, resulting from the introduction of TRACE, has reduced transaction costs.[392] Post-trade transparency could have the same effect in the SBS market, although the Commission acknowledges that the differences between the SBS market

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[391] 15 U.S.C. 78w(a)(2).

[392] See supra note 88.

and other securities markets might be sufficiently great that post-trade transparency might not have the same effects in the SBS market. The Commission requests comment on whether post-trade transparency would have a similar effect on the SBS market as it has in other securities markets – and if not, why not. To the extent that post-trade transparency in the SBS market would lower transaction costs, this would be evidence of greater competition and efficiency. Furthermore, money saved in transaction costs can assist in additional capital formation.

The proposed rules on block trades of SBSs are designed to minimize any adverse impact on efficiency, competition, and capital formation. Though temporarily withholding the full size of a block trade may have some immediate adverse effect on efficiency, as other market participants would lack complete real-time information about large transactions, the Commission's approach is designed to promote efficiency in the longer-term, by allowing SBS market participants to engage in large transactions without the risk of other market participants using this information in ways that promote artificial and adverse short-term price movements. Encouraging such market participants to continue to execute in large size is designed to promote efficiency, competition, and capital formation. The Commission requests comment on the effect of its proposed block trade rules on these considerations.

Proposed Regulation SBSR is designed to provide the Commission and other regulators with detailed, up-to-date information about both positions of particular entities and financial groups as well as positions by multiple market participants in particular instruments. A well-regulated SBS market – where the Commission and other regulators have access to information about all SBS transactions captured and retained in the registered SDRs – could increase the confidence in the soundness and fairness of the market, potentially drawing additional participants and thereby increasing efficiency. The Commission and other regulators also would have greater information with which to surveil the SBS market and bring appropriate enforcement actions. Together, these regulatory factors should have a positive impact on efficiency, competition, and capital formation.

The Commission preliminarily believes that post-trade transparency in the SBS market could improve market participants' ability to value SBSs. In transparent markets with sufficient liquidity, valuations generally can be derived from recent quotations and/or last-sale prices. However, in opaque markets or markets with low liquidity, recent quotations or last-sale prices may not exist or, if they do exist, may not be widely available. Therefore, market participants holding assets that trade in opaque markets or markets with low liquidity frequently rely instead on pricing models. These models might be based on assumptions subject to the evaluator's discretion, and can be imprecise. Thus, market participants holding the same asset but using different valuation models might arrive at significantly different values for the same asset.

The Commission preliminarily believes that post-trade transparency, even in relatively illiquid markets – such as corporate bonds or SBSs – could represent an improvement over relying on valuation models alone, particularly if post-trade information is used as an input to, rather than a substitute for, independent valuation and pricing decisions by other market participants. Market participants might devise means to consider last-sale reports of the asset to be valued, reports of related assets, or reports of benchmark products that include the asset to be valued or closely related assets. There is evidence to suggest that post-trade transparency helps reduce the range of valuations of assets that trade in illiquid markets.[393] The Commission preliminarily believes that post-trade transparency in the SBS market could result in more accurate valuations of SBSs generally, as all market participants would have the benefit of

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393 See supra note 314.

knowing how counterparties to a SBS valued the SBS at a specific moment in time. Especially with complex instruments, investment decisions generally are predicated on a significant amount of due diligence to value the instrument properly. A post-trade transparency system permits other market participants to derive at least some informational benefit from obtaining the views of the two counterparties who traded that instrument.

Better valuations could have a significant impact on efficiency and capital allocation. Efficient allocation of capital is premised on accurate knowledge of asset prices. Overvaluing asset prices could result in a misallocation of capital, as investors seek to obtain more of an asset that cannot deliver the anticipated risk-adjusted return. By the same token, assets that are inappropriately undervalued represent investment opportunities that might go unpursued, because investors do not realize that a good risk-adjusted return is available. To the extent that post-trade transparency enables asset valuations to move closer to their fundamental values, capital may be more efficiently allocated.

Better valuations resulting from post-trade transparency also could reduce prudential and systemic risks. Some financial institutions, including many of the most systemically important financial institutions, have large portfolios of SBSs. The financial system would benefit greatly if the assets of these institutions were more accurately valued. To the extent that post-trade transparency affirms the valuation of an institution's portfolio, regulators, the individual firm, and the market as a whole would have more certainty as to whether the firm would or would not pose prudential or systemic risks. In some cases, however, post-trade transparency in the SBS market might cause an individual firm to revalue its positions and lower the overall value of its portfolio. The sooner that accurate valuations can be made, the more quickly that regulators and the individual firm can take appropriate steps to minimize the firm's prudential risk profile, and the more quickly that regulators and other market participants can take appropriate steps to address any systemic risk concerns raised by that firm.

Finally, the Commission has considered how proposed Regulation SBSR could affect market participation generally, measured by both the number of market participants and the number of SBSs executed. The regulatory environment created by proposed Regulation SBSR would permit all market participants to see last-sale prices in real time, and could thereby incentivize more market participants to enter the market, trade more frequently, and compete with large dealers on price. Reducing information asymmetries is pro-competitive, because it reduces the competitive advantage that certain market participants have solely because they have access to more or better information about the market. Reducing information asymmetries also reduces the likelihood that a less-informed market participant would enter into a trade at an imprudent price. To the extent that fewer such trades occur, efficiency and capital formation could be improved. Moreover, proposed Regulation SBSR could result in greater confidence in the market generally, which could have a beneficial impact on efficiency, competition, and capital formation.

It is also possible that implementing post-trade transparency in the SBS market and the costs of complying with proposed Regulation SBSR could cause some market participants to execute fewer SBSs or to exit the market completely. This could result in a detrimental impact on efficiency, competition, and capital formation. For example, certain market participants that are currently active in the SBS market might find the costs of complying with proposed Regulation SBSR too high. If these market participants respond by reducing their trading activity or exiting the market completely, competition could suffer because there would be fewer participants competing in the market. Moreover, efficiency could suffer because risk that otherwise might have been allocated to the market participant optimally suited to manage it would, if that participant has left the market, necessarily have to reside at a suboptimal location. Moreover, capital formation could be negatively impacted if market participants with risks to hedge find it more difficult or costly to find a counterparty with which to transact and instead reserve more capital against the risk of loss.

On the other hand, the possibility exists that, in certain circumstances, efficiency, competition, and capital formation would be positively impacted even if fewer SBS transactions occur because of proposed Regulation SBSR. This could be the case if market participants that are unable or unwilling to properly manage the attendant risks of participation in the SBS market are deterred from participating, or if there were a reduction in the number of SBS transactions where there is a significant information asymmetry between the counterparties. In the latter case, efficiency, competition, and capital formation could benefit if uninformed parties are deterred from unwittingly taking on imprudent positions in the SBS market.

It is difficult at this stage to ascertain how proposed Regulation SBSR and other measures to implement the Dodd-Frank Act might increase or decrease participation in the SBS market, and what impacts such an increase or decrease might have on efficiency, competition, and capital formation. However, the Commission requests comment on those impacts.

B. Analysis of Amendments to Rule 31 Under the Exchange Act

The Commission preliminarily believes that the proposed amendments to Rule 31 under the Exchange Act would have no significant impact on efficiency, competition, and capital formation. Exempting SBSs from Section 31 fees should have little or no impact on the overall amount of fees collected by the Commission, as the Commission is required to adjust the fee rate to a level that is reasonably likely to produce the aggregate fee collections stipulated in Section

31(d).[394] Exempting SBSs from Section 31 fees would result in other classes of securities that remain subject to Section 31 fees continuing to bear the burden of meeting the aggregate fee collection. Allowing SBSs to become subject to Section 31 fees, however, could result in a competitive imbalance between brokers and SBS dealers. Specifically, the burden for funding Section 31 fees would fall on brokers, rather than SBS dealers. Exempting SBSs from Section 31 fees, therefore, would avoid this concern and any impact it might have on the development of the SBS market.

The Commission requests comment on all aspects of this analysis and, in particular, on whether proposed Regulation SBSR and the proposed amendments to Rule 31 under the Exchange Act would place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

XV. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA")[395] the Commission must advise the OMB 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 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.

394 See 15 U.S.C. 78ee(j).

395 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).

The Commission requests comment on the potential impact of proposed Regulation SBSR 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.

XVI. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")[396] requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) of the Administrative Procedure Act,[397] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."[398] Section 605(b) of the RFA[399] states that this requirement shall not apply to any proposed rule or proposed rule amendment which, if adopted, would not have a significant economic impact on a substantial number of small entities.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less;[400] or (2) a broker-dealer with total capital (net worth plus

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396 5 U.S.C. 601 et seq.

397 5 U.S.C. 603(a).

398 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 under the Exchange Act, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

399 5 U.S.C. 605(b).

400 See 17 CFR 240.0-10(a).

subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[401] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[402]

Based on input from SBS market participants and its own information, the Commission preliminarily believes that the majority of SBS transactions have at least one counterparty that is either a SBS dealer or major SBS participant, and that these entities – whether registered broker-dealers or not – would exceed the thresholds defining "small entities" set out above. Accordingly, neither of these types of entities would likely qualify as small entities for purposes of the RFA. Moreover, even in cases where one of the counterparties to a SBS is not covered by these definitions, the Commission preliminarily does not believe that any such entities would be "small entities" as defined in Commission Rule 0-10. Feedback from industry participants and the Commission's own information about the SBS market indicate that only persons or entities with assets significantly in excess of $5 million participate in the SBS market. For example, as revealed in a current survey conducted by Office of the Comptroller of the Currency, 99.9% of CDS positions by US Commercial Banks and Trusts are held by those with assets over $10 billion.[403] Given the magnitude of this figure, and the fact that it so far exceeds $5 million, the

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401 17 CFR 240.17a-5(d).

402 See 17 CFR 240.0-10(c).

403 See Office of the Comptroller of the Currency, "Quarterly Report on Bank Trading and Derivatives Activities Second Quarter 2010" (2010).

Commission preliminarily believes that the vast majority of, if not all, SBS transactions are between large entities for purposes of the RFA.

In addition, the Commission preliminarily believes that the entities likely to register as SDRs would not be small entities. Based on input from SBS market participants and its own information, the Commission preliminarily believes that most if not all the registered SDRs would be part of large business entities, and that all registered SDRs would have assets exceeding $5 million and total capital exceeding $500,000. Therefore, the Commission preliminarily believes that none of the registered SDRs would be small entities.

On this basis, the Commission preliminarily believes that the number of SBS transactions involving a small entity as that term is defined for purposes of the RFA would be de minimis. Moreover, the Commission does not believe that any aspect of proposed Regulation SBSR would be likely to alter the type of counterparties presently engaging in SBS transactions. Therefore, the Commission preliminarily does not believe that proposed Regulation SBSR would impact any small entities.

For the foregoing reasons, the Commission certifies that Regulation SBSR would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, indicate whether they believe that participants and registered SDRs are unlikely to be small entities, and provide empirical data to support their responses.

XVII. Statutory Basis and Text of Proposed Rule

The Commission is proposing to adopt Regulation SBSR, and Rule 900-911 thereunder, pursuant to the Exchange Act.

List of Subjects in 17 CFR Parts 240 and 242.

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows.

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

1. The authority citation for part 240 continues to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Amend § 240.31 by:

a. Removing "September 30" at the beginning of paragraph (a)(10)(ii) and adding in its place "September 25";

b. Removing the ''and'' at the end of paragraph (a)(11)(vii);

c. Removing the period at the end of paragraph (a)(11)(viii) and adding in its place ''; and'';

d. Adding paragraph (a)(11)(ix); and

e. Adding new paragraph (a)(19) to read as follows:

(a) * * * * *

(11) * * * * *

(ix) Any sale of a security-based swap.

* * * * *

(19) The term security-based swap has the same definition as provided in Section 3(a)(68) of the Act (15 U.S.C. 78c(a)(68)).

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

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

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

4. The part heading for part 242 is revised as set forth above.

5. Add §§ 242.900, 242.901, 242.902, 242.903, 242.904, 242.905, 242.906, 242.907, 242.908, 242.909, 242.910, and 242.911 to read as follows:

§ 242.900 Definitions.

Terms used in this Regulation SBSR (§§ 242.900-911) that appear in Section 3 of the Exchange Act (15 U.S.C. § 78c) have the same meaning as in Section 3 of the Exchange Act (15 U.S.C. § 78c) and the rules or regulations thereunder. In addition, the following definitions shall apply:

Affiliate means any person that, directly or indirectly, controls, is controlled by, or is under common control with, a person.

Asset class means those security-based swaps in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives.

Block trade means a large notional security-based swap transaction that meets the criteria set forth in § 242.907(b).

Broker ID means the UIC assigned to a person acting as a broker for a participant.

Confirm means the production of a confirmation that is agreed to by the parties to be definitive and complete and that has been manually, electronically, or, by some other legally equivalent means, signed.

Control means, for purposes of §§ 242.900-911, the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(1) Is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(2) Directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(3) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

Derivatives clearing organization means the same as provided under the Commodity Exchange Act.

Desk ID means the UIC assigned to the trading desk of a participant or of a broker of a participant.

Effective reporting date, with respect to a security-based swap data repository, means the date six months after the registration date.

Exchange Act means the Securities Exchange Act of 1934 (15 U.S.C. § 78a, et seq.), as amended.

Life cycle event means, with respect to a security-based swap, any event that would result in a change in the information reported to a registered security-based swap data repository under § 242.901, including a counterparty change resulting from an assignment or novation; a partial or full termination of the security-based swap; a change in the cash flows originally reported; for a security-based swap that is not cleared, any change to the collateral agreement; or a corporate action affecting a security or securities on which the security-based swap is based (e.g., a merger, dividend, stock split, or bankruptcy). Notwithstanding the above, a life cycle event shall not include the scheduled expiration of the security-based swap, a previously described and anticipated interest rate adjustment (such as a quarterly interest rate adjustment), or other event that does not result in any change to the contractual terms of the security-based swap.

Parent means a legal person that controls a participant.

Participant means:

(1) A U.S. person that is a counterparty to a security-based swap that is required to be reported to a registered security-based swap data repository; or

(2) A non-U.S. person that is a counterparty to a security-based swap that is (i) required to be reported to a registered security-based swap data repository; and (ii) executed in the United States or through any means of interstate commerce, or cleared through a clearing agency that has its principal place of business in the United States.

Participant ID means the UIC assigned to a participant.

Phase-in period means the period immediately after a security-based swap data repository has registered with the Commission during which it is not required to disseminate security-based swap data pursuant to an implementation schedule, as provided in § 242.910.

Pre-enactment security-based swap means any security-based swap executed before July 21, 2010 (the date of enactment of the Dodd-Frank Act (Pub. L. No. 111-203, H.R. 4173)), the terms of which had not expired as of that date.

Price means the price of a security-based swap transaction, expressed in terms of the commercial conventions used in that asset class.

Product ID means the UIC assigned to a security-based swap instrument.

Publicly disseminate means to make available through the Internet or other electronic data feed that is widely accessible and in machine-readable electronic format.

Real time means, with respect to the reporting of security-based swap information, as soon as technologically practicable, but in no event later than 15 minutes after the time of execution of the security-based swap transaction.

Registered security-based swap data repository means a security-based swap data repository that is registered with the Commission pursuant to Section 13(n) of the Exchange Act (15 U.S.C. § 78m(n)) and any rules or regulations thereunder.

Registration date, with respect to a security-based swap data repository, means the date on which the Commission registers the security-based swap data repository, or, if the Commission registers the security-based swap data repository before the effective date of §§ 242.900-911, the effective date of §§ 242.900-911.

Reporting party means the counterparty to a security-based swap with the duty to report information in accordance with §§ 242.900-911 to a registered security-based swap data repository, or if there is no registered security-based swap data repository that would receive the information, to the Commission.

Security-based swap instrument means each security-based swap in the same asset class, with the same underlying reference asset, reference issuer, or reference index.

Time of execution means the point at which the counterparties to a security-based swap become irrevocably bound under applicable law.

Trader ID means the UIC assigned to a natural person who executes security-based swaps.

Transaction ID means the unique identification code assigned by a registered security-based swap data repository to a specific security-based swap.

Transitional security-based swap means a security-based swap executed on or after July 21, 2010, and before the effective reporting date.

Ultimate parent means a legal person that controls a participant and that itself has no parent.

Ultimate parent ID means the UIC assigned to an ultimate parent of a participant.

Unique Identification Code or UIC means the unique identification code assigned to a person, unit of a person, or product by or on behalf of an internationally recognized standards-setting body that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory. If no standards-setting body meets these criteria, a registered security-based swap data repository shall assign all necessary UICs using its own methodology. If a standards-setting body meets these criteria but has not assigned a UIC to a particular person, unit of a person, or product, a registered security-based swap data repository shall assign a UIC to that person, unit of a person, or product using its own methodology.

U.S. person means a natural person that is a U.S. citizen or U.S. resident or a legal person that is organized under the corporate laws of any part of the United States or has its principal place of business in the United States.

§ 242.901 Reporting obligations.

(a) Reporting party. The reporting party shall be as follows:

(1) Where only one counterparty to a security-based swap is a U.S. person, the U.S. person shall be the reporting party;

(2) Where both counterparties to a security-based swap are U.S. persons:

(i) With respect to a security-based swap in which only one counterparty is a security-based swap dealer or major security-based swap participant, the security-based swap dealer or major security-based swap participant shall be the reporting party;

(ii) With respect to a security-based swap in which one counterparty is a security-based swap dealer and the other a major security-based swap participant, the security-based swap dealer shall be the reporting party; and

(iii) With respect to any other security-based swap not described in subparagraphs (i) and (ii) above, the counterparties to the security-based swap shall select a counterparty to be the reporting party.

(3) If neither counterparty is a U.S. person but the security-based swap meets the criteria of § 242.908(a)(2)) or (a)(3), the counterparties to the security-based swap shall select a counterparty to be the reporting party.

(b) Recipient of security-based swap information. For each security-based swap for which it is the reporting party, the reporting party shall provide the information required by §§

242.900-911 to a registered security-based swap data repository or, if there is no registered security-based swap data repository that would accept the information, to the Commission.

(c) Information to be reported in real time. For each security-based swap for which it is the reporting party, the reporting party shall report the following information in real time:

(1) The asset class of the security-based swap and, if the security-based swap is an equity derivative, whether it is a total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the security-based swap is based;

(2) Information that identifies the security-based swap instrument and the specific asset(s) or issuer(s) of any security on which the security-based swap is based;

(3) The notional amount(s), and the currenc(ies) in which the notional amount(s) is expressed;

(4) The date and time, to the second, of execution, expressed using Coordinated Universal Time (UTC);

(5) The effective date;

(6) The scheduled termination date;

(7) The price;

(8) The terms of any fixed or floating rate payments, and the frequency of any payments;

(9) Whether or not the security-based swap will be cleared by a clearing agency;

(10) If both counterparties to a security-based swap are security-based swap dealers, an indication to that effect;

(11) If applicable, an indication that the transaction does not accurately reflect the market; and

(12) If the security-based swap is customized to the extent that the information provided in items (1) through (11) above does not provide all of the material information necessary to identify such customized security-based swap or does not contain the data elements necessary to calculate the price, an indication to that effect.

(d) Additional information that must be reported. (1) In addition to the information required under paragraph (c) above, for each security-based swap for which it is the reporting party, the reporting party shall report:

(i) The participant ID of each counterparty;

(ii) As applicable, the broker ID, desk ID, and trader ID of the reporting party;

(iii) The amount(s) and currenc(ies) of any up-front payment(s) and a description of the terms and contingencies of the payment streams of each counterparty to the other;

(iv) The title of any master agreement, or any other agreement governing the transaction (including the title of any document governing the satisfaction of margin obligations), incorporated by reference and the date of any such agreement;

(v) The data elements necessary for a person to determine the market value of the transaction;

(vi) If the security-based swap will be cleared, the name of the clearing agency;

(vii) If the security-based swap is not cleared, whether the exception in Section 3C(g) of the Exchange Act was invoked;

(viii) If the security-based swap is not cleared, a description of the settlement terms, including whether the security-based swap is cash-settled or physically settled, and the method for determining the settlement value; and

(ix) The venue where the security-based swap was executed.

(2) Any information required to be reported pursuant to paragraph (d)(1) of this section must be reported promptly, but in no event later than:

(i) Fifteen minutes after the time of execution for a security-based swap that is executed and confirmed electronically;

(ii) Thirty minutes after the time of execution for a security-based swap that is confirmed electronically but not executed electronically; or

(iii) Twenty-four hours after the time of execution for a security-based swap that is not executed or confirmed electronically.

(e) Duty to report any life cycle event of a security-based swap. For any life cycle event, and any adjustment due to a life cycle event, that results in a change to information previously reported pursuant to paragraph (c), (d), or (i) of this section, the reporting party shall promptly provide updated information reflecting such change to the entity to which it reported the original transaction, using the transaction ID, subject to the following exceptions:

(i) If a reporting party ceases to be a counterparty to a security-based swap due to an assignment or novation, the new counterparty shall be the reporting party following such assignment or novation, if the new counterparty is a U.S. person.

(ii) If, following an assignment or novation, the new counterparty is not a U.S. person, the counterparty that is a U.S. person shall be the reporting party following such assignment or novation.

(f) Time stamping incoming information. A registered security-based swap data repository shall time stamp, to the second, its receipt of any information submitted to it pursuant to paragraph (c), (d), or (e) of this section.

(g) Assigning transaction ID. A registered security-based swap data repository shall assign a transaction ID to each security-based swap reported by a reporting party.

(h) Format of reported information. The reporting party shall electronically transmit the information required under this section in a format required by the registered security-based data repository, and in accordance with any applicable policies and procedures of the registered security-based swap data repository.

(i) Reporting of pre-enactment and transitional security-based swaps. With respect to any pre-enactment security-based swap or transitional security-based swap, the reporting party shall report all of the information required by paragraphs (c) and (d) of this section, to the extent such information is available.

§ 242.902 Public dissemination of transaction reports.

(a) Dissemination of transaction reports. Except in the case of a block trade, a registered security-based swap data repository shall publicly disseminate a transaction report of a security-based swap immediately upon receipt of information about the security-based swap from a reporting party, or upon re-opening following a period when the registered security-based swap data repository was closed. The transaction report shall consist of all the information reported by the reporting party pursuant to § 242.901, plus any indicator or indicators contemplated by the registered security-based swap data repository's policies and procedures that are required by § 242.907.

(b) Dissemination of block trades. A registered security-based swap data repository shall publicly disseminate a transaction report of a security-based swap that constitutes a block trade immediately upon receipt of information about the block trade from the reporting party. The transaction report shall consist of all the information reported by the reporting party pursuant to §

242.901(c), except for the notional size, plus the transaction ID and an indicator that the report represents a block trade. The registered security-based swap data repository shall publicly disseminate a complete transaction report for such block trade (including the transaction ID and the full notional size) as follows:

(1) If the security-based swap was executed on or after 05:00 UTC and before 23:00 UTC of the same day, the transaction report (including the transaction ID and the full notional size) shall be disseminated at 07:00 UTC of the following day.

(2) If the security-based swap was executed on or after 23:00 UTC and up to 05:00 UTC of the following day, the transaction report (including the transaction ID and the full notional size) shall be disseminated at 13:00 UTC of that following day.

(3) Notwithstanding the foregoing, if a registered security-based swap data repository is in normal closing hours or special closing hours at a time when it would be required to disseminate information about a block trade pursuant to this section, the registered security-based swap data repository shall instead disseminate information about the block trade immediately upon re-opening.

(c) Non-disseminated information. A security-based swap data repository shall not disseminate:

(1) The identity of either counterparty to a security-based swap;

(2) With respect to a security-based swap that is not cleared at a registered clearing agency and that is reported to a registered security-based swap data repository, any information disclosing the business transactions and market positions of any person; or

(3) Any information regarding a security-based swap reported pursuant to § 242.901(i).

(d) Temporary restriction on other market data sources. No person other than a registered security-based swap data repository shall make available to one or more persons (other than a counterparty) transaction information relating to a security-based swap before the earlier of 15 minutes after the time of execution of the security-based swap; or the time that a registered security-based swap data repository publicly disseminates a report of that security-based swap.

§ 242.903 Coded information.

A reporting party may provide information to a registered security-based swap data repository pursuant to § 242.901 and a registered security-based swap data repository may publicly disseminate information pursuant to § 242.902 using codes in place of certain data elements, provided that the information necessary to interpret such codes is widely available on a non-fee basis.

§ 242.904 Operating hours of registered security-based swap data repositories.

A registered security-based swap data repository shall have systems in place to continuously receive and disseminate information regarding security-based swaps pursuant to §§ 242.900-911, subject to the following exceptions:

(a) A registered security-based swap data repository may establish normal closing hours during periods when, in its estimation, the U.S. market and major foreign markets are inactive. A registered security-based swap data repository shall provide reasonable advance notice to participants and to the public of its normal closing hours.

(b) A registered security-based swap data repository may declare, on an ad hoc basis, special closing hours to perform system maintenance that cannot wait until normal closing hours. A registered security-based swap data repository shall: to the extent reasonably possible under the circumstances, avoid scheduling special closing hours during when, in its estimation, the U.S.

market and major foreign markets are most active; and provide reasonable advance notice of its special closing hours to participants and to the public.

(c) During normal closing hours, and to the extent reasonably practicable during special closing hours, a registered security-based swap data repository shall have the capability to receive and hold in queue information regarding security-based swaps that has been reported pursuant to §§ 242.900-911.

(d) When a registered security-based swap data repository re-opens following normal closing hours or special closing hours, it shall disseminate transaction reports of security-based swaps held in queue, in accordance with the requirements of § 242.902.

(e) If a registered security-based swap data repository could not receive and hold in queue transaction information that was required to be reported pursuant to §§ 242.900-911, it must immediately upon re-opening send a message to all participants that it has resumed normal operations. Thereafter, any participant that had an obligation to report information to the registered security-based swap data repository pursuant to §§ 242.900-911, but could not do so because of the registered security-based swap data repository's inability to receive and hold in queue data, must immediately report the information to the registered security-based swap data repository.

§ 242.905 Correction of errors in security-based swap information.

(a) Duty of counterparties to correct. Any counterparty to a security-based swap that discovers an error in information previously reported pursuant to §§ 242.900-911 shall correct such error in accordance with the following procedures:

(1) If a counterparty that was not the reporting party for a security-based swap discovers an error in the information reported with respect to such security-based swap, the counterparty shall promptly notify the reporting party of the error; and

(2) If the reporting party for a security-based swap transaction discovers an error in the information reported with respect to a security-based swap, or receives notification from its counterparty of an error, the reporting party shall promptly submit to the entity to which the security-based swap was originally reported an amended report pertaining to the original transaction report. If the reporting party reported the initial transaction to a registered security-based swap data repository, the reporting party shall submit an amended report to the registered security-based swap data repository in a manner consistent with the policies and procedures contemplated by § 242.907(a)(3).

(b) Duty of registered security-based swap data repository to correct. A registered security-based swap data repository shall:

(1) Upon discovery of the error or receipt of a notice of the error from a reporting party, verify the accuracy of the terms of the security-based swap and, following such verification, promptly correct the erroneous information regarding such security-based swap contained in its system; and

(2) If such erroneous information falls into any of the categories of information enumerated in § 242.901(c), publicly disseminate a corrected transaction report of the security-based swap promptly following verification of the trade by the parties to the security-based swap, with an indication that the report relates to a previously disseminated transaction.

§ 242.906 Other duties of participants.

(a) Reporting by non-reporting-party counterparty. A registered security-based swap data repository shall identify any security-based swap reported to it for which the registered security-based swap data repository does not have the participant ID and (if applicable) the broker ID, desk ID, and trader ID of each counterparty. Once a day, a registered security-based swap data repository shall send a report to each participant identifying, for each security-based swap to which that participant is a counterparty, the security-based swap(s) for which the registered security-based swap data repository lacks participant ID and (if applicable) broker ID, desk ID, and trader ID. A participant that receives such a report shall provide the missing information to the registered security-based swap data repository within 24 hours.

(b) Duty to provide ultimate parent and affiliate information. Each participant of a registered security-based swap data repository shall provide to the registered security-based swap data repository information sufficient to identify its ultimate parent(s) and any affiliate(s) of the participant that also are participants of the registered security-based swap data repository, using ultimate parent IDs and participant IDs. A participant shall promptly notify the registered security-based swap data repository of any changes to that information.

(c) Policies and procedures of security-based swap dealers and major security-based swap participants. Each participant that is a security-based swap dealer or major security-based swap participant shall establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure that it complies with any obligations to report information to a registered security-based swap data repository in a manner consistent with §§ 242.900-911 and the registered security-based swap data repository's applicable policies and procedures. Each such participant shall review and update its policies and procedures at least annually.

§ 242.907 Policies and procedures of registered security-based swap data repositories.

(a) General policies and procedures. With respect to the receipt, reporting, and dissemination of data pursuant to §§ 242.900-911, a registered security-based swap data repository shall establish and maintain written policies and procedures:

(1) That enumerate the specific data elements of a security-based swap or a life cycle event that a reporting party must report, which shall include, at a minimum, the data elements specified in § 242.901(c) and (d);

(2) That specify one or more acceptable data formats (each of which must be an open-source structured data format that is widely used by participants), connectivity requirements, and other protocols for submitting information;

(3) For specifying how reporting parties are to report corrections to previously submitted information, making corrections to information in its records that is subsequently discovered to be erroneous, and applying an appropriate indicator to any transaction report required to be disseminated by § 242.905(b)(2) that the report relates to a previously disseminated transaction;

(4) Describing how reporting parties shall report and, consistent with the enhancement of price discovery, how the registered security-based swap depository shall publicly disseminate, reports of, and adjustments due to, life cycle events; security-based swap transactions that do not involve an opportunity to negotiate any material terms, other than the counterparty; and any other security-based swap transactions that, in the estimation of the registered security-based swap data repository, do not accurately reflect the market;

(5) For assigning:

(i) A transaction ID to each security-based swap that is reported to it; and

(ii) UICs established by or on behalf of an internationally recognized standards-setting body that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory (or, if no standards-setting body meets these criteria or a standards-setting body meets these criteria but has not assigned a UIC to a particular person, unit of a person, or product, using its own methodology).

(6) For periodically obtaining from each participant information that identifies the participant's ultimate parent(s) and any other participant(s) with which the counterparty is affiliated, using ultimate parent IDs and participant IDs.

(b) Policies and procedures regarding block trades. (1) A registered security-based swap data repository shall establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all security-based swap instruments reported to the registered security-based swap data repository in accordance with the criteria and formula for determining block size as specified by the Commission.

(2) Exceptions. Notwithstanding the above, a registered security-based swap data repository shall not designate as a block trade any security-based swap:

(i) That is an equity total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the security-based swap is based; or

(ii) Contemplated by Section 13(m)(1)(C)(iv) of the Exchange Act ((15 U.S.C. § 78m(m)(1)(C)(iv)).

(c) Public availability of policies and procedures. A registered security-based swap data repository shall make the policies and procedures required by §§ 242.900-911 publicly available on its website.

(d) Updating of policies and procedures. A registered security-based swap data repository shall review, and update as necessary, the policies and procedures required by §§

242.900-911 at least annually. Such policies and procedures shall indicate the date on which they were last reviewed.

(e) A registered security-based swap data repository shall have the capacity to provide to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to §§ 242.900-911 and the registered security-based swap data repository's policies and procedures thereunder.

§ 242.908 Jurisdictional matters.

(a) Notwithstanding any other provision of §§ 242.900-911, no security-based swap is required to be reported to a registered security-based swap data repository, and no registered security-based swap data repository is required to publicly disseminate a report of a security-based swap, unless the security-based swap:

(1) Has at least one counterparty that is a U.S. person;

(2) Was executed in the United States or through any means of interstate commerce; or

(3) Was cleared through a clearing agency having its principal place of business in the United States.

(b) Notwithstanding any other provision of §§ 242.900-911, a counterparty to a security-based swap shall not incur any obligation under §§ 242.900-911 unless it is:

(a) A U.S. person;

(b) A counterparty to a security-based swap executed in the United States or through any means of interstate commerce; or

(c) A counterparty to a security-based swap cleared through a clearing agency having its principal place of business in the United States.

§ 242.909 Registration of security-based swap data repository as a securities information processor.

A registered security-based swap data repository shall also register with the Commission as a securities information processor on Form SIP (§ 249.1001 of this chapter).

§ 242.910 Implementation of security-based swap reporting and dissemination.

(a) Reporting of pre-enactment security-based swaps. The reporting party shall report to a registered security-based swap data repository any pre-enactment security-based swaps no later than January 12, 2012 (180 days after the effective date of the Dodd-Frank Act (Pub. L. No. 111-203, H.R. 4173)).

(b) Phase-in of compliance dates. A registered security-based swap data repository and its participants shall be subject to the following phased-in compliance schedule:

(1) Phase 1, six months after the registration date (i.e., the effective reporting date):

(i) Reporting parties shall report to the registered security-based swap data repository any transitional security-based swaps.

(ii) With respect to any security-based swap executed on or after the effective reporting date, reporting parties shall comply with §§ 242.901.

(iii) Participants and the registered security-based swap data repository shall comply with § 242.905 (except with respect to dissemination) and § 242.906(a) and (b).

(iv) Participants that are SBS dealers or major SBS participants shall comply with § 242.906(c).

(2) Phase 2, nine months after the registration date: Wave 1 of public dissemination – The registered security-based swap data repository shall comply with § 242.902 and 905 (with respect to dissemination of corrected transaction reports) for 50 security-based swap instruments.

(3) Phase 3, 12 months after the registration date: Wave 2 of public dissemination The registered security-based swap data repository shall comply with § 242.902 and 905 (with

respect to dissemination of corrected transaction reports) for an additional 200 security-based swap instruments.

(4) Phase 4, 18 months after the registration date: Wave 3 of public dissemination -- All security-based swaps reported to the registered security-based swap data repository shall be subject to real-time public dissemination as specified in § 242.902.

§ 242.911 Prohibition during phase-in period.

A reporting party shall not report a security-based swap to a registered security-based swap data repository in a phase-in period described in § 242.910 during which the registered security-based swap data repository is not yet required or able to publicly disseminate transaction reports for that security-based swap instrument unless:

(a) The security-based swap is also reported to a registered security-based swap data repository that is disseminating transaction reports for that security-based swap instrument consistent with § 242.902; or

(b) No other registered security-based swap data repository is able to receive, hold, and publicly disseminate transaction reports regarding that security-based swap instrument.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 19, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63358 / November 22, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3114 / November 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14135

In the Matter of **NEW CASTLE FUNDS LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against New Castle Funds LLC ("New Castle" 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 203(e) of the Investment Advisers Act of 1940 and Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. These proceedings arise out of two violations of Rule 105 of Regulation M of the Exchange Act by New Castle, a registered investment adviser at the time of the misconduct, based in White Plains, New York. Rule 105 prohibits short selling securities during a restricted period (generally defined as five business days before the pricing of a follow-on or secondary offering) and then purchasing the same securities in a public follow-on or secondary offering. New Castle, trading for the benefit of its advisory clients, violated Rule 105 in connection with short sales made in advance of public offerings by Anadarko Petroleum Corp. ("Anadarko") and Wells Fargo & Company ("Wells Fargo"), resulting in profits of $183,084.

Respondent

2. New Castle Funds LLC is a Delaware limited liability company based in White Plains, New York. New Castle was an investment adviser registered with the Commission during the time of the Rule 105 violations at issue. During the relevant time period, New Castle was an investment adviser to a number of clients, including proprietary pooled investment vehicles, third-party pooled investment vehicles and separately-managed accounts. New Castle effected the trades that are the subject matter of these proceedings for the benefit of several of its advisory clients.

Background

3. At all relevant times, pursuant to amendments in 2007, Rule 105 prohibits 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. Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale.

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

New Castle's Violation in Connection with the Anadarko Trades

4. During the relevant period, New Castle violated Rule 105 by selling short Anadarko stock during the restricted period and subsequently participating in a follow-on offering by Anadarko. The Rule 105 restricted period relating to this follow-on offering was May 5, 2009 through May 11, 2009, the period beginning five business days before the pricing of Anadarko's offered securities and ending with the pricing of the offering shares.

5. On May 7, 2009, during the Rule 105 restricted period, New Castle sold short a total of 20,000 shares of Anadarko. Of those shares sold short, 18,600 shares were sold at $49.11 per share and the remaining 1,400 shares were sold at $48.17 per share.

6. On May 11, 2009, after the close of the market, Anadarko announced the pricing of a follow-on offering of 30 million shares of its common stock at $45.50 per share. New Castle subsequently participated in the follow-on offering and purchased 100,000 shares of Anadarko stock at a price of $45.50 per share.

7. In comparing the proceeds of the May 7, 2009 short sales to the cost of 20,000 of the 100,000 shares obtained in the May 12, 2009 follow-on offering, New Castle reaped profits of $70,884. New Castle did not obtain profits with respect to the additional 80,000 shares it purchased in the offering.

New Castle's Violation in Connection with the Wells Fargo Trades

8. On May 7, 2009, after the close of the market, Wells Fargo announced the pricing of a follow-on offering of 341 million shares of its common stock at $22.00 per share.

9. The Rule 105 restricted period relating to this follow-on offering was May 1, 2009 through May 7, 2009, the period beginning five business days before the pricing of Wells Fargo's offered securities and ending with the pricing of the offering shares.

10. On May 7, 2009, during the Rule 105 restricted period, New Castle sold short a total of 40,000 shares of Wells Fargo at a price of $27.61 per share.

11. On May 8, 2009, New Castle participated in the follow-on offering and purchased 20,000 shares of Wells Fargo stock at a price of $22.00.

12. In comparing the proceeds of the May 7, 2009 short sales to the cost of the 20,000 shares obtained in the follow-on offering, New Castle reaped profits of $112,200.

13. As a result of the conduct described above, New Castle willfully[2] 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 . . . ."

New Castle's Remedial Efforts

14. 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 and in the public interest to impose the sanctions agreed to in Respondent New Castle'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 New Castle cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M.

B. Respondent New Castle is censured.

C. Respondent New Castle shall, within 15 days of the entry of this Order, pay disgorgement of $183,084, prejudgment interest in the amount of $9,980, and a civil money penalty of $100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717.

D. Such payment by Respondent New Castle 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 New Castle 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 Conway T. Dodge, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

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[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)).

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

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9159 / November 22, 2010

SECURITIES EXCHANGE ACT OF 1934
Release No. 63355 / November 22, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3113 / November 22, 2010

INVESTMENT COMPANY ACT OF 1940
Release No. 29503 / November 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14133

In the Matter of **EMIL C. BUSSE, JR.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b)(6) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Emil C. Busse, Jr. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act, Sections 15(b)(6) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings involve violations of the antifraud provisions of the federal securities laws as the result of the Respondent's attempt to prevent a portfolio that was part of a mutual fund from "breaking the buck," i.e. dropping below a net asset value ("NAV") of $1.00 per share. The Respondent managed a mutual fund that contained a money market portfolio and a bond portfolio. Both portfolios contained funds received exclusively from loans of securities made by customers of an affiliate of the Respondent's employer. From early February through at least March 2008, the Respondent caused the reallocation of numerous loans of securities from customers invested in the money market portfolio to customers invested in the bond portfolio. The Respondent engaged in this activity in an effort to increase the assets in the bond portfolio and enable the fund to keep its portfolio NAV at $1 per share. The Respondent did not disclose these reallocations to customers or to his supervisors. As a result of his improprieties, certain customers in the inflated bond portfolio suffered losses of approximately $6 million when, despite the efforts of the Respondent, the portfolio's NAV dropped to $.99 per share. By engaging in this conduct, Respondent willfully aided and abetted and caused violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondent

1. Busse is 62 years old and lives in Burnsville, Minnesota. Busse worked at FAF Advisors, Inc. ("FAF") as its Managing Director for its securities lending program from 1990 through June 2008, when FAF terminated him. He is not currently employed. Busse has no disciplinary history.

Other Relevant Entities

2. FAF is a Delaware corporation based in Minneapolis, Minnesota. It has been registered with the Commission as an investment adviser since April 13, 2001. FAF is a wholly owned subsidiary of U.S. Bank, N.A.

[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.

3. U.S. Bank, N.A. is a commercial bank and a wholly owned subsidiary of U.S. Bancorp., a diversified financial services company based in Minneapolis, Minnesota.

4. Mount Vernon Securities Lending Trust is an open-end investment company registered with the Commission since October 17, 2005. FAF was the investment adviser for Mount Vernon.

5. Mount Vernon Securities Lending Prime Portfolio is one of the two portfolios in Mount Vernon that was available for investment by customers of U.S. Bank's securities lending program. It operates as a money market mutual fund within the meaning of Rule 2a-7 under the Investment Company Act.

6. Mount Vernon Securities Lending Short-Term Bond Portfolio was one of the two portfolios in Mount Vernon available for investment by securities lending customers. The Bond Portfolio was managed to preserve capital and minimize fluctuations in NAV. It was liquidated in June 2008.

Background

7. FAF hired Busse in April 1990 to develop a securities lending program so that institutional customers of U.S. Bank's Institutional Trust & Custody business could earn additional income from the securities they held at U.S. Bank. Under the program, customers had the option of loaning securities they held at U.S. Bank to certain approved broker-dealers in exchange for cash collateral. FAF acted as the lending agent for customers and administered the program, for which it received a fee of .02 percent annually on the average daily net assets of the portfolios. Customers who participated in the program could then invest the cash proceeds into either the Prime Portfolio or the Bond Portfolio.

8. The Prime Portfolio operated as a money market fund within the meaning of Rule 2a-7 under the Investment Company Act. As such, FAF was required to manage the fund with a view toward maintaining a stable NAV of $1 per share. A team of persons at FAF, including Busse, managed the Prime Portfolio. The Bond Portfolio was not managed as a money market fund. FAF, however, sought to keep the NAV at $1 per share.

9. In presentations to investors about its securities lending program, FAF represented that it allocated lending opportunities fairly among investors who participated in the program. FAF did so by its use of a software program, called "WorldLend," to determine which investor in a lending queue received the next lending opportunity. The primary factor in determining which investor received the next loan opportunity was each investor's percentage of shares it had out on loan, known as the utilization rate. Thus, the investors that had the lowest utilization rates were automatically placed at the top of the queue for the following trading day.

Respondent's Unlawful Scheme

10. In early 2008, certain structured investment vehicles ("SIVs") held by the Bond Portfolio became distressed because part of their value was based on mortgage-backed securities which had declined in value. These investments had been approved by FAF's Credit Committee prior to their purchase, and all held AA or better rating status at the time of their acquisition.

Due to these holdings and their deteriorating condition, FAF's management concluded that there was a high likelihood that the Bond Portfolio's NAV would drop below $1 per share, that is, "break the buck." FAF's management determined, however, that no action was necessary to attempt to counteract the drop in NAV because the Bond Portfolio was not managed as a money market fund and, therefore, was not required to maintain a $1 NAV. FAF informed Bond Portfolio investors that the NAV would likely drop below $1. The NAV remained at $1 until March 5, 2008, when it dropped to $.99 per share, due to the decline in value of the SIVs.

11. In early February 2008, FAF erroneously concluded that the Bond Fund had broken the buck, and began notifying customers of this event. Busse participated in at least one such communication with a large institutional investor which held a significant position in the Bond Fund. However, subsequent to this call with the customer, it was determined that there had been an accounting error and, in fact, the NAV of the Bond Fund had not dropped below $1. Thereafter, in an effort to avoid or delay the occurrence of such an event, Busse directed his assistant to reallocate numerous loans from lenders in the Prime Portfolio to lenders in the Bond Portfolio. Busse knew that this would increase the asset value of the Bond Portfolio and thereby dilute the effect that the distressed SIVs had on its value. Busse told the assistant that the purpose of these reallocations was to try to enable the Bond Portfolio to maintain an NAV of $1.

12. From early February through at least March 2008, Busse caused FAF to reallocate hundreds of loans from investors in the Prime Portfolio to investors in the Bond Portfolio. As part of his effort to maintain the NAV at $1, FAF reallocated loans to certain investors in the Bond Portfolio who were also advisory clients of FAF, exposing them to increased losses when the Bond Portfolio's NAV dropped to $.99.

13. Although the WorldLend queuing system continued to allocate loans properly, Busse effectively counteracted the fairness of the queuing system by subsequently reallocating the outstanding loans made by investors in the Prime Portfolio to investors in the Bond Portfolio. Busse caused certain investors in the Prime Portfolio to lose income when their loan was terminated and their collateral transferred to an investor in the Bond Portfolio. Busse continued to engage in this artifice to support the Bond Fund even after his efforts to prevent the Bond Portfolio from breaking the buck had clearly failed: the Bond Portfolio's NAV fell to $.99 per share on March 5, 2008.

<u>The Discovery of Respondent's Scheme</u>

14. In early March 2008, a representative of one of the clients participating in the securities lending program (the "Client") requested an update on the amount of the Client's assets in the Bond Portfolio. The Client noted that its investment in the Bond Portfolio had increased from between 450 and $500 million to $871.8 million. The Client also discovered that the Bond Portfolio's assets had increased by $800 million, and that it had funded at least $372 million, or close to 50 percent of the increase.

15. On March 12, 2008, several persons from FAF, including Respondent and at least one FAF officer, met with the Client's representative. Before the meeting, the officer asked Busse why the Client's investment in the Bond Portfolio had increased so dramatically. Busse misleadingly stated that another large client could not make additional loans of stock because statutory requirements prevented it from making further loans, resulting in more lending

opportunities for the Client. This statement was misleading because, at the time of this meeting, Busse did not further disclose that reallocations were occurring in order to avoid the NAV falling below $1

16. On March 25, 2008, the FAF officer again asked Busse how the Client's assets in the Bond Portfolio had gotten so high. Respondent again stated that the number of new loans had increased, but this time he also admitted that he had reallocated loans. FAF's compliance department then began an internal investigation, and ultimately retained a law firm to conduct an independent investigation. On June 27, after the independent investigation concluded, FAF terminated Busse's employment.

17. Respondent's activities had a detrimental effect on the investors in both the Prime Portfolio and the Bond Portfolio because the reallocations resulted in increased assets in the Bond Portfolio at a time when its NAV was about to decrease from $1 to $.99. This resulted in losses to Bond Portfolio investors of about $5.7 million. Additionally, investors in the Prime Portfolio lost approximately $200,000 because of decreased lending opportunities to those investors.

Violations

18. As a result of the conduct described above, FAF, through the actions of Busse, violated, and Busse willfully aided and abetted and caused FAF's violations of, Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which makes it a fraudulent, deceptive, or manipulative act, practice, or course of business for any investment adviser to a pooled investment vehicle to make false or misleading statements to investors in the pooled investment vehicle.

19. As a result of the conduct described above, FAF, through the actions of Busse, violated, and Busse willfully aided and abetted and caused violations of, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase, offer, or sale of securities.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b)(6) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Busse cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

B. Respondent Busse be, and hereby is barred from association with any broker, dealer, or investment adviser, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, with the right to reapply for association after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission;

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

D. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $65,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) 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 Emil C. Busse, Jr. as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Robert J. Burson, Senior Associate Regional Director, 175 West Jackson Blvd., Suite 900, Chicago, IL 60604.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63354 / November 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14132

In the Matter of **WORLD GROUP SECURITIES, INC.** **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 World Group Securities, Inc. ("WGS" 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 Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of Respondent's failure to enforce a reasonable system of supervisory policies and procedures to prevent and detect fraudulent conduct by certain registered representatives and to maintain a guideline ratio of registered representatives to supervisors in its Pomona, California branch office from the beginning of 2006 through May 2007 (the "Time Period"). During the Time Period, Respondent failed to require its Pomona branch office to maintain enough supervisors to adequately supervise the branch. While Respondent undertook efforts to add supervisors to, and remove registered representatives from, that office, it failed to do so in a reasonable period of time. During the Time Period, certain registered representatives in the Pomona branch office made unsuitable investment recommendations to customers.

Respondent

1. Respondent, World Group Securities, Inc., a Delaware corporation, has been registered as a broker-dealer with the Commission and a member of the FINRA (formerly the NASD) since January 23, 2002.

Certain Registered Representatives Recommended Unsuitable Securities

2. Certain registered representatives in the Pomona branch office recommended the use of home equity to purchase variable universal life insurance policies, the recommendation of which was unsuitable.

Respondent's Failure to Supervise

3. During 2005, the WGS Pomona branch office experienced significant growth. By June 2005, the Pomona branch office manager supervised approximately 62 registered representatives.

4. In or around April 2006, there were approximately 185 pending and active registered representatives in the Pomona branch office and only three branch supervisors. Subsequently, the Pomona branch had approximately 225 pending and active registered representatives with approximately three branch supervisors. WGS learned of the growth of the Pomona branch office and the number of supervisors in that office.

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

5. WGS advised the branch office manager in the Pomona branch to add additional supervisors, but the branch office manager failed to do so in a timely manner.

6. In January 2007, WGS placed the Pomona branch office manager on a Performance Improvement Plan ("PIP"), requiring him to increase the number of supervisors by five and reduce the ratio of registered representatives to supervisors to 40:1 as an initial step and then to achieve a ratio of 20:1 thereafter, with a total of 12 supervisors. WGS required that additional supervisors be trained and deployed, but the branch office manager failed to do so in a timely manner.

7. The branch office manager failed to adhere to the requirements of the PIP and, as of May 2007, the Pomona branch office still did not have an adequate number of supervisors. On May 21, 2007, WGS replaced the branch office manager in the Pomona branch and undertook other measures to ensure an appropriate ratio of registered representatives to supervisors in that office.

8. WGS has Written Supervisory Procedures ("WSPs") in effect. Every version of the WSPs during the 2004 to 2007 time period included the following language: "A Field Representative may not recommend to a client that he take out a policy loan, home equity line of credit, or any other loan to pay for a securities purchase."

9. WGS has Transaction Guidelines in effect. The Transaction Guidelines in effect during the 2004 to 2007 time period contained multiple references to WGS's prohibition on the use of home equity to purchase a securities product.

10. WGS has issued multiple Supervisory and Compliance Alerts and Bulletins emphasizing and reminding registered representatives of WGS's prohibition on the use of home equity to purchase a securities product, including during the 2004 to 2007 time period.

11. Part of the duties and responsibilities of the Pomona branch office manager included ensuring that the registered representatives under his supervision were aware of WGS's policies and procedures prohibiting registered representatives from recommending that customers use home equity to purchase securities.

12. During the Time Period, the branch office manager in the Pomona branch failed to communicate WGS's policies to the registered representatives he supervised. In addition, he did not have required quarterly meetings with registered representatives to discuss WGS's policies, transaction guidelines, or supervisory and compliance alerts and bulletins.

13. Certain registered representatives in the Pomona branch office stated that they were not aware of the foregoing WGS policies and made unsuitable investment recommendations to customers, including recommendations to use home equity to purchase variable universal life insurance policies.

14. Based on the conduct described above, certain WGS registered representatives in the Pomona branch office violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by recommending that customers purchase unsuitable securities.

15. Based on the conduct described above, Respondent failed reasonably to supervise certain registered representatives in its Pomona branch office within the meaning of Section 15(b)(4)(E) of the Exchange Act with a view to preventing and detecting their violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

WGS's Remedial Efforts

In determining to accept this Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff. The remedial acts include, but are not limited to: enhanced disclosure on order tickets; issuing additional written guidance to registered representatives regarding WGS's prohibition on using home equity to purchase securities; increasing the number of employees in the Business Review Department; generating exception reports on the number of registered representatives per supervisor/branch office; terminating approval of mortgage-related outside business activities through a program that is now inoperative; and enhancing regional supervision with a focus on registered representative interviews, reviews, training, and audits.

Undertaking

Respondent undertakes to retain, within 30 days of the date of entry of the Order, at its own expense, the services of an outside vendor not unacceptable to the Division of Enforcement of the Commission to provide suitability training to WGS that will be required to be given to each registered representative annually for the next two years focusing specifically on: (a) suitability of variable universal life insurance policies, and (b) suitability considerations related to using home equity to purchase securities.

Respondent agrees to certify, in writing, compliance with the undertaking set forth above. The certification shall identify the undertaking, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Karen L. Martinez, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertaking, including annual certification of the completion of the suitability training.

IV.

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

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

A. Respondent WGS is censured.

B. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $200,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) 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 WGS as a Respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Kenneth Israel, Director, Division of Enforcement, Securities and Exchange Commission, Salt Lake Regional Office, 15 W. South Temple, Suite 1800, Salt Lake City, UT 84101.

C. Respondent shall comply with the undertaking enumerated in Section III above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey and Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3112 / November 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14131

In the Matter of F&S Asset Management Group, Inc., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against F&S Asset Management Group, Inc. ("FSAMG" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondent and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. FSAMG is an investment adviser registered with the Commission and a Florida corporation with its principal place of business in Jacksonville, Florida. FSAMG has been a registered investment adviser since January 2008. Kenneth Wayne McLeod was FSAMG's President, CEO, and Chief Compliance Officer.

2. On August 13, 2010, a judgment was entered by consent against FSAMG, permanently enjoining it from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Estate of Kenneth Wayne McLeod, et al., Civil Action Number 10-22078-CIV-MORENO, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that, among other things, from at least 2008 through June 2010, McLeod and FSAMG violated the antifraud provisions of the federal securities laws in connection with a Ponzi scheme, through which McLeod raised at least $34 million from active and retired federal and state government employees. The complaint alleged that McLeod and FSAMG solicited employees to invest in a purported bond fund invested in long-term government securities and promised them guaranteed, tax-free returns of eight to ten percent annually. The complaint alleged that, in reality, the purported bond fund did not exist.

IV.

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

Accordingly, it is hereby ORDERED:

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

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. 63362 / November 23, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14136

In the Matter of **Speednet, Inc.,** **Springfield Acquisitions Corp.,** **Stemcell Global Research, Inc.,** **Sutton Resources Ltd., and** **System Software Associates, 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 Speednet, Inc., Springfield Acquisitions Corp., Stemcell Global Research, Inc., Sutton Resources Ltd., and System Software Associates, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Speednet, Inc. (CIK No. 1135451) is a void Delaware corporation located in Bloomfield Hills, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Speednet 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 $200 for the period from January 18 to December 31, 2001.

2. Springfield Acquisitions Corp. (CIK No. 1097967) is a delinquent Colorado corporation located in Englewood, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Springfield is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of $545 for the prior three months.

3. Stemcell Global Research, Inc. (CIK No. 1084155) is a permanently revoked Nevada corporation located in Camp Dennison, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Stemcell is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of over $71.5 million for the prior twelve months.

4. Sutton Resources Ltd. (CIK No. 899718) 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). Sutton is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 40-F for the period ended December 31, 1997, which reported a net loss of over $13 million (Canadian) for the prior twelve months.

5. System Software Associates, Inc. (CIK No. 808207) is a dissolved Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). System Software 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 April 30, 2000, which reported a net loss of $92.3 million for the prior six months. On May 3, 2000, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was terminated November 15, 2004. On August 25, 2000, the U.S. District Court for the Northern District of Illinois permanently enjoined System Software from violations of Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder. The company has violated that injunction.

B. DELINQUENT PERIODIC FILINGS

6. 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.

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

8. 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 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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63363; File No. S7-04-09)

November 23, 2010

ORDER EXTENDING TEMPORARY CONDITIONAL EXEMPTION FOR NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS FROM REQUIREMENTS OF RULE 17g-5 UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND REQUEST FOR COMMENT

I. Introduction

On May 19, 2010, the Securities and Exchange Commission ("Commission") conditionally exempted, with respect to certain credit ratings and until December 2, 2010, nationally recognized statistical rating organizations ("NRSROs") from certain requirements in Rule 17g-5(a)(3)[1] under the Securities Exchange Act of 1934 ("Exchange Act"), which had a compliance date of June 2, 2010.[2] Pursuant to the Order, an NRSRO is not required to comply with Rule 17g-5(a)(3) until December 2, 2010 with respect to credit ratings where: (1) the issuer of the structured finance product is a non-U.S. person; and (2) the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S. ("covered transactions").[3] The Commission is extending the temporary conditional exemption exempting NRSROs from complying with Rule 17g-5(a)(3) with respect to rating covered transactions until December 2, 2011.

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1 See 17 CFR 240.17g-5(a)(3).

2 See Securities Exchange Act Release No. 62120 (May 19, 2010), 75 FR 28825 (May 24, 2010) ("Order").

3 See id. at 28827-28 (setting forth conditions of relief).

II. Background

Rule 17g-5 identifies, in paragraphs (b) and (c) of the rule, a series of conflicts of interest arising from the business of determining credit ratings.[4] Paragraph (a) of Rule 17g-5[5] prohibits an NRSRO from issuing or maintaining a credit rating if it is subject to the conflicts of interest identified in paragraph (b) of Rule 17g-5 unless the NRSRO has taken the steps prescribed in paragraph (a)(1) (i.e., disclosed the type of conflict of interest in Exhibit 6 to Form NRSRO in accordance with Section 15E(a)(1)(B)(vi) of the Exchange Act[6] and Rule 17g-1)[7] and paragraph (a)(2) (i.e., established and is maintaining and enforcing written policies and procedures to address and manage conflicts of interest in accordance with Section 15E(h) of the Exchange Act).[8] Paragraph (c) of Rule 17g-5 specifically prohibits seven types of conflicts of interest. Consequently, an NRSRO is prohibited from issuing or maintaining a credit rating when it is subject to these conflicts regardless of whether it had disclosed them and established procedures reasonably designed to address them.

In December 2009, the Commission adopted subparagraph (a)(3) to Rule 17g-5. This provision requires an NRSRO that is hired by an arranger to determine an initial credit rating for a structured finance product to take certain steps designed to allow an NRSRO that is not hired by the arranger to nonetheless determine an initial credit rating – and subsequently monitor that credit rating – for the structured finance product.[9] In particular, under Rule 17g-5(a)(3), an NRSRO is prohibited from issuing or maintaining a credit rating when it is subject to the conflict

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4 17 CFR 240.17g-5(b) and (c).

5 17 CFR 240.17g-5(a).

6 15 U.S.C. 78o-7(a)(1)(B)(vi).

7 17 CFR 240.17g-1.

8 15 U.S.C. 78o-7(h).

9 See 17 CFR 240.17g-5(a)(3); see also Securities Exchange Act Release No. 61050 (November 23, 2009), 74 FR 63832 ("Adopting Release") at 63844-45.

of interest identified in paragraph (b)(9) of Rule 17g-5 (i.e., being hired by an arranger to determine a credit rating for a structured finance product)[10] unless it has taken the steps prescribed in paragraphs (a)(1) and (2) of Rule 17g-5 (discussed above) and the steps prescribed in new paragraph (a)(3) of Rule 17g-5.[11] Rule 17g-5(a)(3), among other things, requires that the NRSRO must:

- Maintain on a password-protected Internet Web site a list of each structured finance product for which it currently is in the process of determining an initial credit rating in chronological order and identifying the type of structured finance product, the name of the issuer, the date the rating process was initiated, and the Internet Web site address where the arranger represents the information provided to the hired NRSRO can be accessed by other NRSROs;
- Provide free and unlimited access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification described in paragraph (e) of Rule 17g-5 that covers that calendar year;[12] and

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[10] Paragraph (b)(9) of Rule 17g-5 identifies the following conflict of interest: issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument. 17 CFR 240.17g-5(b)(9).

[11] 17 CFR 240.17g-5(a)(3).

[12] Paragraph (e) of Rule 17g-5 requires that an NRSRO seeking to access the hired NRSRO's Internet website during the applicable calendar year must furnish the Commission with the following certification:

The undersigned hereby certifies that it will access the Internet Web sites described in 17 CFR §240.17g-5(a)(3) solely for the purpose of determining or monitoring credit ratings. Further, the undersigned certifies that it will keep the information it accesses pursuant to 17 CFR §240.17g-5(a)(3) confidential and treat it as material nonpublic information subject to its written policies and procedures established, maintained, and enforced pursuant to section 15E(g)(1) of the Act (15 U.S.C. 78o-7(g)(1)) and 17 CFR §240.17g-4. Further, the undersigned certifies that it will determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to 17 CFR §240.17g-5(a)(3)(iii), if it accesses such information for 10 or more issued securities or money market instruments in the calendar year covered by the certification. Further, the undersigned certifies one of the following as applicable: (1) In the most recent calendar year during which it accessed information pursuant to §17 CFR 240.17g-5(a)(3), the undersigned accessed information for [Insert

- Obtain from the arranger a written representation that can reasonably be relied upon that the arranger will, among other things, disclose on a password-protected Internet web site the information it provides to the hired NRSRO to determine the initial credit rating (and monitor that credit rating) and provide access to the web site to an NRSRO that provides it with a copy of the certification described in paragraph (e) Rule 17g-5.[13]

The Commission stated in the Adopting Release that subparagraph Rule 17g-5(a)(3) is designed to address conflicts of interest and improve the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate structured finance products.[14] For example, the Commission noted that when an NRSRO is hired to rate a structured finance

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Number] issued securities and money market instruments through Internet Web sites described in 17 CFR §240.17g-5(a)(3) and determined and maintained credit ratings for [Insert Number] of such securities and money market instruments; or (2) The undersigned previously has not accessed information pursuant to 17 CFR §240.17g-5(a)(3) 10 or more times during the most recently ended calendar year.

[13] In particular, under paragraph (a)(3)(iii) of Rule 17g-5, the arranger must represent to the hired NRSRO that it will:

(1) Maintain the information described in paragraphs (a)(3)(iii)(C) and (a)(3)(iii)(D) of Rule 17g-5 available at an identified password-protected Internet Web site that presents the information in a manner indicating which information currently should be relied on to determine or monitor the credit rating;

(2) Provide access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification described in paragraph (e) of Rule 17g-5 that covers that calendar year, provided that such certification indicates that the nationally recognized statistical rating organization providing the certification either: (i) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to paragraph (a)(3)(iii) of Rule 17g-5 in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or (ii) has not accessed information pursuant to paragraph (a)(3) of Rule 17g-5 10 or more times during the most recently ended calendar year.

(3) Post on such password-protected Internet Web site all information the arranger provides to the NRSRO, or contracts with a third party to provide to the NRSRO, for the purpose of determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument, at the same time such information is provided to the NRSRO; and

(4) Post on such password-protected Internet Web site all information the arranger provides to the NRSRO, or contracts with a third party to provide to the NRSRO, for the purpose of undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument at the same time such information is provided to the NRSRO.

[14] Adopting Release at 63844.

product, some of the information it relies on to determine the rating is generally not made public.[15] As a result, structured finance products frequently are issued with ratings from only the one or two NRSROs that have been hired by the arranger, with the attendant conflict of interest that creates.[16] The Commission stated that subparagraph Rule 17g-5(a)(3) was designed to increase the number of credit ratings extant for a given structured finance product and, in particular, to promote the issuance of credit ratings by NRSROs that are not hired by arrangers.[17] The Commission's goal in adopting the rule was to provide users of credit ratings with more views on the creditworthiness of structured finance products.[18] In addition, the Commission stated that Rule 17g-5(a)(3) was designed to reduce the ability of arrangers to obtain better than warranted ratings by exerting influence over NRSROs hired to determine credit ratings for structured finance products.[19] Specifically, by opening up the rating process to more NRSROs, the Commission intended to make it easier for the hired NRSRO to resist such pressure by increasing the likelihood that any steps taken to inappropriately favor the arranger could be exposed to the market through the credit ratings issued by other NRSROs.[20]

Rule 17g-5(a)(3) became effective on February 2, 2010, and the compliance date for Rule 17g-5(a)(3) was June 2, 2010.

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15 Id.

16 Id.

17 Id.

18 Id.

19 Id.

20 Id.

III. Extension of Conditional Temporary Extension

In the Order, the Commission requested comment generally, but also on a number of specific issues.[21] The Commission received six comments in response to this solicitation of comment.[22] The commenters continue to express concern that the extraterritorial application of Rule 17g-5(a)(3) could, in the commenter's view, among other things, disrupt local securitization markets,[23] inhibit the ability of local firms to raise capital,[24] and conflict with local laws.[25] Several commenters also requested that the conditional temporary exemption be extended or made permanent.[26] Given the continued concerns about potential disruptions of local securitization markets, and because the Commission's consideration of the issues raised will benefit from additional time to engage in further dialogue with interested parties and to monitor market and regulatory developments, the Commission believes extending the conditional temporary exemption until December 2, 2011 is necessary or appropriate in the public interest, and is consistent with the protection of investors.

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21 See Order, supra note 2, at 28828.

22 Letter from Masamichi Kono, Vice Commissioner for International Affairs, Financial Services Agency, Japan, to Elizabeth Murphy, Secretary, Commission, dated Nov. 12, 2010 ("Japan FSA Letter"); Letter from Masaru Ono, Executive Director, Securitization Forum of Japan, to Elizabeth Murphy, Secretary, Commission, dated Nov. 12, 2010 ("SFJ Letter"); Letter from Rick Watson, Managing Director, Association for Financial Markets in Europe / European Securitisation Forum, to Elizabeth Murphy, Secretary, Commission, dated Nov. 11, 2010 ("AFME Letter"); Letter from Jack Rando, Director, Capital Markets, Investment Industry Association of Canada, to Randall Roy, Assistant Director, Division, Commission, dated Sep. 22, 2010 ("IIAC Letter"); Letter from Christopher Dalton, Chief Executive Officer, Australian Securitisation Forum, to Randall Roy, Assistant Director, Division, Commission, dated Jun. 27, 2010 ("AuSF Letter"); Letter from Takefumi Emori, Managing Director, Japan Credit Rating Agency, Ltd. ("JCR") to Elizabeth Murphy, Secretary, Commission, dated Jun. 25, 2010 ("JCR Letter").

23 See Japan FSA Letter; SFJ Letter; AFME Letter; JCR Letter, AuSF Letter.

24 See AFME Letter; JCR Letter; AuSF Letter.

25 See Japan FSA Letter; AFME Letter; JCR Letter; AuSF Letter; IIAC Letter. With respect to local laws, we note that the European Commission in recent months has issued a relevant proposal for amendments to the European Union Regulation on Credit Ratings. See "Regulation of the European Parliament and of the Counsel on amending Regulation (EC) No 1060/2009 on credit rating agencies" (available at http://ec.europa.eu/internal_market/securities/docs/agencies/100602_proposal_en.pdf).

26 See Japan FSA Letter; SFJ Letter; AFME Letter; JCR Letter.

IV. Request for Comment

The Commission believes that it would be useful to continue to provide interested parties opportunity to comment. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (http://www.sec.gov/rules/exorders.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-04-09 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments

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

All submissions should refer to File Number S7-04-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/exorders.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F St. NE., Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly

V. Conclusion

For the foregoing reasons, the Commission believes it would be necessary or appropriate in the public interest and consistent with the protection of investors to extend the conditional temporary exemption exempting NRSROs from complying with Rule 17g-5(a)(3) with respect to rating covered transactions until December 2, 2011.

ACCORDINGLY,

IT IS HEREBY ORDERED, pursuant to Section 36 of the Exchange Act, that a nationally recognized statistical rating organization is exempt until December 2, 2011 from the requirements in Rule 17g-5(a)(3) (17 CFR 240.17g-5(a)(3)) for credit ratings where:

(1) The issuer of the security or money market instrument is not a U.S. person (as defined under Securities Act Rule 902(k)); and

(2) The nationally recognized statistical rating organization has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63374 / November 24, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14139

In the Matter of HECTOR GALLARDO, MICHAEL ZURITA, and ORION TRADING, LLC, Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Hector Gallardo ("Gallardo"), Michael Zurita ("Zurita"), and Orion Trading, LLC ("Orion") pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. **Orion** is a California limited liability company with its principal place of business in Orlando, Florida. Orion has been registered as a broker-dealer with the Commission since June 1998. Orion conducts business under the name Brokerlatino, among others. From 2005 to 2007, Orion maintained a branch office in New York City.

2. **Zurita**, age 58, is a resident of Orlando, Florida. Zurita, the president of Orion, is a registered representative of Orion and holds Series 7 and 24 licenses. He also held a Series 63 license that expired in October 2004. Zurita was Orion's Chief

Compliance Officer during the relevant period. Orion also employed an outside compliance consultant.

3. **Gallardo**, age 39, is believed to be a resident of Venezuela. He is not currently employed with any U.S.-registered entity. Gallardo has held Series 7 and 63 licenses. From January to September 2007, Gallardo was a registered representative in Orion's New York branch office.

B. RELATED ENTITY AND INDIVIDUAL

4. **Ventel Enterprises Corporation ("Ventel")** is a New York corporation licensed to do business in the state of New York. Sofia Gallardo, Gallardo's wife, serves as the registered agent of Ventel. Ventel is a sham corporation that Gallardo used in 2007 to defraud investors. Ventel does not appear to be a going concern, and is not registered with the Commission in any capacity.

5. **Armando Jaramillo ("Jaramillo")**, age 41, is believed to reside in Lima, Peru. He is not currently employed with any U.S.-registered entity. Jaramillo's Series 7 license expired in May 2004. In 2006 and 2007, Jaramillo worked in Orion's New York branch office, nominally as a foreign associate.

C. GALLARDO DEFRAUDS BOLIVIAN CUSTOMERS OF ORION

6. In 2006, a foreign finder that Orion employed in Bolivia solicited two Bolivian citizens, Jose Moscoso ("Moscoso") and Williams Baina ("Baina") (collectively, the "Bolivian investors"), to invest in U.S. equity markets through Orion. The Bolivian investors formed an entity called Orion Bolivia and solicited and bundled funds from other Bolivian retail investors for the purpose of investing those funds in the U.S. equity markets through Orion. Over time, the Bolivian investors collected and pooled approximately $1.5 million from at least 375 individual Bolivians, who each invested sums ranging from approximately $100 to $32,000. Gallardo was not the registered representative for the Bolivian investors' account at Orion at this time, but in early 2007, Gallardo convinced the Bolivian investors to name him as their registered representative, telling them that he could provide better investment returns.

7. Lured by Gallardo's promises, the Bolivian investors provided Gallardo with a total of approximately $1.154 million for Gallardo to invest on their behalf. Gallardo promised that he would invest in unspecified initial public offerings and/or in investment vehicles offered or managed by Ventel. Gallardo falsely told the Bolivian investors that Ventel was a group of "professional traders" who bought and sold stock for investors, and that Ventel could guarantee a nine to fifteen percent monthly return regardless of market volatility. Gallardo also promised the Bolivian investors that he would return a portion of their principal in six months if he did not obtain the promised returns. Gallardo even returned approximately $275,000 of the Bolivian investors' investments in Ventel to them as illusory "distributions" to maintain the ruse that their investments were performing well.

8. Gallardo initially declined to provide the Bolivian investors with any documentation of their investments, but after several months Gallardo relented and gave them a phony investment contract which described Ventel as a "private complex offering professionally managed investment portfolios," including a fund called the "Capital Partners Fund." Gallardo falsely described the Capital Partners Fund as employing a "proprietary quantitative style" which could take "directional positions" in investments in equities, fixed income, commodities, real estate, currencies, and covered and long options.

9. In fact, Ventel, its "professional traders," its trading strategy, and its purported investments were a complete sham fabricated by Gallardo. Ventel never was an investment "complex." Gallardo did not have any "professional traders" who could invest the Bolivian investors' money or guarantee any returns at all, let alone nine percent monthly returns. Gallardo never invested any of the Bolivian investors' money in any initial public offerings. Instead, Gallardo invested approximately $190,000 of the Bolivian investors' funds in stocks and options through nominee accounts at three brokerages and lost virtually the entire amount — a fact that he did not disclose to the Bolivian investors. Gallardo misappropriated the remainder of the Bolivian investors' money, approximately $685,000. After transferring hundreds of thousands of dollars to a personal checking account, Gallardo used money in that account to pay his and his family's personal expenses, including airline tickets and multiple trips to Atlantic City, where Gallardo liked to gamble.

10. Gallardo repeatedly took steps to conceal his scheme from the Bolivian investors. Initially, when they requested a contract from Ventel setting forth the nine percent guarantee, Gallardo demurred and offered a nonsensical explanation, stating that no contract existed because Ventel was not a bank but rather was comprised of "professional traders." Thereafter, Gallardo orchestrated a meeting with the Bolivian investors in New York in August 2007 with two of Gallardo's associates, Feliciano Carrasco ("Carrasco") and Jaramillo, during which, according to the Bolivian investors, Gallardo and his associates represented that they were affiliated with Ventel and reassured the Bolivian investors that Ventel was a legitimate enterprise. At the time, Carrasco was an employee of JPMorgan Chase Bank, N.A. ("Chase"), and he facilitated the meeting at a Chase bank branch. Shortly after the meeting, Gallardo provided the Bolivian investors with the phony investment contract described in paragraph 8 above. A few weeks later, Gallardo fabricated an email to one of the Bolivian investors from Ventel's "back office" to give the impression that Ventel was a legitimate investment business and to stymie the investor's demands for the returns Gallardo had promised.

11. Gallardo's scheme fell apart by September 2007, when the Bolivian investors demanded to see returns on the initial public offerings of stock in which Gallardo told them he had invested. Because Gallardo could not produce the returns, the Bolivian investors refused to invest further and subsequently lost all contact with Gallardo. Moscoso and Baina lost $876,193 of their and the other 375 investors' money through the investment with Gallardo and Ventel.

D. ZURITA IGNORED RED FLAGS

12. Although stationed in Florida, Zurita was the supervisor responsible for Orion's New York branch office during the relevant period because Orion did not have any qualified supervisory personnel on-site. Zurita recruited Gallardo to be the person in charge of Orion's New York branch office in approximately December 2006. Zurita did not meet with Gallardo in person before retaining him, and performed only cursory due diligence on Gallardo's background. Zurita did learn, however, that Gallardo had little-to-no previous supervisory experience and had never run a branch office. Despite Gallardo's lack of experience, Zurita hired Gallardo in January 2007. Zurita did not travel back to Orion's New York branch office until September 2007. While Zurita hired Gallardo with the understanding that Gallardo would obtain a Series 24 license, thereby becoming qualified to be a branch manager, Zurita knew that Gallardo never took the examination. Zurita therefore remained the person with ultimate responsibility for Orion's New York branch office throughout 2007.

13. In 2007, during the period in which Gallardo carried out his fraud against the Bolivian investors, Zurita ignored a series of red flags that should have put Zurita on notice as to suspicious activity between Gallardo and the Bolivian investors. In particular, in March 2007, following a review of Gallardo's emails, Zurita identified the following email that Gallardo received from Moscoso:

> *I mentioned to you that we are representatives of a company that recruit people that want to invest in the stock market but the condition is that we should pay the client at least 12% (minimum), ideally it would be to pay 15% so that the company also makes money. If you get to make more than 15% on a monthly basis we give you the benefit of 30% of the excess, in this there is a lot of acceptance in that we could send, on average, $100,000 per month. I would like your opinion in this respect, you can call me on my cell phone . . . . I would request you call me urgently because we currently have $100,000 to deposit. If you do not reach us by telephone, send us an email.*

After seeing this email (the "March 2007 email"), Zurita knew, or was reckless in not knowing, that an Orion customer (Moscoso) was communicating with Gallardo about stock market investments that would pay returns in excess of twelve percent *per month* (144% annualized) and was proposing to enter into a profit sharing arrangement with the registered representative, Gallardo. The email also put Zurita on notice that Moscoso was fronting for an unspecified group of other investors. Yet, Zurita waited three weeks to bring the March 2007 email to the attention of Orion's compliance consultant.

14. Zurita claims that he spoke with Gallardo at the time regarding the March 2007 email, and Gallardo orally assured him that Gallardo would follow-up with Moscoso and let him know that Gallardo could not do what Moscoso was asking him to do in the email. No written evidence exists to support Zurita's claim. Zurita's concerns were

sufficiently serious that on multiple occasions from March to May, Zurita sent Gallardo emails demanding a copy of Gallardo's written response to Moscoso. However, Gallardo never responded to Zurita, and Zurita took no steps to determine whether Gallardo had handled the request consistent with Orion's policies and procedures, which required Gallardo to provide Zurita with a copy of Gallardo's written response on the day that Gallardo sent it, or whether disciplinary steps were necessary. Nor did Zurita attempt to contact Moscoso himself. Throughout this period, Zurita still intended for Gallardo to take his Series 24 examination so he could become Orion's New York branch manager.

15. Three months after the March 2007 email, Zurita received further notice that Gallardo was dealing with Moscoso concerning accounts at Orion that involved possible payments to unnamed "clients" of Moscoso. Zurita again failed to respond to this red flag and appears to have condoned the very arrangement with Gallardo that he earlier frowned upon. Specifically, in June 2007, Moscoso complained in an email to Zurita that Zurita had failed to respond to Moscoso's request to wire funds from the Moscoso/Baina accounts at Orion. Moscoso further wrote that he was "very concerned because we need to pay our clients." Zurita responded to Moscoso that Gallardo would liquidate certain positions in the "portfolio" to raise cash to facilitate the requested transfer.

16. Zurita missed other red flags that should have put him on notice about the risks that Gallardo posed to Orion's customers and Gallardo's failure to comply with Orion's policies and procedures. In March 2007, Zurita became aware of a customer complaint alleging that Gallardo had failed to follow a customer's instructions and executed an unauthorized trade at Gallardo's previous brokerage firm. After receiving notice of this complaint, Zurita did not reasonably follow-up on this or other red flags, for example, by placing Gallardo on heightened supervision. Zurita also communicated to Orion's compliance consultant in March his concerns about Gallardo's "aggressive attitude." In April, another registered representative in Orion's New York branch office raised concerns about the conduct of employees in the office, including Gallardo. The representative asserted that Gallardo had placed trades before Gallardo was registered, and that unregistered employees of the branch were cold calling and attempting to sell stock to potential investors. At no time did Zurita visit Orion's New York branch office to assess the veracity of the employee's claims. Nor did Zurita otherwise investigate the operations of the New York branch office or Gallardo's conduct.

E. ORION AND ZURITA FAILED TO DEVELOP REASONABLE SYSTEMS TO IMPLEMENT ORION'S POLICIES AND PROCEDURES

17. Throughout the period when Gallardo was defrauding the Bolivian investors, Zurita was Orion's president. Zurita was therefore ultimately responsible for establishing reasonable policies and procedures and reasonable systems to implement those policies and procedures to detect violative activity by Orion's registered representatives. For example, Orion's Written Supervisory Procedures ("WSP") had a lengthy list of "prohibited transactions/actions." The WSP identified Zurita as the Orion personnel responsible for implementing this section and specified that actions required if Zurita detected prohibited transactions included "[c]onferring with employee," "[i]ssuing a written admonition," and

"[r]estricting the activities of or the transaction handled by the employee." Orion's list of prohibited transactions included "[r]aising money . . . as an agent for any business enterprise whatsoever without the advance written consent of [Zurita];" "[w]arranting or guaranteeing the present/future value or price of any security or warranting that any company, partnership, or issuer of securities will meet its obligations, promises, or comply with its representations to investors;" and "[r]eceiving compensation for securities transactions from anyone (clients or other securities dealers or representatives) for services rendered [including] . . . commissions of any sort."

18. Orion and Zurita failed to develop reasonable systems to implement the WSPs with respect to the prohibited transactions. The March 2007 email from Moscoso to Gallardo that Zurita reviewed involved several transactions on Orion's prohibited list. When Zurita saw the March 2007 email, however, he took no steps other than to ask for Gallardo's written response to Moscoso. Gallardo ignored this request, and other subsequent requests from Zurita. Despite Gallardo's obduracy, Zurita took no other steps to reprimand or otherwise restrict Gallardo's activities.

19. In addition, Orion's WSP referenced a "branch office inspection program." Orion and Zurita failed reasonably to implement the firm's branch office inspection program. In particular, there is no evidence that Zurita ever developed any specific protocol for inspecting the New York branch office, and in fact neither Zurita nor any other supervisor inspected the branch office at any time in 2007, despite the numerous red flags involving that office that he learned of in 2007.

F. ORION EMPLOYED AN UNLICENSED FOREIGN ASSOCIATE

20. Zurita permitted an unlicensed foreign associate to perform the functions of a registered representative at the New York branch office for several months in 2006 and 2007.[1] Jaramillo, a foreign associate affiliated with Orion, began working in Orion's New York branch office by early 2006. Zurita knew that Jaramillo reported to the New York branch office virtually every day. Jaramillo's activities included trading in and otherwise servicing existing customer accounts as well as opening new accounts. Jaramillo worked in Orion's New York branch office until the summer of 2007, when Orion terminated him. At no time did Jaramillo register or take any qualification examination with FINRA.

G. VIOLATIONS

21. As a result of the conduct described above, Zurita and Orion failed reasonably to supervise Gallardo within the meaning of Section 15(b)(4)(E) of the

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1 FINRA defines a "foreign associate" as a person associated with a FINRA member who is not a citizen, national, or resident of the United States and who conducts all of his securities activities outside the jurisdiction of the United States with persons who are not citizens, nationals, or residents of the United States. *See* FINRA Manual, NASD Rule 1100(a).

Exchange Act, which requires broker-dealers reasonably to supervise persons subject to their supervision, with a view toward preventing violations of the federal securities laws.

22. As a result of the conduct described above, Orion willfully violated Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder, which require registration of individuals effecting securities transactions in accordance with standards set forth by a national securities association of which the broker-dealer is a member. Zurita willfully aided and abetted and caused Orion's violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder.

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

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. Whether, pursuant to Section 21C of the Exchange Act, Gallardo should be ordered to cease and desist from committing or causing any violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder; and

D. Whether, pursuant to Section 21C of the Exchange Act, Zurita and Orion should be ordered to cease and desist from committing or causing any violations of and any future violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder.

IV.

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

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

If any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him/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 mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63371 / November 24, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14138

In the Matter of **JOHN BRINER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . attorney . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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. Briner, age 33, is and has been an attorney licensed to practice in the province of British Columbia, Canada. Prior to April 2006, when the Commission temporarily suspended trading in the securities of Golden Apple Oil and Gas, Inc. ("Golden Apple"), he provided legal services at various times to Golden Apple and its predecessors.

2. Golden Apple was, at all relevant times, a Nevada corporation. At times during 2005 and 2006 it purported to have operations in Phoenix and Scottsdale, Arizona. Starting in April 2005, Golden Apple common stock was publicly quoted on an interdealer quotation system, and traded in the Over-the-Counter Market. Golden Apple's website described Briner as Golden Apple's "SEC Counsel."

3. On August 31, 2009, the Commission filed a complaint against Briner in SEC v. Golden Apple Oil and Gas, Inc., et al. (Civil Action No. 09-Civ-7580(HB)). On November 3, 2010, a final judgment was entered by consent against Briner, permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 ("Securities Act"). The judgment also (a) prohibited Briner, for five years following the date of entry of final judgment, from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)]; (b) barred Briner, for five years following the date of entry of final judgment, from participating in an offering of penny stock, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any penny stock; and (c) required Briner to pay $52,488.32 in disgorgement of ill-gotten gains from his sales of stock, and $14,880.08 in prejudgment interest; and a $25,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Briner participated in an invalid Rule 504 offering in order to create purportedly free-trading Golden Apple stock, and then created an appearance of legitimate market activity in Golden Apple stock by participating in the first publicly quoted trade opposite someone to whom he had privately transferred shares from the Rule 504 offering. The Complaint further alleged that Briner, as attorney for Golden Apple, participated in additional issuances of shares that violated the registration requirements of the Securities Act.

IV.

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

Accordingly, it is hereby **ORDERED**, effective immediately, that Briner is suspended from appearing or practicing before the Commission as an attorney for five years. Furthermore, after five years from the date of this Order, Briner 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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63389; File No. S7-16-09)

November 29, 2010

ORDER EXTENDING TEMPORARY CONDITIONAL EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH REQUEST ON BEHALF OF ICE CLEAR EUROPE, LIMITED RELATED TO CENTRAL CLEARING OF CREDIT DEFAULT SWAPS AND REQUEST FOR COMMENT

I. Introduction

The Securities and Exchange Commission ("Commission") has taken multiple actions designed to help foster the prompt development of credit default swap ("CDS") central counterparties ("CCP"), including granting temporary conditional exemptions from certain provisions of the federal securities laws.[1]

In July 2009, the Commission issued an order providing temporary conditional exemptions to ICE Clear Europe Limited ("ICE Clear Europe"), and certain other parties, to permit ICE Clear Europe to clear and settle CDS transactions.[2] In response to ICE Clear

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[1] See generally Securities Exchange Act Release Nos. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) and 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited); Securities Exchange Act Release Nos. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) and 61975 (Apr. 23, 2010), 75 FR 22641(Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG); Securities Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.); Securities Exchange Act Release Nos. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009), and 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) (temporary exemptions in connection with CDS clearing by ICE Trust U.S. LLC); Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.); and other Commission actions discussed in several of these orders. In addition, the Commission has issued interim final temporary rules that provide exemptions under the Securities Act of 1933 and the Securities Exchange Act of 1934 for CDS to facilitate the operation of one or more central counterparties for the CDS market. See Securities Act Release Nos. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval), 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010), and 9158 (Nov. 30, 2010) (extension until Jul. 16, 2011).

[2] Securities Exchange Act Release No. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) ("July 2009 ICE Clear Europe Exemptive Order").

Europe's request, the Commission temporarily extended and expanded the exemptions in April 2010.[3] The current exemptions pursuant to the April 2010 ICE Clear Europe Exemptive Order are scheduled to expire on November 30, 2010, and ICE Clear Europe has requested that the Commission extend the exemptions contained in the April 2010 ICE Clear Europe Exemptive Order.[4]

II. Discussion

A. Legislative Developments

Subsequent to the Commission's issuance of the April 2010 ICE Clear Exemptive Order, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") into law.[5] The Dodd-Frank Act was enacted to, among other purposes, promote the financial stability of the United States by improving accountability and transparency in the financial system.[6] To this end, the provisions of Title VII of the Dodd-Frank Act provide for the comprehensive regulation of security-based swaps[7] by the Commission.[8] The Dodd-

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3 Securities Exchange Act Release No. 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) ("April 2010 ICE Clear Europe Exemptive Order").

4 See Letter from Russell D. Sacks, ICE Clear Europe, to Elizabeth Murphy, Secretary, Commission, Nov. 29, 2010 ("November 2010 Request").

5 Pub. L. No. 111-203 (July 21, 2010).

6 See Pub. L. No. 111-203, Preamble.

7 Section 761(a)(6) of the Dodd-Frank Act defines a "security-based swap" as any agreement, contract, or transaction that is a "swap," as defined in Section 1a(47) of the Commodity Exchange Act, 7 U.S.C. 1a(47), that is based on an index that is a narrow-based security index, a single security, or a loan, including any interest therein or on the value thereof; or the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer. See Section 3(a)(68) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C.78c(a)(68) (as added by Section 761(a)(6) of the Dodd-Frank Act). Section 712(d) of the Dodd-Frank Act provides that the Commission and the Commodity Futures Trading Commission ("CFTC"), in consultation with the Board of Governors of the Federal Reserve System, shall, among other things, jointly further define the terms "swap" and "security-based swap."

Frank Act amends the Exchange Act to require, among other things, that transactions in security-based swaps be cleared through a clearing agency that is registered with the Commission or that is exempt from registration if they are of a type that the Commission determines must be cleared, unless an exception or exemption from mandatory clearing applies.[9] Furthermore, Title VII of the Dodd-Frank Act provides that a derivatives clearing organization registered with the CFTC that cleared swaps pursuant to an exemption from registration as a clearing agency prior to the date of enactment of the Dodd-Frank Act, such as ICE Clear Europe, is deemed registered as a clearing agency for the purposes of clearing security-based swaps ("Deemed Registered Provision").[10] The Deemed Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, becomes effective on July 16, 2011.[11] As a result, ICE Clear Europe will no longer need the exemption from registration as a clearing agency under Section 17A of the Exchange Act provided by the April 2010 ICE Clear Europe Exemptive Order, and previous orders, to clear security-based swaps after the Deemed Registered Provision becomes effective.

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[8] Section 761(a)(2) of the Dodd-Frank Act explicitly includes security-based swaps in the definition of "security" in Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c.

[9] See Section 763(a) of the Dodd-Frank Act (adding new Section 3C to the Exchange Act, 15 U.S.C. 78c-2).

[10] See Section 763(b) of the Dodd-Frank Act (adding new Section 17A(l) to the Exchange Act, 15 U.S.C. 78q-1(l)). Under this Deemed Registered Provision, ICE Clear Europe will be required to comply with all requirements of the Exchange Act, and the rules thereunder, applicable to registered clearing agencies to the extent it clears security-based swaps after the effective date of the Deemed Registered Provision, including, for example, the obligation to file proposed rule changes under Section 19(b) of the Exchange Act.

[11] Section 774 of the Dodd-Frank Act states, "[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle."

B. ICE Clear Europe's Request for Extension of April 2010 ICE Clear Europe Exemptive Order

ICE Clear Europe seeks an extension of the temporary exemptions of the April 2010 ICE Clear Europe Exemptive Order under the same terms and conditions contained in the April 2010 ICE Clear Europe Exemptive Order.[12] In ICE Clear's request for an extension of the April 2010 ICE Clear Exemptive Order, ICE Clear represents that there have been no material changes to the operations of ICE Clear, and that the representations made by ICE Clear in connection with the April 2010 ICE Clear Exemptive Order remain true in all material respects.[13] These representations are discussed in detail in our earlier ICE Clear orders.

Accordingly, consistent with our findings in the April 2010 ICE Clear Europe Order, and, in particular, in light of the risk management and systemic benefits in continuing to facilitate CDS clearing by ICE Clear Europe until Title VII of the Dodd-Frank Act becomes fully effective, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend the exemptive relief granted in the April 2010 ICE Clear Europe Exemptive Order until July 16, 2011. Specifically, pursuant to the Commission's authority under Section 36 of the Exchange Act,[14] based on the facts presented and the representations made by ICE Clear Europe,[15] the Commission is

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12 See November 2010 Request, supra note 4.

13 See id. ICE Clear Europe notes that it has created a set of amendments to its rulebook and procedures for technical improvements to the process for dealing with restructuring credit events and to facilitate the imminent introduction of clearing of non-U.S., non-U.K. sovereign CDS contracts.

14 15 U.S.C. 78mm. Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class of classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

15 See November 2010 Request, supra note 4. The exemptions we are granting today are based on all of the representations made by ICE Clear Europe in its request, which incorporate representations

extending until July 16, 2011, under the same terms and conditions in the April 2010 ICE Clear Europe Exemptive Order each of the existing exemptions connected with CDS clearing by ICE Clear Europe, which include: the temporary conditional exemption granted to ICE Clear Europe from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS; the temporary conditional exemption of ICE Clear Europe and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-market prices for certain non-excluded CDS cleared by ICE Clear Europe; the temporary conditional exemption of ICE Clear Europe and certain eligible contract participants from certain Exchange Act requirements with respect to certain non-excluded CDS cleared by ICE Clear Europe; and the temporary conditional exemption from certain Exchange Act requirements granted to registered broker-dealers with respect to certain non-excluded CDS.[16]

C. Solicitation of Comments

When we granted the April 2010 ICE Clear Europe Order, we requested comment on all aspects of the exemptions. We received no comments in response. In connection with this Order extending the exemptions granted in connection with CDS clearing by ICE Clear Europe, we reiterate our request for comments on all aspects of the exemptions.

Comments may be submitted by any of the following methods:

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made by ICE Clear Europe in connection with the April 2010 ICE Clear Europe Exemptive Order, which in turn incorporate representations related to our earlier exemptive orders. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS (as defined in the April 2010 ICE Clear Europe Exemptive Order) that previously had been cleared pursuant to the exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

16 See April 2010 ICE Clear Europe Exemptive Order, supra note 3.

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-16-09 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov/). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-16-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 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.

III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36(a) of the Exchange Act, that, until July 16, 2011, the following exemptions connected with CDS clearing by ICE Clear Europe contained in the April 2010 ICE Clear Europe Exemptive Order are extended: (i) the temporary conditional exemption granted to ICE Clear Europe from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS; (ii) the temporary conditional exemption of ICE Clear Europe and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-market prices for certain non-excluded CDS cleared by ICE Clear Europe; (iii) the temporary conditional exemption of ICE Clear Europe and certain eligible contract participants from certain Exchange Act requirements with respect to certain non-excluded CDS cleared by ICE Clear Europe; and (iv) the temporary conditional exemption from certain Exchange Act requirements granted to registered broker-dealers with respect to certain non-excluded CDS.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63388; File No. S7-06-09)

November 29, 2010

ORDER EXTENDING TEMPORARY CONDITIONAL EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH REQUEST OF CHICAGO MERCANTILE EXCHANGE INC. RELATED TO CENTRAL CLEARING OF CREDIT DEFAULT SWAPS AND REQUEST FOR COMMENT

I. Introduction

The Securities and Exchange Commission ("Commission") has taken multiple actions designed to help foster the prompt development of credit default swap ("CDS") central counterparties ("CCP"), including granting temporary conditional exemptions from certain provisions of the federal securities laws.[1]

In March 2009, the Commission issued an order providing temporary conditional exemptions to the Chicago Mercantile Exchange Inc. ("CME"), and certain other parties, to permit CME to clear and settle CDS transactions.[2] In response to CME's request, the

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1 See generally Securities Exchange Act Release Nos. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) and 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited); Securities Exchange Act Release Nos. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) and 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG); Securities Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.); Securities Exchange Act Release Nos. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009), and 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) (temporary exemptions in connection with CDS clearing by ICE Trust U.S. LLC); Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.); and other Commission actions discussed in several of these orders. In addition, the Commission has issued interim final temporary rules that provide exemptions under the Securities Act of 1933 and the Securities Exchange Act of 1934 for CDS to facilitate the operation of one or more central counterparties for the CDS market. See Securities Act Release Nos. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval), 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010), and 9158 (Nov. 30, 2010) (extension until Jul. 16, 2011).

2 Securities Exchange Act Release No. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009) ("March 2009 CME Exemptive Order").

Commission temporarily extended and expanded the exemptions in December 2009 and in March 2010.[3] The current exemptions pursuant to the March 2010 CME Exemptive Order are scheduled to expire on November 30, 2010, and CME has requested that the Commission extend the exemptions contained in the March 2010 CME Exemptive Order.[4]

II. Discussion

A. Legislative Developments

Subsequent to the Commission's issuance of the March 2010 CME Exemptive Order, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") into law.[5] The Dodd-Frank Act was enacted to, among other purposes, promote the financial stability of the United States by improving accountability and transparency in the financial system.[6] To this end, the provisions of Title VII of the Dodd-Frank Act provide for the comprehensive regulation of security-based swaps[7] by the Commission.[8] The Dodd-

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3 Securities Exchange Act Release Nos. 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009) ("December 2009 CME Exemptive Order"); 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) ("March 2010 CME Exemptive Order").

4 See Letter from Ann K. Shuman, Managing Director and Deputy General Counsel, CME, to Elizabeth Murphy, Secretary, Commission, Nov. 29, 2010 ("November 2010 Request").

5 Pub. L. No. 111-203 (July 21, 2010).

6 See Pub. L. No. 111-203, Preamble.

7 Section 761(a)(6) of the Dodd-Frank Act defines a "security-based swap" as any agreement, contract, or transaction that is a "swap," as defined in Section 1a(47) of the Commodity Exchange Act, 7 U.S.C. 1a(47), that is based on an index that is a narrow-based security index, a single security, or a loan, including any interest therein or on the value thereof; or the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer. See Section 3(a)(68) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C.78c(a)(68) (as added by Section 761(a)(6) of the Dodd-Frank Act). Section 712(d) of the Dodd-Frank Act provides that the Commission and the Commodity Futures Trading Commission ("CFTC"), in consultation with the Board of Governors of the Federal Reserve System, shall, among other things, jointly further define the terms "swap" and "security-based swap."

8 Section 761(a)(2) of the Dodd-Frank Act explicitly includes security-based swaps in the definition of "security" in Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c.

Frank Act amends the Exchange Act to require, among other things, that transactions in security-based swaps be cleared through a clearing agency that is registered with the Commission or that is exempt from registration if they are of a type that the Commission determines must be cleared, unless an exception or exemption from mandatory clearing applies.[9] Furthermore, Title VII of the Dodd-Frank Act provides that a derivatives clearing organization registered with the CFTC that cleared swaps pursuant to an exemption from registration as a clearing agency prior to the date of enactment of the Dodd-Frank Act, such as CME, is deemed registered as a clearing agency for the purposes of clearing security-based swaps ("Deemed Registered Provision").[10] The Deemed Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, becomes effective on July 16, 2011.[11] As a result, CME will no longer need the exemption from registration as a clearing agency under Section 17A of the Exchange Act provided by the March 2010 CME Exemptive Order, and previous orders, to clear security-based swaps after the Deemed Registered Provision becomes effective.

B. <u>CME's Request for Extension of March 2010 CME Exemptive Order</u>

CME seeks an extension of the temporary exemptions of the March 2010 CME Exemptive Order under the same terms and conditions contained in the March 2010 CME

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9 <u>See</u> Section 763(a) of the Dodd-Frank Act (adding new Section 3C to the Exchange Act, 15 U.S.C. 78c-2).

10 <u>See</u> Section 763(b) of the Dodd-Frank Act (adding new Section 17A(l) to the Exchange Act, 15 U.S.C. 78q-1(1)). Under this Deemed Registered Provision, CME will be required to comply with all requirements of the Exchange Act, and the rules thereunder, applicable to registered clearing agencies to the extent it clears security-based swaps after the effective date of the Deemed Registered Provision, including, for example, the obligation to file proposed rule changes under Section 19(b) of the Exchange Act.

11 Section 774 of the Dodd-Frank Act states, "[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle."

Exemptive Order.[12] CME's request for an extension of the March 2010 CME Exemptive Order incorporates representations made in the requests preceding the March 2010 CME Exemptive Order, the December 2009 CME Exemptive Order, and the March 2009 CME Exemptive Order,[13] which are discussed in detail in our earlier CME orders. CME represents that there have been no material changes to the statements made in the previous requests, apart from CME's adoption of substantive rules for the treatment of customer cleared OTC derivatives.[14] Furthermore, CME represents that it will implement policies and procedures designed to ensure compliance with the terms of the Exemptive Orders and conduct an internal review related to its compliance program.

Accordingly, consistent with our findings in the March 2010 CME Exemptive Order, and, in particular, in light of the risk management and systemic benefits in continuing to facilitate CDS clearing by CME until Title VII of the Dodd-Frank Act becomes fully effective, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend the exemptive relief granted in the March 2010 CME Exemptive Order until July 16, 2011. Specifically, pursuant to the Commission's authority under Section 36 of the Exchange Act,[15] based on the facts presented and the representations made by CME,[16] the Commission is extending until July 16, 2011, under

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12 See November 2010 Request, supra note 4.

13 See id.

14 See infra note 17. CME also notes that it is evaluating the creation of a separate guaranty fund for its CDS and futures business. See November 2010 Request, supra note 4.

15 15 U.S.C. 78mm. Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class of classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

16 See November 2010 Request, supra note 4. The exemptions we are granting today are based on

the same terms and conditions in the March 2010 CME Exemptive Order, each of the existing exemptions connected with CDS clearing by CME, which include: the temporary conditional exemption granted to CME from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS; the temporary conditional exemption of CME and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-market prices for certain non-excluded CDS cleared by CME; the temporary conditional exemption of CME and certain eligible contract participants from certain Exchange Act requirements with respect to certain non-excluded CDS cleared by CME; the temporary conditional exemption of certain CME clearing members that receive customer collateral in connection with certain non-excluded CDS cleared by CME from certain Exchange Act requirements;[17] and the temporary conditional exemption from certain Exchange Act requirements granted to registered broker-dealers with respect to certain non-excluded CDS.[18]

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all of the representations made by CME in its request, which incorporate representations made by CME in its requests for relief in connection with the March 2010 CME Exemptive Order, the December 2009 CME Exemptive Order, and the March 2009 CME Exemptive Order. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS (as defined in the March 2010 CME Exemptive Order) that previously had been cleared pursuant to the exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

17 The March 2010 CME Exemptive Order required CME clearing members relying on this exemption to hold customer collateral in one of three types of accounts: (i) in an account established pursuant to Section 4d of the Commodity Exchange Act; (ii) in the absence of a 4d Order from the CFTC, in an account that is part of a separate account class, specified by CFTC Bankruptcy Rules (see 17 CFR 190.01 et seq.), established for a futures commission merchant ("FCM") to hold its customers' positions and collateral in cleared OTC derivatives; or (iii) if both of those alternatives are not available, in an account established in accordance with CFTC Rule 30.7 (with additional disclosures to be made to the customer). The CFTC has taken final action on proposed rules to establish a new account class that is applicable to positions in "Cleared OTC Derivatives," which became effective on May 6, 2010. See 75 FR 17297 (Apr. 6, 2010). On October 4, 2010, CME implemented rules with substantive requirements for the treatment of customer cleared OTC derivatives, and as of that date all CME cleared customer CDS

C. Solicitation of Comments

When we granted the March 2010 CME Exemptive Order, we requested comment on all aspects of the exemptions. We received one comment in response to this request, the content of which is outside of the scope of the Commission's jurisdiction.[19]

In connection with this Order extending the exemptions granted in connection with CDS clearing by CME, we reiterate our request for comments on all aspects of the exemptions.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-06-09 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov/). Follow the instructions for submitting comments.

Paper comments:

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

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positions and related collateral previously held in CFTC Rule 30.7 accounts are required to be held in "cleared OTC Derivatives Customer Sequestered Accounts." Given these developments, the terms of the March 2010 CME Exemptive Order, and this Order, require customer collateral to be held in an account established pursuant to a 4d Order or an account that is part of a separate account class established for an FCM to hold its customers' positions and collateral in Cleared OTC Derivatives.

18 See March 2010 CME Exemptive Order, supra note 3.

19 See Comment from Richard Gaib, Apr. 5, 2010, commenting on the farm credit system.

All submissions should refer to File Number S7-06-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 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.

III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36(a) of the Exchange Act, that, until July 16, 2011, the following exemptions connected with CDS clearing by CME contained in the March 2010 CME Exemptive Order are extended: (i) the temporary conditional exemption granted to CME from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS; (ii) the temporary conditional exemption of CME and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-market prices for certain non-excluded CDS cleared by CME; (iii) the temporary conditional exemption of CME and certain eligible contract participants from certain Exchange Act requirements with respect to certain non-excluded CDS cleared by CME; (iv) the temporary conditional exemption of certain CME clearing members that receive customer collateral in connection with certain non-excluded CDS cleared by CME from certain Exchange Act requirements; and (v) the temporary conditional exemption from certain Exchange Act requirements granted to registered broker-dealers with respect to certain non-excluded CDS.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63390; File No. S7-17-09)

November 29, 2010

ORDER EXTENDING TEMPORARY CONDITIONAL EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH REQUEST ON BEHALF OF EUREX CLEARING AG RELATED TO CENTRAL CLEARING OF CREDIT DEFAULT SWAPS AND REQUEST FOR COMMENT

I. Introduction

The Securities and Exchange Commission ("Commission") has taken multiple actions designed to help foster the prompt development of credit default swap ("CDS") central counterparties ("CCP"), including granting temporary conditional exemptions from certain provisions of the federal securities laws.[1]

In July 2009, the Commission issued an order providing temporary conditional exemptions to Eurex Clearing AG ("Eurex"), and certain other parties, to permit Eurex to clear and settle CDS transactions.[2] In response to Eurex's request, the Commission temporarily

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1 See generally Securities Exchange Act Release Nos. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) and 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited); Securities Exchange Act Release Nos. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) and 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG); Securities Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.); Securities Exchange Act Release Nos. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009), and 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) (temporary exemptions in connection with CDS clearing by ICE Trust U.S. LLC); Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.); and other Commission actions discussed in several of these orders. In addition, the Commission has issued interim final temporary rules that provide exemptions under the Securities Act of 1933 and the Securities Exchange Act of 1934 for CDS to facilitate the operation of one or more central counterparties for the CDS market. See Securities Act Release Nos. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval), 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010), and 9158 (Nov. 30, 2010) (extension until Jul. 16, 2011).

2 Securities Exchange Act Release No. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) ("July 2009 Eurex Exemptive Order").

extended and expanded the exemptions in April 2010.[3] The current exemptions pursuant to the April 2010 Eurex Exemptive Order are scheduled to expire on November 30, 2010, and Eurex has requested that the Commission extend the exemptions contained in the April 2010 Eurex Exemptive Order.[4]

II. Discussion

A. Legislative Developments

Subsequent to the Commission's issuance of the April 2010 Eurex Exemptive Order, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") into law.[5] The Dodd-Frank Act was enacted to, among other purposes, promote the financial stability of the United States by improving accountability and transparency in the financial system.[6] To this end, the provisions of Title VII of the Dodd-Frank Act provide for the comprehensive regulation of security-based swaps[7] by the Commission.[8] The Dodd-Frank Act amends the Exchange Act to require, among other things, that transactions in security-

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3 Securities Exchange Act Release No. 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) ("April 2010 Eurex Exemptive Order")

4 See Letter from Paul Architzel, Alston & Bird, to Elizabeth Murphy, Secretary, Commission, Nov. 29, 2010 ("November 2010 Request").

5 Pub. L. No. 111-203 (July 21, 2010).

6 See Pub. L. No. 111-203, Preamble.

7 Section 761(a)(6) of the Dodd-Frank Act defines a "security-based swap" as any agreement, contract, or transaction that is a "swap," as defined in Section 1a(47) of the Commodity Exchange Act, 7 U.S.C. 1a(47), that is based on an index that is a narrow-based security index, a single security, or a loan, including any interest therein or on the value thereof; or the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer. See Section 3(a)(68) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C.78c(a)(68) (as added by Section 761(a)(6) of the Dodd-Frank Act). Section 712(d) of the Dodd-Frank Act provides that the Commission and the Commodity Futures Trading Commission ("CFTC"), in consultation with the Board of Governors of the Federal Reserve System, shall, among other things, jointly further define the terms "swap" and "security-based swap."

8 Section 761(a)(2) of the Dodd-Frank Act explicitly includes security-based swaps in the definition of "security" in Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c.

based swaps be cleared through a clearing agency that is registered with the Commission or that is exempt from registration if they are of a type that the Commission determines must be cleared, unless an exception or exemption from mandatory clearing applies.[9] Specifically, Section 763(b) of the Dodd-Frank Act adds a new Section 17A(g) to the Exchange Act which states: "It shall be unlawful for a clearing agency, unless registered with the Commission, directly or indirectly to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to a security-based swap."[10] This new registration provision, along with other general provisions under Title VII of the Dodd-Frank Act, becomes effective on July 16, 2011.[11] As a result, the Commission anticipates that Eurex would need to apply and become registered as a clearing agency under Section 17A of the Exchange Act when relevant provisions of the Dodd-Frank Act become effective in order to clear security-based swaps.

B. Eurex's Request for Extension of April 2010 Eurex Exemptive Order

Eurex seeks an extension of the temporary exemptions of the April 2010 Eurex Exemptive Order under the same terms and conditions contained in the April 2010 Eurex

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9 See Section 763(a) of the Dodd-Frank Act (adding new Section 3C to the Exchange Act, 15 U.S.C. 78c-2).

10 While Title VII of the Dodd-Frank Act provides that certain entities that cleared swaps pursuant to an exemption from registration as a clearing agency prior to the date of enactment of the Dodd-Frank Act are deemed registered as a clearing agency for the purposes of clearing security-based swaps ("Deemed Registered Provision"), Eurex would not qualify for the Deemed Registered Provision. See Section 763(b) of the Dodd-Frank Act (adding new Section 17A(l) to the Exchange Act, 15 U.S.C. 78q-1(l)). A clearing agency must be a depository institution that cleared swaps as a multilateral clearing organization or a derivative clearing organization that cleared swaps pursuant to an exemption from registration as a clearing agency. Id. Since Eurex is not a depository institution and is not a derivative clearing organization, it does not qualify for the Deemed Registered Provision.

11 Section 774 of the Dodd-Frank Act states, "[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle."

Exemptive Order.[12] Eurex's request for an extension of the April 2010 Eurex Exemptive Order incorporates the representations made in its request preceding the April 2010 Eurex Exemptive Order and its request preceding the July 2009 Eurex Exemptive Order.[13] These representations are discussed in detail in our earlier Eurex orders. Eurex represents that these representations remain valid.[14]

Accordingly, consistent with our findings in the April 2010 Eurex Exemptive Order, and, in particular, in light of the risk management and systemic benefits in continuing to facilitate CDS clearing by Eurex until Title VII of the Dodd-Frank Act becomes fully effective, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend the exemptive relief granted in the April 2010 Eurex Exemptive Order until July 16, 2011. Specifically, pursuant to the Commission's authority under Section 36 of the Exchange Act,[15] based on the facts presented and the representations made by Eurex,[16] the Commission is extending until July 16, 2011, under

12 See November 2010 Request, supra note 4.

13 See id.

14 In the April 2010 Eurex Exemptive Order, the Commission described Eurex's proposed activity to clear CDS transactions of its members' customers. Under this proposed activity, Eurex intended to provide customer clearing capability for: (i) customers that would enter into a tri-party agreement with Eurex and the clearing member, in which the clearing member agrees to guarantee the customer's position and the customer agrees to be bound by Eurex's Clearing Conditions ("Registered Customer") and (ii) customers that do not enter into such an agreement. Eurex indicated in its November 2010 Request that it now intends to provide customer clearing capability only for Registered Customers under the exemptive relief.

15 15 U.S.C. 78mm. Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class of classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

16 See November 2010 Request, supra note 4. The exemptions we are granting today are based on all of the representations made by Eurex in its request, which incorporate representations made by Eurex in its request for relief granted in the April 2010 Eurex Exemptive Order and its request for relief granted in the July 2009 Eurex Exemptive Order. We recognize, however, that there could be legal uncertainty in

the same terms and conditions in the April 2010 Eurex Exemptive Order, each of the existing exemptions connected with CDS clearing by Eurex, which include: the temporary conditional exemption granted to Eurex from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS; the temporary conditional exemption of Eurex and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-market prices for certain non-excluded CDS cleared by Eurex; the temporary conditional exemption of Eurex and certain eligible contract participants from certain Exchange Act requirements with respect to certain non-excluded CDS cleared by Eurex; the temporary conditional exemption of Eurex clearing members and certain others from broker-dealer registration requirements and related requirements in connection with CDS clearing by Eurex (including clearing of customer CDS transactions); and the temporary conditional exemption from certain Exchange Act requirements granted to registered broker-dealers with respect to certain non-excluded CDS.[17]

C. Solicitation of Comments

When we granted the April 2010 Eurex Exemptive Order, we requested comment on all aspects of the exemptions. We received no comments in response this request.

In connection with this Order extending exemptions granted in connection with CDS clearing by Eurex, we reiterate our request for comments on all aspects of the exemptions.

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the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS (as defined in the April 2010 Eurex Exemptive Order) that previously had been cleared pursuant to the exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

17 See April 2010 Eurex Exemptive Order, supra note 4.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-17-09 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov/). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-17-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 am and 3 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36(a) of the Exchange Act, that, until July 16, 2011, the following exemptions connected with CDS clearing by Eurex contained in the

April 2010 Eurex Exemptive Order are extended: (i) the temporary conditional exemption granted to Eurex from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS; (ii) the temporary conditional exemption of Eurex and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-market prices for certain non-excluded CDS cleared by Eurex; (iii) the temporary conditional exemption of Eurex and certain eligible contract participants from certain Exchange Act requirements with respect to certain non-excluded CDS cleared by Eurex; (iv) the temporary conditional exemption of Eurex clearing members and certain others from broker-dealer registration requirements and related requirements in connection with CDS clearing by Eurex (including clearing of customer CDS transactions); and (v) the temporary conditional exemption from certain Exchange Act requirements granted to registered broker-dealers with respect to certain non-excluded CDS.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63387; File No. S7-05-09)

November 29, 2010

ORDER EXTENDING AND MODIFYING TEMPORARY EXEMPTIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 IN CONNECTION WITH REQUEST OF ICE TRUST U.S. LLC RELATED TO CENTRAL CLEARING OF CREDIT DEFAULT SWAPS AND REQUEST FOR COMMENT

I. Introduction

The Securities and Exchange Commission ("Commission") has taken multiple actions designed to help foster the prompt development of credit default swap ("CDS") central counterparties ("CCP"), including granting temporary conditional exemptions from certain provisions of the federal securities laws.[1]

In March 2009, the Commission issued an order providing temporary conditional exemptions to ICE Trust U.S. LLC ("ICE Trust"), and certain other parties, to permit ICE Trust

1 See generally Securities Exchange Act Release Nos. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) and 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited); Securities Exchange Act Release Nos. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) and 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG); Securities Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.); Securities Exchange Act Release Nos. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009) ("March 2009 ICE Trust Exemptive Order"), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009) ("December 2009 ICE Trust Exemptive Order"), and 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) ("March 2010 ICE Trust Exemptive Order," and together with the March 2009 ICE Trust Exemptive Order and December 2009 ICE Trust Exemptive Order the "ICE Trust Exemptive Orders") (temporary exemptions in connection with CDS clearing by ICE Trust U.S. LLC); Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.); and other Commission actions discussed in several of these orders. In addition, the Commission has issued interim final temporary rules that provide exemptions under the Securities Act of 1933 and the Securities Exchange Act of 1934 for CDS to facilitate the operation of one or more central counterparties for the CDS market. See Securities Act Release Nos. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval), 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010), and 9158 (Nov. 30, 2010) (extension until Jul. 16, 2011).

to clear and settle CDS transactions.[2] In response to ICE Trust's request, the Commission temporarily extended and expanded the exemptions in December 2009 and in March 2010.[3] The current exemptions pursuant to the March 2010 ICE Trust Exemptive Order are scheduled to expire on November 30, 2010, and ICE Trust has requested that the Commission extend and modify the exemptions contained in the March 2010 ICE Trust Exemptive Order.[4]

The Commission's current authority over the OTC market for CDS is limited.[5] Specifically, Section 3A of the Securities Exchange Act of 1934 ("Exchange Act") limits the Commission's authority over swap agreements, as defined in Section 206A of the Gramm-Leach-Bliley Act.[6] For those CDS that are swap agreements, the exclusion from the definition of security in Section 3A of the Exchange Act, and related provisions, will continue to apply. The Commission's action today does not affect these CDS, and this Order does not apply to them. For those CDS that are not swap agreements ("non-excluded CDS"), the Commission's action today provides temporary conditional exemptions from certain requirements of the Exchange Act.

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2 Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009).

3 Securities Exchange Act Release Nos. 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009) and 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010).

4 See Letter from Kevin McClear, ICE Trust, to Elizabeth Murphy, Secretary, Commission, Nov. 29, 2010 ("November 2010 Request").

5 Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") addresses limitations on the Commission's current authority in this area. As discussed in Part II.A infra, provisions of Title VII of the Dodd-Frank Act generally become effective on July 16, 2011.

6 15 U.S.C. 78c-1. Section 3A excludes both a non-security-based and a security-based swap agreement from the definition of "security" under Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10). Section 206A of the Gramm-Leach-Bliley Act defines a "swap agreement" as "any agreement, contract, or transaction between eligible contract participants (as defined in section 1a(12) of the Commodity Exchange Act . . .) . . . the material terms of which (other than price and quantity) are subject to individual negotiation." 15 U.S.C. 78c note.

II. Discussion

A. Legislative Developments

Subsequent to the Commission's issuance of the March 2010 ICE Trust Exemptive Order, the President signed the Dodd-Frank Act into law.[7] The Dodd-Frank Act was enacted to, among other purposes, promote the financial stability of the United States by improving accountability and transparency in the financial system.[8] To this end, the provisions of Title VII of the Dodd-Frank Act provide for the comprehensive regulation of security-based swaps[9] by the Commission.[10] The Dodd-Frank Act amends the Exchange Act to require, among other things, that transactions in security-based swaps be cleared through a clearing agency that is registered with the Commission or that is exempt from registration if they are of a type that the Commission determines must be cleared, unless an exception or exemption from mandatory clearing applies.[11] Furthermore, Title VII of the Dodd-Frank Act provides that a depository institution that cleared swaps as a multilateral clearing organization prior to the date of

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7 Pub. L. No. 111-203 (July 21, 2010).

8 See Pub. L. No. 111-203, Preamble.

9 Section 761(a)(6) of the Dodd-Frank Act defines a "security-based swap" as any agreement, contract, or transaction that is a "swap," as defined in Section 1a(47) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 1a(47), that is based on an index that is a narrow-based security index, including any interest therein or on the value thereof; a single security, or a loan, including any interest therein or on the value thereof; or the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer. See Section 3(a)(68) of the Exchange Act, 15 U.S.C.78c(a)(68) (as added by Section 761(a)(6) of the Dodd-Frank Act). Section 712(d) of the Dodd-Frank Act provides that the Commission and the Commodity Futures Trading Commission ("CFTC"), in consultation with the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), shall, among other things, jointly further define the terms "swap" and "security-based swap." The Commission and the CFTC will jointly propose a rule to further define these terms, including with respect to credit default swaps.

10 Section 761(a)(2) of the Dodd-Frank Act explicitly includes security-based swaps in the definition of "security" in Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c.

11 See Section 763(a) of the Dodd-Frank Act (adding new Section 3C(a)(1) to the Exchange Act, 15 U.S.C. 78c-2).

enactment of the Dodd-Frank Act, such as ICE Trust, is deemed registered as a clearing agency for the purposes of clearing security-based swaps ("Deemed Registered Provision").[12] The Deemed Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, becomes effective on July 16, 2011.[13] As a result, ICE Trust will no longer need the exemption from registration as a clearing agency under Section 17A of the Exchange Act provided by the March 2010 ICE Trust Exemptive Order, and previous orders, to clear security-based swaps after the Deemed Registered Provision becomes effective.

B. ICE Trust's Request for Extension of March 2010 ICE Trust Exemptive Order

ICE Trust seeks an extension of the relief provided by the March 2010 ICE Trust Exemptive Order, as modified herein.[14] In ICE Trust's request for an extension of the March 2010 ICE Trust Exemptive Order, ICE Trust represents that there have been no material changes to the operations of ICE Trust, and that the representations made by ICE Trust in connection with the March 2010 ICE Trust Exemptive Order remain true in all material respects.[15] These representations are discussed in detail in our earlier ICE Trust orders.

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12 See Section 763(b) of the Dodd-Frank Act (adding new Section 17A(l) to the Exchange Act, 15 U.S.C. 78q-1(l)). Under this Deemed Registered Provision, ICE Trust will be required to comply with all requirements of the Exchange Act, and the rules thereunder, applicable to registered clearing agencies to the extent it clears security-based swaps after the effective date of the Deemed Registered Provision, including, for example, the obligation to file proposed rule changes under Section 19(b) of the Exchange Act.

13 Section 774 of the Dodd-Frank Act states, "[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle."

14 See November 2010 Request, supra note 6.

15 See id. ICE Trust indicated in its November 2010 Request Letter that it intends to apply to the CFTC for registration as a derivatives clearing organization in advance of the date Title VII of the Dodd-Frank Act goes into effect in order to facilitate implementation of the Dodd-Frank Act requirements. As part of the transition to derivatives clearing organization status, ICE Trust expects to admit futures commission merchants registered with the CFTC (which may be registered broker-dealers) as clearing members for customer clearing and may introduce related changes to its rules. See Part II.G, infra.

Accordingly, consistent with our findings in the March 2010 ICE Trust Exemptive Order, and, in particular, in light of the risk management and systemic benefits in continuing to facilitate CDS clearing by ICE Trust until Title VII of the Dodd-Frank Act becomes fully effective, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend and modify the exemptive relief granted in the March 2010 ICE Trust Exemptive Order until July 16, 2011. Specifically, pursuant to the Commission's authority under Section 36 of the Exchange Act,[16] based on the facts presented and the representations made by ICE Trust,[17] and for the reasons discussed in this Order and subject to certain conditions, the Commission is extending, subject to the modifications discussed in this Order, each of the existing exemptions connected with CDS clearing by ICE Trust, which include: the temporary conditional exemption granted to ICE Trust from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS; the temporary conditional exemption of ICE Trust and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of mark-to-

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16 15 U.S.C. 78mm. Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

17 See November 2010 Request, supra note 6. The exemptions we are granting today are based on all of the representations made by ICE Trust in its request, which incorporate representations made by ICE Trust in connection with the March 2010 ICE Trust Exemptive Order, which in turn incorporates representations related to our earlier exemptive orders. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS that previously had been cleared pursuant to the exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

market prices for certain non-excluded CDS cleared by ICE Trust; the temporary conditional exemption of certain eligible contract participants and others from certain Exchange Act requirements with respect to certain non-excluded CDS cleared by ICE Trust; the temporary conditional exemption of ICE Trust clearing members and certain others from broker-dealer registration requirements and related requirements in connection with CDS clearing by ICE Trust (including clearing of customer CDS transactions); and the temporary conditional exemption from certain Exchange Act requirements granted to registered broker-dealers with respect to certain non-excluded CDS.

C. Extended and Modified Temporary Conditional Exemption from Clearing Agency Registration Requirement

In the March 2010 ICE Trust Exemptive Order, the Commission granted a temporary conditional exemption from clearing agency registration under Section 17A of the Exchange Act to permit ICE Trust to act as a CCP for Cleared CDS[18] by novating trades of non-excluded CDS that are securities and generating money and settlement obligations for participants without having to register with the Commission as a clearing agency.

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18 For purposes of this Order, "Cleared CDS" means a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to ICE Trust, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the CEA as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which: (i) the reference entity, the issuer of the reference security, or the reference security is one of the following: (A) an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; (B) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; (C) a foreign sovereign debt security; (D) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or (E) an asset-backed security issued or guaranteed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the Government National Mortgage Association ("Ginnie Mae"); or (ii) the reference index is an index in which 80 percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (i). See definition in paragraph III.(g)(1) of this Order. As discussed above, the Commission's action today does not affect CDS that are swap agreements under Section 206A of the Gramm-Leach-Bliley Act.

In the March 2010 ICE Trust Exemptive Order, the Commission recognized the need to ensure the prompt establishment of ICE Trust as a CCP for CDS transactions. The Commission also recognized the need to ensure that important elements of Section 17A of the Exchange Act, which sets forth the framework for the regulation and operation of the U.S. clearance and settlement system for securities, apply to the non-excluded CDS market. Accordingly, the temporary exemptions in the March 2010 ICE Trust Exemptive Order were subject to a number of conditions designed to enable Commission staff to monitor ICE Trust's clearance and settlement of CDS transactions.[19] Moreover, the temporary exemptions in the March 2010 ICE Trust Exemptive Order in part were based on ICE Trust's representation that it met the standards set forth in the Committee on Payment and Settlement Systems ("CPSS") and IOSCO report entitled: Recommendations for Central Counterparties ("RCCP").[20] The RCCP establishes a framework that requires a CCP to have: (i) the ability to facilitate the prompt and accurate clearance and settlement of CDS transactions and to safeguard its users' assets; and (ii) sound risk management, including the ability to appropriately determine and collect clearing fund and monitor its users' trading. This framework is generally consistent with the requirements of Section 17A of the Exchange Act.

The Commission believes that continuing to facilitate the central clearing of CDS transactions – including customer CDS transactions – through a temporary conditional exemption from Section 17A will continue to provide important risk management and systemic benefits by avoiding an interruption in those CCP clearance and settlement services pending the

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[19] See Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009).

[20] The RCCP was drafted by a joint task force ("Task Force") composed of representative members of IOSCO and CPSS and published in November 2004. The Task Force consisted of securities regulators and central bankers from 19 countries and the European Union. The U.S. representatives on the Task Force included staff from the Commission, the Federal Reserve Board, and the CFTC.

effective date of Title VII of the Dodd-Frank Act and the related Deemed Registered Provision. Any interruption in CCP clearance and settlement services for CDS transactions would eliminate the benefits ICE Trust provides to the non-excluded CDS market.

Our action today balances the aim of facilitating ICE Trust's continued service as a CCP for non-excluded CDS transactions with ensuring that important elements of Commission oversight are applied to the non-excluded CDS market. The temporary exemptions will permit the Commission to continue to develop direct experience with the non-excluded CDS market. During the extended exemptive period, the Commission will continue to monitor closely the impact of the CCPs on the CDS market. In particular, the Commission will continue to monitor the competitive effects of ICE Trust's rules and operations under this exemptive relief with respect to fees charged to members, the dissemination of market data, and the access to clearing services by independent CDS exchanges or CDS trading platforms.[21]

This temporary extension of the March 2010 ICE Trust Exemptive Order also is designed to assure that – as represented in ICE Trust's request – information will continue to be available to market participants about the terms of the CDS cleared by ICE Trust, the creditworthiness of ICE Trust or any guarantor, and the clearance and settlement process for CDS.[22] The

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[21] ICE Trust has no rule requiring an executing dealer to be a clearing member. As an operational matter, ICE Trust currently has one authorized trade processing platform for submission of client CDS transactions, ICE Link. Currently, ICE Link does not have a mechanism by which a non-member dealer could submit a transaction for clearing at ICE Trust. However, ICE Trust Clearing Rule 314 provides for open access to ICE Trust's clearing systems for all reasonably qualified execution venues and trade processing platforms. ICE Trust has represented that it remains committed to work with reasonably qualified execution venues and trade processing platforms to facilitate functionality for submission of trades by non-member dealers if there is interest in such functionality. See Letter from Kevin McClear, ICE Trust, to Elizabeth Murphy, Secretary, Commission, Mar. 5, 2010.

[22] The Commission believes that it is important in the CDS market, as in the market for securities generally, that parties to transactions should have access to financial information that would allow them to evaluate appropriately the risks relating to a particular investment and make more informed investment decisions. See generally Policy Statement on Financial Market Developments, The President's Working

Commission believes continued operation of ICE Trust consistent with the conditions of this Order will facilitate the availability to market participants of information that should enable them to make better informed investment decisions and better value and evaluate their Cleared CDS and counterparty exposures relative to a market for CDS that is not centrally cleared.

Accordingly, and consistent with our findings in the ICE Trust Exemptive Orders and for the reasons described herein, the Commission finds pursuant to Section 36 of the Exchange Act[23] that it is necessary and appropriate in the public interest and is consistent with the protection of investors for the Commission to extend, as modified herein, until July 16, 2011, the relief provided from the clearing agency registration requirements of Section 17A by the March 2010 ICE Trust Exemptive Order.

This temporary extension of the March 2010 ICE Trust Order is subject to a number of conditions that are designed to enable Commission staff to continue to monitor ICE Trust's clearance and settlement of CDS transactions and help reduce risk in the CDS market. These conditions require that ICE Trust: (i) make available on its website its annual audited financial statements; (ii) preserve records related to the conduct of its Cleared CDS clearance and settlement services for at least five years (in an easily accessible place for the first two years); (iii) provide information relating to its Cleared CDS clearance and settlement services to the Commission and provide access to the Commission to conduct on-site inspections of facilities, records, and personnel related to its Cleared CDS clearance and settlement services; (iv) notify the Commission about material disciplinary actions taken against any of its members utilizing its Cleared CDS clearance and settlement services, and about the involuntary termination of the

Group on Financial Markets, March 13, 2008, available at: http://www.treas.gov/press/releases/reports/pwgpolicystatemktturmoil_03122008.pdf.

23 See supra note 16.

membership of an entity that is utilizing ICE Trust's Cleared CDS clearance and settlement services; (v) provide the Commission with changes to rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services; (vi) provide the Commission with reports prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements[24] and its annual audited financial statements prepared by independent audit personnel; and (vii) report all significant systems outages to the Commission.

This temporary extension of the March 2010 ICE Trust Exemptive Order is also conditioned on ICE Trust, directly or indirectly, making available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) all end-of-day settlement prices and any other prices with respect to Cleared CDS that ICE Trust may establish to calculate mark-to-market margin requirements for ICE Trust clearing members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by ICE Trust.[25]

This temporary extension of the March 2010 ICE Trust Exemptive Order is modified by adding one condition. If any ICE Trust clearing member that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons is a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof), and is permitted under the Financial Industry Regulatory Authority ("FINRA") rules to use the applicable margin pursuant to ICE Trust rules as a minimum for

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24 See Automated Systems of Self-Regulatory Organization, Exchange Act Release No. 27445 (November 16, 1989), File No. S7-29-89, and Automated Systems of Self-Regulatory Organization (II), Exchange Act Release No. 29185 (May 9, 1991), File No. S7-12-19.

25 As a CCP, ICE Trust collects and processes information about CDS transactions, prices, and positions. Public availability of such information can improve fairness, efficiency, and competitiveness in the market. Moreover, with pricing and valuation information relating to Cleared CDS, market participants would be able to derive information about underlying securities and indices, potentially improving the efficiency and effectiveness of the securities markets.

computing customer or broker-dealer margin, ICE Trust shall not materially change its methodology for determining Cleared CDS margin levels without prior written approval from the Commission staff, and from FINRA with respect to customer margin requirements that would apply to broker-dealers.

D. Extended Temporary Conditional Exemption from Exchange Registration Requirements

In the March 2010 ICE Trust Exemptive Order, the Commission granted a temporary conditional exemption to ICE Trust from the requirements of Sections 5 and 6 of the Exchange Act, and the rules and regulations thereunder, in connection with ICE Trust's calculation of mark-to-market prices for open positions in Cleared CDS. The Commission also temporarily exempted ICE Trust participants from the prohibitions of Section 5 to the extent that they use ICE Trust to effect or report any transaction in Cleared CDS in connection with ICE Trust's calculation of mark-to-market prices for open positions in Cleared CDS. Section 5 of the Exchange Act contains certain restrictions relating to the registration of national securities exchanges,[26] while Section 6 provides the procedures for registering as a national securities exchange.[27]

The Commission granted these temporary exemptions to facilitate the establishment of ICE Trust's end-of-day settlement price process. ICE Trust had represented that in connection

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26 In particular, Section 5 states:

> It shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange . . . to effect any transaction in a security, or to report any such transactions, unless such exchange (1) is registered as a national securities exchange under section 6 of [the Exchange Act], or (2) is exempted from such registration . . . by reason of the limited volume of transactions effected on such exchange . . . .

15 U.S.C. 78e.

27 15 U.S.C. 78f. Section 6 of the Exchange Act also sets forth various requirements to which a national securities exchange is subject.

with its clearing and risk management process it would calculate an end-of-day settlement price for each Cleared CDS in which an ICE Trust participant has a cleared position, based on prices submitted by the participants. As part of this mark-to-market process, ICE Trust has periodically required its clearing members to execute certain CDS trades at the price at which certain quotations of the clearing members cross. ICE Trust represents that it wishes to continue periodically requiring clearing members to execute certain CDS trades in this manner.

As discussed above, the Commission has found in general that it is necessary or appropriate in the public interest, and is consistent with the protection of investors, to facilitate continued CDS clearing by ICE Trust. Consistent with that finding – and in reliance on ICE Trust's representation that the end-of-day settlement pricing process, including the periodically required trading, is integral to its risk management – the Commission further finds that it is necessary or appropriate in the public interest, and is consistent with the protection of investors that the Commission exercise its authority under Section 36 of the Exchange Act to extend, until July 16, 2011, ICE Trust's temporary exemption from Sections 5 and 6 of the Exchange Act in connection with its calculation of mark-to-market prices for open positions in Cleared CDS, and ICE Trust clearing members' temporary exemption from Section 5 with respect to such trading activity.

The temporary exemption for ICE Trust will continue to be subject to three conditions. First, ICE Trust must report the following information with respect to its calculation of mark-to-market prices for Cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports during the life of the enterprise and of any successor enterprise:

- The total dollar volume of transactions executed during the quarter, broken down by reference entity, security, or index; and

- The total unit volume and/or notional amount executed during the quarter, broken down by reference entity, security, or index.

Second, ICE Trust must establish and maintain adequate safeguards and procedures to protect participants' confidential trading information. Such safeguards and procedures shall include: (a) limiting access to the confidential trading information of participants to those employees of ICE Trust who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and (b) establishing and maintaining standards restricting the trading by employees of ICE Trust for their own accounts. ICE Trust must establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed.

Third, ICE Trust must comply with the conditions to the temporary exemption from Section 17A of the Exchange Act in this Order, given that this exemption is granted in the context of our goal of continuing to facilitate ICE Trust's ability to act as a CCP for non-excluded CDS, and given ICE Trust's representation that the end-of-day settlement pricing process, including the periodically required trading, is integral to its risk management.

E. <u>Extended Temporary Conditional General Exemption for ICE Trust, Certain ICE Trust Clearing Members, and Certain Eligible Contract Participants</u>

As the Commission recognized when it initially provided temporary exemptions in connection with CDS clearing by ICE Trust, applying the full panoply of Exchange Act requirements to participants in transactions in non-excluded CDS likely would deter some participants from using CCPs to clear CDS transactions. The Commission also recognized that it is important that the antifraud provisions of the Exchange Act apply to transactions in non-excluded CDS, particularly given that OTC transactions subject to individual negotiation that qualify as security-based swap agreements already are subject to those provisions.[28]

As a result, the Commission concluded that it is appropriate in the public interest and consistent with the protection of investors to apply temporarily substantially the same framework to transactions by market participants in non-excluded CDS that applies to transactions in security-based swap agreements. Consistent with that conclusion, the Commission temporarily exempted ICE Trust, and certain members and eligible contract participants, from a number of Exchange Act requirements, subject to certain conditions, while excluding certain enforcement-related and other provisions from the scope of the exemption.

The Commission believes that continuing to facilitate the central clearing of CDS transactions by ICE Trust through this type of temporary exemption will provide important risk management benefits and systemic benefits. The Commission also believes that facilitating the central clearing of customer CDS transactions, subject to the conditions in this Order, will provide an opportunity for the customers of ICE Trust clearing members to control counterparty risk.

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[28] While Section 3A of the Exchange Act excludes "swap agreements" from the definition of "security," certain antifraud and insider trading provisions under the Exchange Act explicitly apply to security-based swap agreements. See (a) paragraphs (2) through (5) of Section 9(a), 15 U.S.C. 78i(a), prohibiting the manipulation of security prices; (b) Section 10(b), 15 U.S.C. 78j(b), and underlying rules prohibiting fraud, manipulation or insider trading (but not prophylactic reporting or recordkeeping requirements); (c) Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices; (d) Sections 16(a) and (b), 15 U.S.C. 78p(a) and (b), which address disclosure by directors, officers and principal stockholders, and short-swing trading by those persons, and rules with respect to reporting requirements under Section 16(a); (e) Section 20(d), 15 U.S.C. 78t(d), providing for antifraud liability in connection with certain derivative transactions; and (f) Section 21A(a)(1), 15 U.S.C. 78u-1(a)(1), related to the Commission's authority to impose civil penalties for insider trading violations.

"Security-based swap agreement" is defined in Section 206B of the Gramm-Leach Bliley Act as a swap agreement in which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend the relief provided by the March 2010 ICE Trust Exemptive Order, until July 16, 2011, related to ICE Trust's, and certain members' and eligibility contract participants' exemption from certain requirements under the Exchange Act, as modified herein.

This temporary conditional exemption applies to ICE Trust and to any eligible contract participants[29] – including any ICE Trust clearing member – other than eligible contract participants that are self-regulatory organizations, registered brokers or dealers, or futures commission merchants registered pursuant to Section 4f(a)(1) of the CEA that receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons.[30]

As before, under this temporary conditional exemption, and solely with respect to Cleared CDS, those persons generally are exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements. Thus, those persons would still be subject to those Exchange Act requirements that explicitly are

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[29] This exemption in general applies to eligible contract participants, as defined in Section 1a(12) of the CEA as in effect on the date of this Order, other than persons that are eligible contract participants under paragraph (C) of that section.

[30] A separate temporary exemption addresses the Cleared CDS activities of registered broker-dealers (including broker-dealers that are also registered as futures commission merchants pursuant to Section 4f(a)(1) of the CEA). See Part II.H, infra. Solely for purposes of this Order, a registered broker-dealer, or a broker or dealer registered under Section 15(b) of the Exchange Act, does not refer to someone that would otherwise be required to register as a broker or dealer solely as a result of activities in Cleared CDS in compliance with this Order. In addition, a separate temporary exemption addresses the Cleared CDS activities of a futures commission merchant registered pursuant to Section 4f(a)(1) of the CEA (but that is not registered as a broker-dealer under Section 15(b) of the Exchange Act (other than paragraph 11 thereof)) that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons. See Part II.G, infra.

applicable in connection with security-based swap agreements.[31] In addition, all provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions would remain applicable.[32] In this way, the temporary conditional exemption would apply the same Exchange Act requirements in connection with non-excluded CDS as apply in connection with OTC credit default swaps.

Consistent with the March 2010 ICE Trust Exemption Order, this temporary conditional exemption does not extend to: the exchange registration requirements of Exchange Act Sections 5 and 6;[33] the clearing agency registration requirements of Exchange Act Section 17A; the requirements of Exchange Act Sections 12, 13, 14, 15(d), and 16;[34] the broker-dealer registration requirements of Section 15(a)(1)[35] and the other requirements of the Exchange Act, including paragraphs (4) and (6) of Section 15(b),[36] and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission; or certain provisions related to government securities.[37]

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31 See note 28, supra.

32 Thus, for example, the Commission retains the ability to investigate potential violations and bring enforcement actions in the federal courts as well as in administrative proceedings, and to seek the full panoply of remedies available in such cases.

33 This Order includes a separate temporary exemption from Sections 5 and 6 in connection with the mark-to-market process of ICE Trust, discussed above, at Section II.D.

34 15 U.S.C. 78l, 78m, 78n, 78o(d), 78p. Eligible contract participants and other persons instead should refer to the interim final temporary rules issued by the Commission.

35 15 U.S.C. 78o(a)(1).

36 Exchange Act Sections 15(b)(4) and 15(b)(6), 15 U.S.C. 78o(b)(4) and (b)(6), grant the Commission authority to take action against broker-dealers and associated persons in certain situations.

37 This exemption specifically does not extend to the Exchange Act provisions applicable to government securities, as set forth in Section 15C, 15 U.S.C. 78o-5, and its underlying rules and regulations. The exemption also does not extend to related definitions found at paragraphs (42) through (45) of Section 3(a), 15 U.S.C. 78c(a). The Commission does not have authority under Section 36 to issue exemptions in connection with those provisions. See Exchange Act Section 36(b), 15 U.S.C. 78mm(b).

As before, any ICE Trust clearing member relying on this temporary conditional exemption from Exchange Act requirements must be in material compliance with ICE Trust rules to be eligible for this exemption. In addition, any ICE Trust clearing member relying on this exemption that participates in the clearing of Cleared CDS transactions on behalf of other persons annually must provide a certification to ICE Trust that attests to whether the clearing member is relying on the temporary conditional exemption from broker-dealer related requirements described below.[38]

F. Extended Conditional Temporary Exemption from Broker-Dealer Related Requirements for Certain Clearing Members of ICE Trust and Others

In the March 2010 ICE Trust Exemptive Order, the Commission granted a conditional temporary exemption from particular Exchange Act requirements to certain clearing members of ICE Trust, and to certain eligible contract participants, in connection with CDS cleared on ICE Trust. Absent an exception or exemption, persons that effect transactions in non-excluded CDS that are securities may be required to register as broker-dealers pursuant to Section 15(a)(1) of the Exchange Act.[39] Certain reporting and other requirements of the Exchange Act could apply

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38 This condition requiring clearing members to convey information to ICE Trust as a repository for regulators, and other conditions of this Order that require clearing members or others to convey information (e.g., an audit report related to the clearing member's compliance with exemptive conditions) to ICE Trust, does not impose upon ICE Trust any independent duty to audit or otherwise review that information. These conditions also do not impose on ICE Trust any independent fiduciary or other obligation to any customer of a clearing member.

39 15 U.S.C. 78o(a)(1). This section generally provides that, absent an exception or exemption, a broker or dealer that uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the Commission.

Section 3(a)(4) of the Exchange Act generally defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others," but excludes certain bank securities activities. 15 U.S.C. 78c(a)(4). Section 3(a)(5) of the Exchange Act generally defines a "dealer" as "any person engaged in the business of buying and selling securities for his own account," but includes exceptions for certain bank activities. 15 U.S.C. 78c(a)(5). Exchange Act Section 3(a)(6) defines a "bank" as a bank or savings association that is directly supervised and examined by state or to such persons, as broker-dealers, regardless of whether they are registered with the Commission.

In granting that exemption, the Commission noted that it is consistent with our investor protection mandate to require securities intermediaries that receive or hold funds and securities on behalf of others to comply with standards that safeguard the interests of their customers.[40] The Commission recognized, however, that requiring intermediaries that receive or hold funds and securities on behalf of customers in connection with transactions in non-excluded CDS to register as broker-dealers may deter the use of CCPs in customer CDS transactions, to the detriment of the markets and market participants generally. The Commission concluded that those factors, along with certain representations of ICE Trust,[41] argued in favor of flexibility in applying the requirements of the Exchange Act to these intermediaries, conditioned on requiring the intermediaries to take reasonable steps to help increase the likelihood that their customers

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federal banking authorities (with certain additional requirements for banks and savings associations that are not chartered by a federal authority or a member of the Federal Reserve System). 15 U.S.C. 78c(a)(6).

40 Registered broker-dealers are required to segregate assets held on behalf of customers from proprietary assets, because segregation will assist customers in recovering assets in the event the intermediary fails. Absent such segregation, collateral could be used by an intermediary to fund its own business, and could be attached to satisfy the intermediary's debts were it to fail. Moreover, the maintenance of adequate capital and liquidity protects customers, CCPs, and other market participants. Adequate books and records (including both transactional and position records) are necessary to facilitate day to day operations as well as to help resolve situations in which an intermediary fails and either a regulatory authority or receiver is forced to liquidate the firm. Appropriate records also are necessary to allow examiners to review for improper activities, such as insider trading or fraud.

41 We noted that in granting the temporary exemption, we also relied on ICE Trust's representation that before offering the Non-Member Framework, it will adopt a requirement that non-U.S. clearing members subject to the framework are regulated by: (i) a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, or (ii) a signatory to a bilateral arrangement with the Commission for enforcement cooperation. We further noted that non-U.S. clearing members that do not meet these criteria would not be eligible to rely on this exemption.

would be protected in the event the intermediary became insolvent, even if those safeguards are as not as strong as those required of registered broker-dealers.

As a result, and solely with respect to Cleared CDS, the Commission provided a temporary conditional exemption from the broker-dealer registration requirements of Section 15(a)(1), and the other requirements of the Exchange Act (other than paragraphs (4) and (6) of Section 15(b)[42]) and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission, to: (i) ICE Trust clearing members other than registered broker-dealers; and (ii) any eligible contract participant, other than a registered broker-dealer, that does not receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons.[43]

That exemption was subject to a number of conditions. For ICE Trust clearing members that receive or hold funds or securities of U.S. persons (or who receive or hold funds or securities of any person in the case of a U.S. clearing member) – other than for an affiliate that controls, is controlled by, or is under common control with the clearing member – in connection with Cleared CDS, these included a condition requiring the clearing member, as promptly as practicable after receipt, to transfer such funds and securities (other than those promptly returned

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42 As noted above, see note 36, supra, Exchange Act Sections 15(b)(4) and 15(b)(6) grant the Commission authority to take action against broker-dealers and associated persons in certain situations. Accordingly, while the exemption we granted from broker-dealer requirements generally extended to persons that act as broker-dealers in the market for Cleared CDS (potentially including inter-dealer brokers that do not hold funds or securities for others), such persons may be subject to actions under Sections 15(b)(4) and (b)(6) of the Exchange Act.

In addition, such persons may be subject to actions under Exchange Act Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices. As noted above, Section 15(c)(1) explicitly applies to security-based swap agreements. Sections 15(b)(4), 15(b)(6) and 15(c)(1), of course, would not apply to persons subject to this exemption who do not act as broker-dealers or associated persons of broker-dealers.

43 In some circumstances, an eligible contract participant that does not hold customer funds or securities nonetheless may act as a dealer in securities transactions, or as a broker (such as an inter-dealer broker).

to such other persons) to either the Custodial Client Omnibus Margin Account at ICE Trust or to an account held by a third-party custodian. Additional related conditions addressed the types of permissible arrangements for holding collateral at a third-party custodian, and permissible custodians.[44] These conditions requiring customer collateral to be segregated from clearing members address only the initial margin that customers post in connection with Cleared CDS.

As before, the Commission is required to balance the goals of promoting the central clearing of customer CDS transactions against the goal of protecting customers, and to be mindful that these conditions cannot provide legal certainty that customer collateral in fact would be protected in the event an ICE Trust clearing member were to become insolvent. The Commission believes that the segregation framework set forth in the earlier orders represents a reasonable step to help protect the collateral posted by customers of ICE Trust's clearing members from the threat of loss in the event of clearing member insolvency.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend, as modified herein, until July 16, 2011, relief provided from certain Exchange Act requirements related to broker-dealers by the March 2010 ICE Trust Exemption Order.[45]

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44 Other conditions of this exemption precluded the clearing of CDS transaction for natural persons, required certain risk disclosures to customers, required the clearing member also must annually provide ICE Trust with a self-assessment that it is in compliance with the requirements along with a report by the clearing member's independent third-party auditor that attests to that assessment, and required the clearing member to agree to provide the Commission with access to information related to Cleared CDS transactions.

45 As before, in granting this relief we are relying on representations by ICE Trust that non-U.S. clearing members that provide their customers with access to CDS clearing on ICE Trust are regulated by: (i) a signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, or (ii) a signatory to a bilateral arrangement with the Commission for enforcement cooperation. Non-U.S. clearing members that do not meet these criteria would not be eligible to rely on this exemption.

This exemption is available to ICE Trust clearing members other than registered broker-dealers or futures commission merchants registered pursuant to Section 4f(a)(1) of the CEA that receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons.[46] As before, this relief is also available to any eligible contract participant, other than a registered broker-dealer, that does not receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons.[47] As before, and solely with respect to Cleared CDS, those persons temporarily will be exempt from the broker-dealer registration requirements of Section 15(a)(1), and the other requirements of the Exchange Act (other than paragraphs (4) and (6) of Section 15(b)) and the rules and regulation thereunder that apply to a broker or dealer that is not registered with the Commission.

As before, for all ICE Trust clearing members – regardless of whether they receive or hold customer collateral in connection with Cleared CDS – this temporary exemption is conditioned on the clearing member being in material compliance with ICE Trust's rules, as well as on the clearing member being in compliance with applicable laws and regulations relating to

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[46] Only registered broker-dealers were excluded in the March 2010 ICE Trust Exemptive Order.

[47] In some circumstances, an eligible contract participant that does not hold customer funds or securities nonetheless may act as a dealer in securities transactions, or as a broker (such as an inter-dealer broker).

Solely for purposes of this requirement, an eligible contract participant would not be viewed as receiving or holding funds or securities for purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons, if the other persons involved in the transaction would not be considered "customers" of the eligible contract participant under the analysis used for determining whether certain persons would be considered "customers" of a broker-dealer under Exchange Act Rule 15c3-3(a)(1). For these purposes, and for the purpose of the definition of "Cleared CDS," the terms "purchasing" and "selling" mean the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under, a Cleared CDS, as the context may require. This is consistent with the meaning of the terms "purchase" or "sale" under the Exchange Act in the context of security-based swap agreements. See Exchange Act Section 3A(b)(4).

capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS.

Additional conditions apply to ICE Trust clearing members that receive or hold funds or securities of U.S. persons (or that receive or hold funds or securities of any person in the case of a U.S. clearing member) – other than for an affiliate that controls, is controlled by, or is under common control with the clearing member – in connection with Cleared CDS. For those ICE Trust clearing members, this temporary exemption is conditioned on the customer not being a natural person, and on the clearing member providing certain risk disclosures to the customer.[48]

In addition, such clearing members must, as promptly as practical after receipt, transfer such funds and securities – other than those promptly returned to such other person – to either the Custodial Client Omnibus Margin Account at ICE Trust[49] or an account held by a third-party custodian, as described below.

As before, collateral that is held at a third-party custodian must either be held: (1) in the name of the customer, subject to an agreement in which the customer, the clearing member and the custodian are parties, acknowledging that the assets held therein are customer assets used to collateralize obligations of the customer to the clearing member, and that the assets held in the account may not otherwise be pledged or rehypothecated by the clearing member or the custodian; or (2) in an omnibus account for which the clearing member maintains daily records as to the amount owing to each customer, and which is subject to an agreement between the

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48 The clearing member must disclose that it is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply, that the insolvency law of the applicable jurisdiction may affect the customer's ability to recover funds and securities or the speed of any such recovery, and (if applicable) that non-U.S. members may be subject to an insolvency regime that is materially different from that applicable to U.S. persons.

49 Cash collateral transferred to ICE Trust may be invested in "Eligible Custodial Assets," as defined in ICE Trust's "Custodial Asset Policies." Also, collateral transferred to ICE Trust may be held at a subcustodian.

clearing member and the custodian specifying: (i) that all account assets are held for the exclusive benefit of the clearing member's customers and are being kept separate from any other accounts that the clearing member maintains with the custodian; (ii) that the account assets may not be used as security for a loan to the clearing member by the custodian, and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the custodian or any person claiming through the custodian; and (iii) that the assets may not otherwise be pledged or rehypothecated by the clearing member or the custodian.[50] Under either approach, the third-party custodian cannot be affiliated with the clearing member.[51] Moreover, if the third-party custodian is a U.S. entity, it must be a bank (as that term is defined in Section 3(a)(6) of the Exchange Act), have total regulatory capital of at least $1 billion,[52] and have been approved to engage in a trust business by an appropriate regulatory agency. A custodian that is not a U.S. entity must have regulatory capital of at least $1 billion,[53] and must provide the clearing member,

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[50] We do not contemplate that either of these approaches involving the use of a third-party custodian would interfere with the ability of a clearing member and its customer to agree as to how any return or losses earned on those assets would be distributed between the clearing member and its customer.

Also, the restriction in both approaches on the clearing member's and the custodian's ability to rehypothecate these customer funds and securities does not preclude that collateral from being transferred to ICE Trust as necessary to satisfy variation margin requirements in connection with the customer's CDS position.

[51] For purposes of the Order, an "affiliated person" of a clearing member mean any person who directly or indirectly controls a clearing member or any person who is directly or indirectly controlled by or under common control with a clearing member; ownership of 10 percent or more of an entity's common stock will be deemed prima facie control of that entity. See definition in paragraph III.(g)(2) of this Order. This standard is analogous to the standard used to identify affiliated persons of broker-dealers under Exchange Act Rule 15c3-3(a)(13), 17 CFR 240.15c3-3(a)(13).

[52] In particular, custodians that are U.S. entities must have total capital, as calculated to meet the applicable requirements imposed by the entity's appropriate regulatory agency of at least $1 billion. The term "appropriate regulatory agency" is defined in Section 3(a)(34) of the Exchange Act, 15 U.S.C. 78c(a)(34).

[53] Custodians that are non-U.S. entities must have total capital, as calculated to meet the applicable requirements imposed by the foreign financial regulatory authority of at least $1 billion. The term "foreign financial regulatory authority" is defined in Section 3(a)(52) of the Exchange Act, 15 U.S.C. 78c(a)(52).

the customer and ICE Trust with a legal opinion providing that the account assets are subject to regulatory requirements in the custodian's home jurisdiction designed to protect, and provide for the prompt return of, custodial assets in the event of the custodian's insolvency, and that the assets held in that account reasonably could be expected to be legally separate from the clearing member's assets in the event of the clearing member's insolvency. Also, cash collateral posted with the third-party custodian may be invested in other assets, consistent with the investment policies that govern collateral held at ICE Trust.[54] Finally, a clearing member that uses a third-party custodian to hold customer collateral must notify ICE Trust of that use.

As before, to the extent there is any delay in the clearing member transferring such funds and securities to ICE Trust or a third-party custodian,[55] the clearing member must effectively segregate the collateral in a way that, pursuant to applicable law, could reasonably be expected to effectively protect the collateral from the clearing member's creditors. The clearing member may not permit customers to "opt out" of such segregation even if applicable regulations or laws otherwise would permit such "opt out."

Also, as before, this temporary exemption is conditioned on clearing member compliance with a self-assessment and audit requirement,[56] and on the clearing member's agreement to provide the Commission with access to information related to Cleared CDS transactions.[57]

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54 See note 49, supra.

55 This provision is intended to address short-term technology or operational issues. ICE Trust rules require collateral to be transferred promptly on receipt, with the expectation that margin would be transferred on the same business day.

56 In particular, to facilitate compliance with the segregation practices that are required as a condition to this temporary exemption, the clearing member must annually provide ICE Trust with a self-assessment that it is in compliance with the requirements, along with a report by the clearing member's independent third-party auditor that attests to that assessment. The report must be dated the same date as the clearing member's annual audit report (but may be separate from it), and must be produced in accordance with the standards that the auditor follows in auditing the clearing member's financial statements.

As the Commission discussed in the March 2010 ICE Trust Exemptive Order, requiring clearing members that receive or hold customer collateral to satisfy such conditions will not guarantee that a customer would receive the return of its collateral in the event of a clearing member's insolvency, particularly in light of the fact-specific nature of the insolvency process and the multiplicity of insolvency regimes that may apply to ICE Trust's members clearing for U.S. customers. The Commission believes, however, that these steps will increase the likelihood that customers would be able to access collateral in such an insolvency event. The Commission also recognizes that these customers generally may be expected to be sophisticated market participants that should be able to weigh the risks associated with entering into arrangements with intermediaries that are not registered broker-dealers, particularly in light of the disclosure required as a condition to this temporary exemption.

As the self-assessment is intended to serve as the basis for the third-party auditor's report, we expect the self-assessment to be generally contemporaneous with that report.

[57] Specifically, to support these segregation practices and enhance the ability to detect and deter circumstances in which clearing members fail to segregate customer collateral consistent with the exemption, this temporary exemption is conditioned on the clearing member agreeing to provide the Commission with access to information related to Cleared CDS transactions. This requirement is consistent with a requirement in Exchange Act Rule 15a-6(a)(3)(i)(B), which exempts certain foreign broker-dealers from registering with the Commission. See Exchange Act Rule 15a-6(a)(3)(i)(B).

Under this condition, the clearing member would provide the Commission (upon request and subject to agreements reached between the Commission or the U.S. Government and an appropriate foreign securities authority, see Section 3(a)(50) of the Exchange Act, 15 U.S.C. 78c(a)(50)), with information or documents within the clearing member's possession, custody, or control, as well as testimony of clearing member personnel and assistance in taking the evidence of other persons, that relates to Cleared CDS transactions. If, after the clearing member has exercised its best efforts to provide this information (including requesting the appropriate governmental body and, if legally necessary, its customers), the clearing member nonetheless is prohibited from providing the information by applicable foreign law or regulations, this temporary conditional exemption would no longer be available to the clearing member.

Consistent with the discussion above as to the loss of an exemption due to an underlying representation no longer being accurate, see note 17, supra, if a clearing member were to lose the benefit of this exemption due to the failure to provide information to the Commission as the result of a prohibition by an applicable foreign law or regulation, the legal status of existing open positions in non-excluded CDS associated with those clearing members and its customers would remain unchanged, but the clearing member could not establish new CDS positions pursuant to the exemption.

G. Conditional Temporary Exemption for Certain Clearing Members of ICE Trust that are Registered Futures Commission Merchants

Absent an exception or exemption, futures commission merchants that effect transactions in non-excluded CDS that are securities may be required to register as broker-dealers pursuant to Section 15(a)(1) of the Exchange Act.[58] Moreover, certain reporting and other requirements of the Exchange Act could apply to such persons, as broker-dealers, regardless of whether they are registered with the Commission.

It is consistent with our investor protection mandate to require that intermediaries in securities transactions that receive or hold funds and securities on behalf of others comply with standards that safeguard the interests of their customers. At the same time, requiring intermediaries that receive or hold funds and securities on behalf of customers in connection with transactions in non-excluded CDS, prior to the effective date of the Dodd-Frank Act, to register as broker-dealers may deter the use of CCPs in CDS transactions, to the detriment of the markets and market participants generally.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to grant a conditional exemption until July 16, 2011 from certain Exchange Act requirements. In general, the Commission is providing a temporary exemption, subject to the conditions discussed below, to any ICE Trust clearing member registered as a futures commission merchant pursuant to Section 4f(a)(1) of the CEA (but that is not registered as a broker-dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)) that

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[58] 15 U.S.C. 78o(a)(1). This section generally provides that, absent an exception or exemption, a broker or dealer that uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the Commission.

receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling or holding Cleared CDS positions for other persons. Solely with respect to Cleared CDS, those members generally will be exempt from those provisions of the Exchange Act and the underlying rules and regulations that do not apply to security-based swap agreements. This exemption does not extend to Exchange Act provisions that explicitly apply in connection with security-based swap agreements,[59] or to related enforcement authority provisions.[60]

This temporary exemption also does not extend to: the exchange registration requirements of Exchange Act Sections 5 and 6;[61] the clearing agency registration requirements of Exchange Act Section 17A; the requirements of Exchange Act Sections 12, 13, 14, 15(d), and 16;[62] the Commission's administrative proceeding authority under Sections 15(b)(4) and (b)(6);[63] or certain provisions related to government securities.[64]

This temporary exemption is subject to the clearing member complying with conditions that are important for protecting customer funds and securities. Any ICE Trust clearing member relying on this temporary exemption must be in material compliance with the rules of ICE Trust, and in material compliance with applicable laws and regulations relating to capital, liquidity, and

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59 See note 28, supra.

60 Thus, for example, the Commission retains the ability to investigate potential violations and bring enforcement actions in the federal courts as well as in administrative proceedings, and to seek the full panoply of remedies available in such cases.

61 This Order also includes a separate temporary exemption from Sections 5 and 6 in connection with the settlement price calculation methodology of ICE Trust. See Part II.D, supra.

62 15 U.S.C. 78l, 78m, 78n, 78o(d), 78p. Futures commission merchants instead should refer to the interim final temporary rules issued by the Commission. See note 1, supra.

63 Exchange Act Sections 15(b)(4) and 15(b)(6), 15 U.S.C. 78o(b)(4) and (b)(6), grant the Commission authority to take action against broker-dealers and associated persons in certain situations.

64 This exemption specifically does not extend to the Exchange Act provisions applicable to government securities, as set forth in Section 15C, 15 U.S.C. 78o-5, and its underlying rules and regulations; nor does the exemption extend to related definitions found at paragraphs (42) through (45) of Section 3(a), 15 U.S.C. 78c(a). The Commission does not have authority under Section 36 to issue exemptions in connection with those provisions. See Exchange Act Section 36(b), 15 U.S.C. 78mm(b).

segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS.[65] In addition, the customers for whom the clearing member receives or holds such funds or securities may not be natural persons, and the clearing member must make certain risk disclosures to those customers.[66]

This temporary exemption is further conditioned on funds or securities received or held by the clearing member for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for those customer being held: (i) in an account established pursuant to Section 4d of the CEA; or (ii) in the absence of a 4d Order from the CFTC, in an account that is part of a separate account class, specified by CFTC Bankruptcy Rules,[67] established for a futures commission merchant to hold its customers' positions and collateral in cleared OTC derivatives.

To facilitate compliance with these segregation conditions, the clearing member – regardless of the type of account discussed above that it uses – also must annually provide ICE Trust with a self-assessment that it is in compliance with the requirements, along with a report by the clearing member's independent third-party auditor that attests to that assessment.[68] Finally, an ICE Trust clearing member that receives or holds funds or securities of customers for the

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65 The term "customer," solely for purposes of Part III.(e) and (f)2, infra, and corresponding references in this Order, means a "customer" as defined under CFTC Regulation 1.3(k). 17 CFR 1.3(k).

66 The clearing member must disclose that it is not regulated by the Commission, that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member to collateralize Cleared CDS, and that the applicable insolvency law may affect such customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding.

67 17 CFR 190.01 et seq.

68 The report must be dated the same date as the clearing member's annual audit report (but may be separate from it), and must be produced in accordance with the standards that the auditor follows in auditing the clearing member's financial statements.

This condition requiring the clearing member to convey a third-party audit report to ICE Trust as a repository for regulators does not impose upon ICE Trust any independent duty to audit or otherwise review that information. This condition also does not impose on ICE Trust any independent fiduciary or other obligation to any customer of a clearing member.

purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions shall segregate such funds and securities of customers from the ICE Trust clearing member's own assets (i.e., the member may not permit the customers to "opt out" of applicable segregation requirements for such funds and securities even if regulations or laws would permit the customer to "opt out").

H. Extended and Modified Temporary General Exemption for Certain Registered Broker-Dealers

The March 2010 ICE Trust Exemptive Order included limited exemptions from Exchange Act requirements to registered broker-dealers in connection with their activities involving Cleared CDS. In crafting these temporary exemptions, the Commission balanced the need to avoid creating disincentives to the prompt use of CCPs against the critical role that certain broker-dealers play in promoting market integrity and protecting customers (including broker-dealer customers that are not involved with CDS transactions). In light of the risk management and systemic benefits in continuing to facilitate CDS clearing by ICE Trust through targeted exemptions to registered broker-dealers prior to the effective date of the Dodd-Frank Act, the Commission finds pursuant to Section 36 of the Exchange Act that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend this temporary registered broker-dealer exemption from certain Exchange Act requirements until July 16, 2011, subject to certain modifications discussed below.[69]

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[69] The temporary exemptions addressed above – with regard to ICE Trust, certain clearing members and certain eligible contract participants – are not available to persons that are registered as broker-dealers with the Commission (other than those that are notice registered pursuant to Exchange Act Section 15(b)(11)). Exchange Act Section 15(b)(11) provides for notice registration of certain persons that effect transactions in security futures products. 15 U.S.C. 78o(b)(11).

Consistent with the temporary exemptions discussed above, and solely with respect to Cleared CDS, the Commission is temporarily exempting registered broker-dealers, including registered broker-dealers that are also registered as futures commission merchants pursuant to Section 4f(a)(1) of the CEA ("BD-FCMs"), from provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements, subject to certain conditions. The Commission is not excluding registered broker-dealers, including BD-FCMs, from Exchange Act provisions that explicitly apply in connection with security-based swap agreements or from related enforcement authority provisions.[70] As above, and for similar reasons, the Commission is not exempting registered broker-dealers, including BD-FCMs, from: Sections 5, 6, 12(a) and (g), 13, 14, 15(b)(4), 15(b)(6), 15(d), 16 and 17A of the Exchange Act.[71]

Further the Commission is not exempting registered broker-dealers, including BD-FCMs (except as discussed below), from the following additional provisions under the Exchange Act: (1) Section 7(c),[72] regarding the unlawful extension of credit by broker-dealers; (2) Section 15(c)(3),[73] regarding the use of unlawful or manipulative devices by broker-dealers; (3) Section 17(a),[74] regarding broker-dealer obligations to make, keep and furnish information; (4) Section

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70 See note 28, supra. As noted above, broker-dealers also would be subject to Section 15(c)(1) of the Exchange Act, which prohibits brokers and dealers from using manipulative or deceptive devices, because that provision explicitly applies in connection with security-based swap agreements. In addition, to the extent the Exchange Act and any rule or regulation thereunder imposes any other requirement on a broker-dealer with respect to security-based swap agreements (e.g., requirements under Rule 17h-1T to maintain and preserve written policies, procedures, or systems concerning the broker or dealer's trading positions and risks, such as policies relating to restrictions or limitations on trading financial instruments or products), these requirements would continue to apply to broker-dealers' activities with regard to Cleared CDS.

71 See notes 33 and 34, supra, and accompanying text. We also are not exempting those members from provisions related to government securities, as discussed above. See note 37, supra.

72 15 U.S.C. 78g(c).

73 15 U.S.C. 78o(c)(3).

74 15 U.S.C. 78q(a).

17(b),[75] regarding broker-dealer records subject to examination; (5) Regulation T,[76] a Federal Reserve Board regulation regarding extension of credit by broker-dealers; (6) Exchange Act Rule 15c3-1,[77] regarding broker-dealer net capital; (7) Exchange Act Rule 15c3-3,[78] regarding broker-dealer reserves and custody of securities; (8) Exchange Act Rules 17a-3 through 17a-5,[79] regarding records to be made and preserved by broker-dealers and reports to be made by broker-dealers; and (9) Exchange Act Rule 17a-13,[80] regarding quarterly security counts to be made by certain exchange members and broker-dealers.[81] Registered broker-dealers, including BD-FCMs (except as discussed below), must comply with these provisions in connection with their activities involving non-excluded CDS because these provisions are especially important to helping protect customer funds and securities, ensure proper credit practices, and safeguard against fraud and abuse.[82]

ICE Trust clearing members that are BD-FCMs and that receive or hold customer funds or securities for the purpose of purchasing, selling, clearing, settling, or holding CDS positions cleared by ICE Trust in a futures account (as that term is defined in Rule 15c3-3(a)(15)[83]) also shall be exempt from Exchange Act Rule 15c3-3, subject to conditions that are similar to those—

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75 15 U.S.C. 78q(b).

76 12 CFR 220.1 et seq.

77 17 CFR 240.15c3-1.

78 17 CFR 240.15c3-3.

79 17 CFR 240.17a-3 through 240.17a-5.

80 17 CFR 240.17a-13.

81 Solely for purposes of this temporary exemption, in addition to the general requirements under the referenced Exchange Act sections, registered broker-dealers shall only be subject to the enumerated rules under the referenced Exchange Act sections.

82 Indeed, Congress directed the Commission to promulgate broker-dealer financial responsibility rules, including rules relating to custody, the use of customer securities, the use of customers' deposits or credit balances, and the establishment of minimum financial requirements.

83 17 CFR 240.15c3-3(a)(15).

discussed above—that are applicable to ICE Trust clearing members that are FCMs but are not registered broker-dealers and that hold customer funds and securities in connection with Cleared CDS transactions. Thus, such BD-FCMs must be in material compliance with ICE Trust rules, as well as applicable laws and regulations relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS. A BD-FCM may not receive or hold funds or securities relating to Cleared CDS transactions and positions for customers who are natural persons. In addition, the BD-FCM must make certain risk disclosures to each such customer.[84] Further, the BD-FCM must hold the customer funds or securities in the same type of account as is required for other futures commission merchants that hold customer funds and securities in connection with Cleared CDS transactions.[85] The BD-FCM also must segregate the funds and securities of customers from the ICE Trust clearing member's own assets (i.e., the member may not permit the customers to "opt out" of applicable segregation requirements for such funds and securities even if regulations or laws would permit the customer to "opt out"). In addition, the BD-FCM also must annually provide ICE Trust with a self-assessment that it is in compliance with the requirements, along

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[84] The BD-FCM must disclose that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member to collateralize Cleared CDS positions, and that the applicable insolvency law may affect such customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding.

This BD-FCM condition differs from the analogous disclosure conditions related to other ICE Trust clearing members that hold customer funds and securities, in that the other conditions also require disclosure that the clearing member is not regulated by the Commission.

[85] As with the exemption applicable to those other ICE Trust clearing members, in the absence of a 4d order from the CFTC, the BD-FCM may hold the funds and securities in an account that is part of a separate account class, specified by CFTC Bankruptcy Rules, established for a futures commission merchant to hold its customers' positions in cleared OTC derivatives (and funds and securities posted to margin, guarantee, or secure such positions). See Part II.G, supra.

with a report by the clearing member's independent third-party auditor that attests to that assessment.[86]

Finally – and in addition to the conditions that are applicable to ICE Trust clearing members that are not broker-dealers and that hold customer funds and securities in connection with Cleared CDS transactions – the ICE Trust clearing member must comply with the margin rules for Cleared CDS of the self-regulatory organization that is its designated examining authority[87] (e.g., FINRA).

I. Solicitation of Comments

When the Commission granted the March 2010 ICE Trust Exemptive Order extending the exemptions granted in connection with CDS clearing by ICE Trust, it requested comment on all aspects of the exemptions. The Commission received one comment in response to this request.[88]

In connection with this Order extending the exemptions granted in connection with CDS clearing by ICE Trust, the Commission reiterates the request for comments on all aspects of the exemptions.

Comments may be submitted by any of the following methods:

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86 The report must be dated the same date as the clearing member's annual audit report (but may be separate from it), and must be produced in accordance with the standards that the auditor follows in auditing the clearing member's financial statements. See text accompanying note 68, supra.

87 See 17 CFR 240.17d-1 for a description of a designated examining authority.

88 See Comment from Alessandro Cocco, Managing Director and Associate General Counsel, JP Morgan, Mar. 2, 2010, suggesting that customers' variation margin should not be required to be held in a segregated account. We also solicited comments earlier as part of the December 2009 ICE Trust Order and the March 2009 ICE Trust Order. We received one comment in response to our request to the December 2009 ICE Trust Order, see Comment from Kristie L. Lovelady, Dec. 9, 2009, requesting stronger restrictions generally, and no comments in response to our request to the March 2009 ICE Trust Order.

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-05-09 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov/). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-05-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 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.

III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36(a) of the Exchange Act, that, until July 16, 2011:

(a) Exemption from Section 17A of the Exchange Act.

ICE Trust U.S. LLC (ICE Trust U.S. LLC and any successor entity thereto is hereinafter referred to as "ICE Trust")[89] shall be exempt from Section 17A of the Exchange Act solely to perform the functions of a clearing agency for Cleared CDS (as defined in paragraph (g)(1) of this Order), subject to the following conditions:

(1) ICE Trust shall make available on its website its annual audited financial statements.

(2) ICE Trust shall keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it relating to its Cleared CDS clearance and settlement services. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.

(3) ICE Trust shall supply information and periodic reports relating to its Cleared CDS clearance and settlement services as may be reasonably requested by the Commission, and shall provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to ICE Trust's Cleared CDS clearance and settlement services.

(4) ICE Trust shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any of its members utilizing its Cleared CDS clearance and settlement services, including the denial of services, fines, or penalties. ICE Trust shall notify the Commission promptly when ICE Trust involuntarily terminates the

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89 ICE Trust has stated it intends to apply to the CFTC for registration as a derivatives clearing organization ("DCO") in advance of the Dodd-Frank Act implementation date to facilitate implementation of the Dodd-Frank Act requirements. ICE Trust has also indicated it may accomplish this transition by establishing a new entity registered as a DCO and either merging ICE Trust into the new DCO entity or transferring the assets and liabilities of ICE Trust to the new DCO entity. See November 2010 Request, supra note 4.

membership of an entity that is utilizing ICE Trust's Cleared CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to ICE Trust's disciplinary action.

(5) ICE Trust shall notify the Commission of all changes to rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services, including its fee schedule and changes to risk management practices, the day before effectiveness or implementation of such rule changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. All such rule changes will be posted on ICE Trust's website. Such notifications will not be deemed rule filings that require Commission approval.

(6) ICE Trust shall provide the Commission with reports prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements. ICE Trust shall provide the Commission (beginning in its first year of operation) with its annual audited financial statements prepared by independent audit personnel.

(7) ICE Trust shall report all significant systems outages to the Commission. If it appears that the outage may extend for 30 minutes or longer, ICE Trust shall report the systems outage immediately. If it appears that the outage will be resolved in less than 30 minutes, ICE Trust shall report the systems outage within a reasonable time after the outage has been resolved.

(8) ICE Trust, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) all end-of-day settlement prices and any other prices with respect to Cleared CDS that ICE Trust may

establish to calculate mark-to-market margin requirements for ICE Trust clearing members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by ICE Trust.

(9) If any ICE Trust clearing member that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons is a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof), and is permitted under FINRA rules to use the applicable margin pursuant to ICE Trust rules as a minimum for computing customer or broker-dealer margin, ICE Trust shall not materially change its methodology for determining Cleared CDS margin levels without prior written approval from the Commission staff, and from FINRA with respect to customer margin requirements that would apply to broker-dealers.

(b) Exemption from Sections 5 and 6 of the Exchange Act.

(1) ICE Trust shall be exempt from the requirements of Sections 5 and 6 of the Exchange Act and the rules and regulations thereunder in connection with its calculation of mark-to-market prices for open positions in Cleared CDS, subject to the following conditions:

(i) ICE Trust shall report the following information with respect to the calculation of mark-to-market prices for Cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports during the life of the enterprise and of any successor enterprise:

(A) The total dollar volume of transactions executed during the quarter, broken down by reference entity, security, or index; and

(B) The total unit volume and/or notional amount executed during the quarter, broken down by reference entity, security, or index;

(ii) ICE Trust shall establish and maintain adequate safeguards and procedures to protect clearing members' confidential trading information. Such safeguards and procedures shall include:

(A) limiting access to the confidential trading information of clearing members to those employees of ICE Trust who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and

(B) establishing and maintaining standards controlling employees of ICE Trust trading for their own accounts. ICE Trust must establish and maintain adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed; and

(iii) ICE Trust shall satisfy the conditions of the temporary exemption from Section 17A of the Exchange Act set forth in paragraphs (a)(1) – (9) of this Order.

(2) Any ICE Trust clearing member shall be exempt from the requirements of Section 5 of the Exchange Act to the extent such ICE Trust clearing member uses any facility of ICE Trust to effect any transaction in Cleared CDS, or to report any such transaction, in connection with ICE Trust's clearance and risk management process for Cleared CDS.

(c) Exemption for ICE Trust, certain ICE Trust clearing members, and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (c)(2) is available to:

(i) ICE Trust; and

(ii) Any eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), including any ICE Trust clearing member, other than:

(A) an eligible contract participant that is a self-regulatory organization, as that term is defined in Section 3(a)(26) of the Exchange Act;

(B) a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof); or

(C) a futures commission merchant registered pursuant to Section 4f(a)(1) of the Commodity Exchange Act that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons.

(2) Scope of exemption.

(i) In general. Subject to the conditions specified in paragraph (c)(3) of this subsection, such persons generally shall, solely with respect to Cleared CDS, be exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply in connection with security-based swap agreements. Accordingly, under this exemption, those persons remain subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements (i.e., paragraphs (2) through (5) of Section 9(a), Section 10(b), Section 15(c)(1), paragraphs (a) and (b) of Section 16, Section 20(d) and Section 21A(a)(1) and the rules thereunder that explicitly are applicable to security-based swap agreements). All provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions also remain applicable.

(ii) Exclusions from exemption. The exemption in paragraph (c)(2)(i), however, does not extend to the following provisions under the Exchange Act:

(A) Paragraphs (42), (43), (44), and (45) of Section 3(a);

(B) Section 5;

(C) Section 6;

(D) Section 12 and the rules and regulations thereunder;

(E) Section 13 and the rules and regulations thereunder;

(F) Section 14 and the rules and regulations thereunder;

(G) The broker-dealer registration requirements of Section 15(a)(1), and the other requirements of the Exchange Act (including paragraphs (4) and (6) of Section 15(b)) and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission;

(H) Section 15(d) and the rules and regulations thereunder;

(I) Section 15C and the rules and regulations thereunder;

(J) Section 16 and the rules and regulations thereunder; and

(K) Section 17A (other than as provided in paragraph (a)).

(3) Conditions for ICE Trust clearing members.

(i) Any ICE Trust clearing member relying on this exemption must be in material compliance with the rules of ICE Trust.

(ii) Any ICE Trust clearing member relying on this exemption that participates in the clearing of Cleared CDS transactions on behalf of other persons must annually provide a certification to ICE Trust that attests to whether the clearing member is relying on the exemption from broker-dealer related requirements set forth in paragraph (d) of this Order.

(d) Exemption from broker-dealer related requirements for certain ICE Trust clearing members and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (d)(2) is available to:

(i) Any ICE Trust clearing member (other than one that is registered as a broker or dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) or one that is registered as a futures commission merchant pursuant to Section 4f(a)(1) of the Commodity Exchange Act that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons); and

(ii) Any eligible contract participant that does not receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons (other than one that is registered as a broker or dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)).

(2) Scope of exemption. The persons described in paragraph (d)(1) shall, solely with respect to Cleared CDS, be exempt from the broker-dealer registration requirements

of Section 15(a)(1) and the other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)) and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission, subject to the conditions set forth in paragraph (d)(3) with respect to ICE Trust clearing members.

(3) Conditions for ICE Trust clearing members.

(i) General condition for ICE Trust clearing members. An ICE Trust clearing member relying on this exemption must be in material compliance with the rules of ICE Trust, and also must be in material compliance with applicable laws and regulations relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS.

(ii) Additional conditions for ICE Trust clearing members that receive or hold customer funds or securities. Any ICE Trust clearing member that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for U.S. persons (or for any person if the clearing member is a U.S. clearing member) – other than for an affiliate that controls, is controlled by, or is under common control with the clearing member – also shall comply with the following conditions with respect to such activities:

(A) The U.S. person (or any person if the clearing member is a U.S. clearing member) for whom the clearing member receives or holds such funds or securities shall not be natural persons;

(B) The clearing member shall disclose to such U.S. person (or to any such person if the clearing member is a U.S. clearing member) that the clearing member is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member, that the insolvency law of the applicable jurisdiction may affect such persons' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding, and, if applicable, that non-U.S. clearing members may be subject to an insolvency regime that is materially different from that applicable to U.S. persons;

(C) As promptly as practicable after receipt, the clearing member shall transfer such funds and securities (other than those promptly returned to such other person) to:

(I) the clearing member's Custodial Client Omnibus Margin Account at ICE Trust; or

(II) an account held by a third-party custodian, subject to the following requirements:

(a) the funds and securities must be held either:

(1) in the name of a customer, subject to an agreement to which the customer, the clearing member and the custodian are parties, acknowledging that the assets held therein are customer assets used to collateralize obligations of the customer to the clearing member, and that the

assets held in that account may not otherwise be pledged or rehypothecated by the clearing member or the custodian; or

(2) in an omnibus account for which the clearing member maintains a daily record as to the amount held in the account that is owed to each customer, and which is subject to an agreement between the clearing member and the custodian specifying that:

(i) all assets in that account are held for the exclusive benefit of the clearing member's customers and are being kept separate from any other accounts maintained by the clearing member with the custodian;

(ii) the assets held in that account shall at no time be used directly or indirectly as security for a loan to the clearing member by the custodian and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the custodian or any person claiming through the custodian; and

(iii) the assets held in that account may not otherwise be pledged or rehypothecated by the clearing member or the custodian;

(b) the custodian may not be an affiliated person of the clearing member (as defined at paragraph (g)(2)); and

(1) if the custodian is a U.S. entity, it must be a bank (as that term is defined in section 3(a)(6) of the Exchange Act), have total capital, as calculated to meet the applicable requirements imposed by the entity's appropriate regulatory agency (as defined in section 3(a)(34) of the Exchange Act), of at least $1 billion, and have been approved to engage in a trust business by its appropriate regulatory agency;

(2) if the custodian is not a U.S. entity, it must have total capital, as calculated to meet the applicable requirements imposed by the foreign financial regulatory authority (as defined in section 3(a)(52) of the Exchange Act) responsible for setting capital requirements for the entity, equating to at least $1 billion, and provide the clearing member, the customer and ICE Trust with a legal opinion providing that the assets held in the account are subject to regulatory requirements in the

custodian's home jurisdiction designed to protect, and provide for the prompt return of, custodial assets in the event of the insolvency of the custodian, and that the assets held in that account reasonably could be expected to be legally separate from the clearing member's assets in the event of the clearing member's insolvency;

(c) such funds may be invested in Eligible Custodial Assets as that term is defined in ICE Trust's Custodial Asset Policies; and

(d) the clearing member must provide notice to ICE Trust that it is using the third-party custodian to hold customer collateral.

(D) To the extent there is any delay in transferring such funds and securities to the third-parties identified in paragraph (C), the clearing member shall effectively segregate the collateral in a way that, pursuant to applicable law, is reasonably expected to effectively protect such funds and securities from the clearing member's creditors. The clearing member shall not permit such persons to "opt out" of such segregation even if regulations or laws otherwise would permit such "opt out."

(E) The clearing member annually must provide ICE Trust with

(I) an assessment by the clearing member that it is in compliance with all the provisions of paragraphs (d)(3)(ii)(A) through (D) in connection with such activities, and

(II) a report by the clearing member's independent third-party auditor that attests to, and reports on, the clearing member's assessment described in paragraph (d)(3)(ii)(E)(I) and that is

(a) dated as of the same date as, but which may be separate and distinct from, the clearing member's annual audit report;

(b) produced in accordance with the auditing standards followed by the independent third party auditor in its audit of the clearing member's financial statements.

(F) The clearing member shall provide the Commission (upon request or pursuant to agreements reached between the Commission or the U.S. Government and any foreign securities authority (as defined in Section 3(a)(50) of the Exchange Act)) with any information or documents within the possession, custody, or control of the clearing member, any testimony of personnel of the clearing member, and any assistance in taking the evidence of other persons, wherever located, that the Commission requests and that relates to Cleared CDS transactions, except that if, after the clearing member has exercised its best efforts to provide the information, documents, testimony, or assistance, including requesting the appropriate governmental body and, if legally necessary, its customers (with respect to customer information) to permit the clearing member to provide the information, documents, testimony, or assistance to the Commission, the clearing member is prohibited from providing this information, documents, testimony, or assistance by applicable foreign law or regulations, then this exemption shall not longer be available to the clearing member.

(e) Exemption for certain ICE Trust clearing members registered as futures commission merchants.

Any ICE Trust clearing member registered as a futures commission merchant pursuant to Section 4f(a)(1) of the Commodity Exchange Act (but that is not registered as a broker or dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)) that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (c)(2), and from the broker-dealer registration requirements of Section 15(a)(1) and the other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6)) and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission, solely with respect to Cleared CDS, subject to the following conditions:

(1) The clearing member shall be in material compliance with the rules of ICE Trust and also shall be in material compliance with applicable laws and regulations, relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS;

(2) The customers for whom the clearing member receives or holds such funds or securities shall not be natural persons;

(3) The clearing member shall disclose to such customers that the clearing member is not regulated by the Commission, that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member to collateralize Cleared CDS positions, and that the applicable insolvency law may affect such customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding;

(4) Customer funds and securities received or held by the clearing member for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for such customers shall be held in one of the following manners:

(i) In an account established in accordance with section 4d of the Commodity Exchange Act and CFTC Rules 1.20 through 1.30 and 1.32 [17 CFR 1.20 through 1.30 and 1.32] thereunder; or

(ii) In the absence of an Order from the Commodity Futures Trading Commission ("CFTC") permitting the use of an account specified in subparagraph (e)(4)(i) for holding such funds and securities, in an account that is part of a separate account class, specified by CFTC Bankruptcy Rules [17 CFR 190.01 et seq.], established for a futures commission merchant to hold its customers' positions in cleared OTC derivatives (and funds and securities posted to margin, guarantee, or secure such positions);

(5) The clearing member annually shall provide ICE Trust with

(i) an assessment by the clearing member that it is in compliance with subparagraph (e)(4) in connection with such activities, and

(ii) a report by the clearing member's independent third-party auditor that attests to, and reports on, the clearing member's assessment described in subparagraph (e)(5)(i) and that is:

(A) dated as of the same date as, but which may be separate and distinct from, the clearing member's annual audit report; and

(B) produced in accordance with the auditing standards followed by the independent third-party auditor in its audit of the clearing member's financial statements.

(6) To the extent that the clearing member receives or holds funds or securities of customers for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions, the clearing member shall segregate such funds and securities of customers from the clearing member's own assets (i.e., the member may not permit such customers to "opt out" of applicable segregation requirements for such funds and securities even if regulations or laws would permit the customer to "opt out").

(f) Exemption for certain registered broker-dealers.

(1) In general. A broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (c)(2), solely with respect to Cleared CDS, except:

(i) Section 7(c);

(ii) Section 15(c)(3);

(iii) Section 17(a);

(iv) Section 17(b);

(v) Regulation T, 12 CFR 200.1 et seq.;

(vi) Rule 15c3-1;

(vii) Rule 15c3-3;

(viii) Rule 17a-3;

(ix) Rule 17a-4;

(x) Rule 17a-5; and

(xi) Rule 17a-13.

(2) Broker-dealers that also are futures commission merchants. An ICE Trust clearing member that is a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) and that is also registered as a futures commission merchant pursuant to Section 4f(a)(1) of the Commodity Exchange Act and that receives or holds customer funds and securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS in a futures account (as that term is defined in Rule 15c3-3(a)(15) [17 CFR 240.15c3-3(a)(15)]) also shall be exempt from Exchange Act Rule 15c3-3, subject to the following conditions:

(i) the clearing member shall comply with the conditions set forth in paragraphs (e)(1), (2), (4), (5), and (6) above;

(ii) the clearing member shall disclose to Cleared CDS customers that the U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to funds or securities held by the clearing member to collateralize Cleared CDS positions, and that the applicable insolvency law may affect such customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding; and

(iii) The clearing member shall collect from each customer the amount of margin that is not less than the amount required for Cleared CDS under the margin rule of the self-regulatory organization that is its designated examining authority.

(g) Definitions.

(1) For purposes of this Order, the term "Cleared CDS" shall mean a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to ICE Trust, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which:

(i) the reference entity, the issuer of the reference security, or the reference security is one of the following:

(A) an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available;

(B) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States;

(C) a foreign sovereign debt security;

(D) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or

(E) an asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae; or

(ii) the reference index is an index in which 80 percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (1).

(2) For purposes of this Order, the term "Affiliated Person of the Clearing Member" shall mean any person who directly or indirectly controls a clearing member or any person who is directly or indirectly controlled by or under common control with the clearing member. Ownership of 10 percent or more of the common stock of the relevant entity will be deemed prima facie control of that entity.

IV. Paperwork Reduction Act

Certain provisions of this Order contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995.[90] The Commission has submitted the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

A. Collection of Information

The Commission found it to be necessary or appropriate in the public interest and consistent with the protection of investors to grant the conditional temporary exemptions

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[90] 44 U.S.C. 3501 et seq.

discussed in this Order until July 16, 2011. Among other things, the Order would require certain ICE Trust clearing members that receive or holds customers' funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions to: (i) provide ICE Trust with certain certifications/notifications, (ii) make certain disclosures to cleared CDS customers, (iii) enter into certain agreements to protect customer assets, (iv) maintain a record of each customer's share of assets maintained in an omnibus account, and (v) obtain a separate report, as part of its annual audit report, as to its compliance with the conditions of the ICE Trust Order regarding protection of customer assets. The Order also would require certain ICE Trust clearing members that receive or hold customers' funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions to: (a) make certain disclosures to those customers; and (b) provide ICE Trust with a self-assessment as to its compliance with certain exemptive conditions, and obtain a separate report, as part of its annual audit report, as to its compliance with the conditions of the Order regarding protection of customer assets.

B. <u>Proposed Use of Information</u>

These collection of information requirements are designed, among other things, to inform cleared CDS customers that their ability to recover assets placed with the clearing member are dependent on the applicable insolvency regime, provide Commission staff with access to information regarding whether clearing members are complying with the conditions of the ICE Trust order, and provide documentation helpful for the protection of cleared CDS customers' funds and securities.

C. Respondents

Based on conversations with industry participants, the Commission understands that approximately 14 firms may be presently engaged as CDS dealers and thus may seek to be a clearing member of ICE Trust. In addition, 6 more firms may enter into this business. Consequently, the Commission estimates that ICE Trust, like the other CCPs that clear CDS transactions, may have up to 20 clearing members.

D. Total Annual Reporting and Recordkeeping Burden

Paragraph III.(c)(3)(ii) of this Order requires any ICE Trust clearing member relying on the exemptive relief specified in paragraph (c) that participates in the clearing of cleared CDS transactions on behalf of other persons to annually provide a certification to ICE Trust that attests to whether the clearing member is relying on the exemption from broker-dealer related requirements set forth in paragraph (d) of that Order. The Commission estimates that it would take a clearing member approximately one half hour each year to complete the certification and provide it to ICE Trust, resulting in an aggregate burden of 10 hours per year for all 20 clearing members to comply with this requirement on an annual basis.[91]

Paragraph III.(d)(3)(ii)(C)(II)(d) of this Order requires that a clearing member notify ICE Trust if it is using a third-party custodian to hold customer collateral. The Commission estimates that it would take a clearing member approximately one half hour each year to draft a

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[91] 10 hours = (20 clearing members x ½ hour per clearing member). This estimate is based on burden estimates published with respect to other Commission actions that contained similar certification requirements (see e.g., Exchange Act Release No. 41661 (Jul 27, 1999) (64 FR 42012 (Aug. 3, 1999)), and the burden associated with the Year 2000 Operational Capability Requirements, including notification and certifications required by Rule 15b7-3T(e).

notification and provide it to ICE Trust, which would result in an aggregate burden of 10 hours per year for all 20 clearing members to comply with this requirement on an annual basis.[92]

Paragraph III.(d)(3)(ii)(B) of this Order requires an ICE Trust clearing member to disclose to its U.S. customers[93] that it is not regulated by the Commission and that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities it holds, that the insolvency law of the applicable jurisdiction may affect the customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding, and, if it is not a U.S. entity, that it may be subject to an insolvency regime that is materially different from that applicable to U.S. persons. The Commission believes that clearing members could use the language in the ICE Trust order that describes the disclosure that must be made as a template to draft the disclosure. Consequently the Commission estimates, based on staff experience, that it would take a clearing member approximately one hour to draft the disclosure. Further, the Commission believes clearing members will include this disclosure with other documents or agreements provided to cleared CDS customers and a clearing member may take approximately one half hour to determine how the disclosure should be integrated into those other documents or agreements, resulting in a one-time aggregate burden of 30 hours for all 20 clearing members to comply with this requirement.[94]

Paragraph III.(d)(3)(ii)(C)(II)(a)(1) of this Order requires that, if an ICE Trust clearing member chooses to segregate each of its customers' funds and securities in a separate account, it

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92 Id.

93 If the clearing member is a U.S. entity, it must make this disclosure to all of its customers.

94 30 hours = (1 hour per clearing member to draft the disclosure + ½ hour per clearing member to determine how the disclosure should be integrated into those other documents or agreements) x 20 clearing members.

must obtain a tri-party agreement for each such account acknowledging that the assets held in the account are customer assets used to collateralize obligations of the customer to the clearing member, and that the assets held in the account may not otherwise be pledged or re-hypothecated by the clearing member or the custodian. Paragraph III.(d)(ii)(C)(II)(a)(2) of the ICE Trust order requires that, if an ICE Trust clearing member chooses to segregate its customers' funds and securities on an omnibus basis, it must obtain an agreement with the custodian with respect to the omnibus account acknowledging that the assets held in the account (i) are customer assets and are being kept separate from any other accounts maintained by the clearing member with the custodian, (ii) may at no time be used directly or indirectly as security for a loan to the clearing member by the custodian and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the custodian or any person claiming through the custodian, and (iii) may not otherwise be pledged or re-hypothecated by the clearing member or the custodian. Opening a bank account generally includes discussions regarding the purpose for the account and a determination as to the terms and conditions applicable to such an account. The Commission understands that most banks presently maintain omnibus and other similar types of accounts that are designed to recognize legally that the assets in the account may not be attached to cover debts of the account holder. Thus the standard agreement for this type of account used by banks should contain the representations and disclosures required by the proposed amendment. However, a small percentage of clearing members may need to work with a bank to modify its standard agreement. The Commission estimates that 5% of the 20 clearing members, or 1 firm, may use a bank with a standard agreement that does not contain the required language.[95] The

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[95] This estimate is based on burden estimates published with respect to other Commission actions that contained similar certification requirements (see e.g., Exchange Act Release No. 55431 (Mar. 9,

Commission further estimates each clearing member that uses a bank with a standard agreement that does not contain the required language would spend approximately 20 hours of employee resources working with the bank to update its standard agreement template. Therefore, the Commission estimates that the total one-time burden to the industry as a result of this proposed requirement would be approximately 20 hours.[96]

Paragraph III.(d)(3)(ii)(C)(II)(a)(2) of this Order further requires that the clearing member maintain a daily record as to the amount held in the omnibus account that is owed to each customer. The Commission included this requirement in the ICE Trust order to stress the importance of such a record. However it believes that a prudent clearing member likely would create and maintain such a record for business purposes. Consequently, the Commission believes this requirement would not create any additional paperwork burden.

Paragraph III.(d)(3)(ii)(E) of this Order requires ICE Trust clearing members that receive or hold customers' funds or securities for the purpose of purchasing, selling, clearing, settling, or holding cleared CDS positions annually to provide ICE Trust with an assessment that it is in compliance with all the provisions of paragraphs III.(d)(3)(ii)(A) through (D) of that order in connection with such activities, and a report by the clearing member's independent third-party auditor, as of the same date as the firm's annual audit report,[97] that attests to, and reports on, the clearing member's assessment. Paragraph III.(e)(5) of this Order requires ICE Trust clearing members that receive or hold customers' funds or securities for the purpose of purchasing,

2007) (72 FR 12862 (Mar. 19, 2007)), and the burden associated with the amendments to the financial responsibility rules, including language required in securities lending agreements).

96 20 hours = (20 clearing members x 5%) x 20 hours to work with a bank to update its standard agreement template to include the necessary language.

97 The Commission intends for this requirement to be performed in conjunction with the firm's annual audit report.

selling, clearing, settling, or holding Cleared CDS positions annually to provide ICE Trust with an assessment that it is in compliance with all the provisions of paragraphs III.(e)(4)(i) through (iii) of that order in connection with such activities, and a report by the clearing member's independent third-party auditor, as of the same date as the firm's annual audit report,[98] that attests to, and reports on, the clearing member's assessment. Each clearing member will have to comply with either Paragraph III.(d)(3)(ii)(E) of this Order or Paragraph III.(e)(5) of this Order but not both. The Commission estimates that it will take each clearing member approximately five hours each year to assess its compliance with the requirements of the order relating to segregation of customer assets and attest that it is in compliance with those requirements.[99] Further, the Commission estimates that it will cost each clearing member approximately $200,000 more each year to have its auditor prepare this special report as part of its audit of the clearing member.[100] Consequently, the Commission estimates that compliance with this requirement will result in an aggregate annual burden of 100 hours for all 20 clearing members,

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98 The Commission intends for this requirement to be performed in conjunction with the firm's annual audit report.

99 This estimate is based on burden estimates published with respect to other Commission actions that contained similar certification requirements (see e.g., Securities Act Release No. 8138 (Oct. 9, 2002) (67 FR 66208 (Oct. 30, 2002)), and the burden associated with the Disclosure Required by the Sarbanes-Oxley Act of 2002, including requirements relating to internal control reports).

100 This estimate is based on staff conversations with an audit firm. That firm suggested that the cost of such an audit report could range from $10,000 to $1 million, depending on the size of the clearing member, the complexity of its systems, and whether the work included a review of other systems already being reviewed as part of audit work the firms is already providing to the clearing member. The staff understands that it would be less costly to perform this type of audit if the clearing member chooses to forward all customer collateral to ICE Trust (an option allowed by this Order) and does not use any third party. The staff understands that most ICE Trust clearing members are large dealers whose audits likely include internal control reviews and SAS 70 reports regarding custody of customer assets, which would require a review of the same or similar systems used to comply with the audit report requirement in this order. Finally, the staff notes that if the clearing member were a futures commission merchant complying with Paragraph III.(e)(5) of this Order, an auditor already must review custody of customer assets pursuant to CFTC Rule 17 CFR 1.16(d)(1). Consequently, the Commission believes the cost of this requirement for FCMs may be lower than it would be for other types of entities that are not subject to a specific audit requirement to review custody of customer assets.

and that the total additional cost of this requirement will be approximately $4,000,000 each year.[101]

Paragraph III.(e)(3) of the Order requires that any ICE Trust clearing member holding customer collateral in connection with cleared customer CDS transactions that seeks to rely on the exemptive relief specified in paragraph III.(e) of the Order to disclose to those customers that the clearing member is not regulated by the Commission, that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities its holds, and that the applicable insolvency law may affect the customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding. The Commission believes that clearing members could use the language in the Order that describes the disclosure that must be made as a template to draft the disclosure. Consequently the Commission estimates, based on staff experience, that it would take a clearing member approximately one hour to draft the disclosure. Further, the Commission believes clearing members will include this disclosure with other documents or agreements provided to cleared CDS customers, and estimates (based on staff experience) that a clearing member may take approximately one half hour to determine how the disclosure should be integrated into those other documents or agreements, resulting in a one-time aggregate burden of 30 hours for all 20 clearing members to comply with this requirement.[102]

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[101] 100 hours = (5 hours for each clearing member to assess its compliance with the requirements of the order relating to segregation of customer assets and attest that it is in compliance with those requirements x 20 clearing members). $4 million = $200,000 per clearing member x 20 clearing members.

[102] 30 hours = (1 hour per clearing member to draft the disclosure + ½ hour per clearing member to determine how the disclosure should be integrated into those other documents or agreements) x 20 clearing members.

E. Collection of Information is Mandatory

The collections of information contained in the conditions to this Order are mandatory for any entity wishing to rely on the exemptions granted by this Order.

F. Confidentiality

Certain of the conditions of this Order that address collections of information require ICE Trust clearing members to make disclosures to their customers, or to provide other information to ICE Trust (and in some cases also to customers). Apart from those requirements, the provisions of this Order that address collections of information do not address or restrict the confidentiality of the documentation prepared by ICE Trust clearing members under the exemptive conditions. Accordingly, ICE Trust clearing members would have to make the applicable information available to regulatory authorities or other persons to the extent otherwise provided by law.

G. Request for Comment on Paperwork Reduction Act

The Commission requests, pursuant to 44 U.S.C. 3506(c)(2)(B), comment on the collections of information contained in this Order to:

(i) evaluate whether the collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

(ii) evaluate the accuracy of the Commission's estimates of the burden of the collections 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 collections of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and 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, and refer to File No. S7-05-09. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the Federal Register; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-05-09, and be submitted to the Securities and Exchange Commission, Records Management Office, 100 F Street, NE, Washington, DC 20549.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63384 / November 29, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14143

In the Matter of Dennis H. Johnston, Esq., **Respondent.**	**ORDER OF SUSPENSION, PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Dennis H. Johnston ("Johnston") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.[1]

II.

The Commission finds that:

1. Johnston is an attorney, whom the State of California admitted to practice law in 1978.

2. On December 15, 2009, the Supreme Court of California disbarred Johnston. The court based its ruling on a decision of the Hearing Department-Los Angeles, State Bar Court of California ("California Bar Court"), which found that Johnston engaged in multiple violations of the California Rules of Professional Conduct.

[1] See 17 C.F.R. 201.102(e)(2).

III.

In view of the foregoing, the Commission finds that Johnston is an attorney who has been disbarred by a State court within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9160 / November 30, 2010

SECURITIES EXCHANGE ACT OF 1934
Release No. 63394 / November 30, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3116 / November 30, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14145

In the Matter of PRISCILLA G. SABADO, Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b)(6) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Priscilla G. Sabado ("Respondent" or "Sabado").

II.

After an investigation, the Division of Enforcement alleges that:

A. <u>RESPONDENT</u>

Sabado, 60, resides in Irvine, California, and worked as both a broker-dealer and investment adviser representative at AXA Advisors, LLC until April 1, 2010. Currently, Sabado sells fixed income products for a life insurance company.

B. OTHER RELEVANT ENTITIES

1. **AXA Advisors, LLC ("AXA")** is a Delaware limited liability company headquartered in New York, New York. AXA, which is a subsidiary of AXA Financial, Inc., became a Commission-registered broker-dealer on December 30, 1973, and a Commission-registered investment adviser on July 19, 1999.

2. **Halek Energy, LLC** is a Texas limited liability company located in Southlake, Texas, that purports to drill and operate oil and gas wells in Texas. On August 31, 2010, the Commission filed a partially settled civil injunctive action alleging that between June 2007 and September 2009, Halek Energy, CBO Energy, Inc., and Jason Halek fraudulently sold investments in Texas oil and gas projects, raising approximately $22 million from 300 investors nationwide. *SEC v. Halek Energy, LLC, et al.*, Civil Action No. 3:10-cv-0719-K (N.D. Tex.), Lit. Release No. 21637 (Sept. 1, 2010).

C. MATERIAL MISREPRESENTATIONS AND OMISSIONS

1. From August 2008 to November 2009, Sabado offered and sold Halek Energy and CBO Energy (collectively "Halek Energy") oil and gas working interests to several of her clients. While soliciting her clients, Sabado made material misrepresentations and omissions regarding the risks of the returns, the projected returns and her family's investment. As a result of Sabado's recommendations, six of her clients purchased working interests in Halek Energy oil and gas leases in the aggregate amount of $491,880.

2. Sabado, who had no experience in selling or investing in oil and gas working interests, did no meaningful due diligence on Halek Energy or the investments it was selling. Halek Energy agreed to pay Sabado an 8% to 10% commission for each working interest sold, which it paid in the form of working interests in one of its projects.

3. Sabado offered and sold Halek Energy working interests to her AXA clients. In doing so, she violated AXA's compliance policies and procedures prohibiting selling away and requiring disclosure to, and approval by, the firm of all outside business. Sabado was aware of AXA's requirement that she obtain AXA's approval prior to selling oil and gas working interests and failed to obtain the required approval. She also failed to disclose her Halek Energy sales on her annual outside business activities forms.

4. In addition, she made several material misrepresentations and omissions while offering the oil and gas working interests to her clients. For example, Sabado told some of her clients to expect monthly "dividends" of $1,200 to $2,500, beginning within three months of their initial investment. Sabado also falsely represented to some investors that her family invested in Halek Energy. In reality, her relatives received their working interests as compensation for Sabado's sales. Further, Sabado falsely told certain investors that her family was receiving $5,000 a month from their Halek Energy investment.

5. Sabado also failed to adequately disclose the risks involved in the oil and gas investments, telling her clients that the project included a proven well and that they would "most likely" receive the promised returns. Sabado assured one of her clients, a financially unsophisticated 24-year-old blind man, that he would receive $2,500 to $5,000 from his Halek Energy investment. She even instructed him to represent in Halek Energy subscription documents that he was a sophisticated, accredited investor, when he was not. In reality, he was an unaccredited investor seeking a safe, income-producing product for over $139,000 he received as part of the settlement of a lawsuit over the accident that caused his blindness.

6. Sabado continued to solicit new sales of Halek Energy oil and gas projects even after her earlier clients complained that they were not receiving the promised returns. In particular, in November 2009, Sabado recommended that two clients, one of whom was unaccredited, buy another Halek Energy oil and gas project, telling these clients that they would receive significant monthly income. She failed to tell them, however, that her other clients had yet to receive their projected returns from a similar Halek Energy investment.

D. VIOLATIONS

1. As a result of the conduct described above, Sabado willfully violated:

a. Sections 5(a) and 5(c) of the Securities Act, which prohibit the offer or sale of any security, absent an exemption, when no registration statement has been filed or is in effect as to the security.

b. Section 17(a) of the Securities Act 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.

c. Section 15(a) of the Exchange Act, which prohibits persons or entities, while acting as a broker or dealer, from effecting transactions in or attempting to induce the purchase or sale of securities when such person or entities was not registered with the Commission as a broker or dealer or when such person was not associated with an entity registered with the Commission as a broker or dealer.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203(i) of the Advisers Act;

E. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 5(a) and 5(c) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder and whether Respondent should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act and Section 21C(e) of the Exchange Act.

IV.

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

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

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

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

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63399 / November 30, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12631

In the Matter of	)	
	)	**ORDER DIRECTING**
Morgan Stanley & Co.	)	**DISBURSEMENT OF**
Incorporated,	)	**DISGORGEMENT FUND**
	)	
Respondent.	)	
	)	

On June 23, 2009, the Commission issued a Notice of the Proposed Plan of Disgorgement and Opportunity for Comment ("Notice") in connection with this proceeding (see Exchange Act Rel. No. 60160) pursuant to Rule 1103 of the Commission's Rules on Fair Funds and Disgorgement Plans, 17 C.F.R. 201.1103. No comments were received by the Commission in response to the Notice and on August 25, 2009, the Commission approved the Plan (see Exchange Act Rel. No. 60568).

The Plan provides that the Commission will arrange for distribution of the Disgorgement Fund when a validated payment file listing the payees with the identification information required to make a distribution has been received and accepted. The validated payment file has been received and accepted for the disbursement of $457,821.82.[1]

Accordingly, it is ORDERED that the Commission staff shall disburse the Disgorgement Fund in the amount stated in the validated payment file of $457,821.82 as provided in the Plan.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

[1] By Order Directing Disbursement of Disgorgement Fund dated May 24, 2010, the Commission ordered the disbursement of $2,891,887.33 (see Exchange Act Rel. No. 62162).