

SECURITIES AND EXCHANGE COMMISSION

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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

(47 Documents)

*Commissioner Walter
not participating*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63356 / November 22, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3214 / November 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14134

In the Matter of

CATHERINE ROZANSKI (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 Catherine Rozanski ("Respondent" or "Rozanski") 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. Rozanski, age 42, is and has been a certified public accountant licensed to practice in the State of Michigan since 1992. Rozanski served as Director of Financial Accounting and Reporting at Delphi Corporation ("Delphi") from April 2001 to 2004. She was separated by the company in 2005. As Director of Financial Accounting and Reporting, Rozanski was consulted for Generally Accepted Accounting Principles ("GAAP") accounting guidance.

2. Delphi was, at all relevant times, an auto parts supplier headquartered in Troy, Michigan. It was incorporated in Delaware in 1998. At all relevant times, Delphi's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and was listed on the New York Stock Exchange ("NYSE") under the symbol "DPH."

3. On October 30, 2006, the Commission filed a complaint against Rozanski and others in SEC v. Delphi Corporation and Catherine Rozanski, et al. (Civil Action No. 2:06-cv-14891-AC-SDP). On November 17, 2010, the court entered an order permanently enjoining Rozanski, by consent, from future violations of Section 17(a) of the Securities Act of 1933, and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and aiding and abetting violations of Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, and 13a-1 thereunder. Rozanski was also ordered to pay a \$40,000 civil money penalty.

4. The Commission's Complaint alleged, among other things, that Rozanski engaged in a fraudulent scheme which resulted in Delphi filing materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal year ended December 31, 2001. Specifically, the Complaint alleged that Delphi improperly recorded a \$20 million payment from an information technology ("IT") company in December 2001, made in connection with a new IT contract between the IT company and Delphi, as a reduction in expense, although the payment was in substance a loan which Delphi was required to repay with

interest. The Complaint alleged that, when the IT contract was signed, Delphi agreed to repay the \$20 million over 5 years with interest, through an intentionally opaque scheme involving accelerated payments on other IT company service invoices, and using a supplier finance program; because the \$20 million was refundable, it contravened GAAP to record the \$20 million as an immediate reduction of IT expense instead of a Delphi liability to the IT company. In connection with the payment, Delphi allegedly entered into a false side letter with the IT company which was intended to mislead Delphi's auditors as to the correct accounting treatment for the transaction. The Complaint alleged that Rozanski, knowing that the \$20 million payment was tied to the new contract and in substance a loan to Delphi, conducted meetings and discussions leading to the signing of the relevant contract and the payment of the \$20 million. The Complaint further alleged that Rozanski directed the drafting of versions of a false and misleading side letter to mislead Delphi's auditors and make the transaction appear legitimate.

IV.

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

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

A. Rozanski is suspended from appearing or practicing before the Commission as an accountant.

B. After three (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


By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-3118; File No. S7-23-07

RIN 3235-AJ96

Temporary Rule Regarding Principal Trades with Certain Advisory Clients

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing to amend rule 206(3)-3T under the Investment Advisers Act of 1940, a temporary rule that establishes an alternative means for investment advisers who are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Investment Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients. The amendment would extend the date on which rule 206(3)-3T will sunset from December 31, 2010 to December 31, 2012.

DATES: Comments must be received on or before December 20, 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.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-23-07 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 S7-23-07. 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: Brian M. Johnson, Attorney-Adviser, Devin F. Sullivan, Senior Counsel, Matthew N. Goldin, 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 20549-5041.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is proposing an amendment to temporary rule 206(3)-3T [17 CFR 275.206(3)-3T] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] that would extend the date on which the rule will sunset from December 31, 2010 to December 31, 2012.

I. BACKGROUND

On September 24, 2007, we adopted, on an interim final basis, rule 206(3)-3T, a temporary rule under the Investment Advisers Act of 1940 (the "Advisers Act") that provides an alternative means for investment advisers who are registered with us as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients.¹ The purpose of the rule was to permit broker-dealers to sell to their advisory clients, in the wake of *Financial Planning Association v. SEC* (the "FPA Decision"),² certain securities held in the proprietary accounts of their firms that might not be available on an agency basis — or might be available on an agency basis only on less attractive terms³ — while protecting clients from conflicts of interest as a result of such transactions.⁴

¹ Rule 206(3)-3T [17 CFR 275.206(3)-3T]. All references to rule 206(3)-3T and the various sections thereof in this release are to 17 CFR 275.206(3)-3T and its corresponding sections. *See also Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 (Sep. 24, 2007) [72 FR 55022 (Sep. 28, 2007)] ("2007 Principal Trade Rule Release").

² 482 F.3d 481 (D.C. Cir. 2007). In the FPA Decision, handed down on March 30, 2007, the Court of Appeals for the D.C. Circuit vacated (subject to a subsequent stay until October 1, 2007) rule 202(a)(11)-1 under the Advisers Act. Rule 202(a)(11)-1 provided, among other things, that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act. For further discussion of fee-based brokerage accounts, see 2007 Principal Trade Rule Release, Section I.

³ *See* 2007 Principal Trade Rule Release at nn.19-20 and Section VI.C.

⁴ As a consequence of the FPA Decision, broker-dealers offering fee-based brokerage accounts with an advisory component became subject to the Advisers Act with respect to those accounts, and the client relationship became fully subject to the Advisers Act. These broker-dealers — to the extent they wanted to continue to offer fee-based accounts and met the requirements for registration — had to: register as investment advisers, if they had not done so already; act as fiduciaries with respect to those clients; disclose all material conflicts of interest; and otherwise fully comply with the Advisers Act, including the restrictions on principal trading contained in section 206(3) of the Act. *See* 2007 Principal Trade Rule Release, Section I.

As initially adopted on an interim final basis, rule 206(3)-3T was set to expire on December 31, 2009. In December 2009, however, we adopted rule 206(3)-3T as a final rule in the same form in which it was adopted on an interim final basis in 2007, except that we extended the rule's sunset period by one year to December 31, 2010.⁵ We deferred final action on rule 206(3)-3T in December 2009 because we needed additional time to understand how, and in what situations, the rule was being used.⁶

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").⁷ Under section 913 of the Dodd-Frank Act, we are required to conduct a study; and provide a report to Congress, concerning the obligations of broker-dealers and investment advisers, including the standards of care applicable to those intermediaries and their associated persons.⁸ We intend to deliver the report concerning this study, as required by the Dodd-Frank Act, no later than January 21, 2011.⁹

Our staff has observed the use of the rule by entities that are investment advisers also registered with us as broker-dealers.¹⁰ Of the firms contacted by our staff, some

⁵ See *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965 (Dec. 23, 2009) [74 FR 69009 (Dec. 30, 2009)] ("Extension Release") and *Temporary Rule Regarding Principal Trades With Certain Advisory Clients*, Investment Advisers Act Release No. 2965A (Dec. 31, 2009) [75 FR 742 (Jan. 6, 2010)] (making a technical correction to the Extension Release).

⁶ See Extension Release, Section II.c.

⁷ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁸ See generally section 913 of the Dodd-Frank Act and *Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, Investment Advisers Act Release No. 3058 (July 27, 2010) [75 FR 44996 (July 30, 2010)].

⁹ See section 913(d)(1) of the Dodd-Frank Act (requiring us to submit the study to Congress no later than six months after the date of enactment of the Dodd-Frank Act).

¹⁰ Rule 206(3)-3T is available only to an investment adviser that is a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 [15 U.S.C. 78o]. Rule 206(3)-3T(a)(7).

firms indicated that they were relying on the rule. As discussed more fully below, our staff observed several compliance issues. The staff is pursuing those matters where appropriate, including referrals to the Division of Enforcement.

II. DISCUSSION

We are proposing to amend rule 206(3)-3T only to extend the rule's expiration date by two additional years. If the rule is amended, absent further action by the Commission, the rule will expire on December 31, 2012.

As noted above, under section 913 of the Dodd-Frank Act, we are required to conduct a study and provide a report to Congress concerning the obligations of broker-dealers and investment advisers, including the standard of care applicable to those intermediaries.¹¹ We are required to deliver the report concerning this study no later than six months after the enactment of the Dodd-Frank Act, in January 2011.¹²

Section 913 of the Dodd-Frank Act also authorizes us to promulgate rules concerning, among other things, the legal or regulatory standards of care for broker-dealers, investment advisers, and persons associated with these intermediaries for providing personalized investment advice about securities to retail customers. In enacting any rules pursuant to this authority, we are required to consider the findings, conclusions, and recommendations of the mandated study. The study and our consideration of the need for further rulemaking pursuant to this authority are part of our

¹¹ See *supra* note 8 and accompanying text.

¹² See *supra* note 9 and accompanying text.

broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers in connection with the Dodd-Frank Act.¹³

As part of this study and any rulemaking that may follow, we expect to consider the issues raised by principal trading, including the restrictions in section 206(3) of the Advisers Act and our experiences with, and observations regarding, the operation of rule 206(3)-3T. We will not, however, complete our consideration of these issues before December 31, 2010, rule 206(3)-3T's current expiration date.

We believe that firms' compliance with the substantive provisions of rule 206(3)-3T as currently in effect provides sufficient protections to advisory clients to warrant the rule's continued operation for an additional limited period of time while we conduct the study mandated by the Dodd-Frank Act and consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers.¹⁴

If we permit rule 206(3)-3T to expire on December 31, 2010, after that date investment advisers also registered as broker-dealers who currently rely on rule 206(3)-3T would be required to comply with section 206(3)'s transaction-by-transaction written disclosure and consent requirements without the benefit of the alternative means of complying with these requirements currently provided by rule 206(3)-3T. This could limit the access of non-discretionary advisory clients of advisory firms that are also

¹³ The study mandated by section 913 of the Dodd-Frank Act is one of several studies and other actions relevant to the regulation of broker-dealers and investment advisers mandated by that Act. *See, e.g.*, section 914 of the Dodd-Frank Act (requiring the Commission to review and analyze the need for enhanced examination and enforcement resources for investment advisers); section 919 of the Dodd-Frank Act (authorizing the Commission to issue rules designating documents or information that shall be provided by a broker or dealer to a retail investor before the purchase of an investment product or service by the retail investor).

¹⁴ For a discussion of some of the benefits underlying rule 206(3)-3T, see 2007 Principal Trade Rule Release, Section VI.C.

registered as broker-dealers to certain securities.¹⁵ In addition, certain of these firms have informed us that, if rule 206(3)-3T were to expire on December 31, 2010, they would be required to make substantial changes to their disclosure documents, client agreements, procedures, and systems.

As noted above, our staff has observed the use of the rule by entities that are investment advisers and are also registered as broker-dealers.¹⁶ Of the firms contacted by our staff, some indicated that they were relying on the rule. Significantly, among those advisers, our staff did not identify instances of “dumping,” a particular concern underlying section 206(3) of the Advisers Act.¹⁷ However, our staff did observe certain compliance issues, including but not limited to instances in which firms:

- did not comply with section 206(3) or rule 206(3)-3T for certain transactions that were executed on a principal basis;¹⁸

¹⁵ See *id.*

¹⁶ The Office of Compliance Inspections and Examinations conducted examinations regarding compliance with rule 206(3)-3T. The staff’s observations discussed in this release are from these examinations.

¹⁷ Congress intended section 206(3) to address concerns that an adviser might engage in principal transactions to benefit itself or its affiliates, rather than the client. In particular, Congress was concerned that advisers might use advisory accounts to “dump” unmarketable securities or those the advisers fear may decline in value. See *Investment Trusts and Investment Companies: Hearings on S. 3580 Before the Subcomm. of the Comm. on Banking and Currency, 76th Cong., 3d Sess. 320, 322 (1940)* (“[i]f a fellow feels he has a sour issue and finds a client to whom he can sell it, then that is not right. . . .”) (statement of David Schenker, Chief Counsel, Securities and Exchange Commission Investment Trust Study).

¹⁸ For example, the staff observed instances in which transactions in underwritten securities were not identified as being executed in a principal capacity, even when these securities passed through a firm’s inventory. In addition, the staff observed instances in which firms executed principal transactions in reliance on rule 206(3)-3T in securities that were ineligible for trading pursuant to the rule.

- demonstrated weaknesses relating to compliance monitoring of electronic systems to identify principal trades and to validate compliance with rule 206(3)-3T's disclosure and consent provisions;¹⁹
- failed to test periodically the adequacy of their compliance programs;
- had inadequate policies and procedures concerning rule 206(3)-3T;²⁰
- did not provide disclosures or provided disclosures that appeared to be potentially confusing, misleading, or incomplete;²¹
- failed to obtain transaction-by-transaction consent;
- provided written confirmations that appeared to be potentially confusing or incomplete;²² and
- maintained books and records in a manner that did not enable the staff meaningfully to assess compliance with rule 206(3)-3T.²³

¹⁹ For example, in some instances, automated compliance systems erroneously permitted advisory client transactions to be executed on a principal basis for clients that had not authorized such transactions.

²⁰ See 2007 Principal Trade Rule Release, Section II.B.8 (“... an adviser relying on rule 206(3)-3T as an alternative means of complying with section 206(3) must have adopted and implemented written policies and procedures reasonably designed to comply with the requirements of the rule.”); Rule 206(4)-7(a) [17 CFR 275.206(4)-7(a)] (requiring an investment adviser registered with us to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act (and the rules thereunder) by the adviser or any of its supervised persons).

²¹ Such observations were made with respect to prospective written disclosures, transaction-by-transaction disclosures, and client annual reports. For example, the staff observed instances in which firms placed limitations on clients' ability to revoke their permission to execute transactions on a principal basis. The staff also observed instances in which annual summary reports were not sent to clients or were incomplete.

²² For example, the staff observed instances in which confirmations did not clearly state that the client's consent was given *prior to execution*.

²³ For example, in some instances, the staff was unable to verify whether oral transaction-by-transaction disclosures were, in fact, provided. The staff also observed instances in

We find it important that the staff found no instances of "dumping" by advisers the staff observed were relying on rule 206(3)-3T.²⁴ However, we remain concerned about the compliance issues observed by the staff. As noted above, the staff is pursuing those matters where appropriate, including referrals to the Division of Enforcement. If the rule is extended, the staff will monitor compliance and continue to take appropriate action to help ensure that firms are complying with the rule's conditions, including referring firms to the Division of Enforcement if warranted. We further encourage all firms that rely on rule 206(3)-3T to evaluate whether they have any of the compliance issues discussed in this Release, and if so, to take steps to address them.

In light of these and other considerations discussed in this Release, we believe that it would be premature to require these firms to restructure their operations and client relationships before we complete our study and our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers. To the extent our consideration of these issues leads to new rules concerning principal trading, these firms would again be required to restructure their operations and client relationships, potentially at substantial expense.

As part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers, we intend to carefully consider principal trading by advisers, including whether rule 206(3)-3T should be substantively modified, supplanted, or permitted to expire. In making these determinations, we expect to consider, among other things, the results of the study required by section 913 of the

which it was unable to establish whether certain transactions were, in fact, subject to section 206(3).

²⁴

See supra note 17.

Dodd-Frank Act, relevant comments received in connection with the study and any potential rulemaking that may follow, the results of our staff's evaluation of the operation of rule 206(3)-3T, any relevant comments we receive in connection with this proposal, and comments we received in response to the 2007 Principal Trade Rule Release.

We expect to revisit the relief provided in rule 206(3)-3T following the completion of our study. Although we anticipate that will occur prior to the proposed amended expiration date for the temporary rule, we want to ensure that we have sufficient time to complete any potential rulemaking process prior to the rule's expiration.

III. REQUEST FOR COMMENT

We request comment on our proposal to extend rule 206(3)-3T for two additional years.

- Is it appropriate to extend rule 206(3)-3T for a limited period of time in its current form while we complete our study and our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers? Or should we allow the rule to expire?
- Given the compliance issues observed, is extending the rule appropriate?
- Is two years an appropriate period of time to extend the rule? Or should we extend the rule for a different period of time? If so, for how long?

IV. PAPERWORK REDUCTION ACT

Rule 206(3)-3T contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.²⁵ The Office of Management and Budget ("OMB") approved the burden estimates presented in the 2007 Principal Trade

²⁵ 44 U.S.C. 3501 *et seq.*

Rule Release,²⁶ first on an emergency basis and subsequently on a regular basis. OMB approved the collection of information with an expiration date of March 31, 2011. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for the collection of information is: "Temporary rule for principal trades with certain advisory clients, rule 206(3)-3T" and the OMB control number for the collection of information is 3235-0630. As noted in the Extension Release, the 2007 Principal Trade Rule Release solicited comments on our PRA estimates, but we did not receive comment on them.²⁷

The amendment to the rule we are proposing today — to extend rule 206(3)-3T for two years — does not affect the burden estimates contained in the 2007 Principal Trade Rule Release. Therefore, as was the case when we extended rule 206(3)-3T in December 2009, we are not revising our Paperwork Reduction Act burden and cost estimates submitted to OMB.

We request comment on whether the estimates and underlying assumptions that are more fully described in the 2007 Principal Trade Rule Release continue to be reasonable.²⁸ Have circumstances changed since that time such that these estimates should be modified or revised? Persons submitting comments should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Elizabeth M. Murphy, Secretary,

²⁶ See 2007 Principal Trade Rule Release, Section V.B&C.

²⁷ See Extension Release, Section IV.

²⁸ See 2007 Principal Trade Rule Release, Section V.

Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-23-07.

V. COST-BENEFIT ANALYSIS

Other than proposing to extend rule 206(3)-3T's sunset period for two years, we are not otherwise proposing to modify the rule from the form in which we initially adopted it on an interim final basis in September 2007 or as final in December 2009. We discussed the benefits provided by rule 206(3)-3T in both the 2007 Principal Trade Rule Release and the Extension Release.

In summary, as explained in the 2007 Principal Trade Rule Release and the Extension Release,²⁹ we believe the principal benefit of rule 206(3)-3T is that it maintains investor choice and protects the interests of investors who formerly held an estimated \$300 billion in fee-based brokerage accounts. A resulting second benefit of the rule is that non-discretionary advisory clients of advisory firms that are also registered as broker-dealers have easier access to a wider range of securities which, in turn, should continue to lead to increased liquidity in the markets for these securities and promote capital formation in these areas. A third benefit of the rule is that it provides the protections of the sales practice rules of the Securities Exchange Act of 1934 ("Exchange Act")³⁰ and the relevant self-regulatory organizations because an adviser relying on the rule must also be a registered broker-dealer. Another benefit of rule 206(3)-3T is that it provides a lower cost alternative for an adviser to engage in principal transactions. We did not receive comments directly addressing with supporting data the cost-benefit

²⁹ See *id.*, Section VI; Extension Release, Section V.

³⁰ 15 U.S.C. 78 *et seq.*

analysis we presented in the 2007 Principal Trade Rule Release and we continue to believe those benefits apply today.

In addition to the general benefits described in those releases, there also are benefits to extending the rule for an additional two years. If we do not extend the rule in its current form, firms currently relying on the rule would be required to restructure their operations and client relationships on or before the rule's current expiration date — potentially only to have to do so again shortly thereafter (first when the rule expires or is modified, and again if we adopt a new approach after the study mandated by the Dodd-Frank Act, discussed above, is complete). By extending the rule for two years, non-discretionary advisory clients who have had access to certain securities because of their advisers' reliance on the rule to trade on a principal basis would continue to have access to those securities without disruption. Firms relying on the rule would continue to be able to offer clients and prospective clients access to certain securities on a principal basis as well and would not need during this two-year period to incur the cost of adjusting to a new set of rules or abandoning the systems established to comply with the current rule. In other words, extension would avoid disruption to clients and firms during the period while we complete the study mandated by section 913 of the Dodd-Frank Act and our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

We also described the costs associated with rule 206(3)-3T, including the operational costs associated with complying with the rule, in the 2007 Principal Trade Rule Release and the Extension Release. We presented estimates of the costs of each of the rule's disclosure elements, including: prospective disclosure and consent; transaction-

by-transaction disclosure and consent; transaction-by-transaction confirmations; and the annual report of principal transactions. We also provided estimates for the following related costs of compliance with rule 206(3)-3T: (i) the initial distribution of prospective disclosure and collection of consents; (ii) systems programming costs to ensure that trade confirmations contain all of the information required by the rule; and (iii) systems programming costs to aggregate already-collected information to generate compliant principal transactions reports. We did not receive comments directly addressing with supporting data the cost-benefit analysis we presented in the 2007 Principal Trade Rule Release and we believe the amendments we are proposing today would not materially affect those costs.³¹

We recognize that if today's amendment is adopted, firms relying on the rule would incur the costs associated with complying with the rule for two additional years.

We request comment on all aspects of the cost-benefit analysis, including the accuracy of the potential costs and benefits identified and assessed in this Release, the 2007 Principal Trade Rule Release and the Extension Release, as well as any other costs or benefits that may result from the proposal.

VI. PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 202(c) of the Advisers Act mandates that the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of

³¹ In the 2007 Principal Trade Rule Release, we estimated the total overall costs, including estimated costs for all eligible advisers and eligible accounts, relating to compliance with rule 206(3)-3T to be \$37,205,569. See 2007 Principal Trade Rule Release, Section VI.D.

investors, whether the action will promote efficiency, competition, and capital formation.³²

We explained in the 2007 Principal Trade Rule Release and the Extension Release the manner in which rule 206(3)-3T, in general, would promote these aims. We continue to believe that this analysis generally applies today.

As noted in the Extension Release, we received comments on the 2007 Principal Trade Rule Release from commenters who opposed the limitation of the temporary rule to investment advisers that are also registered as broker-dealers, as well as to accounts that are subject to both the Advisers Act and Exchange Act as providing a competitive advantage to investment advisers that are also registered broker-dealers.³³ Based on our experience with the rule to date, just as we noted in the Extension Release, we have no reason to believe that broker-dealers (or affiliated but separate investment advisers and broker-dealers) are put at a competitive disadvantage to advisers that are themselves also registered as broker-dealers;³⁴ however we intend to continue to evaluate the effects of the rule on efficiency, competition and capital formation as we complete the study mandated by section 913 of the Dodd-Frank Act and our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

We anticipate no new effects on efficiency, competition and capital formation would result from the two-year extension. However, during that time, we would continue to assess the rule's operation and impact along with intervening developments.

³² 15 U.S.C. 80b-2(c).

³³ See Extension Release, Section VI; Comment Letter of the Financial Planning Association (Nov. 30, 2007).

³⁴ See Extension Release, Section VI.

We request comment on whether the proposal, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data to support their views.

VII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") regarding the proposed amendment to rule 206(3)-3T in accordance with section 3(a) of the Regulatory Flexibility Act.³⁵

A. Reasons for Proposed Action

We are proposing to extend rule 206(3)-3T for two years in its current form because we believe that it would be premature to require firms relying on the rule to restructure their operations and client relationships before we complete our study and our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

B. Objectives and Legal Basis

The objective of the proposed amendment to rule 206(3)-3T, as discussed above, is to permit firms currently relying on rule 206(3)-3T to limit the need to modify their operations and relationships on multiple occasions, both before and potentially after we complete our study and any related rulemaking.

We are proposing to amend rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 15 U.S.C. 80b-11(a)].

C. Small Entities Subject to the Rule

³⁵ 5 U.S.C. 603(a).

Rule 206(3)-3T is an alternative method of complying with Advisers Act section 206(3) and is available to all investment advisers that: (i) are registered as broker-dealers under the Exchange Act; and (ii) effect trades with clients directly or indirectly through a broker-dealer controlling, controlled by or under common control with the investment adviser, including small entities. Under Advisers Act rule 0-7, for purposes of 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.³⁶

We estimate that as of November 1, 2010, 680 SEC-registered investment advisers were small entities.³⁷ As discussed in the 2007 Principal Trade Rule Release, we opted not to make the relief provided by rule 206(3)-3T available to all investment advisers, and instead have restricted it to investment advisers that also are registered as broker-dealers under the Exchange Act.³⁸ We therefore estimate for purposes of this IRFA that 38 of these small entities (those that are both investment advisers and broker-dealers) could rely on rule 206(3)-3T.³⁹

D. Reporting, Recordkeeping, and other Compliance Requirements

³⁶ See 17 CFR 275.0-7.

³⁷ IARD data as of November 1, 2010.

³⁸ See 2007 Principal Trade Rule Release, Section VIII.B.

³⁹ IARD data as of November 1, 2010.

The provisions of rule 206(3)-3T impose certain reporting or recordkeeping requirements, and our proposal, if adopted, would extend the imposition of these requirements for an additional two years. We do not, however, expect that the proposed two-year extension would alter these requirements.

Rule 206(3)-3T is designed to provide an alternative means of compliance with the requirements of section 206(3) of the Advisers Act. Investment advisers taking advantage of the rule with respect to non-discretionary advisory accounts would be required to make certain disclosures to clients on a prospective, transaction-by-transaction and annual basis.

Specifically, rule 206(3)-3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Advisers Act by, among other things: (i) making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client confirmation statements for each principal trade that disclose the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. Advisers are already required to communicate the content of many of the disclosures pursuant to their fiduciary obligations to clients. Other disclosures are already required by rules applicable to broker-dealers.

Our proposed amendment, if adopted, only would extend the rule for two years in its current form. Advisers currently relying on the rule already should be making the disclosures described above.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that there are no rules that duplicate or conflict with rule 206(3)-3T, which presents an alternative means of compliance with the procedural requirements of section 206(3) of the Advisers Act that relate to principal transactions.

We note, however, that rule 10b-10 under the Exchange Act is a separate confirmation rule that requires broker-dealers to provide certain information to their customers regarding the transactions they effect. Furthermore, FINRA rule 2230 requires broker-dealers that are members of FINRA to deliver a written notification containing certain information, including whether the member is acting as a broker for the customer or is working as a dealer for its own account. Brokers and dealers typically deliver this information in confirmations that fulfill the requirements of rule 10b-10 under the Exchange Act. Rule G-15 of the Municipal Securities Rulemaking Board also contains a separate confirmation rule that governs member transactions in municipal securities, including municipal fund securities. In addition, investment advisers that are qualified custodians for purposes of rule 206(4)-2 under the Advisers Act and that maintain custody of their advisory clients' assets must send quarterly account statements to their clients pursuant to rule 206(4)-2(a)(3) under the Advisers Act.

These rules overlap with certain elements of rule 206(3)-3T, but we designed the temporary rule to work efficiently together with existing rules by permitting firms to incorporate the required disclosure into one confirmation statement.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.⁴⁰ Alternatives in this category would include: (i) establishing different compliance or reporting standards or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

We believe that special compliance or reporting requirements or timetables for small entities, or an exemption from coverage for small entities, may create the risk that the investors who are advised by and effect securities transactions through such small entities would not receive adequate disclosure. Moreover, different disclosure requirements could create investor confusion if it creates the impression that small investment advisers have different conflicts of interest with their advisory clients in connection with principal trading than larger investment advisers. We believe, therefore, that it is important for the disclosure protections required by the rule to be provided to advisory clients by all advisers, not just those that are not considered small entities. Further consolidation or simplification of the proposals for investment advisers that are small entities would be inconsistent with the Commission's goals of fostering investor protection.

⁴⁰

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

We have endeavored through rule 206(3)-3T to minimize the regulatory burden on all investment advisers eligible to rely on the rule, including small entities, while meeting our regulatory objectives. It was our goal to ensure that eligible small entities may benefit from the Commission's approach to the new rule to the same degree as other eligible advisers. The condition that advisers seeking to rely on the rule must also be registered as broker-dealers and that each account with respect to which an adviser seeks to rely on the rule must be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which it is a member, reflect what we believe is an important element of our balancing between easing regulatory burdens (by affording advisers an alternative means of compliance with section 206(3) of the Act) and meeting our investor protection objectives.⁴¹ Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

G. Solicitation of Comments

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

Do small investment advisers believe an alternative means of compliance with section 206(3) of the Advisers Act should be available to more of them?

⁴¹ See 2007 Principal Trade Rule Release, Section II.B.7 (noting commenters that objected to this condition as disadvantaging small broker-dealers (or affiliated but separate investment advisers and broker-dealers)).

VIII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"⁴² we 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 amendment 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 to amend rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act.

LIST OF SUBJECTS IN 17 CFR PART 275

Investment advisers, Reporting and recordkeeping requirements.

TEXT OF PROPOSED RULE AMENDMENT

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,

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).

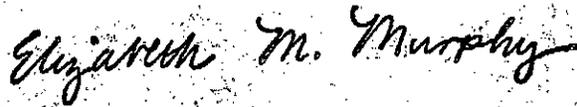
80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

§275.206(3)-3T

2. In § 275.206(3)-3T, amend paragraph (d) by removing the words "December 31, 2010" and adding in their place "December 31, 2012."

By the Commission.



Elizabeth M. Murphy
Secretary

Dated: December 1, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3117 / December 1, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14147

In the Matter of

NEIL GODBOLE,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 203(f) AND 203(k)
OF THE INVESTMENT ADVISERS ACT OF
1940, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND 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(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Neil Godbole ("Godbole" or "Respondent").

II.

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

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III.

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

Summary

These proceedings involve Respondent's efforts to hide large trading losses in Opulent Lite, LP, a hedge fund he managed with approximately \$30 million in assets and 70 investors. In the February 2008 trading period, the fund suffered \$8.3 million in losses. For the remainder of 2008, Godbole unsuccessfully tried to "make up" the loss. In the end, Opulent Lite suffered a total of \$14.5 million in trading losses in 2008. Investors were unaware of the losses throughout 2008 because Godbole misstated both trading results and the fund's assets in materials he authored and sent to investors. In February 2009, Godbole finally disclosed the fund's losses and its true financial conditions to investors. The majority of investors sought to withdraw their funds and by March 2009, the fund was liquidated.

Respondent

1. Respondent Godbole, age 29, lives in San Francisco, California. He was the sole principal and owner of Trueblue Strategies, and was wholly responsible for managing Opulent Lite, including its trading and recordkeeping. He holds a Series 65 license.

Other Relevant Entities

2. Trueblue Strategies, LLC, a California limited liability company, was an investment adviser located in San Francisco, California. The firm was registered as an investment adviser with the California Department of Corporations; it has since filed for withdrawal with the state as an investment adviser. It was the investment adviser for Opulent Lite, LP.

3. Opulent Lite, LP, a California limited partnership, was a hedge fund located in Saratoga, California. It had approximately 70 investors and assets under management of approximately \$30 million.

Background

4. Beginning in 2005, Godbole managed Opulent Lite through Trueblue Strategies. He was solely responsible for all of the fund's business operations, including trading

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.

decisions, record-keeping, and communications with investors. At its peak, the fund had approximately \$30 million in assets under management and 70 investors.

5. Until 2008, Godbole's trading strategy was to invest most of the funds in short-term treasury bonds which would mature at the end of the fund's monthly trading period. The remainder of the cash was invested in S&P index options which would expire at the end of the monthly trading period.

6. During the February 2008 trading period, Godbole lost approximately \$8.3 million as a result of a series of highly unprofitable trades. He failed, however, to disclose the loss. He also misrepresented the new total value of the fund, telling investors the fund had a value of \$28.7 million, rather than the accurate \$18.5 million.

7. In an effort to make up losses, and to stem further losses, Godbole began to use what he called a "rollover" strategy. Prior to 2008, Godbole ended each monthly trading period fully in cash. In 2008, however, he began to open option positions toward the end of the trading period. Instead of expiring at the end of the monthly trading period, the option contracts had expiration dates extending into the next trading periods. The "rollover" strategy did not, in fact, stem losses.

8. Throughout 2008, Godbole continued to misrepresent the fund's trading results and asset value. He repeatedly underreported Opulent Lite's trading losses to investors. For example, in September, Godbole reported trading losses of \$859,000, when in fact the fund had lost \$4 million; at the same time, he reported the fund's asset value as \$29 million, when in reality it had fallen to \$19 million. Even in the few months when the fund experienced gains, Godbole underreported those gains, allowing him to smooth the fund's returns and conceal the losses he had failed to report previously. By December 2008, when Godbole had informed investors that the fund had an asset value of over \$26 million, the fund had actually fallen below \$14.4 million in assets – an 81% overstatement.

9. In addition to misrepresenting the value of the fund, Godbole also misrepresented the reason for the losses he did disclose. In early 2008, Godbole implemented what he called a "rollover strategy," with option positions remaining open at the end of each monthly reporting period (rather than ending each month fully in cash, as the fund had previously done). During several trading periods throughout 2008, Godbole blamed the losses on the "rollover strategy," minimizing these declines as merely artificial "paper" losses or "projected" losses tied to open option positions. In reality, these losses represented actual, realized trading losses.

10. During the year, Godbole caused the fund to pay his management fees based on the inflated fund value. In addition, he caused the fund to redeem units at the inflated value, to the detriment of investors who remained in Opulent Lite as well as the fund itself.

11. In February 2009, Godbole informed investors of the accurate results for 2008, disclosing both accurate trading losses and the fund's value. He also reimbursed the fund for overpayment of management fees. Although Godbole disclosed that actual losses were

incurred in early 2008, he attributed the losses for the year to the "rollover strategy" when actually there were additional realized losses throughout 2008. The fund was fully liquidated by March 2009.

12. As a result of the conduct described above, Godbole willfully violated Sections 206(1) and (2), which prohibit fraudulent and misleading conduct by an investment adviser. He also willfully violated Section 206(4) and Rule 206(4)-8 thereunder by providing false information to the fund's 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, pursuant to Sections 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Godbole 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;

B. Respondent Godbole be, and hereby is, barred from association with any investment adviser, with the right to reapply for association after five (5) 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 Godbole shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$40,000. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that

identifies Neil Godbole as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Marc J. Fagel, San Francisco Regional Office, Securities and Exchange Commission, 44 Montgomery, Suite 2600, San Francisco, California 94104.

By the Commission.

Elizabeth M. Murphy
Secretary

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

*Chairman Shapiro
not participating*

SECURITIES AND EXCHANGE COMMISSION

Release No. IA-3119; File No. S7-38-10

Approval of Investment Adviser Registration Depository Filing Fees

AGENCY: Securities and Exchange Commission.

ACTION: Notice of intent to charge revised IARD filing fees for advisers registering with or registered with the Commission.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is revising Investment Adviser Registration Depository annual and initial filing fees that will be charged beginning January 1, 2011.

HEARING OR NOTIFICATION OF HEARING: An order approving the IARD filing fees will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary. Hearing requests should be received by the SEC by 5:30 p.m. on December 21, 2010. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested.

Persons may request notification of a hearing by writing to the Commission's Secretary.

ADDRESS: Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.

FOR FURTHER INFORMATION CONTACT: Keith Kanyan, IARD System Manager, at 202-551-6737, or Iarules@sec.gov, Office of Investment Adviser

Regulation, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-8549.

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SUPPLEMENTARY INFORMATION:

Section 204(b) of the Investment Advisers Act of 1940 ("Advisers Act") authorizes the Commission to require investment advisers to file applications and other documents through an entity designated by the Commission, and to pay reasonable costs associated with such filings.¹ In 2000, the Commission designated the Financial Industry Regulatory Authority Regulation, Inc. ("FINRA") as the operator of the Investment Adviser Registration Depository ("IARD") system. At the same time, the Commission approved, as reasonable, filing fees.² The Commission later required advisers registered or registering with the SEC to file Form ADV through the IARD.³ Over 11,000 advisers currently use the IARD system to register with the SEC and make state notice filings electronically through the Internet.

Commission staff, representatives of the North American Securities Administrators Association, Inc. ("NASAA"),⁴ and representatives of FINRA periodically hold discussions on IARD system finances. In the early years of operations, SEC-associated IARD revenues exceeded projections while SEC-associated IARD expenses were lower than estimated, resulting in a surplus. In 2005, FINRA wrote a

¹ 15 U.S.C. 80b-4(b).

² Designation of NASD Regulation, Inc., to Establish and Maintain the Investment Adviser Registration Depository; Approval of IARD Fees, Investment Advisers Act Release No. 1888 (July 28, 2000) [65 FR 47807 (Aug. 3, 2000)]. FINRA was formerly known as NASD.

³ Electronic Filing by Investment Advisers; Amendments to Form ADV, Investment Advisers Act Release No. 1897 (Sept. 12, 2000) [65 FR 57438 (Sept. 22, 2000)].

⁴ The IARD system is used by both advisers registering or registered with the SEC and advisers registered or registering with one or more state securities authorities. NASAA represents the state securities administrators in setting IARD filing fees for state-registered advisers.

letter to SEC staff recommending a waiver of annual fees for a one-year period.⁵ The Commission concluded that this was appropriate and waived annual fees.⁶ In 2006, 2008, and 2009 FINRA wrote to the staff again, recommending a two-year, a nine-month, and a five-month waiver, respectively, of all fees to continue to reduce the surplus.⁷ The Commission agreed and issued orders waiving all IARD fees.⁸ At the conclusion of the 2009 waiver, FINRA wrote to the staff again, recommending reduced levels of fees be charged in 2010.⁹ The Commission concluded this was appropriate and issued an order reducing the level of fees charged for one year.¹⁰ As a result of the four waivers and reduced fee levels, the surplus was reduced from \$9 million in 2005 to a level of approximately \$3 million.

FINRA has again written to Commission staff, recommending revised annual and initial IARD filing fees commence on January 1, 2011.¹¹ The new recommended fee

⁵ NASD letter dated September 9, 2005, available at <http://www.sec.gov/rules/other/nasdlet090905.pdf>.

⁶ Approval of Investment Adviser Registration Depository Filing Fees, Investment Advisers Act Release No. 2439 (Oct. 7, 2005) [70 FR 59789 (Oct. 13, 2005)].

⁷ NASD letter dated October 13, 2006 and FINRA letters dated October 10, 2008 and July 8, 2009 available at <http://www.sec.gov/rules/other/2006/nasdletter101306-iardfee.pdf>, <http://www.sec.gov/rules/other/2008/finraletter101008-iardfees.pdf>, and <http://www.sec.gov/rules/other/2009/finraletter070809-iardfees.pdf>, respectively.

⁸ Approval of Investment Adviser Registration Depository Filing Fees, Investment Advisers Act Release No. 2564 (Oct. 26, 2006), Investment Advisers Act Release No. 2806 (Oct. 30, 2008) [73 FR 65900 (Nov. 5, 2008)], and Investment Advisers Act Release No. 2909 (July 31, 2009) [74 FR 39352 (Aug. 6, 2009)].

⁹ FINRA letter dated September 29, 2009, available at <http://www.sec.gov/rules/other/2009/finraletter092909-iardfees.pdf>.

¹⁰ Approval of Investment Adviser Registration Depository Filing Fees, Investment Advisers Act Release No. 2959 (Dec. 10, 2009) [74 FR 66710 (Dec. 16, 2009)].

¹¹ FINRA letter dated November 12, 2010 available at <http://www.sec.gov/rules/other/2010/finraletter11122010-iardfees.pdf>

levels would increase the fee for advisers with assets under management of \$100 million or higher, but would not change the fee levels for advisers with assets under management under \$100 million.¹² The recommended annual filing fees due beginning January 1, 2011 are \$40 for advisers with assets under management under \$25 million; \$150 for advisers with assets under management from \$25 million to \$100 million; and \$225 for advisers with assets under management of \$100 million or higher. The recommended initial IARD filing fees due beginning January 1, 2011 are \$40 for advisers with assets under management under \$25 million; \$150 for advisers with assets under management from \$25 million to \$100 million; and \$225 for advisers with assets under management of \$100 million or higher. Based on projections of expected revenues and expenses and taking into account an expected reduction in the number of advisers registered or reporting to the SEC as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act,¹³ the Commission believes these revised fee levels would be reasonable, as the Commission projects that they will provide adequate funding to cover IARD system expenditures.¹⁴ This reduction in fees is expected to reduce aggregate filing fees that SEC-registered advisers would incur by approximately \$2 million annually compared

¹² The revised fee level for advisers in the largest category would newly include advisers that report assets under management of exactly \$100 million (not just over \$100 million). We are making this revision to track the new mid-sized adviser category for advisers reporting assets under management of \$25 million up to, but not including, \$100 million. See section 410 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, 124 Stat. 1376 (2010)).

¹³ The threshold, for most advisers, to be eligible for SEC registration will be increased from \$25 million to \$100 million in assets under management. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, 124 Stat. 1376 (2010)).

¹⁴ The fee levels for advisers with assets under management under \$100 million are not changed as the number of advisers in these categories are expected to fall as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

to the filing fees that would be collected based on the fee levels established in 2000. The revised filing fees will apply to all annual updating amendments filed by SEC-registered advisers beginning January 1, 2011 and to all initial applications for registration filed by advisers applying for SEC registration beginning January 1, 2011. The Commission will reassess the fee levels and issue orders, if necessary, to adjust these levels.

By the Commission.



Elizabeth M. Murphy
Secretary

Dated: December 2, 2010.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63409 / December 2, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-14148

In the Matter of

Colormax Technologies, Inc.,

Respondent.

ORDER INSTITUTING PROCEEDINGS,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES
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 proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Colormax Technologies, Inc. ("CXTE" or "Respondent").

II.

In anticipation of the institution of these proceedings, CXTE 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, CXTE consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

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1. CXTE (CIK No. 108473) is a Delaware corporation located in Salt Lake City, Utah with a class of securities registered with the Commission under Exchange Act Section 12. As of May 24, 2010, the common stock of CXTE (symbol "CXTE") was traded on the over-the-counter markets.

2. CXTE has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended September 30, 2000.

IV.

Section 12(j) of the Exchange Act provides as follows:

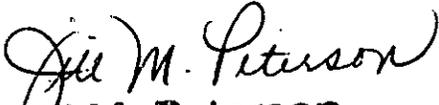
The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission deems it necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of CXTE's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63410 / December 2, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14149

In the Matter of

Payphone Wind Down Corp.,

Respondent.

ORDER INSTITUTING PROCEEDINGS,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES
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 proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Payphone Wind Down Corp. ("Payphone" or "Respondent").

II.

In anticipation of the institution of these proceedings, Payphone 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, Payphone consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

1. Payphone (CIK No. 1287065) is a dissolved Delaware corporation located in Fayetteville, Georgia with a class of securities registered with the Commission under Exchange Act Section 12.

2. Payphone has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended September 30, 2007.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission deems it necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Payphone's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Elizabeth M. Murphy
Secretary

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

**COMMODITY FUTURES TRADING COMMISSION
SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-63423; File No. 4- 620]

**Acceptance of Public Submissions on a Study Mandated by the Dodd-Frank Wall
Street Reform and Consumer Protection Act, Section 719(b)**

AGENCIES: Commodity Futures Trading Commission; Securities and Exchange
Commission.

ACTION: Request for Comments.

SUMMARY: The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) was enacted on July 21, 2010. The Dodd-Frank Act, among other things, mandates that the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC”) conduct a study on “the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions which may be used to describe complex and standardized financial derivatives.” These algorithmic descriptions should be designed to “facilitate computerized analysis of individual derivative contracts and to calculate net exposures to complex derivatives.” The study also must consider the extent to which the algorithmic description, “together with standardized and extensible legal definitions, may serve as the binding legal definition of derivative contracts.” In connection with this study, the staff of the CFTC and SEC seek responses of interested parties to the questions set forth below.

DATES: The CFTC will accept submissions on behalf of both agencies in response to the questions through December 31, 2010.

ADDRESSES: You may submit responses to the CFTC, identified in the subject line with "algorithmic study" by any of the following methods:

- CFTC Agency web site, www.cftc.gov, via its Comments Online process at <http://comments.cftc.gov>. Follow the instructions for submitting comments through the web site.
- Mail: David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- Hand Delivery/Courier: Same as mail above.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to www.cftc.gov and www.sec.gov. You should submit only information that you wish to make available publicly. If you wish the CFTC to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in CFTC Regulation 145.9, 17 CFR 145.9.

The CFTC and the SEC reserve the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from www.cftc.gov and www.sec.gov that they may deem to be inappropriate for publication,

such as obscene language. All submissions that have been redacted or removed that contain comments may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: Nancy R. Doyle, Office of the General Counsel, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581, telephone: (202) 418-5136, or Matthew P. Reed, Division of Risk, Strategy, and Financial Innovation, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549-[mail stop], telephone (202) 551-2607.

SUPPLEMENTARY INFORMATION:

On July 21, 2010, The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Public Law 111-203, was enacted.

Pursuant to Title VII, Sec. 719(b) of Dodd-Frank, the Commodity Futures Trading Commission with the Securities and Exchange Commission, jointly, must report to Congress by March of 2011 on "the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions which may be used to describe complex and standardized financial derivatives." These algorithmic descriptions should be designed to "facilitate computerized analysis of individual derivative contracts and to calculate net exposures to complex derivatives." The study also must consider whether a combination of these algorithmic descriptions and "standardized and extensible legal definitions[] may serve as the binding legal definition of derivative contracts."

A copy of the text of the statute calling for this study may be found here:

http://www.dodd-frank-act.us/Dodd_Frank_Act_Text_Section_719.html.

In furtherance of this report, we seek responses to the following questions. Please note that responses may be made public, and may be cited in this report. Questions relate to the current use of standardized computer-readable descriptions for both data storage and messaging, and to the usefulness and cost of any transition to a universal standard for messaging and data storage. Responders are encouraged to provide any additional relevant information beyond that called for by these questions.

Calculation of "Net Exposures to Complex Derivatives" and other "Computerized Analysis":

1. How would your organization or community define "net exposures to complex derivatives?"
2. Do you calculate net exposures to complex derivatives?
3. What data do you require to calculate net exposures to complex derivatives? Does it depend on the derivatives instrument type? How?
4. Are there any difficulties associated with your ability to gather the data needed to calculate net exposures to complex derivatives? What are they?
5. What other analyses do you currently perform on derivatives agreements? What kinds of analyses would you like to perform, and how could regulators and standards setters make those analyses possible?
6. How often do you perform net exposure calculations at the level of your organization? Is it continuous and real time, only for periodic external reporting, or some frequency in between?

Current practices concerning standardized computer descriptions of derivatives:

7. Do you rely on a discrete set of computer-readable descriptions ("ontologies") to define and describe derivatives transactions and positions? If yes, what computer language do you use?
8. If you use one or more ontologies to define derivatives transactions and positions, are they proprietary or open to the public? Are they used by your counterparties and others in the derivatives industry?
9. How do you maintain and extend the ontologies that you use to define derivatives data to cover new financial derivative products? How frequently are new terms, concepts and definitions added?
10. What is the scope and variety of derivatives and their positions covered by the ontologies that you use? What do they describe well, and what are their limitations?
11. How do you think any limitations to the ontologies you use to describe derivatives can be overcome?
12. Are these ontologies able to describe derivatives transactions in sufficient detail to enable you to calculate net exposures to complex derivatives?
13. Are these ontologies able to describe derivatives transactions in sufficient detail to enable you to perform other analysis? What types of analysis can you conduct with this data, and what additional data must be captured to perform this analysis?
14. Which identifier regimes, if any, do you use to identify counterparties, financial instruments, and other entities as part of derivatives contract analysis?

Current use of standardized computer readable descriptions for messaging of derivatives transactions:

15. Which computer language or message standard do you currently use to create and communicate your messages for derivatives transactions?

16. Is there a difference between the created message and the communicated message?
For example, does your internally archived version of the message contain proprietary fields or data that are removed when it is communicated to counterparties or clearing houses?
17. Are different messaging standards used to describe different contracts, counterparties, and transactions?
18. How and where are the messages stored, and do the messages capture different information from that information stored in internal systems?
19. What information is currently communicated, by and to whom, and for what purposes?
20. For lifecycle event messages (e.g., credit events, changes of party names or identifiers), are there extant messaging standards that can update data relating to derivatives contracts that are stored in data repositories?
21. What other standards (i.e., FpML, FIX, etc.) related to derivatives transactions does your organization or community use, and for what purposes? Has your implementation of these standards had any effect on the way your business is conducted (e.g., does it reduce misunderstanding of contract terms, has it increased the frequency or ease of trades).
22. Is the data represented by this/these messaging standard(s) complete enough to calculate net exposures to complex derivatives? What additional information would need to be represented?

23. In general, to what extent are XML-based languages able to describe a derivatives contract for further analysis? To what extent is other technology needed to provide a full description?
24. What other analysis can be conducted with this data? What additional information should be captured?
25. Do you have plans to change your messaging schemes/formats in the near future?
26. Are there identifier regimes widely used in the derivatives market for identifying counterparties, financial instruments, and other entities in messaging?

The need for standardized computer descriptions of derivatives:

27. Would there be a benefit to standardizing computer readable descriptions of financial derivatives? What about standardization for a certain class/type of financial derivatives (i.e., CDS versus interest rate, or plain vanilla versus complex)?
28. What would be the issues, costs and concerns associated with standardizing computer readable descriptions of financial derivatives? Are there existing standards that could or should be expanded (i.e., FpML, FIX, etc.)? Do the existing standards in this area have materially different costs or issues?
29. What would be an ideal ontology for you in terms of design, implementation, and maintenance of the data sets and applications needed for your business?
30. How would a standardized computer readable description of financial derivatives be developed and maintained (i.e., a government-sponsored initiative, a public-private partnership, standard-setting by a collaborative process, etc.)? Are there current models that should be considered?

31. What is the importance of ontologies for the representation of derivatives data now and in the future?

Implementation:

32. Have you ever implemented a transition to a new data ontology, data messaging standard, or internal data standard?

33. If yes, how did the perceived and actual benefits compare to estimated and actual costs over the short- and long-run?

34. What were the main difficulties that you experienced during a transition/implementation of new data standards? What could the organization developing and maintaining the standards do (or avoid) to help alleviate these difficulties?

35. Would it be useful to use a standardized, computer readable description for financial derivatives instruments? How would it be useful? Would such a standard be useful for communicating transactions, storing position information, both, or other purposes? What would be the costs involved?

36. How should regulators and standard setters implement description standards in the derivatives market?

Making computer descriptions legally binding:

37. Are there currently aspects of financial derivatives messaged in a computer readable format that have a legally-binding effect?

38. What information, if any, is not captured that would be required to make the computer descriptions themselves, without reference to other materials, legally binding?

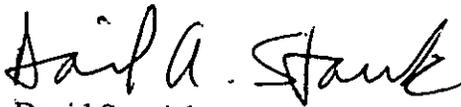
39. What information would need to be captured for a legally binding contract that would not need to be captured for analyzing the contract? Is there a substantial cost differential between the processes needed to capture one set of information versus another?

40. Would there be a benefit to making the computer readable descriptions of financial derivatives legally binding? Would there be drawbacks? What are they?

Other:

41. Is there other information not called for by these questions that we should consider?

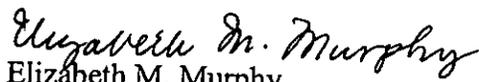
By the CFTC.



David Stawick

Secretary of the Commission

By the Commission (SEC).



Elizabeth M. Murphy

Secretary

December 2, 2010

*Chairman Schapiro
Commissioner Watter
Commissioner Aguilar
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63420 / December 2, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12628

In the Matter of

Zurich Capital Markets, Inc.,

Respondents.

ORDER DIRECTING DISBURSEMENT
OF FAIR FUND

On April 15, 2010, the United States Securities and Exchange Commission ("Commission") issued a Notice of Proposed Plan of Distribution and Opportunity for Comment (Exchange Act Rel. No. 61918) pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. §201.1103. The Notice advised parties that they could obtain a copy of the Distribution Plan at www.sec.gov. The Notice also advised that all persons desiring to comment on the Distribution Plan could submit their comments, in writing, no later than 30 days from the date of the Notice. No comments were received by the Commission in response to the Notice. On June 3, 2010, the Commission issued an Order Approving Plan, Appointing a Fund Administrator, and Waiving Bond (Exchange Act Rel. No. 62217).

The Distribution Plan provides that the Commission will arrange for distribution of the Fair Fund through the United States Department of Treasury's Financial Management System when a validated electronic payment file listing the payees with the identification information required to make the distribution and the distribution amounts has been received and accepted by the staff. The validated electronic payment file has been received and accepted for the disbursement of \$17,264,322.93.

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Accordingly, it is ORDERED that the Commission staff shall disburse the Fair Fund in the amount stated in the validated electronic payment file of \$17,264,322.93 as provided for in the Distribution Plan.

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. 63429 / December 3, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-14150

In the Matter of

**Springfield Co., Inc.,
SRR Mercantile Inc.,
Standard Mining Corp.,
Stewart Foods, Inc.,
Strathclair Ventures, Ltd. (n/k/a
SilverCrest Mines, Inc.),
Sunlite, Inc.,
Syndicated Food Service
International, Inc., and
Syspower Multimedia Industries, 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 Springfield Co., Inc., SRR Mercantile, Inc., Standard Mining Corp., Stewart Foods, Inc., Strathclair Ventures, Ltd. (n/k/a SilverCrest Mines, Inc.), Sunlite, Inc., Syndicated Food Service International, Inc., and Syspower Multimedia Industries, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Springfield Co., Inc. (CIK No. 1157850) 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). Springfield is delinquent in its periodic filings with the Commission, having not filed its Forms 10-Q for the periods ended September 30 and December 31, 2006, and March 31, 2007, and its Form 10-K for the period ended June 30, 2010. In addition, in a Form 8-K filed on October 18, 2010, the company reported that its previously issued audited financial statements as of and for the year ended June 30, 2009, and its unaudited financial statements for each of the quarters ended March 31, 2009, September 30, 2009, December 31, 2009, and March 31, 2010 should no longer be relied upon. The company has not filed corrected periodic reports with regard to these time periods.

2. SRR Mercantile, Inc. (CIK No. 1062728) is a British Columbia corporation located in Richmond, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SRR Mercantile is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR/A for the year ended June 30, 1998, which reported a net loss of \$347,923 (Canadian) for the prior twelve months.

3. Standard Mining Corp. (CIK No. 866732) is a Yukon corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Standard Mining is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 1999, which reported a net loss of over \$10.5 million for the prior twelve months.

4. Stewart Foods, Inc. (CIK No. 94369) is a purged Virginia corporation located in Virginia Beach, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Stewart Foods 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 June 27, 1997, which reported a net loss of \$4,775 for the prior twelve months. On December 31, 1992, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of Virginia, which was terminated on March 26, 1997.

5. Strathclair Ventures, Ltd. (n/k/a SilverCrest Mines, Inc.) (CIK No. 1112979) is an Ontario corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Strathclair is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR for the period ended December 31, 1999, which reported a deficit of over \$2.5 million (Canadian) as of December 31, 1999. As of November 30, 2010, the company's stock (symbol "STVZF") was traded on the over-the-counter markets.

6. Sunlite, Inc. (CIK No. 312540) is a Delaware corporation located in Washington, D.C. with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sunlite 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 June 30, 1994, which reported a net loss of over \$3.9 million for the prior twelve months.

7. Syndicated Food Service International, Inc. (CIK No. 1044434) is a dissolved Florida corporation located in Front Royal, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Syndicated Food 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 \$537,002 for the prior three months. On March 2, 2009, the U.S. District Court for the Eastern District of New York permanent enjoined the company against future violations of Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder. The company has violated that injunction. As of November 30, 2010, the company's stock (symbol "SYFSQ") was traded on the over-the-counter markets.

8. Syspower Multimedia Industries, Inc. (CIK No. 933477) is a British Virgin Islands corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Syspower 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 December 1, 1994, which reported a net loss of over \$2.55 million (Canadian) for the six months ended August 31, 1994.

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

COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34- 63435; File No. 4-621]

Joint Public Roundtable on Issues Related to Capital and Margin Requirements for Swaps and Security-Based Swaps

AGENCIES: Commodity Futures Trading Commission ("CFTC") and Securities and Exchange Commission ("SEC") (each, an "Agency," and collectively, the "Agencies").

ACTION: Notice of roundtable discussion; request for comment.

SUMMARY: On Friday, December 10, 2010, commencing at 1:00 p.m. and ending at 5:00 p.m., staff of the Agencies will hold a public roundtable meeting at which invited participants will discuss provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") that require the Agencies to adopt rules for the capital and margin requirements applicable to swaps and security-based swaps of swap dealers, major swap participants, security-based swap dealers, and security-based swap participants. The discussion will be open to the public with seating on a first-come, first-served basis. Members of the public may also listen to the meeting by telephone. Call-in participants should be prepared to provide their first name, last name and affiliation. The information for the conference call is set forth below.

- U.S. Toll-Free: 877-951-7311
- International Toll: 1-203-607-0666
- Conference ID: 8978249

A transcript of the public roundtable discussion will be published at http://www.cftc.gov/LawRegulation/DoddFrankAct/OTC_5_CapMargin.html. The roundtable discussion will take place in Lobby Level Hearing Room (Room 1000) at the CFTC's headquarters at Three Lafayette Centre, 1155 21st Street, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: The CFTC's Office of Public Affairs at (202) 418-5080 or the SEC's Office of Public Affairs at (202) 551-4120.

SUPPLEMENTARY INFORMATION: The roundtable discussion will take place on Friday, December 10, 2010, commencing at 1:00 p.m. and ending at 5:00 p.m. Members of the public who wish to comment on the topics addressed at the discussion, or on any other topics related to capital and margin requirements for swaps and security-based swaps in the context of the Act, may do so via:

- Paper submission to David Stawick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581, or Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; or
- Electronic submission to CapitalandMargin@CFTC.gov (all e-mails must reference "Dodd Frank Roundtable Capital and Margin Requirements" in the subject field); and/or by email to rule-comments@sec.gov or through the comment form available at: <http://www.sec.gov/rules/other.shtml>.

All submissions will be reviewed jointly by the Agencies. All comments must be in English or be accompanied by an English translation. All submissions provided to either Agency in any electronic form or on paper will be published on the Web site of the respective Agency,

without review and without removal of personally identifying information. Please submit only information that you wish to make publicly available.

By the Securities and Exchange Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

December 6, 2010

By the Commodity Futures Trading Commission.

David A. Stawick
Secretary

December 6, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63438 / December 6, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-14151

In the Matter of

**Apex Capital Group, Inc.,
Applied Carbon Technology, Inc. (n/k/a
Merchant Capital Group, Inc.),
Ardeo PLC,
Asia Fiber Holdings Ltd., and
Atlas Consolidated Mining &
Development Corp.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Apex Capital Group, Inc., Applied Carbon Technology, Inc. (n/k/a Merchant Capital Group, Inc.), Ardeo PLC, Asia Fiber Holdings Ltd., and Atlas Consolidated Mining & Development Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Apex Capital Group, Inc. (CIK No. 1086141) is a revoked Nevada corporation located in Shenyang City, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Apex Capital is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2006, which reported a net loss of \$78,701 from the company's inception on January 25, 1996.

2. Applied Carbon Technology, Inc. (n/k/a Merchant Capital Group, Inc.) (CIK No. 833186) is an Ontario corporation located in Montreal, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Applied Carbon is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 1995.

3. Ardeo PLC (CIK No. 1066798) is a United Kingdom corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ardeo is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR on September 16, 1998, which reported a net loss of \$182,582 for the fiscal year ended March 31, 1998.

4. Asia Fiber Holdings Ltd. (CIK No. 357434) is a void Delaware corporation located in Kowloon, Hong Kong, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Asia Fiber is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2002, which reported a net loss of over \$26.3 million for the prior six months. As of April 8, 2010, 2009, the company's stock (symbol "AFBR") was traded on the over-the-counter markets.

5. Atlas Consolidated Mining & Development Corp. (CIK No. 8299) is a Philippines corporation located in Manila, Philippines with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Atlas Consolidated is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A for the period ended December 31, 1993. A Form 6-K filed on January 11, 1995 stated that the company had a net loss of over \$42 million for the three months ended September 30, 1994.

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

*Commissioner Walter
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63451 / December 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14153

In the Matter of

**BANC OF AMERICA
SECURITIES LLC**, now known as
Merrill Lynch, Pierce, Fenner & Smith
Incorporated, successor by merger,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Banc of America Securities LLC, now known as Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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III.

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

Summary

1. This matter involves Respondent's role in certain improper bidding practices that occurred, from at least 1998 through 2002 (the "relevant time period"), involving the temporary investment of proceeds of tax-exempt municipal securities in reinvestment products, such as guaranteed investment contracts ("GICs"), repurchase agreements ("Repos"), and forward purchase agreements ("FPAs"). As described below, these practices affected the prices of the reinvestment products and jeopardized the tax-exempt status of the underlying municipal securities.

Respondent

2. **Banc of America Securities LLC**, now known as Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger ("Respondent"), was a Delaware limited liability corporation with its principal place of business in New York, New York. During the relevant period, Respondent was the investment banking subsidiary of the public corporation, Bank of America Corporation ("BAC"), a financial holding company organized and existing under the laws of the State of Delaware with its principal place of business in Charlotte, North Carolina.¹ Respondent was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and as an investment adviser pursuant to Section 203(c) of the Investment Advisers Act of 1940. Respondent was an affiliate of Bank of America, N.A. ("BofA"), a federally-chartered bank and a provider of municipal reinvestment instruments. In January 2007, the Antitrust Division of the Department of Justice ("DOJ") conditionally granted BAC amnesty from criminal prosecution because, among other things, it voluntarily self-reported possible anticompetitive bidding practices involving municipal reinvestment products to DOJ before DOJ had begun an investigation into the matter and because of its continuing cooperation.

Background

3. State and local governmental entities in the United States from time to time issue tax-exempt bonds and notes, the proceeds of which are temporarily invested pending their use for the original purpose of the offering. A significant portion (over \$100 billion a year) of such proceeds is invested in financial instruments tailored to meet specific collateral and spend-down needs. Under the relevant IRS regulations, proceeds of tax-exempt municipal securities must generally be invested at fair market value. The most common way of establishing fair market value is through a competitive bidding process, which generally occurs contemporaneously with the offer and sale of the municipal securities. Moreover, compliance with the IRS's detailed

¹ On November 1, 2010, Banc of America Securities LLC was merged into Merrill Lynch, Pierce, Fenner & Smith Incorporated, an indirect wholly-owned subsidiary of BAC that is registered with the Commission as a broker-dealer.

regulations concerning the competitive bidding process for certain types of investments of bond proceeds creates a conclusive safe harbor for establishing the fair market value of the reinvestment instruments. These detailed regulations require the issuer to make a bona fide solicitation for the purchase of the reinvestment instruments. A bona fide solicitation requires, among other things, that the issuer:

a. Forward in a timely manner written bid specifications containing all material terms of the bid to potential providers;

b. Include in the bid specifications a statement notifying potential providers that the submission of a bid is a representation that:

i. the potential provider did not consult with any other potential provider about its bid;

ii. the bid was determined without regard to any other formal or informal agreement that the potential provider has with the issuer or any other person (whether or not in connection with the bond issue); and

iii. the bid was not being submitted solely as a courtesy to the issuer or any other person for purposes of satisfying the requirements of the receipt of three bids from disinterested providers or the receipt of at least one bid from a reasonably competitive provider;²

c. Solicit bids from at least three reasonably competitive providers; and

d. Afford all potential providers an equal opportunity to bid; for example, no potential provider is to be given the opportunity to review other bids (i.e., a last look) before providing a bid.

4. To obtain the benefit of the safe harbor provisions, the issuer must also select the highest yielding bona fide bid or the lowest cost bona fide bid, whichever is appropriate under the circumstances.

5. The IRS regulations also contemplate that an issuer may use an agent to conduct the bidding process as long as the agent does not bid to provide the reinvestment product.

² More specifically, IRS regulations require the issuer to receive bids from at least three potential providers that do not have a material financial interest in the issue. A lead underwriter in a negotiated underwriting transaction (or a provider related to the lead underwriter) is deemed to have a material financial interest in the issue until 15 days after the issue date for the underlying security. Furthermore, one of the three disinterested bids received must be from a reasonably competitive provider.

6. In this matter, bidding agents at times steered business to favored providers through a variety of mechanisms, including giving them information on competing bids ("last looks") and deliberately obtaining off-market courtesy bids or purposefully non-winning bids so that the favored providers could win the transaction ("set-ups"). In return, the bidding agents were at times rewarded with, among other things, undisclosed gratuitous payments and kickbacks. This misconduct primarily affected the bond issuers and purchasers, which relied on inaccurate certifications executed by the providers (and on most occasions also the bidding agents) to the effect that the bids were competitive, *i.e.*, not tainted by undisclosed consultations, agreements, or payments and reflected fair market value for the purchase of the reinvestment instrument.

Improper Bidding Practices

7. From the inception of the Municipal Reinvestment and Risk Management Group (the "Desk") in 1998 through at least 2002, many of its members, including two heads of the Desk, participated in and condoned improper practices in connection with the bidding of reinvestment instruments. During the relevant period of time, the Desk was a marketing group comprised of 4 to 9 members that focused on selling derivative products associated with the issuance of municipal debt. The Desk generated business through, among other things, client relationships in commercial lending and securities underwriting performed by Respondent. The Desk also generated business through independent advisors, bidding agents, and brokers. During the relevant period of time, the Desk was based in Charlotte, North Carolina, with one member in New York, New York for a portion of that time. During the relevant time period, members of the Desk were dual officers of both Respondent and BofA.

8. As part of the conduct described herein, bidding agents at times steered business to the Desk through last looks and set-ups. As a result, the Desk won the bids for 88 affected reinvestment instruments.

9. In return, the Desk, among other things, at times steered business to bidding agents and submitted courtesy and purposefully non-winning bids upon request.

10. On occasion, members of the Desk also paid bidding agents that favored the Desk monies in addition to the fees disclosed as brokerage fees. These additional monies were sometimes mischaracterized as payments for services rendered in connection with swaps and marketing pricing letters. On other occasions, the Desk made undisclosed, gratuitous payments to the bidding agents by identifying them on the trade tickets as the brokers on transactions that did not utilize brokers.

11. In certain transactions, the Desk misstated in its bid submissions and/or provider's certificates that, among other things: its bids were arms-length bids; the Desk did not consult with any other potential provider about its bids; its bids were determined without regard to any other formal or informal agreement that the Desk had with the issuer or any other person (whether or not in connection with the bond issue); and that its bids were not submitted solely as a courtesy to the issuer or any other person for purposes of satisfying the requirements that (a) the issuer receive at least three bids from providers that the issuer solicited under a bona fide

solicitation and (b) at least one of the three bids received was from a reasonably competitive provider.

Representative Transactions

12. **Transaction One.** In an eight-month period, Bidding Agent I improperly rigged two large bids for the investment of bond proceeds on behalf of Municipality One. The first, in October 2001, was arranged to favor the Desk, while the second, in June 2002, was arranged to favor Provider B. With respect to each bid, the potential provider was required to submit the bid initially via telephone and then follow it up with a signed copy of the bid, which was sent to the bidding agent via fax.

a. In late October 2001, a senior member of the bidding agent's municipal derivatives group hosted a breakfast meeting for one of the Desk's marketers. At that meeting, among other items, another bidding agent representative suggested his firm could "help" the Desk on an upcoming \$823,845,000 FPA in return for monetary consideration. Consistent with the aforementioned offer, the bidding agent representative, on October 31, 2001, provided the Desk with a last look, thereby allowing the Desk to win the transaction over Provider B, which had submitted the cover bid.

b. The Desk's bid submission and provider's certificate, among other things, collectively misstated that the bidding agent had not provided any information inducing the Desk to bid a higher amount, and that the Desk had bid without regard to any formal or informal agreement with any other person.

c. In return for the last look, the Desk paid the bidding agent at least \$175,000 in early 2002 for services not rendered.

d. Provider B was upset that the Desk had won this transaction. The bidding agent mollified Provider B by promising its marketer that it would receive favored treatment on the next significant Municipality One transaction – *i.e.*, a \$1.9 billion FPA bid out in June 2002. This bidding process was structured so that the firm providing the earliest escrow roll-over date won the right to provide all of the investments.

e. On the morning of the bid, senior marketers from the Desk and Provider B, during several telephone calls, discussed with each other how they were planning to bid. During one such conversation, the Desk marketer suggested that Provider B could "do better" (*i.e.*, make more profit) than his analysis suggested. Internally, the Desk agreed that a fair price would correlate to a bid of September 24, 2010. Immediately thereafter, the Desk submitted a bid at a level slightly off that price (early October 2010), only to be told by the bidding agent that "you are killing me at that level." The Desk marketer made a quick call to Provider B's marketer. After the call to Provider B's marketer and within 5 minutes of the submission of its original bid, the Desk submitted a revised, less competitive bid with a date of January 15, 2011.

f. The Desk misstated in its bid submission that the Desk had not consulted with any other potential provider about the Desk's bid; that the bidding agent had not provided any information inducing the Desk to bid a higher amount; and that the Desk had submitted the bid without regard to any formal or informal agreement with any other person.

13. *Transaction Two.* Respondent underwrote a \$65,225,000 offering of special assessment bonds and, in March and April of 2002, the Desk won the bids for two instruments in which the offering proceeds would be invested. The head of the Desk recommended the hiring of Bidding Agent II to bid the reinvestment instrument for this deal. During the relevant time period, certain bidding agents would favor the firm that had both underwritten the bonds and arranged for the bidding agent's hiring. Such favoritism generally took the form of either a last look or a set-up. Here, the two bids associated with this transaction were set-up for the Desk to win. This transaction included a refunding escrow that was bid in March 2002 and a debt service reserve fund that was bid in April 2002. The Desk provided Bidding Agent II with the Desk's pricing indications for the instruments that were the subject of the bids, which allowed the bidding agent to advise other prospective bidders where they should not bid. In addition to the brokerage fees that were paid to Bidding Agent II, the Desk paid the bidding agent an additional \$50,000 as purported fees for a market pricing letter in another transaction. In reality, the additional \$50,000 was payment for the favored treatment that the bidding agent showed the Desk in steering these bids in favor of the Desk. The Desk misstated collectively in bid submissions and provider's certificates for these instruments that, among other things, its bids were arms-length bids; based on market prices; and/or were determined without regard to any other formal or informal agreement that the potential provider had with the issuer or any other person.

14. *Transaction Three.* Respondent underwrote a \$145,000,000 offering of revenue bonds and, on October 23, 2001, the Desk won the bid for one of the instruments in which the offering proceeds would be invested. The head of the Desk arranged for the hiring of Bidding Agent III to bid the reinvestment instruments for this deal. As previously stated, certain bidding agents would favor the firm that had both underwritten the bonds and arranged for the hiring of the bidding agent. Here, Bidding Agent III arranged, through the mechanism of a set-up, for the Desk to win the bid for the debt service reserve. In addition, the Desk and bidding agent reached an undisclosed agreement with respect to the fees to be paid to the bidding agent. As an initial matter, the bidding agent was to be paid \$75,000 (five basis points) for brokerage fees. However, the borrower, on whose behalf the bonds were issued, balked at such a high fee. To placate the borrower, the bidding agent subsequently claimed to have "reduced" its fee to \$5,000. However, the Desk and Bidding Agent III had made alternative arrangements for the latter to be paid the additional \$70,000, mischaracterized as payment for services rendered in connection with a swap on another transaction. Once again, the Desk's bid submission misstated that, among other things, its bid was determined without regard to any other formal or informal agreement with the issuer or any other person.

Legal Discussion

15. Section 15(c)(1)(A) of the Exchange Act prohibits any broker or dealer from using the mails or other means of interstate commerce "to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security . . . by means of any manipulative,

deceptive, or other fraudulent device or contrivance." Exchange Act Rule 15c1-2 defines such means to include "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," and "any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading."

16. As described above, Respondent, using the mails or any means or instrumentality of interstate commerce, engaged in improper bidding practices such as set-ups, last looks, the submission of courtesy and purposefully non-winning bids, and other conduct that it knows or has reasonable grounds to believe is misleading. As a result of such conduct, Respondent willfully violated Exchange Act Section 15(c)(1)(A).

Cooperation and Remedial Efforts

17. In determining to accept Respondent's offer, the Commission considered the cooperation of and the remedial actions undertaken by Respondent in connection with the Commission's investigation as well as investigations conducted by other law enforcement agencies. Among other things, Respondent and its affiliates voluntarily self-reported the bidding practices described herein to the DOJ; cooperated extensively with investigations conducted by the Commission Staff, the DOJ, and other law enforcement and regulatory entities into these practices; implemented personnel actions and other remedial measures designed to prevent recurrence of these or similar practices; and committed to paying restitution to issuers affected by these practices. The DOJ accepted BAC into Part A of its Corporate Leniency Program, the Department's highest cooperation status.

IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent is censured;
- B. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 15(c)(1)(A) of the Exchange Act; and

C. Respondent shall, within 30 days of the entry of this Order, pay disgorgement in the amount of \$24,926,375.00 plus prejudgment interest thereon in the amount of \$11,170,067.00, for a total of \$36,096,442.00, to the Payee(s) or their successors-in-interest or assigns in the individual amounts identified in the attached Exhibit "A."

By the Commission.

Elizabeth M. Murphy
Secretary

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

EXHIBIT "A"			
Transaction	Approximate Bid Date	Payee(s)	Disgorgement and Prejudgment Interest To Be Paid
\$50,000,000 The Health Educational and Housing Facility Board of the County of Montgomery, Tennessee, Hospital Improvement and Revenue Bond Series 1998 (Clarksville Regional Health System)	July 20, 1998	Clarksville Regional Health System, Inc.	\$ 34,470.00
\$50,000,000 The Health Educational and Housing Facility Board of the County of Montgomery, Tennessee, Hospital Improvement and Revenue Bond Series 1998 (Clarksville Regional Health System)	July 20, 1998	Clarksville Regional Health System, Inc.	\$ 418,815.00
Illinois Development Finance Authority \$20,000,000 Economic Development Revenue Bonds, Series 1998 (The Latin School of Chicago Project)	August 10, 1998	The Latin School of Chicago	\$ 17,135.00
Illinois Development Finance Authority \$20,000,000 Economic Development Revenue Bonds, Series 1998 (The Latin School of Chicago Project)	August 10, 1998	The Latin School of Chicago	\$ 77,105.00
Missouri Development Finance Board \$9,740,000 Multifamily Housing Revenue Refunding Bonds (Quality Hill Project) S Series 1999A; \$532,000 Multifamily Housing Revenue Refunding Bonds (Quality Hill Project) Series 1998B	November 16, 1998	Quality Hill-Historic Rehabilitation, LP	\$ 8,418.00
City of Detroit Water System Revenue and Refunding Bonds Series 1993	January 28, 1999	City of Detroit	\$ 333,067.00
City of Detroit Water System Revenue and Refunding Bonds Series 1993	January 28, 1999	City of Detroit	\$ 333,067.00
Missouri Development Finance Board \$9,740,000 Multifamily Housing Revenue Refunding Bonds (Quality Hill Project) Series 1999A; \$532,000 Multifamily Housing Revenue Refunding Bonds; (Quality Hill Project) Series 1998B; \$4,540,000 Taxable Multifamily Housing Revenue Bonds (Quality Hill Project) Series 1998C	March 3, 1999	Quality Hill Historic Rehabilitation, LP	\$ 115,386.00

109,335,000 City of Loma Linda, California, Hospital Revenue Refunding Bonds (Loma Linda University Medical Center Project) Series 1989	March 3, 1999	Loma Linda University Medical Center	\$	263,740.00
\$4,000,000 ABAG Finance Authority for Nonprofit Corporations Variable Rated Demand Certificates of Participation (Marin Academy Project)	June 16, 1999	Marin Academy	\$	42,116.00
\$19,500,000 Fairfax County Economic Development Authority Revenue Bonds (National Wildlife Federation Project), Series 1999	June 17, 1999	National Wildlife Federation and National Wildlife Endowment, Inc. (jointly)	\$	55,075.00
Massachusetts State College Building Authority \$37,816,966.40 Massachusetts State College Building Authority Project Revenue Bonds, Senior Series 1999-A and \$45,915,000 Massachusetts State College Building Authority Project Revenue Bonds, Series 1999-1	August 4, 1999	Massachusetts State College Building Authority	\$	101,679.00
Massachusetts State College Building Authority \$37,816,966.40 Massachusetts State College Building Authority Project Revenue Bonds, Senior Series 1999-A and \$45,915,000 Massachusetts State College Building Authority Project Revenue Bonds, Series 1999-1	August 4, 1999	Massachusetts State College Building Authority	\$	78,460.00
Massachusetts State College Building Authority \$37,816,966.40 Massachusetts State College Building Authority Project Revenue Bonds, Senior Series 1999-A and \$45,915,000 Massachusetts State College Building Authority Project Revenue Bonds, Series 1999-1	August 4, 1999	Massachusetts State College Building Authority	\$	21,617.00
\$5,600,000 South Carolina Jobs-Economic Development Authority Economic Development Revenue Bonds (LATI Industries Inc. Project), Series 1999	August 26, 1999	LATI Industries, Inc.	\$	16,012.00
County of San Diego, \$51,500,000 Certificates of Participation (The Burnham Institute)	September 9, 1999	The Burnham Institute	\$	405,938.00
City of Virginia Beach Development Authority \$7,500,000 Multifamily Residential Rental Housing Revenue Bonds (The Hamptons and The Hampton Court Apartments Project), Series 1999	October 5, 1999	Renaissance Hamptons, L.P.	\$	79,139.00

City of Virginia Beach Development Authority \$7,500,000 Multifamily Residential Rental Housing Revenue Bonds (The Mayfair I and Mayfair II Apartments Project) Series 1999	October 5, 1999	Renaissance Mayfair, L.P.	\$	79,139.00
City of Virginia Beach Development Authority \$7,500,000 Multifamily Residential Rental Housing Revenue Bonds (The Hamptons and The Hampton Court Apartments Project), Series 1999	October 5, 1999	Renaissance Hamptons, L.P.	\$	102,880.00
City of Virginia Beach Development Authority \$7,500,000 Multifamily Residential Rental Housing Revenue Bonds (The Mayfair I and Mayfair II Apartments Project), Series 1999	October 5, 1999	Renaissance Mayfair, L.P.	\$	102,880.00
\$155,410,000 Oregon State Lottery Revenue Bonds 1999 Series	November 18, 1999	State of Oregon	\$	232,900.00
\$155,410,000 Oregon State Lottery Revenue Bonds 1999 Series	November 18, 1999	State of Oregon	\$	58,225.00
California Statewide Communities Development Authority, \$24,000,000 Certificates of Participation (PRIDE Industries and Pride Industries One, Inc.)	November 23, 1999	PRIDE Industries and Pride Industries One, Inc. (jointly)	\$	217,557.00
California Statewide Communities Development Authority, \$24,000,000 Certificates of Participation (PRIDE Industries and Pride Industries One, Inc.)	November 23, 1999	PRIDE Industries and Pride Industries One, Inc. (jointly)	\$	31,079.00
The Oklahoma Development Finance Authority \$236,190,000 Hillcrest Healthcare System Revenue and Refunding Bonds	December 22, 1999	Hillcrest Healthcare System	\$	1,438,373.00
The Oklahoma Development Finance Authority \$236,190,000 Hillcrest Healthcare System Revenue and Refunding Bonds	December 22, 1999	Hillcrest Healthcare System	\$	202,174.00
The Oklahoma Development Finance Authority \$236,190,000 Hillcrest Healthcare System Revenue and Refunding Bonds	December 22, 1999	Hillcrest Healthcare System	\$	2,910,700.00
The Oklahoma Development Finance Authority \$236,190,000 Hillcrest Healthcare System Revenue and Refunding Bonds	December 22, 1999	Hillcrest Healthcare System	\$	233,041.00
Oakland Joint Powers Financing Authority \$187,500,000 Lease Revenue Bonds 1998 Series A- 1 and A-2	February 9, 2000	Oakland Joint Powers Financing Authority	\$	182,500.00
County of Mecklenburg \$25,000,000 Variable Rate Certificates of Participation (2000 Mecklenburg County - Corporation Project)	April 13, 2000	County Of Mecklenburg, North Carolina	\$	61,876.00

Housing and Development Authority of the City of Saint Paul, Minnesota's \$34,080,000 Hospital Facility Revenue Bonds (HealthEast Project), Series 1997A and 1997B	April 14, 2000	HealthEast Corporation	\$	1,038,904.00
Washington County Housing and Redevelopment Authority \$49,135,000 Hospital Revenue Bonds (HealthEast Project) Series 1998	April 14, 2000	HealthEast Corporation	\$	2,322,461.00
The Public Building Authority of the City of Clarksville, Tennessee, \$75,000,000 Adjustable Rate Pooled Financing Revenue Bonds Series 1990 (The Tennessee Municipal Bond Fund)	May 15, 2000	The Public Building Authority of the City of Clarksville, Tennessee	\$	166,974.00
\$16,610,000 North Carolina Education Facilities Finance Agency Variable Rate Educational Facilities Revenue Bonds (Charlotte Country Day School), Series 2000	June 7, 2000	Charlotte Country Day School	\$	71,937.00
Alameda Corridor Transportation Authority, \$494,893,616.80 Tax-Exempt Senior Lien Revenue Bonds Series 1999A and \$497,453,395.70 Taxable Senior Lien Revenue Bonds Series 1999C	June 19, 2000	Alameda Corridor Transportation Authority	\$	373,253.00
Alameda Corridor Transportation Authority, \$494,893,616.80 Tax-Exempt Senior Lien Revenue Bonds Series 1999A and \$497,453,395.70 Taxable Senior Lien Revenue Bonds Series 1999C	June 19, 2000	Alameda Corridor Transportation Authority	\$	373,253.00
\$10,000,000 South Carolina Educational Facilities Authority for Private Institutions of Higher Learning Education Facilities Revenue Bonds (Converse College Project) Series 2000	July 10, 2000	Converse College	\$	24,724.00
Hillsborough County Industrial Development Authority \$23,400,000 Variable Rate Demand Revenue Bonds (Tampa Metropolitan Area YMCA), Series 2000	July 12, 2000	Tampa Metropolitan YMCA, Inc.	\$	194,800.00
Tensas Parish Law Enforcement District (Louisiana) \$9,995,000 Certificates of Participation in Lease Agreement (with Option to Purchase) (Western Correctional Facility)	August 25, 2000	Tensas Parish Law Enforcement District, Louisiana	\$	66,997.00
Guam Power Authority Revenue Bonds, 1993 Series A and 1999 Series A	August 30, 2000	Guam Power Authority	\$	5,173,671.00
California Educational Facilities Authority \$18,000,000 Variable Rate Demand Revenue Bonds (Chapman University) Series 2000	September 18, 2000	Chapman University	\$	36,979.00

California Infrastructure and Economic Development Bank \$108,135,000 Revenue Bonds Series 2000 (Asian Art Museum of San Francisco Project)	September 20, 2000	Asian Art Museum Foundation of San Francisco	\$	168,628.00
King County, Washington Shoreline Fire Department Fire Protection District No. 4 \$13,800,000 Unlimited Tax General Obligation Bond Series 1997	September 22, 2000	King County, Washington	\$	73,220.00
\$12,570,000 California Health Facilities Financing Authority Insured Hospital Refunding Revenue Bonds (Lodi Memorial Hospital) 2000 Series A	November 20, 2000	Lodi Memorial Hospital Association, Inc.	\$	56,953.00
\$12,570,000 California Health Facilities Financing Authority Insured Hospital Refunding Revenue Bonds (Lodi Memorial Hospital) 2000 Series A	November 20, 2000	Lodi Memorial Hospital Association, Inc.	\$	43,810.00
\$25,000,000 California Statewide Communities Development Authority Solid Waste Exempt Facility Revenue Bonds (Republic Services, Inc. Project) Series 2000	December 14, 2000	Republic Services, Inc.	\$	117,524.00
\$31,705,000 Oxnard Union High School (County of Ventura, California) 2001 District General Obligation Refunding Bonds, Series A	April 19, 2001	Oxnard Union High School District	\$	417,497.00
\$75,600,020 California Educational Facilities Authority Refunding Revenue Bonds (Loyola Marymount University) Series 2001A	May 24, 2001	Loyola Marymount University	\$	914,687.00
\$24,105,000 Pomona Unified School District: General Obligation Refunding Bonds,	May 30, 2001	Pomona Unified School District	\$	63,324.00
\$24,105,000 Pomona Unified School District: General Obligation Refunding Bonds,	May 30, 2001	Pomona Unified School District	\$	63,324.00
Massachusetts Development Finance Agency, \$10,640,000 Devens Electric System Revenue Series 2001	June 15, 2001	Massachusetts Development Finance Agency	\$	68,559.00
Massachusetts Development Finance Agency, \$10,640,000 Devens Electric System Revenue Series 2001	June 15, 2001	Massachusetts Development Finance Agency	\$	39,177.00
Educational Facilities Authority for Private Nonprofit Colleges of Higher Learning \$10,000,000 Educational Facilities Revenue Bonds (Columbia College Project), Series 2001	June 19, 2001	The Columbia College	\$	17,210.00

Health & Education Facilities Authority of the State of Missouri, Missouri School District Direct Deposit Program for School Districts in the State of Missouri	August 21, 2001	Health and Educational Facilities Authority of the State of Missouri, Program Administrator for the Missouri School District Direct Deposit Program	\$ 1,544,685.00
\$7,300,000 Illinois Development Finance Authority Variable Rate Demand Revenue Bonds (WTVP Channel 47 Project) Tax Exempt Series 2001-A and \$3,000,000 Illinois Development Finance Authority Variable Rate Demand Revenue Bonds (WTVP Channel 47 Project) Taxable Series 2001-B	August 23, 2001	Illinois Valley Public Telecommunications Corporation	\$ 23,551.00
\$20,920,000 Oxnard School District (County of Ventura, California) 2001 District General Obligation Refunding Bonds, Series A	August 29, 2001	Oxnard School District	\$ 259,063.00
City of Boynton Beach, Florida \$24,400,000 Utility System Revenue Refunding Bonds, Series 2002	September 17, 2001	City of Boynton Beach, Florida	\$ 117,169.00
\$145,000,000 California Infrastructure and Economic Development Bank Revenue Bonds (The J. David Gladstone Institutes Project), Series 2001	October 23, 2001	The J. David Gladstone Institutes	\$ 678,978.00
City of Clearwater, Florida \$11,470,000 Improvement Revenue Refunding Bonds, Series 2000	October 23, 2001	City of Clearwater, Florida	\$ 72,698.00
\$28,610,000 West Contra Costa Unified School District General Obligation Refunding Bonds, Series 2001A	October 24, 2001	West Contra Costa Unified School District	\$ 301,768.00
\$10,255,000 West Contra Costa Unified School District General Obligation Refunding Bonds, Series 2001B	October 24, 2001	West Contra Costa Unified School District	\$ 102,875.00
\$20,590,000 Parking Authority of the City of Trenton Parking Revenue Refunding Bonds (City Guaranteed, Series 2001), County of Mercer, New Jersey	October 24, 2001	Parking Authority of the City of Trenton, NJ	\$ 109,734.00
Commonwealth of Massachusetts, \$823,845,000 General Obligation Bonds, Consolidated Loan of 2001, Series D	October 30, 2001	The Commonwealth of Massachusetts	\$ 6,172,530.00
\$25,000,000 Director of the State of Nevada Department of Business and Industry Variable Rate Demand Solid Waste Disposal Revenue Bonds (Republic Services, Inc. Project), Series 2001	December 18, 2001	Republic Services, Inc.	\$ 42,780.00

\$25,000,000 Director of the State of Nevada Department of Business and Industry Variable Rate Demand Solid Waste Disposal Revenue Bonds (Republic Services, Inc. Project), Series 2001	December 18, 2001	Republic Services, Inc.	\$	42,780.00
\$11,275,000 Redevelopment Agency of the City of West Covina Housing Set-Aside Tax Allocation Revenue Bonds, Series 2001	December 20, 2001	Redevelopment Agency of the City of West Covina, CA	\$	84,202.00
California Educational Facilities Authority: Variable Rate Demand Revenue Bonds 21,600,000 California Educational Facilities Revenue Bonds (Santa Clara University), Series 2002A and the \$10,390,000 California Educational Facilities Authority Variable Rate Demand Revenue Bonds (Santa Clara University), Series 2002B	January 17, 2002	The President and Board of Trustees of Santa Clara College, doing business as Santa Clara University	\$	64,643.00
Puerto Rico Highway and Transportation Authority, Transportation Revenue Refunding Bonds (Series 2002 E) MBIA Escrow	January 24, 2002	Puerto Rico Highway and Transportation Authority	\$	243,426.00
Puerto Rico Highway and Transportation Authority, Transportation Revenue Refunding Bonds (2002 Series E)	January 25, 2002	Puerto Rico Highway and Transportation Authority	\$	682,945.00
\$65,255,000 Beacon Tradeport Community Development District Special Assessment Bonds, Series 2002A (Commercial Project)	March 13, 2002	Beacon Tradeport Community Development District	\$	1,005,576.00
Educational Facilities Authority for Private Nonprofit Institutions of Higher Learning, South Carolina, \$30,455,000 Educational Facilities Capital Improvement and Refunding Revenue Bonds, Series 2002 (Benedict College Project)	March 22, 2002	The Benedict College	\$	576,587.00
\$27,000,000 City of Tampa, Florida, Revenue Bonds, Series 2002 (University of Tampa Project)	March 22, 2002	University of Tampa, Incorporated	\$	830,689.00
\$27,000,000 City of Tampa, Florida, Revenue Bonds, Series 2002 (University of Tampa Project)	March 22, 2002	University of Tampa, Incorporated	\$	278,908.00
\$65,255,000 Beacon Tradeport Community Development District Special Assessment Bonds, Series 2002A (Commercial Project)	April 15, 2002	Beacon Tradeport Community Development District	\$	389,226.00
Illinois Development Finance Authority \$21,220,000 General Obligation Bonds (Waterworks System Alternate Revenue Source), Series 2002, of the City of West Chicago, DuPage County, Illinois	April 15, 2002	City of West Chicago, DuPage County, Illinois	\$	190,941.00

\$31,425,000 County of Santa Barbara 2001 Certificates of Participation (2001 Capital Improvement Plan Project)	May 6, 2002	County of Santa Barbara, CA	\$	132,961.00
\$31,425,000 County of Santa Barbara 2001 Certificates of Participation (2001 Capital Improvement Plan Project)	May 6, 2002	County of Santa Barbara, CA	\$	66,480.00
\$13,055,000 California Educational Facilities Authority Variable Rate Demand Revenue Refunding Bonds (Art Center College of Design) 2002 Series B	May 7, 2002	Art Center College of Design	\$	35,899.00
Texas Community Mental Health and Mental Retardation Centers, \$89,200,000 Public Property Finance Corporation of Texas Mental Health and Mental Retardation Center Facilities Acquisition Problem, Acquisition and Refunding Bonds, Series 1993; \$10,000,000 Dallas County Mental Health Retardation Center Revenue Bonds, Mental Health and Mental Retardation Center Facilities Acquisition Program, Series 1995; \$3,375,000 Texas Community MMHR Centers Revenue Bonds, Mental Health Retardation and Mental Retardation Center Facilities Acquisition Program, Series 1995 A-E; \$9,900,000 Public Property Finance Corporation of Texas Mental Health and Mental Retardation Center Facilities Acquisition Program, Revenue Bonds, Series 1996.	May 16, 2002	Texas Council of Community Mental Health and Retardation Centers, Inc., Program Administrator	\$	146,257.00
\$20,410,000 West Covina Unified School District (County of Los Angeles, California) 2002 General Obligation Refunding Bonds, Series A	May 30, 2002	West Covina Unified School District	\$	138,279.00
Puerto Rico Electric Power Authority, \$385,000,000 Power Revenue Refunding Bonds, Series KK	June 11, 2002	Puerto Rico Electric Power Authority	\$	165,495.00
\$224,150,000 New Jersey Transit Corporation Certificates of Participations (Series 2002A) Subordinated Certificates of Participation (2002 B)	June 20, 2002	New Jersey Transit Corporation	\$	198,594.00
\$224,150,000 New Jersey Transit Corporation Certificates of Participations (Series 2002A) Subordinated Certificates of Participation (2002 B)	June 20, 2002	New Jersey Transit Corporation	\$	132,396.00

\$685,390,000 Tobacco Settlement Financing Corporation--\$649,730,000 Tobacco Settlement Asset-Backed Bonds, Series 2002A (Tax-Exempt) and \$35,660,000 Tobacco Settlement Asset-Backed Bonds, Series 2002B. (Taxable)	June 20, 2002	The State of Rhode Island and Providence Plantations	\$	926,772.00
West Covina Public Finance Authority, \$2,690,000 Taxable Variable Rate Lease Revenue Refunding Bonds, 2002 Series A	June 21, 2002	West Covina Public Finance Authority	\$	26,479.00
West Covina Public Finance Authority, \$19,205,000 Taxable Variable Rate Lease Revenue Bonds, 2002 Series B	June 21, 2002	West Covina Public Finance Authority	\$	26,479.00
Tampa Port Authority, \$25,000,000 Hillsborough County Port District Revenue Bonds (Tampa Port Authority Project) Series 2002A and \$10,000,000 Hillsborough County Port District Revenue Bonds (Tampa Port Authority Project) Series 2000B	July 2, 2002	Tampa Port Authority	\$	43,606.00
Allegheny County Airport Authority, \$114,500,000 Series AMT Airport Revenue Refunding Bonds	August 6, 2002	Allegheny County Airport Authority	\$	98,462.00
TOTAL			\$	36,096,442.00

*Commissioner Walter
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63450 / December 7, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3120 / December 7, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14152

In the Matter of

Douglas Lee Campbell,

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 Douglas Lee Campbell ("Campbell" 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:

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1. Campbell, from June 1998 through August 2002, served as a dual officer of Banc of America Securities LLC ("BAS") and Bank of America, N.A ("BANA").¹ BAS, a Delaware limited liability corporation with its principal place of business in New York, New York, was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act and as an investment adviser pursuant to Section 203(c) of the Advisers Act.² BANA is a federally-chartered commercial bank with its principal place of business in Charlotte, North Carolina. During the relevant period, Campbell worked in BofA's Municipal Reinvestment and Risk Management Group (the "Desk") as a Senior Vice President and a marketer of investment agreements and other municipal finance contracts. In that role, Campbell focused on selling derivative products associated with the issuance of municipal debt. From June 1998 through approximately September 2001, Campbell worked at BofA's offices located in Charlotte and, from approximately September 2001 through approximately August 2002, worked at BofA's offices in New York. Campbell, age 45, is a resident of New York, New York.

2. On September 9, 2010, in United States v. Douglas Lee Campbell, Criminal No. 10-cr-803, Campbell pled guilty to two counts of conspiracy in violation of 15 U.S.C. § 1 and 18 U.S.C. § 371, respectively, and to one count of wire fraud in violation of 18 U.S.C. § 1343 before the United States District Court for the Southern District of New York. Campbell is currently scheduled to be sentenced on January 28, 2011.

3. The criminal information to which Campbell pled guilty charged, among other things, that Campbell engaged in fraudulent misconduct in connection with the competitive bidding process for the selection of the firms to provide instruments in which municipal issuers, in accordance with federal tax laws and regulations, temporarily invested the proceeds of tax-exempt municipal bonds. More specifically, the information charged that, from as early as 1998 until approximately September 2005, Campbell conspired to allocate and rig bids for investment agreements or other municipal finance contracts, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. The information further charged that, from as early as 1998 until approximately September 2005, Campbell, in violation of 18 U.S.C. § 371, conspired to defraud the United States and an agency thereof, the Internal Revenue Service of the United States Department of Treasury ("IRS"), by impeding, impairing, obstructing, and defeating the lawful government functions of the IRS in the ascertainment, computation, assessment, and collection of revenue due and owing from municipal issuers and in exercising its responsibilities to monitor compliance with Treasury regulations related to tax-exempt municipal bonds. In addition, the information charged that

¹ BAS and BANA will be referred to jointly as "BofA". During the relevant period, both entities were wholly-owned subsidiaries of Bank of America Corporation ("BAC"), a Delaware corporation with its principal place of business in Charlotte, North Carolina. BAC is a bank holding company and a financial holding company, registered under the Bank Holding Company Act of 1956, as amended.

² On November 1, 2010, BAS was merged into Merrill Lynch, Pierce, Fenner & Smith Incorporated, an indirect wholly-owned subsidiary of BAC that is registered with the Commission as a broker-dealer.

Campbell and other persons known and unknown devised a scheme and artifice to defraud municipal issuers and to obtain money and property from these municipal issuers by means of false and fraudulent pretenses, representations and promises and for the purposes of executing such scheme and artifice transmitted and caused to be transmitted via interstate wire transfer a payment of approximately \$6,276,912.57 to a state development authority, which payment included principal and interest, the latter of which was artificially determined and suppressed, in violation of 18 U.S.C. § 1343.

IV.

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

Respondent acknowledges that the Commission is not imposing a civil penalty based upon his cooperation in a Commission investigation and related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and without prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay a civil money penalty. Respondent may not, by way of defense to any resulting administrative proceeding, contest the findings in the Order.

By the Commission.

Elizabeth M. Murphy
Secretary

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

Chairman Schapiro
not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63453 / December 7, 2010

Admin. Proc. File No. 3-13841

In the Matter of the Application of
MISSION SECURITIES CORPORATION
and
CRAIG M. BIDDICK
c/o Craig M. Biddick
P.O. Box 3038
Rancho Santa Fe, CA 92067
For Review of Disciplinary Action Taken by
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY
PROCEEDINGS

Conversion and Misuse of Customer Securities

Registered securities association found that registered representative, while associated with member firm, caused member firm to convert and misuse customers' securities. *Held*, association's findings of violations and sanctions are *sustained*.

APPEARANCES:

Craig M. Biddick, pro se and for Mission Securities Corporation.

Marc Menchel, Allen Lawhead, and Andrew J. Love, for the Financial Industry Regulation Authority, Inc.

Appeal filed: April 1, 2010
Last brief received: July 12, 2010

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I.

Mission Securities Corporation ("Mission" or the "Firm"), formerly a FINRA member firm, and Craig M. Biddick, formerly a registered representative associated with the Firm, appeal from FINRA disciplinary action.¹ FINRA found that Mission and Biddick (together, "Applicants") converted and misused customer securities in violation of NASD Rules 2330 and 2110.² FINRA expelled Mission, barred Biddick in all capacities, and ordered Mission and Biddick to disgorge \$38,946.06 in ill-gotten gains and to pay such proceeds, plus interest, to thirteen Mission customers. We base our findings on an independent review of the record.

II.

The parties do not dispute the core facts in this matter: that Applicants transferred certain securities out of their customers' accounts – without notice or authorization – and then liquidated a portion of those securities to pay the Firm's operating expenses. The parties do dispute, however, the details surrounding why Applicants took these actions. Specifically, Applicants

¹ On July 26, 2007, we approved a proposed rule change filed by National Association of Securities Dealers, Inc. ("NASD") to amend NASD's Restated Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of NASD and certain member-regulation, enforcement, and arbitration functions of the New York Stock Exchange ("NYSE"). *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517. Although the investigation into this matter was initiated before the consolidation, the complaint was filed afterwards. References to FINRA, therefore, include NASD actions.

² As part of the effort to consolidate and reorganize NASD's and NYSE's rules into one FINRA rulebook, NASD Rule 2110 (which was otherwise unchanged) was codified as FINRA Rule 2010, effective December 15, 2008, and the relevant portions of NASD Rule 2330 were codified as FINRA Rule 2150, effective December 14, 2009. *See* FINRA Regulatory Notice 08-57 (Oct. 2008) (discussing NASD Rule 2110); FINRA Regulatory Notice 09-60 (Oct. 2009) (discussing NASD Rule 2330); *see generally Kirlin Sec., Inc.*, Exchange Act Rel. No. 61135 (Dec. 10, 2009), 97 SEC Docket 23299, 23300 n. 4 (describing rules consolidation). Because the conduct at issue here occurred before the consolidation, we will continue to refer to the NASD Rules.

NASD Rule 2330 prohibits members or persons associated with members from "improper use of a customer's securities or funds." NASD Conduct Rule 2110 requires members to observe "high standards of commercial honor and just and equitable principles of trade." A violation of any NASD rule constitutes a violation of Rule 2110. *Stephen H. Gluckman*, 54 S.E.C. 175, 185 (1999). NASD Rule 2110 applies to Biddick through NASD General Rule 115 (recodified as FINRA Rule 140), which provides that persons associated with a member have the same duties and obligations as a member.

claim that the customers at issue had abandoned their accounts; that the stock Applicants appropriated from their customers was worthless; and that the Firm had been paying quarterly safekeeping fees on behalf of the customers' accounts. The record does not support these assertions.

A. Background

Biddick entered the securities industry in July 1993 and was first associated with a firm called Centex Securities. A few years later, while still associated with Centex, Biddick founded Mission Securities. Biddick served as Mission's president, chief executive officer, chief financial officer, and compliance officer. Biddick was also registered with Mission as a general securities representative, general securities principal, and financial and operations principal.

1. Mission Acquires Another Firm's Customer Accounts

The customers at issue originally held accounts with Centex Securities, but NASD expelled Centex from the industry in 2002. Although Biddick was no longer associated with Centex when the firm was expelled and the record contains few details about what transpired, certain Centex customer accounts were apparently transferred to Mission, including approximately thirty to forty accounts that held, among other things, shares of Chartwell International, Inc. ("Chartwell") – the security at issue here. By February 2005, however, all but eighteen of these former Centex customers had sold their shares of Chartwell stock.

As for these last eighteen customers, Biddick testified that "I [could]n't get ahold of these 18 people." He explained that, "[w]hen I inherited these accounts, I was given no account documentation." Biddick claimed that he had only addresses and that, as a result, "any correspondence or statements that I sent to these people, it either got to them or it didn't get to them. I had no phone numbers at all to contact these people." Biddick reasoned that his inability to reach his customers meant that their accounts were "abandoned accounts, as far as I'm concerned."

Biddick claimed that the Chartwell stock these customers held was not only worthless, but was also incurring a \$5 quarterly safekeeping fee that the Firm had to pay on the customers' behalf.³ Applicants contend that "over the years" these fees "amounted to approximately \$6500." Biddick testified that he eventually "got tired of the bleeding" and made the "business decision" in February 2005 to transfer the Chartwell shares out of the Firm's customer accounts and into an account owned by Mission.

³ Biddick testified that the fees originated with the Depository Trust Company, which charged Mission's clearing agent, North American Clearing, Inc. ("North American"), which in turn passed them along to Mission.

2. Applicants Appropriate Their Customers' Shares

On February 8, 2005, Biddick sent a facsimile to North American requesting that the clearing firm transfer "all positions [of Chartwell stock] to Mission Securities Segregated Account." North American, however, did not respond to Biddick's initial request, nor did North American respond to numerous subsequent written and oral requests. The record does not indicate why North American failed to respond, but Biddick testified that North American was "not the most efficient clearing firm one would hope for. Nothing got done unless you prodded them." Regardless of the reason for this failure to respond, North American finally complied approximately seven months later, on September 30, 2005, by transferring all 21,061 shares of the customers' Chartwell stock into Mission's "segregated account."

Mission's so-called "segregated account," however, was in reality a Mission proprietary account. A FINRA examiner explained during Applicants' hearing that "segregated accounts" are used for the exclusive benefit of customers, and that such accounts must comply with certain regulatory requirements, including holding the account at a bank and signifying in the account's title that the account is for the exclusive use for customers. Applicants' segregated account, according to the FINRA examiner, met none of these requirements. It was, instead, "a firm account."

Moreover, the record does not support Applicants' claim that the customers abandoned their accounts. Customers testified that they repeatedly spoke with Applicants about their accounts. Customer William Kroske, for example, testified that "Biddick called me [in the summer of 2005] and told me that there were fees [in my account], and I either needed to pay them, or we could sell stock and pay them that way." Customer Kathryn Enders similarly testified that she contacted Applicants after her account was transferred from Centex to Mission. She explained that Mission "charged so many fees . . . over the years [that] I had called from time to time saying, 'Why did I get this charge? Why did I get this charge when I don't do anything?'" A third customer, Jacob Krommenhock, testified that he called Mission after his shares were first transferred to Mission, but that he "was uncomfortable with whomever I was talking with. I've always felt that information was being withheld."

The evidence also contradicts Applicants' assertion that Chartwell stock was worthless at the time they decided to appropriate the stock from their customers. Although Chartwell was a thinly traded stock quoted on the Over-the-Counter Bulletin Board, trading data shows that the daily closing price for Chartwell was between \$3.30 and \$5 per share for several months before and after Mission acquired the shares from its customers.⁴ In fact, Chartwell's closing price was \$4.15 on the same day (July 20, 2005) that Applicants faxed one of their requests to North American about transferring the shares to Mission's account, and the closing price was \$5 per share three days before the September 30, 2005 transfer finally occurred. Even Mission's own

⁴ Prior to a one-for-ten reverse stock split in June 2005, the daily closing price of Chartwell shares had been in a proportionally similar range of between \$0.30 to \$0.45 per share.

quarterly account statement (in a section listing Mission's assets) valued Chartwell stock at \$5 per share on the date Applicants acquired the stock. Curiously, however, a different page of the same account statement (in a section noting Mission's acquisition of Chartwell stock) labeled the Chartwell stock as "worthless" – an internal inconsistency that later raised concerns for FINRA examiners, as discussed below.

The evidence also fails to support Applicants' claims regarding the alleged \$5 safekeeping fees. The record contains customer account statements for only one month, June 2005. Although those statements show that each customer incurred a \$5 safekeeping debit related to their holdings of Chartwell stock, those fees total only \$90, an amount inconsistent with Applicants' claim of incurring \$6,500 in safekeeping fees.⁵ The record also contains no evidence, other than Biddick's testimony, that Applicants paid these safekeeping fees on their customers' behalf. To the contrary, the account statement for Jacob Krommenhock shows that Mission liquidated part of Krommenhock's money market account to cover the \$5 safekeeping fee. And Biddick himself acknowledged at his hearing that certain customers had sufficient cash balances in their account to cover future fees. In fact, when asked whether he had to seize a customer's stock to cover debits in the account, Biddick answered, "No, I didn't. But I wasn't going to sit and do this on a quarterly basis. I mean, let's just make the decision and get it done."

3. Customers Discover the Loss of Their Chartwell Stock

Applicants admit that neither Biddick nor any other Mission employee sought or obtained authorization from, or provided notice to, any of the Firm's eighteen customers in advance of the Chartwell shares being transferred out of the customers' accounts. Instead, Applicants' customers learned of the transfer from their account statements for the period ending September 30, 2005, which showed that their Chartwell stock had been delivered to an unspecified recipient and that the stock was "worthless."

Customer Kumar Narasimhan quickly complained. He testified that he had been following Chartwell stock regularly, "almost on – if not on a daily basis, on alternate daily basis I would be checking on the internet price" and saw that Chartwell was trading at approximately \$3.50 or \$4 per share a few days before Mission transferred the shares out of his account. He

⁵ Notably, the June 2005 account statements also show that Chartwell stock was worth \$4 per share. Furthermore, even if we were to assume, *arguendo*, that the customer accounts had been incurring \$90 in safekeeping fees every quarter since the beginning of 2002 (the year in which the customers' accounts were transferred from Centex), the total safekeeping fees would still amount to only \$1,080 (*i.e.*, 3 years (or 12 quarters) x 18 customers x \$5 safekeeping fee = \$1,080).

therefore "could not understand" why the Chartwell stock had been designated as worthless.⁶ Narasimhan contacted Mission Securities to ask what had happened, to which Biddick allegedly responded "that these penny stocks could lose value at any time." Biddick later explained during his disciplinary hearing that "I'm not a good market predictor, but in February [2005] I felt the stock was worthless. It had been worthless for years." Narasimhan did not understand this reasoning, however, "because the bulletin board on the internet was giving me a different story."

Unsatisfied with Biddick's explanation that his stock was worthless, Narasimhan filed a complaint with NASD on November 30, 2005, in which he wrote that "I have not been able to get a straight answer from brokerage and they never sought my permission to declare the stocks worthless." Narasimhan also wrote that "[t]he objective appears to be to defraud the investor at the perfect time appropriate." Narasimhan filed a similar complaint with the Commission.

A little more than two weeks after Narasimhan filed these complaints, Biddick returned Narasimhan's shares. Biddick also wrote to Narasimhan, in a letter dated December 22, 2005, that "your Chartwell stock has very little or no value. When a stock such as Chartwell trades 100 shares a month or less, it is viewed by many in the securities industry as worthless." Biddick added that he "would like nothing more than to assist you in selling your shares," but "the stock has little or no volume and is difficult at best to sell."

Customer Krommenhock similarly telephoned Mission to ask why his Chartwell stock had been removed from his account. Krommenhock testified that "whoever answered the phone" explained to him that "[t]here was no volume [in Chartwell], and it was worthless." Krommenhock nevertheless asked Mission to return his stock, to which the person who answered the phone allegedly responded, "that could be done, but there might be a one-time fee involved." In January 2006, Applicants returned Krommenhock's stock, without charging a one-time fee.

Two other customers testified that they also noticed that their Chartwell shares had been designated as worthless, but there is no record of them contacting Mission to inquire about the change in valuation. As customer Kroske testified, "hell, I don't know enough, but I looked at it and I thought worthless must mean that maybe the company went out of business." A few months later, however, Kroske saw that the stock had been put back in his account, valued at \$3 per share. Customer Enders similarly testified that, when she saw her account statement listing Chartwell stock as worthless, she "had no reason other than to trust that I was being given accurate information and . . . my understanding was what worthless meant was that it was – it

⁶ Other customers also testified about following the value of Chartwell stock. Kroske, for instance, testified that he contacted Biddick at some point about selling his Chartwell stock when he saw that it was valued at \$4 per share, but he "never did hear back." Enders similarly testified that, after noticing her Chartwell stock trading at \$4 per share, she called Mission "a couple times and wanted to sell my Chartwell stock, and I was told . . . something to the effect of 'Join the club. Nobody wants to buy Chartwell stock, so there's nobody to sell it to. So tough luck.'"

was of no value, so it's gone." Enders' shares were eventually returned in April 2007. A fifth customer, Gary Duggins, had his shares returned in October 2005 after he requested that they be transferred to an account at a different broker. In total, Biddick returned 4,087 Chartwell shares to these five customers.

4. Applicants Liquidate Their Customers' Stock

As for the Chartwell shares that Applicants did not return to their customers, Applicants began selling those shares out of the Firm's account, without notice to the customers. Applicants then used some of the proceeds from those sales to pay the Firm's general business expenses. For instance, on December 19, 2005 – three days before Biddick wrote to Narasimhan that his shares were of "very little or no value" and "difficult at best to sell" – Applicants sold 500 shares of Chartwell out of the Firm's account at \$3.50 per share. Applicants continued to sell Chartwell shares, including another 500 shares on the same day Biddick wrote to Narasimhan and another block of 500 shares a day later, all at \$3.50 per share. In total, Applicants liquidated more than half their customers' Chartwell shares – in twenty-five separate sale transactions of 500 shares each between December 19, 2005 and March 3, 2006 at prices ranging from \$2.25 to \$4 per share – for a total of \$38,946.06. Biddick testified that he sold these shares "as a lark" and that he stopped selling the shares only after FINRA asked him to do so.

B. FINRA's Investigation

In March 2006, FINRA staff conducted an examination of Mission Securities and quickly noticed that the Firm's securities holdings had jumped nearly 600% between June 2005 (when the Firm had reported holdings of \$21,144) and September 2005 (when the firm reported holdings of \$126,618). A FINRA examiner testified that Biddick claimed during FINRA's examination that one of the Firm's stock holdings had "hit." FINRA staff also noticed the internal inconsistency in the Firm's quarterly account statement in which, as noted above, one portion of the account statement indicated that the Firm had acquired 21,061 shares of "worthless" Chartwell stock, while the portion of the same account statement listing the Firm's assets valued Chartwell stock at \$5 per share – all as of the same day, September 30, 2005.

Staff asked Biddick about the source of these shares, and, according to a FINRA examiner, Biddick responded that it "was journaled from customer accounts for tax purposes." When FINRA staff asked Biddick for evidence that the customers had given their consent to the transactions, Biddick provided FINRA with some letters of authorization, but none that had anything to do with the Chartwell transaction. The only other document Applicants produced was a copy of the facsimile Biddick sent to North American asking that the customers' Chartwell shares be transferred into Mission's account.

FINRA subsequently sent Mission a more formal, written request to explain the circumstances around the Chartwell transactions. In that request, FINRA asked whether Biddick determined Chartwell stock was worthless or, if not, who did determine the stock was worthless.

Biddick responded by letter on September 6, 2006 that "I determined Chartwell was essentially worthless. I determined it was worthless [when the Chartwell stock price] went to \$.30 in July 2003 on virtually no volume."⁷ He added: "No one at Mission Securities contacted the customers. These accounts had been dormant and inactive since they were transferred to Mission Securities in March 2001." In that same response, Biddick admitted that he was aware Chartwell may have had value, but explained that, "[w]hen I saw [Chartwell] had value on paper I didn't believe the data was valid. I dismissed it as a bad quote and carried the position on the firm's books as zero."

More than a year after FINRA began investigating Applicants, Biddick finally attempted to contact his customers about the appropriation of their property. At the suggestion of his former attorney, Biddick sent his customers a letter in which, according to Biddick's own testimony, he informed them simply: "Please contact your broker. We have important information about your account." The following year, again at the suggestion of his lawyer, Biddick attempted – albeit unsuccessfully – to return his customers' Chartwell stock. Biddick's attempt was allegedly "rebuffed" by the Firm's then-clearing agent, Sterne Agee Clearing, because, Biddick testified, "it's a third party transfer prohibited by the Patriot Act." Biddick added that, "I'd love to have this thing over and done with, give them back their money, give them back their stock, and back at the clock."

FINRA filed a complaint against Applicants on February 4, 2008, and after a two-day hearing in October 2008, a FINRA hearing panel (the "Hearing Panel") found that Applicants converted and misused customer securities in violation of NASD Rules 2330 and 2110. The Hearing Panel expelled Mission and barred Biddick for this misconduct. Applicants appealed to the National Adjudicatory Council ("NAC"), which affirmed the Hearing Panel's finding that Applicants violated NASD Rules 2330 and 2110 by converting and misusing their customers' securities.⁸ This appeal followed.

⁷ In contradiction to this response, Applicants now claim on appeal that "the 'worthless' designation was assigned by the [Depository Trust Company], not [Applicants] or its [sic] clearing agent." Applicants also claim on appeal that, "[a]t the time the decision to transfer the shares was requested (early February 2005) the total aggregate value for all the shares was \$582.00" (which translates into a value of less than \$0.03 per share). Applicants provide no support for any of these claims. Instead, as discussed herein, the record shows that Chartwell stock had value during the relevant time and that Applicants took advantage of this value by liquidating a portion of their customers' shares for a profit of nearly \$39,000. *See supra* Section II.A.4.

⁸ The Hearing Panel also found that Biddick caused Mission to operate with insufficient net capital in violation of Section 15(c) of the Securities Exchange Act of 1934, Exchange Act Rule 15c3-1, and NASD Rule 2110, but did not impose any additional sanctions for this misconduct. The Hearing Panel declined to address FINRA's allegations that Applicants

(continued...)

III.

Pursuant to Section 19(e) of the Exchange Act, we will sustain FINRA's decision if the record shows by a preponderance of the evidence that Applicants engaged in the alleged violative conduct and that FINRA applied its rules in a manner consistent with the purposes of the Exchange Act.⁹ Based on our independent review of the record, we find that the record amply supports FINRA's findings that Applicants violated NASD Rules 2330 and 2110.

Applicants admit that they intentionally transferred 21,061 shares of their customers' Chartwell stock into Mission's account without prior notice to, or approval from, the customers. Applicants also admit that, several months after appropriating their customers' shares, Applicants began liquidating those shares – again without notice – and used a portion of the proceeds to pay for Mission's operating expenses.

Despite these admissions, Applicants contend that their conduct did not amount to conversion because they never intended "to permanently deprive any customer the use of their funds." Applicants claim that they "made every effort to return these shares to these customers," and that the proceeds from the liquidated Chartwell stock "reside with SIPC Receiver of North American Securities."¹⁰ "[I]t can't be emphasized more," Applicants claim, that "the customers have not been harmed in any way by their own admission." We disagree.

The evidence shows that Applicants not only intended to permanently deprive their customers of their property, but did, in fact, deprive their customers of their property. Applicants admit that they took and liquidated their customers' securities to pay operating expenses, without notice or approval. Thirteen customers are still without access to their Chartwell shares, or to the

⁸ (...continued)

failed to alert customers and potential customers that their telephone calls were being recorded by Mission in violation of NASD Rules 3010(b)(2) ("Taping Rule") and 2110. On appeal, the NAC declined to address the Hearing Panel's findings regarding Applicants' alleged net capital violations, stating that, "[i]n light of our findings that respondents converted and misused customer securities in violation of Rules 2330 and 2110, we need not decide whether Biddick caused Mission to be in violation of its net capital requirement." Therefore, although Applicants devote a significant portion of their briefs to arguing that these additional allegations were false, none of these allegations are at issue on appeal.

⁹ 15 U.S.C. § 78s(e).

¹⁰ In 2008, a federal court appointed a receiver for North American in connection with a complaint in which the Commission alleged that certain defendants had engaged in illegal activities, including the misuse of customer funds. *See SEC v. N. Am. Clearing, Inc.*, Litigation Rel. No. 20602 (May 28, 2008), 93 SEC Docket 6175 (noting that the Commission had obtained an order appointing a receiver over North American Clearing).

profits Applicants made from selling those shares, and have been so for years. Although Applicants claim they attempted to return to their customers the Chartwell stock Applicants had not yet liquidated, they did so unsuccessfully, two and one half years after FINRA began its examination of Mission and just ten days before Applicants' disciplinary hearing began. Such attempts to undo their misconduct do not negate Applicants' original conversion.¹¹ Even if we concluded that no customers were harmed, which we do not, Applicants' conduct still "flouts the ethical standards to which members of [the securities] industry must adhere."¹²

Applicants' assertion that their customers did not complain about Applicants' misconduct is similarly without merit. FINRA's "power to enforce its rules is independent of a customer's decision not to complain."¹³ Moreover, customers did complain. Several customers questioned why Mission had transferred their Chartwell stock out of their accounts, and customer Narasimhan went so far as to file a formal complaint with both FINRA and the Commission that Applicants were attempting to defraud him.

Applicants alternatively rationalize their appropriation of their customers' Chartwell shares by asserting (for the first time in their Reply Brief) that, although they defrauded their

¹¹ See *Joel Eugene Shaw*, 51 S.E.C. 1224, 1225-26 (1994) (finding that representative converted customer funds even though representative repaid those funds after his firm discovered the misconduct); *Kirlin Sec., Inc.*, Exchange Act Rel. No. 61135 (Dec. 10, 2009), 97 SEC Docket 23299, 23326 n.93 (rejecting applicants' argument that there can be no violation where no one was harmed by applicants' misconduct).

¹² *Ronald H. V. Justiss*, 52 S.E.C. 746, 750 (1996) (sustaining bar although "the misconduct did not involve direct harm to customers"); cf. *Donner Corp. Int'l*, Exchange Act Rel. No. 55313 (Feb. 20, 2007), 90 SEC Docket 11, 41 n.91 (affirming bar and expulsion despite applicants' claims that "there are no customer complaints and no evidence that anyone was harmed by the two [misleading] reports"); *Barr Fin. Group, Inc.*, 56 S.E.C. 1243, 1262 (2003) (finding cease-and-desist order, bar, and revocation of registration "amply warranted" where, "[a]lthough there is no evidence that any customer lost money as a result of respondents' violations, their actions clearly posed a threat to the investing public"); *Coastline Fin., Inc.*, 54 S.E.C. 388, 396 (1999) (affirming expulsion of firm and permanent bar of president where, "[a]lthough, as the NASD noted, there was no evidence of customer harm, Respondents raised hundreds of thousands of dollars by selling securities through outright falsehoods to forty-eight investors").

¹³ *Maximo Justo Guevara*, 54 S.E.C. 655, 664 (2000), *pet. for review denied*, 47 F. App'x 198 (3d Cir. 2002) (Table); see also *Kevin M. Glodek*, Exchange Act Rel. No. 60937 (Nov. 4, 2009), 97 SEC Docket 22027, 22038 n.23 ("The fact that many of the customers did not lose money and did not complain about the violations does not further mitigate Glodek's misconduct.").

customers, they did so for the Firm's benefit.¹⁴ As they explain, "Biddick has argued throughout the proceedings that he did not commit what amounts to 'honest services fraud' because his fraud was in the corporate interest (foregoing ongoing safekeeping fees) and therefore was not 'self-dealing'" In support, Applicants point to the recent U.S. Supreme Court decision in *Skilling v. United States*.¹⁵ FINRA, however, neither accused nor charged Applicants with honest services fraud.¹⁶ Furthermore, neither *Skilling*, nor any other authority of which we are aware, supports Applicants' broader proposition that they are entitled to defraud their customers so long as it is in the Firm's best interest.

Nor does the record support Applicants' contention that their actions were done to avoid safekeeping fees. As discussed earlier, the evidence shows that, to the extent Mission was incurring fees, it was passing them along to its customers, and that at least some customer accounts had sufficient funds to cover future \$5 safekeeping fees. Moreover, the record contains evidence of only \$90 in total fees related to the customers' Chartwell stock, substantially less than the almost \$39,000 Applicants netted from liquidating their customers' shares.

We also reject Applicants' claim that the appropriation of their customers' Chartwell stock conformed with "known standard industry practice with respect to worthless securities." In support of their assertion, Applicants introduced two exhibits, which they claim represent "industry practice as it relates to worthless securities."¹⁷ One exhibit is a letter from Southwest Securities, Inc. notifying a customer that his position in a security was being "deleted from your account" because "[t]he shares have been deemed worthless due to bankruptcy." The other exhibit is an email from Sterne Agee instructing Mission to notify its clients that their accounts were "currently holding a position deemed to be non-transferable for the previous six years and is now eligible for destruction by DTCC." If anything, these documents show that Applicants failed to comply with the very industry standard they claim exists, as both exhibits suggest that

¹⁴ Because Applicants raise this argument for the first time in their Reply Brief, we do not have the benefit of FINRA's counter-arguments. As discussed herein, however, Applicants' arguments are without merit and do not warrant additional briefing.

¹⁵ 130 S. Ct. 2896 (June 24, 2010).

¹⁶ The U.S. Code criminalizes the use of the mails or wires in furtherance of "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C. § 1341 (mail fraud); § 1343 (wire fraud). The honest services statute, in turn, defines "the term 'scheme or artifice to defraud'" to include "a scheme or artifice to deprive another of the intangible right of honest services." *Id.* § 1346.

¹⁷ We allowed Applicants to introduce these two exhibits on appeal, along with eleven other exhibits, when we granted Applicants' Motion to Adduce Additional Evidence. *Mission Sec. Corp.*, Admin. Proc. File No. 3-13841 (determining "as a discretionary matter to admit all the documents Applicants seek to adduce").

customer notice is a central component of this alleged industry standard. Biddick, in fact, was expressly asked during his disciplinary hearing whether the industry standard that these exhibits supposedly showed included a responsibility to notify clients that their stock had been deemed worthless and was being removed from their accounts. Biddick answered, "Yes, it would. Okay? And I'll fall on my sword. I made a mistake. I should have notified them in writing."

In any event, the record does not support Applicants' underlying claim that the Chartwell shares were worthless at the time Applicants acquired the shares. Transaction data shows that the closing price for Chartwell was between \$3.30 and \$5 per share for the several months before and after Mission acquired the shares from its customers, and Chartwell's own account statement shows Chartwell stock to have been valued at \$5 per share as of the date Applicants acquired their customers' securities.¹⁸

The record similarly contradicts Applicants' claim that the clients had abandoned their accounts. Several customers testified that they had conversations with Biddick or other Mission employees about their accounts, and Biddick acknowledged that mail he sent to the customers was generally not returned as undeliverable. Moreover, even if some of Applicants' customers had abandoned their accounts, state law establishes specific requirements that holders of abandoned property must take when dealing with such property, most notably escheating the property to the state, rather than keeping the property for oneself, as Applicants did here.¹⁹ Applicants took none of these steps, and their only explanation for why they did not is an unsigned, handwritten note on stationary "From the desk of Craig Biddick" dated September 26, 2008 – the first day of Applicants' disciplinary hearing – which purports to summarize a telephone conversation between Biddick and a Sterne Agee employee named "Eric," who, according to the note, told Biddick that Sterne Agee "never escheats to the state."

Applicants also argue (for the first time in their Reply Brief) that "FINRA's charge against Respondents is too vague, poorly defined, open to interpretation and is based on old statutes."

¹⁸ Applicants claim that the FINRA examiner testified during the hearing that the Chartwell stock was worthless. This is incorrect. The examiner testified consistently that Chartwell stock had value, stating, for example, that "we checked VISTA, and we checked Bloomberg to see if this security, in fact, had [a] price and had a volume. And it did." In the portion of the transcript to which Applicants cite, the examiner was only summarizing the portion of the Firm's account statement indicating that the shares were worthless, and she noted that this was internally inconsistent with the portion of the same account statement valuing the stock at \$5 per share.

¹⁹ See, e.g., Cal. Civ. Proc. Code § 1500 *et seq.*; Accounts-Abandoned or Unclaimed, <http://www.sec.gov/answers/escheat.htm> (noting that "[a]ll states require financial institutions, including brokerage firms, to report when personal property has been abandoned or unclaimed" and providing that, "[b]efore a brokerage account can be considered abandoned or unclaimed, the firm must make a diligent effort to try to locate the account owner").

Applicants provide no details for this claim, other than to assert that the Supreme Court in *Skilling* "did find" that the "honest services fraud" statute "was unconstitutionally vague and ambiguous." To the contrary, however, the Supreme Court expressly avoided "the due process concerns underlying the vagueness doctrine" in *Skilling* by interpreting the honest services statute as applicable only to bribes and kickbacks.²⁰ Moreover, the constitutionality of that statute is irrelevant here, as this matter does not involve honest services fraud.

Instead, the standard we use for determining whether pleadings in an administrative proceeding are sufficient is whether "the respondent 'understood the issue' and 'was afforded full opportunity' to justify its conduct during the course of the litigation."²¹ That standard is met here, as FINRA's complaint specifies that Applicants violated NASD Rules 2330 and 2110 by acquiring and then liquidating their customers' stock without providing notice or compensation. Applicants, who were represented by counsel at their hearing, had a full opportunity to defend themselves against these core factual allegations and have admitted to all of them.²²

²⁰ 130 S. Ct. at 2931 (examining the scope of the statute concerning "honest services fraud" (18 U.S.C. § 1346) and concluding that the statute is limited to misconduct involving bribes and kickbacks).

²¹ *Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979) (quoting *NLRB v. Mackay Radio & Tel. Co.*, 304 U.S. 333, 350 (1938)). To the extent that Applicants are claiming FINRA denied them due process, we note that courts have held that self-regulatory organizations such as FINRA are not state actors for purposes of due process claims. See, e.g., *Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999) (rejecting due process claim by concluding that "NASD is a private actor, not a state actor"), *cert. denied*, 531 U.S. 1069 (2001); *First Jersey Secs., Inc. v. Bergen*, 605 F.2d 690, 699 n.5 (3d Cir. 1979) (concluding that NASD is not a state agency); see also, e.g., *Timothy H. Emerson, Jr.*, Exchange Act Rel. No. 60328 (July 17, 2009), 96 SEC Docket 18882, 18892 (noting that "as a general matter, self-regulatory organizations ('SROs') are not state actors and thus are not subject to the Constitution's due process requirements").

²² See, e.g., *John M.E. Saad*, Exchange Act Rel. No. 62178 (May 26, 2010), 98 SEC Docket 28591, 28598 (finding that applicant had sufficient notice where he "was represented by counsel since at least the time FINRA issued its complaint [and] had a full opportunity to defend himself against these factual allegations, which he admitted"), *appeal filed*, No. 10-1195 (D.C. Cir. July 23, 2010); *William C. Piontek*, 57 S.E.C. 79, 90-91 (2003) (finding that respondent who "understood the issue[s]" and "was afforded full opportunity" to litigate" them had sufficient notice of the charges against him (quotations and citations omitted)); *Jonathan Feins*, 54 S.E.C. 366, 378 (1999) ("Administrative due process is satisfied where the party against whom the proceeding is brought understands the issues and is afforded a full opportunity to meet the charges during the course of the proceeding.").

For these reasons, we conclude that Applicants misused, and ultimately converted, their customers' securities in violation of NASD Rule 2330. As FINRA accurately observed, "[a] clearer prima facie case of misuse and conversion is difficult to imagine." We similarly conclude that Applicants' actions were contrary to the just and equitable principles of trade mandated by NASD Rule 2110.

IV.

Applicants allege that a wide range of procedural improprieties occurred in this matter. Most of these claims relate to Applicants' assertion that FINRA's proceedings against them were a "mechanism to silence [Applicants'] opposition" to FINRA's creation and policies. Applicants claim that FINRA – and FINRA's Los Angeles office in particular – have "held an animus toward [Biddick] and his firm" and have "a well known history of uneven enforcement with respect to small firms." Applicants assert that FINRA threw "allegation after allegation at Respondents in order to wear Respondents down, and the moment one specious investigation was closed a new one seemed to begin." Applicants claim this harassment continued into their disciplinary hearing, where the hearing officer overseeing their disciplinary hearing (the "Hearing Officer") allegedly "came into and conducted the hearing with overt and unjustified prejudice towards [Applicants]."

We address Applicants' broad claims against FINRA first, and we then turn to Applicants' more specific claims about the Hearing Officer.²³

1. FINRA's Alleged Animus and Impropriety

Applicants' primary complaint against FINRA revolves around allegations that the self-regulatory organization engaged in selective prosecution against Applicants. Applicants claim that FINRA's 2006 examination of Mission "was anything but routine" and allege, without evidentiary support, that FINRA instead undertook an examination of Mission "to intimidate Respondent's [sic] in a continuing unwarranted pattern of harassment" because Applicants had joined The Financial Industry Association, which "had as it's [sic] mission and purpose of [sic] solidifying the interests and representations of small Broker/Dealers."

²³ Applicants make a passing reference to also being "denied their Constitutional Sixth Amendment Rights." Sixth Amendment protections, however, "are explicitly confined to 'criminal prosecutions.'" *Austin v. United States*, 509 U.S. 602, 608 (1993) (quoting *United States v. Ward*, 448 U.S. 242, 248 (1980)). This is not a criminal prosecution, and Applicants neither explain which right under the Sixth Amendment they were denied nor describe how they were deprived of that right. Our own review of the record uncovered no evidence of any Sixth Amendment violations. And as noted above, Applicants were represented by counsel during the FINRA proceedings.

To prevail on such a claim, Applicants must prove they were "singled out for enforcement action while others similarly situated were not and that [their] selection as a target for enforcement was based on an unjustifiable consideration such as [] race, religion, national origin, or the exercise of constitutionally protected rights."²⁴ Here, the record shows only that FINRA conducted a fair exam, during which it uncovered Applicants' violation of NASD Rules 2330 and 2110. And to the extent Applicants are arguing malicious prosecution, the record shows only that FINRA had ample cause to bring this action against Applicants.²⁵

Applicants also complain that FINRA, along with the Commission, failed to investigate purported price manipulation of Chartwell stock. The relevance of this allegation is unclear. Applicants liquidated their customers' Chartwell shares over several months, yet complain only about manipulation with respect to "a single trade of 100 shares, thirty days after the [Chartwell] transfer took place." Moreover, Applicants provide no evidence that any price manipulation took place, other than to argue – without documentation – that Chartwell shares traded with a \$2 spread between the bid and offer price on that single day. Whether or not market manipulation took place, Applicants netted \$38,946 from the improper sale of their customers' stock. Applicants cannot avoid blame for their failure to comply with NASD rules by blaming

²⁴ *Scott Mathias*, Exchange Act Rel. No. 61120 (Dec. 7, 2009), 97 SEC Docket 23228, 23243-44 (rejecting applicant's claim that NASD engaged in selective prosecution); *see also, e.g., Fog Cutter Capital Group Inc. v. SEC*, 474 F.3d 822, 826 (D.C. Cir. 2007) (holding that, to make a claim of selective prosecution against NASD, respondent must establish that he was part of a protected class under the Equal Protection Clause, "that prosecutors acted with bad intent, [and] that similarly situated individuals outside the protected category were not prosecuted" (quoting *United States v. Armstrong*, 517 U.S. 456, 465 (1996))); *United States v. Huff*, 959 F.2d 731, 735 (8th Cir. 1992) (setting forth elements of selective prosecution claim); *Scott Epstein*, Exchange Act Rel. No. 59328 (Jan. 30, 2009), 95 SEC Docket 13833, 13856 n.44 (same), *appeal filed*, No. 09-1550 (3d Cir. Feb. 24, 2009); *CMG Inst'l. Trading, LLC*, Exchange Act Rel. No. 59325 (Jan. 30, 2009), 95 SEC Docket 13802, 13813 n.34 (same); *Robert Radano*, Investment Advisers Act Rel. No. 2750 (June 30, 2008), 93 SEC Docket 7495, 7510 n.74 (same).

²⁵ *Cf. Hart v. Parks*, 450 F.3d 1059, 1071 (9th Cir. 2006) (stating that a malicious prosecution claim under 42 U.S.C. § 1983 requires a lack of probable cause); *HMS Capital, Inc. v. Lawyers Title Co.*, 12 Cal. Rptr. 3d 786, 793 (Cal. Ct. App. 2004) (stating that a plaintiff establishes a claim of malicious prosecution under California law by showing that an action "(1) was commenced by or at the direction of the defendant, or the defendant continued to prosecute it after discovering it lacked probable cause, and it was pursued to a legal termination in plaintiff's favor; (2) was brought without probable cause; and (3) was initiated with malice").

regulators, nor can Applicants diminish the wrongfulness of their actions by claiming that others also engaged in wrongdoing.²⁶

Applicants also argue (for the first time in their Reply Brief) that the disciplinary action should be set aside because FINRA and the NAC violate the separation of powers under the U.S. Constitution. In support, Applicants point to the recent U.S. Supreme Court decision, *Free Enterprise Fund v. Public Co. Accounting Oversight Board*, in which the Supreme Court held that certain limitations on the removal of members of the Public Company Accounting Oversight Board ("PCAOB") contravened the Constitution's separation of powers.²⁷ According to Applicants, FINRA is similarly flawed because it "is authorized by and overseen by the Securities [and] Exchange Commission, much like and in the same manner as the Public Company Accounting Oversight Board." Applicants thus claim that "the same infirmities that plague PCAOB plague FINRA" and that, "for this reason alone and because of the blatant abuse of unchecked power wielded by FINRA[,] their order should be overturned."

The Supreme Court's decision in *Free Enterprise Fund*, however, is not as broad as Applicants contend. The Supreme Court held only that the provisions regarding removal of PCAOB members were unconstitutional, but that all other aspects of the PCAOB should remain in effect.²⁸ Moreover, *Free Enterprise Fund* is not applicable here. FINRA does not exercise federal executive power, and, in fact, the Supreme Court expressly distinguished the PCAOB from self-regulatory organizations when reaching its decision.²⁹ FINRA is instead registered

²⁶ Cf. *Janet Gurley Katz*, Exchange Act Rel. No. 61449 (Feb. 1, 2010), 97 SEC Docket 25074, 25101 ("Katz cannot shift the blame for her violations to others or claim that others' misconduct somehow excuses her own misdeeds"), *appeal filed*, No. 10-1068 (D.C. Cir. Mar. 26, 2010); *John D. Audifferen*, Exchange Act Rel. No. 58230 (July 25, 2008), 93 SEC Docket 8129, 8141 (holding that an applicant "cannot shift the blame for his violations to his firm"); *Donner Corp. Int'l*, Exchange Act Rel. No. 55313 (Feb. 20, 2007), 90 SEC Docket 11, 37 (holding that "a broker-dealer cannot shift its responsibility for compliance with applicable requirements to the NASD"); *Barry C. Wilson*, 52 S.E.C. 1070, 1073 n.12 (1996) (noting that "failings on the part of certain firm personnel do not excuse misconduct by others").

²⁷ ___ U.S. ___, ___, 130 S. Ct. 3138, 3161 (2010).

²⁸ *Free Enter. Fund*, 130 S. Ct. at 3161-62 (holding that "[t]he Sarbanes-Oxley Act remains 'fully operative as a law' with these tenure restrictions excised" (citations omitted)).

²⁹ *Id.* at 3147 ("Unlike the self-regulatory organizations . . . the Board is a Government-created, Government-appointed entity, with expansive powers to govern an entire industry.").

under, and operates subject to, Section 15A of the Exchange Act,³⁰ which the Supreme Court has noted, "supplements the [S]ecurities and Exchange Commission's regulation of the over-the-counter markets by providing a system of cooperative self-regulation."³¹ Although Section 15A authorizes the SEC to exercise a "significant oversight function" over registered associations,³² self-regulatory organizations, such as FINRA, are not "Government-created, Government-appointed entit[ies]."³³ FINRA, therefore, is not "contrary to Article 2 of the Constitution's vesting of executive power in the President," as Applicants contend.

Applicants also complain more specifically about FINRA's actions during the hearing itself. For example, Applicants contend that FINRA, "in an effort to confuse the Hearing Panel[,] proffered exhibits that did not support any allegation and were consequently stricken from the record." Applicants, however, do not explain – nor can we find any evidence that suggests – how these proffered exhibits prejudiced their case, particularly given that the Hearing Officer ruled in Applicants' favor and declined to introduce the documents into evidence.

Applicants also complain that the testimony of a FINRA examiner during their hearing was "replete with inaccuracies and misstatements." Specifically, Applicants claim that the examiner misstated the net capital rule during cross-examination. We have no found evidence, however, of misstatements by the examiner in the record.³⁴ Moreover, the net capital rule is not at issue on appeal, as FINRA declined to make findings with respect to the rule in its decision.

Applicants also argue that the examiner lied when she testified that Biddick had told FINRA staff he had journaled Chartwell stock for tax reasons. Such a claim is not relevant. The record provides no definitive evidence of what Biddick first told FINRA staff (such as a tape recording), and our finding that Applicants misused customer securities does not depend on this testimony by the examiner.

³⁰ 15 U.S.C. § 78o-3.

³¹ *United States v. NASD*, 422 U.S. 694, 700 n.6 (1975) (statutory citations omitted).

³² *Id.*

³³ *Free Enter. Fund*, 130 S. Ct. at 3142 (contrasting "expansive powers" granted to the Public Company Accounting Oversight Board with the more limited powers granted to self-regulatory organizations).

³⁴ In fact, in the one passage to which Applicants cite, the examiner made no statement about the net capital rule at all. She was simply responding to a question from Applicants' counsel about the rule, to which she answered that she did not understand his question and that "I would have to be able to see the rule, actually, to be able to answer that, quite honestly."

2. The Hearing Officer's Alleged Bias

We next turn to Applicants' claim that the Hearing Officer displayed "[u]nquestionable overt prejudice" during the hearing. The Applicants hang their assertion of bias largely on a single statement from the Hearing Panel's decision, which stated: "After Centex was expelled from FINRA membership for sales practice violations, Biddick's brother and certain other Centex representatives became associated with Mission."

Applicants claim that "[n]owhere in the transcript has anyone testified that my brother worked for Mission." Applicants' argument is without merit. To prevail on a claim of adjudicatory prejudice, Applicants must meet two prongs: the Hearing Officer's supposed bias must "stem[] from an extrajudicial source *and* result[] in a decision on the merits based on matters other than those gleaned from participation in a case."³⁵ Applicants meet neither prong. The source of the Hearing Panel's statement, for example, appears to have been Biddick's own testimony. Biddick expressly stated that his brother had an interest in Mission at its inception and that Biddick bought out that interest "around" 1999. Thus, the most that can be said about the Hearing Panel's statement is that the timing of the brother's association may be wrong: Biddick claims his brother was associated with Mission sometime in the 1990s, while the Hearing Panel's decision states it was after Centex was expelled from FINRA membership, which occurred in 2002. But even Applicants are not entirely consistent about when Biddick's brother was associated with the Firm.³⁶

Regardless, the Hearing Panel's statement has no bearing on any decision on the merits in this matter, as the statement served only as background in the Hearing Panel's discussion about how Mission came to be formed and was made only in connection with the panel's discussion of the alleged Taping Rule violations, violations that both the Hearing Panel and the NAC declined to reach because of Applicants' "clear violation of Rules 2330 and 2110."

Applicants claim the Hearing Officer also exhibited bias when he "deliberately and with malice quashed most of Respondents [sic] efforts to introduce vital documentation of facts as evidence and testimony from any Respondents [sic] witness." Our review of the record, however, uncovers no evidence of improper conduct by the Hearing Officer. "[A]dverse rulings,

³⁵ *Epstein*, 95 SEC Docket at 13860-61 (emphasis added).

³⁶ As already noted, Biddick testified at his hearing that his brother was associated with Mission "around" 1999. In their opening appellate brief, however, Applicants assert that the brother "dropped his association with the, then [sic] pending approval of the Broker/Dealer in 1997." In their reply brief, Applicants claim that "Biddick's brother was affiliated with Mission Securities for a brief time in 1996."

by themselves, generally do not establish improper bias,"³⁷ and the Hearing Officer gave Applicants repeated opportunities to introduce relevant evidence, including after Applicants failed to adhere to the Hearing Officer's pre-hearing scheduling order. Moreover, we have allowed Applicants to introduce all the documents they sought to adduce on appeal, and "our *de novo* review, in which we have carefully considered all of the evidence in the case and the transcripts of the proceedings below, 'dissipates even the possibility of unfairness."³⁸

We similarly find no evidence of bias regarding the Hearing Officer's decision not to allow Applicants' proposed witness. Applicants claim, for example, that the Hearing Officer ruled that certain FINRA officials (whom Applicants wished to call as witnesses) were not subject to FINRA's jurisdiction. To the contrary, the Hearing Officer expressly agreed with Applicants that he had the "inherent authority" to order FINRA employees to testify if they had relevant, material, and non-cumulative information. The Hearing Officer instead denied Applicants' request to call the witnesses because Applicants proffered only that the witnesses would testify about how they had either "declined to advise Respondents about how to comply with the Taping Rule" or told Applicants where to find recording equipment. The Hearing Officer reasonably concluded that none of this proposed testimony was relevant and, to the extent that the evidence might be relevant, Applicants' own "motion makes it clear that Biddick himself is fully competent to testify as to their content, since he was directly involved in each communication."³⁹ Moreover, because FINRA ultimately declined to make findings regarding Applicants' alleged failure to comply with the Taping Rule, the FINRA officials' proposed testimony has no relevance to the merits of this appeal.

Applicants also sought to call John Busacca, an employee of North American Clearing, to testify as an expert. The Hearing Officer denied their request and, according to Applicants, allegedly stated, while off the record, that "I know Mr. Busacca, and we don't want to hear from Mr. Busacca in this case." Applicants now argue that the Hearing Officer's decisions were infected by a conflict of interest because the Hearing Officer presided as the hearing officer in a subsequent, unrelated disciplinary proceeding against Busacca.⁴⁰ Applicants contend that the "Hearing Officer should have disclosed this conflict of interest and recuse [sic] himself

³⁷ *Mitchell M. Maynard*, Advisers Act Rel. No. 2875 (May 15, 2009), 95 SEC Docket 16844, 16856 (internal quotations and citation omitted).

³⁸ *Epstein*, 95 SEC Docket at 13862 (quoting *Robert Tretiak*, 56 S.E.C. 209, 232 (2003)).

³⁹ See *supra* note 26 and accompanying text (noting that Applicants cannot shift their failure to comply with FINRA rules to regulators).

⁴⁰ See generally *John B. Busacca, III*, Exchange Act Rel. No. 63312 (Nov. 12, 2010), ___ SEC Docket ___ (sustaining FINRA's finding that Busacca failed to exercise reasonable supervision over North American's back-office operations).

immediately." The mere fact that the Hearing Officer was to preside in Busacca's disciplinary hearing on unrelated violations, however, does not evidence bias in this case against Applicants.

To the contrary, the record indicates that the Hearing Officer's exclusion of Busacca's proposed testimony was a reasonable application of his power to exclude irrelevant or immaterial evidence.⁴¹ For example, Applicants contend that Busacca would have testified about the handling of worthless securities and that "[i]n a perfect world Respondent's [sic] were entitled to have the debits it paid on behalf of clients that were charged by the clearing firms credited back." As discussed earlier, however, Chartwell was not a worthless security and Applicants were not seeking credit for fees. Applicants instead were seizing and then liquidating their customers' shares to pay firm operating costs, and doing so without notice or authorization.

Applicants claim Busacca would also have testified "with respect to returned mail" from the customers and about "the abandoned accounts and the problems caused by such abandonment." As noted earlier, however, the evidence indicates that customers had not abandoned their accounts, and, regardless, state law requires holders of abandoned property to take certain steps that Applicants did not take. Applicants also contend that Busacca would have testified that Applicants' proceeds from selling their customers' shares resided with a receiver and that, as a result, "expos[ed] not one of the firms' [sic] customers to any risk or harm." As already discussed, however, Applicants did cause their customers harm by depriving them of access to their securities or proceeds from Applicants' unauthorized liquidation of Chartwell shares, regardless of whether some proceeds of Applicants' sales may reside with a receiver.⁴²

V.

FINRA expelled Mission, barred Biddick in all capacities, and ordered Mission and Biddick to disgorge \$38,946.06 in ill-gotten gains and to pay such proceeds, plus interest, to the thirteen Mission customers to whom Applicants never returned the Chartwell shares.⁴³ In doing so, FINRA noted that its Sanction Guidelines recommend that FINRA consider a bar for improper use of a customer's securities and, where the misuse involves conversion, that a bar is

⁴¹ NASD Rule 9263(c) – now recodified as FINRA Rule 9263(a) – provides that a Hearing Officer may exclude irrelevant, immaterial, or unduly repetitious evidence.

⁴² Applicants also allege that the Hearing Officer afforded FINRA "a greater advantage in this hearing . . . [because] the Hearing Officer . . . was paid a yearly salary by FINRA of over \$1 Million Dollars [sic]." The Hearing Officer's asserted pay standing alone, however, is not evidence of bias, and we see no other evidence of bias in the record. And, as stated above, our *de novo* review "dissipates even the possibility of unfairness." See *supra* note 38 and accompanying text.

⁴³ According to FINRA, Biddick is no longer associated with a FINRA member firm, and Mission is no longer in business.

the standard sanction, regardless of the amount converted.⁴⁴ Exchange Act Section 19(e)(2) directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive, or impose an unnecessary or inappropriate burden on competition.⁴⁵ Applicants' conduct was egregious, and we see no basis for setting aside FINRA's imposition of sanctions here.

As we stated in a different case, but is equally applicable in this matter, "respondents' misconduct – and their continued refusal to acknowledge wrongdoing – demonstrates either that they fundamentally misunderstand the regulatory obligations to which they are subject or that they hold those obligations in contempt."⁴⁶ Here, Applicants deliberately took their customers' property, without notice, and then sold that property and used the proceeds to pay the Firm's operating expenses. This was not an isolated event, but rather a course of conduct that took place over an entire year. Applicants also attempted to conceal their misconduct by, for example, telling one customer, Narasimhan, that his Chartwell shares had little or no value, while at the same time selling Chartwell stock out of the Firm's account at prices ranging from \$2.25 to \$4 per share.⁴⁷

⁴⁴ FINRA Sanction Guidelines 38 (2007). The Sanction Guidelines define conversion "generally [a]s an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to possess it." *Id.* at n.2. Although the Commission is not bound by FINRA's guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2). *Paz Sec., Inc.*, Exchange Act Rel. No. 57656 (April 11, 2008), 93 SEC Docket 5122, 5125, *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009).

⁴⁵ 15 U.S.C. § 78s(e)(2). Applicants do not specifically contest FINRA's imposition of sanctions, and the record does not show that FINRA's sanctions imposed an undue burden on competition.

⁴⁶ *Barr Fin.*, 56 S.E.C. at 1261-62 (affirming bar and expulsion).

⁴⁷ *See, e.g., Geoffrey Ortiz*, Exchange Act Rel. No. 58416 (Aug. 22, 2008), 93 SEC Docket 8977, 8989-90 (affirming bar where representative attempted to conceal misconduct by supplying false information during an investigation); *Gregory W. Gray, Jr.*, Exchange Act Rel. No. 60361 (July 22, 2009), 96 SEC Docket 19038, 19053 (affirming imposition of sanctions by considering aggravating factors, including that applicant sought to conceal his conduct); *Fox & Co. Invs.*, 58 S.E.C. 873, 896-98 (2005) (finding imposition of a bar to be neither excessive nor oppressive where applicants, among other things, concealed their conduct); *Robin Bruce McNabb*, 54 S.E.C. 917, 928-29 (2000) (sustaining bar where applicant attempted to conceal his misconduct), *aff'd*, 298 F.3d 1126 (9th Cir. 2002).

Not only was Applicants' initial conversion of customer property a blatant violation of NASD rules, but Applicants' subsequent justifications are equally troubling. Applicants admit, for instance, that they took their customers' property, but claim they were justified because they did so for the Firm's benefit. Even now, Applicants continue to deny that they did anything wrong. Applicants provide no assurances that they will not repeat their misconduct and, in fact, complain on appeal that FINRA "had no right" to order them to stop selling their customers' converted Chartwell shares.⁴⁸

A bar and expulsion are severe sanctions. Applicants' demonstrated lack of fitness to be in the securities industry, however, supports the remedial purpose to be served by such sanctions. Applicants represent a clear danger to the investing public if they remain in the securities industry, and, as FINRA accurately observed in its decision, "expelling Mission and barring Biddick in all capacities are the only effective remedial sanctions."⁴⁹

We also find FINRA's order that Applicants disgorge their ill-gotten gains and pay those proceeds to the injured customers to be an appropriate remedy. Where a broker-dealer has benefitted from violating FINRA rules, we encourage self regulatory organizations "to use [their] remedial powers to return to investors funds lost in cases where, as here, a professional has acquired a benefit by failing to meet his obligations."⁵⁰

⁴⁸ At some point after FINRA's investigation of Applicants began, FINRA advised Biddick to stop liquidating the Chartwell stock because Mission had exceeded the number of trades it was entitled to execute per year based on its net capital requirements. Biddick testified at his disciplinary hearing that he followed this advice, because "I take the advice of FINRA staff."

⁴⁹ See *James C. Dawson*, Advisers Act Rel. No. 3057 (July 23, 2010), 98 SEC Docket 30706 (affirming bar by noting, in part, the Commission's concern "about the possibilities any participation by Dawson in the investment advisory industry would present for future violations, and our concern that Dawson's lack of appreciation for the wrongful nature of his conduct increases the likelihood of recurrence"); *Paz Secs.*, 93 SEC Docket at 5131-33 (holding that a bar was an appropriate sanction, in part, because applicants' "cavalier" attitude "poses a clear risk of future misconduct").

⁵⁰ *David Joseph Dambro*, 51 S.E.C. 513, 518 (1993) (affirming restitution order and discussing the "related context of disgorgement"); see also *Michael David Sweeney*, 50 S.E.C. 761, 769 (1991) (noting that the Commission "fully endorse[s]" the policy of payment of disgorgement).

For these reasons, we find that FINRA's decision to expel Mission, to bar Biddick, and to order disgorgement is neither excessive nor oppressive and that the sanctions serve a remedial rather than a punitive purpose.

An appropriate order will issue.⁵¹

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

Elizabeth M. Murphy
Secretary


By Florence E. Harmon
Deputy Secretary

⁵¹ We have considered all of the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63453 / December 7, 2010

Admin. Proc. File No. 3-13841

In the Matter of the Application of
MISSION SECURITIES CORPORATION
and
CRAIG M. BIDDICK

c/o Craig M. Biddick
P.O. Box 3038
Rancho Santa Fe, CA 92067

For Review of Disciplinary Action Taken by
FINRA

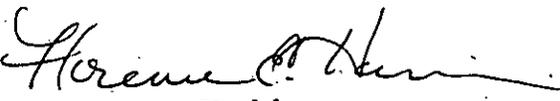
ORDER SUSTAINING DISCIPLINARY ACTION

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

ORDERED that the disciplinary action taken by the Financial Industry Regulation Authority against Mission Securities Corporation and Craig M. Biddick be, and hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary


Florence E. Harmon
Deputy Secretary

*Chairman Schapiro
not participating*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 63456 / December 7, 2010

Admin. Proc. File No. 3-13655

In the Matter of

THEODORE W. URBAN

ORDER DENYING
MOTION FOR
SUMMARY AFFIRMANCE

I.

On September 8, 2010, an administrative law judge issued an initial decision dismissing administrative proceedings against Theodore W. Urban, formerly general counsel, executive vice president, and member of the Board of Directors of Ferris Baker Watts, Inc. ("FBW" or the "Firm"), a registered broker-dealer and investment adviser.¹ In her decision, the law judge concluded that Urban should not be sanctioned, under Sections 15(b)(4)(E) and 15(b)(6) of the Securities Exchange Act of 1934² and Section 203(f) of the Investment Advisers Act of 1940,³ for supervisory failure.⁴ The law judge therefore dismissed the proceedings. Urban now moves

¹ FBW was acquired by the Royal Bank of Canada in 2008 and now operates under the name RBC Wealth Management.

² 15 U.S.C. §§ 78o(b)(4)(E), (b)(6).

³ 15 U.S.C. § 80b-3(f).

⁴ These provisions authorize the Commission to impose sanctions on associated persons of brokers and dealers or investment advisers when the person "has failed reasonably to supervise, with a view to preventing violations" of the federal securities laws "another person who commits such a violation, if such other person is subject to his supervision."

that we summarily affirm the law judge's decision.⁵ For the reasons discussed below, we decline to do so.

II.

This case involves allegations that Urban failed to supervise Stephen Glantz, a top-producing FBW salesperson. The law judge found that Glantz violated the antifraud provisions of the securities laws based on various misconduct and that Urban supervised him; however, the law judge declined to hold Urban liable for supervisory failure because she concluded that Urban, who had sought to have Glantz terminated, acted reasonably under the circumstances. In particular, the law judge found that Urban reasonably relied on the Firm's director of retail sales, Louis Akers, to exercise heightened supervision over Glantz once indications of Glantz's misconduct were made known. Moreover, even if reliance on Akers to supervise Glantz was unreasonable, Urban could not be faulted, the law judge found, for failing to raise concerns about Glantz with the Firm's Chief Executive Officer or its Board of Directors because Urban reasonably believed that they would simply defer to Akers, who had opposed Urban's recommendation that Glantz be terminated.

Urban urges us to summarily affirm the law judge's decision because, after having "lived under a cloud for four years" and having "invested thousands of hours in an extended hearing," he believes "the evidence, the law, and common decency require that the Commission say that enough is enough." In support of his motion, Urban argues, among other things, that Commission review of the matter would be essentially redundant because a determination of whether a supervisor acted reasonably under Exchange Act Section 15(b) is "so fact intensive [that] the Commission must necessarily defer to the findings of an administrative law judge who hears the facts firsthand," "especially . . . where, as here, an assessment of the credibility of the witnesses is key to the factual outcome." Urban also argues that the law judge committed no error in finding that Urban was reasonable in deciding not to elevate to the CEO or the Firm's Board of Directors the issue of Glantz's recommended termination and subsequent special supervision arrangement. Instead, he argues, the law judge's recognition of a "futility defense" is consistent with current legal requirements, analogous standards of professional conduct, and Commission case law noting that attorneys have not been sanctioned "in litigated enforcement proceedings based on alleged negligent acts or omissions they may have committed in providing non-public legal advice to clients."⁶

⁵ The Division filed a petition for review of the law judge's decision. In response, Urban filed a motion asking the Commission to deny the Division's petition or, alternatively, to grant his own cross-petition for review of the law judge's decision. Both petitions for review were granted on October 22, 2010; and a schedule for briefing was established.

⁶ Citing *Scott G. Monson*, Investment Company Act Rel. No. 28323 (June 30, 2008), 93 SEC Docket 7517, 7524.

The Division opposes Urban's motion, stating that summary affirmance has been granted "only a handful of times in the last 30 years," which are "readily distinguishable from this case, which involves a lengthy record, complex issues of law and fact, significant policy and programmatic implications, and a detailed Cross-Petition alleging numerous prejudicial errors." The Division urges that the initial decision should be reviewed because it "is inconsistent with prior Commission precedent," "significantly lower[s] the standards that must be met by supervisors at brokers, dealers, and investment advisers," and "fails to protect the investing public through the imposition of sanctions against Urban." In support of its position, the Division argues that the law judge departed from applicable precedent in finding that Urban's supervision was reasonable because, the Division argues, Urban failed to respond adequately "[d]espite regularly receiving red flags regarding Glantz." The Division also objects to the law judge's finding that "Urban is legally excused from elevating the supervisory breakdown and red flags surrounding Glantz to FBW's chief executive officer . . . and board of directors, because it would have been futile for him to do so." According to the Division, this "creates an entirely new 'futility' defense within the law of supervision cases" and would "eviscerate the protections provided by existing law and permit supervisors at even the most corrupt firms to escape liability."

III.

Commission Rule of Practice 411(e) governs our review of motions for summary affirmance.⁷ In pertinent part, that rule provides that "[t]he Commission may grant summary affirmance if it finds that no issue raised in the initial decision warrants consideration by the Commission of further oral or written argument." The rule further provides that we "will decline to grant summary affirmance upon a reasonable showing that . . . the decision embodies an exercise of discretion or decision of law or policy that is important and that the Commission should review." We have previously noted that "[s]ummary affirmance is rare, given that generally we have an interest in articulating our views on important matters of public interest and the parties have a right to full consideration of those matters."⁸ Summary affirmance is appropriate when it is clear that "submission of briefs by the parties will not benefit us in reaching a decision."⁹

Based on our own preliminary review of the record, and given the important matters of public interest this case presents, summary affirmance does not appear appropriate here. As a

⁷ 17 C.F.R. § 201.411(e).

⁸ *Salvatore F. Sodano*, Order Denying Motion for Summary Affirmance, Securities Exchange Act Rel. No. 56961 (Dec. 13, 2007), 92 SEC Docket 469, 471, citing *Richard Cannistraro*, 53 S.E.C. 388, 389 n.3 (1998); see also *Terry T. Steen*, 52 S.E.C. 1337, 1338 (1997) (denying summary affirmance and noting that such action is appropriate only where there are "compelling reasons").

⁹ *Cannistraro*, 53 S.E.C. at 389 n.3.

general matter, we note that Commission review of the findings and conclusions of an initial decision is conducted *de novo*.¹⁰ We note further that, although the Commission grants "considerable weight and deference" to credibility determinations of the law judges,¹¹ those determinations are not sacrosanct.¹² Moreover, the proceeding raises important legal and policy issues, including whether Urban acted reasonably in supervising Glantz and responded reasonably to indications of his misconduct, whether securities professionals like Urban are, or should be, legally required to "report up," and whether Urban's professional status as an attorney and the role he played as FBW's general counsel affect his liability for supervisory failure.

Under the circumstances, it appears appropriate to consider the record and the parties' arguments as part of the normal appellate process rather than the abbreviated process involved with a summary affirmance. We will therefore deny Urban's motion, though our denial should not be construed as suggesting any view as to the outcome of this case.

¹⁰ *Gary M. Kornman*, Exchange Act Rel. No. 59403 (Feb. 13, 2009), 95 SEC Docket 14246, 14260 n.44, *pétition denied*, 592 F.3d 173 (D.C. Cir. 2010); *see also* Rule of Practice 411(a), 17 C.F.R. § 201.411(a) ("The 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.").

To the extent that Urban suggests in support of his motion that an initial decision dismissing administrative proceedings is akin to a trial court dismissing proceedings against a criminal defendant and therefore "findings in favor of a respondent must also be given great weight," we find no support in the law for this deference, and indeed, Urban cites to none. Our rules make no distinction between initial decisions that favor respondents versus Commission staff, and we are aware of no Commission appeal that has been decided in this fashion.

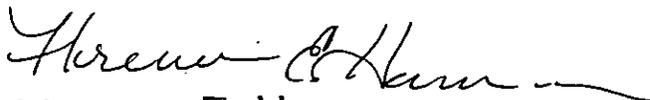
¹¹ *Leslie A. Arouh*, Exchange Act Rel. No. 50889 (Dec. 20, 2004), 84 SEC Docket 1880, 1893 n.40; *see also Anthony Tricarico*, 51 S.E.C. 457, 460 (1993).

¹² *Kenneth R. Ward*, 56 S.E.C. 236, 260 (2003) ("While we have held that a fact finder's 'explicit credibility' findings are to be accorded 'considerable weight,' we do not accept such findings 'blindly.' Rather, there are circumstances where, in the exercise of our review function, we must disregard explicit determinations of credibility.") (internal citations omitted), *aff'd*, 75 F. App'x. 320 (5th Cir. 2003).

Accordingly, it is ORDERED that the motion for summary affirmance by Theodore W. Urban be, and it hereby is, denied.

By the Commission.

Elizabeth M. Murphy
Secretary



By: Florence E. Harmon
Deputy Secretary

The Fund Administrator submitted a Final Accounting pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans, which was approved by the Commission. Pursuant to the Administrator's Final Accounting, all liabilities have been satisfied and \$11,164.26 in residual funds will be transmitted to the U.S. Treasury.

Accordingly, IT IS ORDERED that the Disgorgement Fund is terminated and the Fund Administrator is discharged.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038-AD06

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-63452; File No. S7-39-10]

RIN 3235-AK65

Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant."

AGENCIES: Commodity Futures Trading Commission; Securities and Exchange Commission.

ACTION: Joint proposed rule; proposed interpretations.

SUMMARY: In accordance with Section 712(d)(1) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, the "Commissions"), in consultation with the Board of Governors of the Federal Reserve System, are proposing rules and interpretative guidance under the Commodity Exchange Act ("CEA"), 7 U.S.C. § 1 et seq., and the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a et seq., to further define the terms "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible contract participant."

DATES: Submit comments on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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

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CFTC:

- *Agency website*, via its Comments Online process: <http://comments.cftc.gov>.

Follow the instructions for submitting comments through the web site.

- *Mail*: David A. Stawick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- *Hand Delivery/Courier*: Same as mail above.
- *Federal eRulemaking Portal*: Comments also may be submitted at <http://www.regulations.gov>. Follow the instructions for submitting comments.

“Definitions” must be in the subject field of responses submitted via e-mail, and clearly indicated on written submissions. All comments must be submitted in English, or if not, accompanied by an English translation. All comments provided in any electronic form or on paper will be published on the CFTC website, without review and without removal of personally identifying information. All comments are subject to the CFTC Privacy Policy.

SEC:**Electronic comments:**

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-39-10 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 S7-39-10. 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: CFTC: Mark Fajfar, Assistant General Counsel, at 202-418-6636, mfajfar@cftc.gov, Julian E. Hammar, Assistant General Counsel, at 202-418-5118, jhammar@cftc.gov, or David E. Aron, Counsel, at 202-418-6621, daron@cftc.gov, Office of General Counsel, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581; SEC: Joshua Kans, Senior Special Counsel, Jeffrey Dinwoodie, Attorney Advisor, or Richard Grant, Attorney Advisor, at 202-551-5550, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:**I. Background**

On July 21, 2010, President Obama signed the Dodd-Frank Act into law.¹ Title VII of the Dodd-Frank Act² established a comprehensive new regulatory framework for swaps and security-based swaps. The legislation was enacted, among other reasons, to reduce risk, increase transparency, and promote market integrity within the financial system, including by: (1) providing for the registration and comprehensive regulation of swap dealers, security-based swap dealers, major swap participants and major security-based swap participants; (2) imposing clearing and trade execution requirements on swaps and security-based swaps, subject to certain exceptions; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the rulemaking and enforcement authorities of the Commissions with respect to, among others, all registered entities and intermediaries subject to the Commissions' oversight.

More specifically, the Dodd-Frank Act provides that the CFTC will regulate "swaps," and the SEC will regulate "security-based swaps." The Dodd-Frank Act also adds to the CEA and Exchange Act definitions of the terms "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible contract participant." These terms are defined in Sections 721 and 761 of the Dodd-Frank Act and, with respect to the term "eligible contract participant," in

¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

² Pursuant to Section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

Section 1a(18) of the CEA,³ as re-designated and amended by Section 721 of the Dodd-Frank Act.

Section 712(d)(1) of the Dodd-Frank Act provides that the CFTC and the SEC, in consultation with the Board of Governors of the Federal Reserve System, 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.” 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 SEC 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 security-based swaps, for the purpose of including transactions and entities that have been structured to evade Title VII of the Dodd-Frank Act.⁴

In light of the requirements in the Dodd-Frank Act noted above, the CFTC and the SEC issued a joint Advance Notice of Proposed Rulemaking (“ANPRM”) on August 13, 2010, requesting public comment regarding the definitions of “swap,” “security-based swap,” “security-based swap agreement,” “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant,” and “eligible contract

³ See 7 U.S.C. 1a(18).

⁴ The definitions of the terms “swap,” “security-based swap,” and “security-based swap agreement,” and regulations regarding mixed swaps are the subject of a separate rulemaking by the Commissions.

participant” in Title VII of the Dodd-Frank Act.⁵ The Commissions reviewed more than 80 comments in response to the ANPRM. The Commissions also informally solicited comments on the definitions on their respective websites.⁶ In addition, the staffs of the CFTC and the SEC have met with many market participants and other interested parties to discuss the definitions.⁷

In this release, the Commissions propose to further define “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant” and “eligible contract participant,” and propose related rules, and also discuss certain factors that are relevant to market participants when determining their status with respect to the defined terms. In developing these proposals, the Commissions have been mindful that the markets for swaps and security-based swaps are evolving, and that the rules that we adopt will, as intended by the Dodd-Frank Act, significantly affect those markets. The rules not only will help determine which entities will be subject to comprehensive regulation of their swap and security-based swap activities, but may also cause certain entities to modify their activities to avoid being subject to the regulations. As a result, we are aware of the importance of crafting these rules carefully to maximize the benefits of the regulation imposed by the Dodd-Frank Act, and to do so in a way that is flexible enough to respond to market developments. While we preliminarily believe

⁵ See Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Rel. No. 34-62717, 75 FR 51429 (Aug. 20, 2010). The comment period for the ANPRM closed on September 20, 2010.

⁶ Comments were solicited by the CFTC at http://www.cftc.gov/LawRegulation/DoddFrankAct/OTC_2_Definitions.html and the SEC at <http://www.sec.gov/spotlight/regreformcomments.shtml>.

⁷ The views expressed in the comments in response to the ANPRM, in response to the Commissions’ informal solicitation, and at such meetings are collectively referred to as the views of “commenters.”

that these proposals, if adopted, would appropriately effect the intent of the Dodd-Frank Act, we are very interested in commenters' views as to whether we have achieved this purpose, and, if not, how to improve these proposals.⁸

II. Definitions of "swap dealer" and "security-based swap dealer"

The Dodd-Frank Act defines the terms "swap dealer" and "security-based swap dealer" in terms of whether a person engages in certain types of activities involving swaps or security-based swaps.⁹ Persons that meet either of those definitions are subject to statutory requirements related to, among other things, registration, margin, capital and business conduct.¹⁰

The two definitions in general encompass persons that engage in any of the following types of activity:

- (i) holding oneself out as a dealer in swaps or security-based swaps,
- (ii) making a market in swaps or security-based swaps,

⁸ In addition, we recognize that the appropriateness of these proposals also should be considered in light of the substantive requirements that will be applicable to dealers and major participants, including capital, margin and business conduct requirements, which are the subject of separate rulemakings. For example, whether the definition of a major participant is too broad or too narrow may well depend in part on the substantive requirements applicable to such entities, and whether those substantive requirements are themselves appropriate may in turn depend in part on the scope of the major participant definition. We therefore encourage comments that take into account the interplay between the proposed definitions and these substantive requirements.

⁹ See Section 721 of the Dodd-Frank Act (defining "swap dealer" in new Section 1a(49) of the CEA, 7 U.S.C. 1a(49)) and Section 761 of the Dodd-Frank Act (defining "security-based swap dealer" in new Section 3(a)(71) of the Exchange Act, 15 U.S.C. 78c(a)(71)).

¹⁰ The Dodd-Frank Act excludes from the Exchange Act definition of "dealer" persons who engage in security-based swap transactions with eligible contract participants. See Section 3(a)(5) of the Exchange Act, 15 U.S.C. 78c(a)(5), as amended by Section 761(a)(1) of the Dodd-Frank Act.

The Dodd-Frank Act does not include comparable amendments for persons who act as brokers in swaps and security-based swaps. Because security-based swaps are a type of security, persons who act as brokers in connection with security-based swaps must, absent an exemption, register with the SEC as a broker pursuant to Exchange Act section 15(a), and comply with the Exchange Act's requirements applicable to brokers.

- (iii) regularly entering into swaps or security-based swaps with counterparties as an ordinary course of business for one's own account, or
- (iv) engaging in activity causing oneself to be commonly known in the trade as a dealer or market maker in swaps or security-based swaps.¹¹

The definitions are disjunctive, in that a person that engages in any of the enumerated dealing activities is a swap dealer or security-based swap dealer even if the person does not engage in any of the other enumerated activities.

The definitions, in contrast, do not include a person that enters into swaps or security-based swaps "for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business."¹² The Dodd-Frank Act also instructs the Commissions to exempt from designation as a dealer an entity that "engages in a de minimis quantity of [swap or security-based swap] dealing in connection with transactions with or on behalf of its customers."¹³ Moreover, the definition of "swap dealer" (but not the definition of "security-based swap dealer") provides that an insured depository institution is not to be considered a swap dealer "to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer."¹⁴

¹¹ See CEA section 1a(49)(A); Exchange Act section 3(a)(71)(A).

¹² See CEA section 1a(49)(C); Exchange Act section 3(a)(71)(C).

¹³ See CEA section 1a(49)(D); Exchange Act section 3(a)(71)(D).

¹⁴ CEA section 1a(49)(A).

The definitions also provide that a person may be designated as a dealer for one or more types, classes or categories of swaps, security-based swaps, or activities without being designated a dealer for other types, classes or categories or activities.¹⁵

The Commissions are proposing rules to further define certain aspects of the meaning of “swap dealer” and “security-based swap dealer,” and are providing guidance on how the Commissions propose to interpret these terms. This release specifically addresses: (A) the types of activities that would cause a person to be a swap dealer or security-based swap dealer, including differences in how those two definitions should be applied; (B) the statutory provisions requiring the Commissions to exempt persons from the dealer definitions in connection with de minimis activity; (C) the exception from the “swap dealer” definition in connection with loans by insured depository institutions; (D) the possibility that a person may be considered a dealer for some types, classes or categories of swaps, security-based swaps, or activities but not others; and (E) certain interpretative issues that arise in particular situations. The Commissions request comment on all aspects of the proposals, including the particular points noted in the discussion below.

A. Swap and Security-Based Swap Dealing Activity

1. Comments regarding dealing activities

Commenters provided numerous examples of conduct they viewed as dealing activities – as well as conduct they did not view as dealing activities. For example, many of the commenters stated that dealers provide “bid/ask” or “two-way” prices for swaps on a regular basis, or regularly participate in both sides of the swap market. Some

¹⁵ See CEA section 1a(49)(B); Exchange Act section 3(a)(71)(B).

commenters indicated that dealers perform an intermediary function. Other commenters stated that a person holds itself out as a dealer if it consistently and systematically markets itself as a swap dealer to third parties. Some commenters described market makers in the swap markets as persons that stand ready to buy or sell swaps at all times, are open to doing swaps business on both sides of a market, or make bids to buy and offers to sell swaps or a type of swap at all times. Commenters stated that a person should be included in the definition of dealer if its sole or dominant line of business is swaps activity. One commenter urged the Commissions to adopt a swap association's definition of a primary member as the definition of dealer.

Some commenters stated that the definition of dealer should be read narrowly. For example, some commenters suggested that the market maker concept should not encompass persons that provide occasional quotes or that do not make bids or offers consistently or at all times. Another commenter stated that a willingness to buy or sell a swap or security-based swap at a particular time does not constitute market making absent the creating of a two-way market. One commenter suggested that solely acting as a market maker should not cause a person to be a dealer, since firms may have commercial purposes for offering two-way trades. Another commenter stated that an entity that "holds itself out" as a dealer should qualify as a swap dealer only if it "consistently and systematically markets itself as a dealer to third-parties."¹⁶

Many commenters called for the exclusion of particular types of persons from the definition of swap dealer or security-based swap dealer. Several commenters maintained

¹⁶ See letter from Eric Dennison, Sr. Vice President and General Counsel, Stephanie Miller, Assistant General Counsel – Commodities, and Bill Hellinghausen, Director of Regulatory Affairs, EDF Trading, dated September 20, 2010 (distinguishing transactions that the commenter enters into as part of energy management services).

that commercial end-users of swaps or security-based swaps that enter into swaps or security-based swaps to hedge or mitigate commercial risk should be excluded from the definitions. Another commenter stated the definitions should exclude persons who use swaps or security-based swaps for bona fide hedging. Other commenters indicated that cooperatives that enter into swaps in connection with the business of their members should be excluded. Commenters also stated that if all of a person's swaps are cleared on an exchange or derivatives clearing organization, the person should not be deemed to be a dealer. One commenter stated competitive power suppliers should be excluded, and another stated that the dealer definition should not apply to futures commission merchants that act economically like brokers.

Commenters, particularly those in the securities industry, urged the Commissions to interpret the definitions of swap dealer and security-based swap dealer consistently with precedent that distinguishes between dealers in securities and traders in securities. However, one commenter also noted that some concepts from the securities and commodities laws may not easily be applied to these markets.

2. Application of the core tests to "swap dealers" and "security-based swap dealers"

The Dodd-Frank Act defines the terms "swap dealer" and "security-based swap dealer" in a functional manner, encompassing how a person holds itself out in the market, the nature of the conduct engaged in by the person, and how the market perceives the person's activities. This suggests that the definitions should not be interpreted in a constrained or overly technical manner. Rigid standards would not provide the necessary flexibility to respond to evolution in the ways that dealers enter into swaps and security-based swaps. The different types of swap and security-based swap markets are diverse,

and there does not appear to be a single set of criteria that can be determinative in all markets.

At the same time, we note that there may be certain distinguishing characteristics of swap dealers and security-based swap dealers, including that:

- dealers tend to accommodate demand for swaps and security-based swaps from other parties;
- dealers are generally available to enter into swaps or security-based swaps to facilitate other parties' interest in entering into those instruments;
- dealers tend not to request that other parties propose the terms of swaps or security-based swaps; rather, dealers tend to enter into those instruments on their own standard terms or on terms they arrange in response to other parties' interest; and
- dealers tend to be able to arrange customized terms for swaps or security-based swaps upon request, or to create new types of swaps or security-based swaps at the dealer's own initiative.

We also recognize that the principles relevant to identifying dealing activity involving swaps can differ from comparable principles associated with security-based swaps. These differences are due, in part, to differences in how those instruments are used. For example, because security-based swaps may be used to hedge or gain economic exposure to underlying securities (while recognizing distinctions between securities-based swaps and other types of securities, as discussed below), there is a basis to build upon the same principles that are presently used to identify dealers for other

types of securities. Accordingly, we separately address how the core tests would apply to swap dealers and to security-based swap dealers.

a. Application to swap dealers

The definition of swap dealer should be informed by the differences between swaps, on the one hand, and securities and commodities, on the other. Transactions in cash market securities and commodities generally involve purchases and sales of tangible or intangible property. Swaps, in contrast, are notional contracts requiring the performance of agreed terms by each party.¹⁷ Thus, many of the concepts cited by commenters, such as whether a person buys and sells swaps or makes a two-sided market in swaps or trades within a bid/offer spread, cannot necessarily be applied to all types of swaps to determine if the person is a swap dealer. We understand that market participants do use this terminology colloquially to describe the process of entering into a swap. For example, a person seeking a fixed/floating interest rate swap may inquire as to the fixed rates, spread above the floating rate and other payments that another person would require in order to enter into a swap. But, while these persons may discuss bids, offers, prices and so forth, the parties are negotiating the terms of a contract, they are not negotiating the price at which they will transfer ownership of tangible or intangible property. Accordingly, these concepts are not determinative of whether a person is a "swap dealer."

Instead, persons who are swap dealers may be identified by the functional role they fulfill in the swap markets. As noted above, swap dealers tend to accommodate

¹⁷ As discussed below, however (see note 42, *infra*), the Dodd-Frank Act amended the Exchange Act definitions of "buy," "purchase," "sale" and "sell" to apply to particular actions involving security-based swaps.

demand and to be available to enter into swaps to facilitate other parties' interest in swaps (although swap dealers may also advance their own investment and liquidity objectives by entering into such swaps). In addition, swap dealers can often be identified by their relationships with counterparties. Swap dealers tend to enter into swaps with more counterparties than do non-dealers, and in some markets, non-dealers tend to constitute a large portion of swap dealers' counterparties. In contrast, non-dealers tend to enter into swaps with swap dealers more often than with other non-dealers.¹⁸ The Commissions can most efficiently achieve the purposes underlying Title VII of the Dodd-Frank Act – to reduce risk and to enhance operational standards and fair dealing in the swap markets – by focusing their attention on those persons whose function is to serve as the points of connection in those markets. The definition of swap dealer, construed functionally in the manner set forth above, will help to identify those persons.

Clause (A)(iii) of the statutory definition of swap dealer, which includes any person that “regularly enters into swaps with counterparties as an ordinary course of business for its own account,”¹⁹ has been the subject of significant uncertainty among commenters. The commenters point out that its literal terms could encompass many parties who regularly enter into swaps without engaging in any form of swap dealing activity. In this regard, clause (A)(iii) of the definition should be read in combination

¹⁸ Some of the commenters appeared to suggest that significant parts of the swap markets operate without the involvement of swap dealers. We believe that this analysis is likely incorrect, and that the parties that fulfill the function of dealers should be identified and are likely to be swap dealers.

¹⁹ We interpret this reference to a person entering into swaps “with counterparties . . . for its own account” to refer to a person entering into a swap as a principal, and not as an agent. A person who entered into swaps as an agent for customers (i.e., for the customers' accounts) would be required to register as either a Futures Commission Merchant, Introducing Broker, Commodity Pool Operator or Commodity Trading Advisor, depending on the nature of the person's activity.

with the express exception in subparagraph (C) of the swap dealer definition, which excludes “a person that enters into swaps for such person’s own account, either individually or in a fiduciary capacity, but not as a part of a regular business.” Thus, the difference between the inclusion in clause (A)(iii) and the exclusion in subparagraph (C) is whether or not the person enters into swaps as a part of, or as an ordinary course of, a “regular business.”²⁰ We believe that persons who enter into swaps as a part of a “regular business” are those persons whose function is to accommodate demand for swaps from other parties and enter into swaps in response to interest expressed by other parties. Conversely, persons who do not fulfill this function should not be deemed to enter into swaps as part of a “regular business” and are not likely to be swap dealers.

In sum, to determine if a person is a swap dealer, we would consider that person’s activities in relation to the other parties with which it interacts in the swap markets. If the person is available to accommodate demand for swaps from other parties, tends to propose terms, or tends to engage in the other activities discussed above, then the person is likely to be a swap dealer. Persons that rarely engage in such activities are less likely to be deemed swap dealers.

We request comment on this interpretive approach for identifying whether a person is a swap dealer.

²⁰ The definition of “security-based swap dealer” is structured similarly, and should be interpreted similarly.

b. Application to security-based swap dealers

The definition of "security-based swap dealer" has parallels to the definition of "dealer" under the Exchange Act.²¹ In addition, security-based swaps may be used to hedge risks associated with the ownership of certain other types of securities,²² and security-based swaps may be used to gain economic exposure akin to ownership of certain other types of securities.²³ As a result, the SEC would consider the same factors that are relevant to determining whether a person is a "dealer" under the Exchange Act as also generally relevant to the analysis of whether a person is a security-based swap dealer.

The Exchange Act has been interpreted to distinguish between "dealers" and "traders." In this context, the SEC previously has noted that the dealer-trader distinction:

recognizes that dealers normally have a regular clientele, hold themselves out as buying or selling securities at a regular place of business, have a regular turnover of inventory (or participate in the sale or distribution of new issues, such as by acting as an underwriter), and generally provide liquidity services in transactions with investors (or, in the case of dealers who are market makers, for other professionals).²⁴

²¹ The Exchange Act in relevant part defines "dealer" to mean "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," but with an exception for "a person that buys or sells 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, either individually or in a fiduciary capacity, but not as a part of a regular business." Exchange Act sections 3(a)(5)(A) and (B), 15 U.S.C. 78c(a)(5)(A) and (B), as amended by Section 761(a)(1) of the Dodd-Frank Act.

²² For example, an entity that owns a particular security may use a security-based swap to hedge the risks of that security. Conversely, an entity may seek to offset exposure involving a security-based swap by using another security as a hedge.

²³ For example, an entity may enter into a security-based swap to gain economic exposure akin to a long or short position in a stock or bond, without having to engage in a cash market transaction for that instrument.

²⁴ Securities Exchange Act Release No. 47364 (Feb. 13, 2003) (footnotes omitted).

Other non-exclusive factors that are relevant for distinguishing between dealers and non-dealers can include the receipt of customer property and the furnishing of incidental advice in connection with transactions.

The markets involving security-based swaps are distinguishable in certain respects from markets involving cash market securities – particularly with regard to the concepts of “inventory” (which generally appears inapplicable in this context)²⁵ and “regular place of business.” For example, the suggestion that dealers are more likely to operate at a “regular place of business” than traders should not be construed in a way that ignores the reality of how the security-based swap markets operate (or that ignores evolution in dealing practices involving other types of securities). Dealers may use a variety of methods to communicate their availability to enter into security-based swaps with other market participants. The dealer-trader distinction should not be applied to the security-based swap markets without taking those distinctions into account.²⁶ Even in light of those differences, however, we believe that the dealer-trader distinction provides an important analytical tool to assist in determining whether a person is a “security-based swap dealer.”

²⁵ In particular, an analysis that considers dealers to differ from traders in part because dealers have regular turnover in “inventory” appears not to apply in the context of security-based swaps, given that those instruments are created by contract between two market counterparties, rather than reflecting financial rights issued by third-parties.

²⁶ The definition of “security-based swap dealer,” unlike the Exchange Act’s definition of “dealer,” does not specifically refer to “buying” and “selling.” We do not believe that this language difference is significant, however, as the Dodd-Frank Act amended the Exchange Act definitions of “buy” and “purchase,” and the Exchange Act definitions of “sale” and “sell,” to encompass the execution, termination (prior to its scheduled maturity date), assignment, exchange or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap. See Dodd-Frank Act sections 761(a)(3), (4) (amending Exchange Act sections 3(a)(13), (14)).

Commenters have raised concerns that the ambit of the security-based swap dealer definition could encompass end-users that use security-based swaps for hedging their business risks. Deeming those entities to be security-based swap dealers due to their hedging activities could discourage their use of hedging transactions or subject them to a regulatory framework that was not intended to address their businesses and could subject them to unnecessary costs. Under the dealer-trader distinction, however, we would expect entities that use security-based swaps to hedge their business risks, absent other activity, likely would not be dealers.²⁷ Also, as discussed below, both the “security-based swap dealer” definition and the dealer-trader distinction in part turn on whether a person holds itself out as a dealer.

We request comment on the application of the dealer-trader distinction as part of the analysis of whether a person is a security-based swap dealer.

c. Issues common to both definitions

- i. Holding oneself out as, and being commonly known in the trade as, a swap dealer or security-based swap dealer

As noted above, the application of these definitions to persons that “hold themselves out” as dealers or that are “commonly known in the trade” as dealers highlights the need for a functional interpretation of the dealer definitions. We believe that factors that may reasonably indicate that a person is holding itself out as a dealer or

²⁷ Of course, if a person’s other activities satisfy the definition of security-based swap dealer, it must comply with the applicable requirements with regard to all of its security-based swap activities, absent an order to the contrary, as discussed below. Also, as discussed below, we would expect end-users to use security-based swaps for hedging purposes less commonly than they use swaps for hedging purposes.

is commonly known in the trade as a dealer may include (but are not limited to) the following:

- contacting potential counterparties to solicit interest in swaps or security-based swaps,
- developing new types of swaps or security-based swaps (which may include financial products that contain swaps or security-based swaps) and informing potential counterparties of the availability of such swaps or security-based swaps and a willingness to enter into such swaps or security-based swaps with the potential counterparties,
- membership in a swap association in a category reserved for dealers,
- providing marketing materials (such as a web site) that describe the types of swaps or security-based swaps that one is willing to enter into with other parties, or
- generally expressing a willingness to offer or provide a range of financial products that would include swaps or security-based swaps.

Notably, holding oneself out as a security-based swap dealer would likely encompass a situation in which a person that is a "dealer" in another type of security enters into a security-based swap with a customer.²⁸ Another example of holding oneself out as a security-based swap dealer would likely be an entity expressing its availability to provide liquidity to counterparties that seek to enter into security-based swaps, regardless of the

²⁸ For example, if a person that is a dealer in securities that are not security-based swaps enters into a security-based swap transaction with one of its cash market customers, the person would appear to be engaged in security-based swap dealing activity with that customer. In that circumstance, the customer reasonably would be expected to view the person as a dealer for purposes of the security-based swap, making the applicable business conduct requirements particularly important.

“direction” of the transaction or across a broad spectrum of risks (e.g., credit default swaps related to a variety of issuers).

The determination of who is commonly known in the trade as a swap dealer or security-based swap dealer may appropriately reflect, among other factors, the perspective of persons with substantial experience with and knowledge of the swap and security-based swap markets, regardless of whether an entity is known as a dealer by persons without that experience and knowledge.

ii. Making a market in swaps or security-based swaps

A number of commenters suggested that the market making component of the definitions should apply only to persons that quote a two-sided market consistently or at all times. Some commenters also suggested that a person’s willingness to buy or to sell a swap or security-based swap at any particular time should not be deemed to be market making activity. While continuous two-sided quotations and a willingness to stand ready to buy and sell a security are important indicators of market making in the equities markets,²⁹ these indicia may not be appropriate in the context of the swap or security-based swap markets, given that parties do not enter into many types of swaps or security-based swaps on a continuous basis, and that parties may use a variety of methods for communicating their willingness to enter into swaps or security-based swaps. Any analysis that would impute to the definitions a “continuous” activity requirement may cause certain persons that engage in non-continuous dealing activities not to be regulated

²⁹ See Exchange Act Release No. 58875 (Oct. 14, 2008), 73 FR 61690 (Oct. 17, 2008) (“Although determining whether or not a market maker is engaged in bona-fide market making would depend on the facts and circumstances of the particular activity, factors that indicate a market maker is engaged in bona-fide market making activities may include, for example, whether the market maker incurs any economic or market risk with respect to the securities (e.g., by putting their own capital at risk to provide continuous two-sided quotes in markets).”).

as swap dealers or security-based swap dealers. We have not identified anything in the statutory text or legislative history of the Dodd-Frank Act to suggest that Congress intended such a result.

iii. No predominance test

Although some commenters suggested that a person should be a swap dealer or security-based swap dealer only if such activity is the person's sole or predominant business, the statutory definition does not contain a predominance test or otherwise depend upon the level of the person's dealing activity, other than the de minimis exception discussed below. A predominance standard would not provide a workable test of dealer status because many of the parties that are commonly acknowledged as swap or security-based swap dealers also engage in other businesses that often outweigh their swap or security-based swap dealing business in terms of transaction volume or other measures. Based on the plain meaning of the statutory definition, so long as a person engages in dealing activity that is not de minimis, as discussed below, the person is a swap dealer or security-based swap dealer.³⁰

iv. Application of the definition to new types of swaps and new activities

The Commissions intend to apply the definitions of swap dealer and security-based swap dealer flexibly when the development of innovative business models is accompanied by new types of dealer activity. As discussed above, the Commissions generally intend to follow a "facts-and-circumstances" approach with respect to

³⁰ As one example, a non-financial company that engages in both swap dealing and other commercial activities would fall within the definition of swap dealer because of its swap dealing activities, notwithstanding that it also engages in other commercial activities.

identifying dealing activities. The dealer definitions must be flexible enough to cover appropriate persons as the swap markets evolve.

v. Request for comment

The Commissions request comment on these interpretations of holding oneself out as a dealer and being commonly known in the trade as a dealer, as well as the lack of a predominance test, and the application of the definitions to new types of swaps and new activities. Commenters particularly are requested to address the relevance, to the dealer analysis, of activities such as an entity's membership in a swap execution facility ("SEF") or a security-based SEF, or use of facilities that may not be SEFs or security-based SEFs. Are there factors that would lead entities to become members of SEFs that would not make membership relevant to the dealer analysis? Commenters also are requested to generally address how the dealer analysis should appropriately apply the requirements applicable to dealers (e.g., capital, margin and business conduct requirements) to the entities that should be subject to those requirements. In addition, commenters are requested to address how the dealer definitions should be applied to entities such as, for example, federal home loan banks subject to restrictions limiting their dealing activities to particular types of counterparties. Finally, commenters are requested to address whether additional guidance is advisable to help identify dealer activity and to promote effective enforcement of the requirements applicable to swap dealers and security-based swap dealers.

3. Designation of a person as a swap dealer

The Dodd-Frank Act has amended the CEA and the Exchange Act to require a person that meets either of the definitions to register as a swap dealer and/or security-

based swap dealer,³¹ and the Commissions are proposing separate rules regarding this registration requirement. In connection with the registration requirement, market participants are in a position to assess their activities to determine whether they function in the manner described in the definitions. In addition, the Commissions have the authority to take enforcement actions in response to a dealer's failure to register. In determining whether a person meets the applicable definitions, the Commissions may use information from other regulators, swap data repositories, registered clearing agencies, derivatives clearing organizations and other sources.

4. Application of the swap dealer definition to agricultural commodities

Section 723(c)(3)(B) of the Dodd-Frank Act provides that swaps in agricultural commodities shall be subject to such terms and conditions as the CFTC may prescribe. In a separate rulemaking, the CFTC has proposed a definition of the term "agricultural commodity."³² Acting under the authority in Section 723(c)(3)(B), the CFTC may develop particular terms and conditions for the interpretation of the swap dealer definition when it is applied to dealing in swaps in agricultural commodities. Any such terms and conditions would not be applicable to the definition of security-based swap dealer. The CFTC requests comment on the application of the swap dealer definition to dealers, including potentially agricultural cooperatives, that limit their dealing activity primarily to swaps in agricultural commodities. The CFTC may consider any comments on this topic for both the definition of swap dealer and also for any rulemaking regarding swaps in agricultural commodities.

³¹ See CEA section 4s(a)-(b); Exchange Act section 15F(a)-(b).

³² See 75 FR 65586 (Oct. 26, 2010).

B. De minimis exemption to the definitions

The Dodd-Frank Act requires that the Commissions exempt, from designation as a “swap dealer” or “security-based swap dealer,” a person who “engages in a de minimis quantity of [swap or security-based swap] dealing in connection with transactions with or on behalf of its customers.”³³ The statutory definitions do not require that the Commissions fix a specific level of swap activity that will be considered de minimis, but instead require that the Commissions “promulgate regulations to establish factors with respect to the making of this determination to exempt.”

1. Comments regarding the de minimis exemption

Some commenters asserted that the de minimis exemption should be linked to systemic risk concerns, stating that persons engaged in dealing activities that do not pose systemic risk should be able to take advantage of the exemption. Other commenters suggested that a person’s dealing activities should be considered de minimis if they do not pose undue risks to the person. Commenters also expressed the view that the application of the exemption should be based on quantitative criteria.

2. Proposed rule regarding the de minimis exemption

The Commissions preliminarily believe that the “de minimis” exemption should be interpreted to address amounts of dealing activity that are sufficiently small that they do not warrant registration to address concerns implicated by the regulations governing swap dealers and security-based swap dealers.³⁴ In other words, the exemption should

³³ See CEA section 1a(49)(D); Exchange Act section 3(a)(71)(D).

³⁴ The Title VII requirements applicable to swap and security-based swap dealers include, for example: requirements that dealers conform to regulatory standards relating to the confirmation, processing, netting, documentation and valuation of swaps and security-based swaps (CEA section 4s(i), Exchange Act section 15F(i)); requirements that dealers disclose, to

apply only when an entity's dealing activity is so minimal that applying dealer regulations to the entity would not be warranted.

We thus preliminarily do not agree with those commenters that argued that a de minimis quantity of dealing should be measured in relation to the level of the person's other activities (or other swap or security-based swap activities). Aside from the fact that the statute does not explicitly call for a relative test, such an approach would lead to the result that larger and more active companies, which presumably would be more able to influence the swap markets, would be more likely to qualify for the exemption than smaller and less active companies. Also, a relative test not only would require a means of measuring the person's dealing activities, but also would require a means of measuring the larger scope of activities to which its swap dealing or security-based swap dealing activities are to be compared, thus introducing unnecessary complexity to the exemption's application.

Our proposed factors for the de minimis exemption seek to focus the availability of the exemption toward entities for which registration would not be warranted from a regulatory point of view in light of the limited nature of their dealing activities. At the same time, we recognize that this focus does not appear to readily translate into objective criteria. Thus, while the proposed factors discussed below reflect our attempt to delimit the de minimis exemption appropriately, we recognize that a range of alternative

regulators, information concerning terms and conditions of swaps or security-based swaps, as well as information concerning trading practices, financial integrity protections and other trading information (CEA section 4s(j)(3), Exchange Act section 15F(j)(3)); conflicts of interest provisions (CEA section 4s(j)(5), Exchange Act section 15F(j)(5)); and chief compliance officer requirements (CEA section 4s(k), Exchange Act section 15F(k)).

approaches may be reasonable, and we are particularly interested in commenters' suggestions as to the appropriate factors.

The first proposed factor is that the aggregate effective notional amount, measured on a gross basis, of swaps or security-based swaps that an entity enters into over the prior 12 months in connection with its dealing activities³⁵ could not exceed \$100 million.³⁶ We understand that in general the notional size of a small swap or security-based swap is \$5 million or less, and this proposed threshold would reflect 20 instruments of that size. Given the customer protection issues raised by swaps and security-based swaps – including the risks that counterparties may not fully appreciate when entering into swaps or security-based swaps – we believe that this notional amount reflects a reasonable limit for identifying those entities that engage in a de minimis level of dealing activity.³⁷ This standard would measure an entity's quantity of dealing on a gross basis (without consideration of the market risk offsets associated with combining long and short positions) to reflect the entity's overall amount of dealing activity. Similarly, the proposed notional threshold would not account for the amount of collateral held by or provided by the entity, nor other risk mitigating factors, in determining whether it

³⁵ The de minimis exemption specifically places limits on a person's dealing activity involving swaps or security-based swaps. Thus, these limits would not apply to swap or security-based swap activity that does not itself constitute dealing activity, such as activity in which a person hedges or mitigates a commercial risk of its business that is unrelated to a dealing business (i.e., as discussed above, when the person did not accommodate demand from the other party, respond to the other party's interest in swaps or security-based swaps, solicit the other party, propose economic terms, intermediate between parties, provide liquidity, or engage in other dealing activities). See part II.A.2, *supra*.

³⁶ See proposed CEA rule 1.3(ppp)(4)(ii); proposed Exchange Act rule 3a71-2(a). To the extent that the stated notional amount of a swap or security-based swap is leveraged or enhanced by its structure, the calculation shall be based on the effective notional amount of the swap or security-based swap rather than on its stated notional amount.

³⁷ We preliminarily believe that activity above this amount would be sufficient to warrant dealer registration to bring about the benefits of such registration.

engages in a de minimis quantity of dealing, given that dealer status focuses on an entity's absolute level of activity, and is not directly based on the risks that an entity poses or faces.³⁸

In addition, the aggregate effective notional amount of such swaps or security-based swaps, in which the person's counterparty is a "special entity" (as that term is defined in CEA Section 4s(h)(2)(C) and Exchange Act Section 15F(h)(2)(C)),³⁹ that an entity enters into over the prior 12 months could not exceed \$25 million.⁴⁰ The Dodd-Frank Act provided special protections to special entities in connection with swaps and security-based swaps, and we preliminarily believe that this lower proposed threshold reasonably reflects the special protections afforded to those entities.

In addition, to take advantage of the de minimis exemption, the proposed rule would provide that the entity could not have entered into swaps or security-based swaps (as applicable) as a dealer with more than 15 counterparties, other than security-based swap dealers, over the prior 12 months.⁴¹ The Commissions preliminarily believe that an entity that enters into swaps or security-based swaps, in a dealer capacity, with a larger number of counterparties should be registered to help achieve Title VII's orderly market goals, and thus cannot be said to engage in a de minimis quantity of dealing (even if the

³⁸ Also, allowing offsets for collateral would result in a de minimis standard that could encompass positions of virtually unlimited size.

³⁹ The term "special entity" encompasses: Federal agencies; states, state agencies and political subdivisions (including cities, counties and municipalities); "employee benefit plans" as defined under the Employee Retirement Income Security Act of 1974 ("ERISA"); "governmental plans" as defined under ERISA; and endowments.

⁴⁰ See proposed CEA rule 1.3(ppp)(4)(ii); proposed Exchange Act rule 3a71-2(b).

⁴¹ See proposed CEA rule 1.3(ppp)(4)(iii); proposed Exchange Act rule 3a71-2(c). That these tests measure the entity's activities over the prior 12 months provides certainty. As of the end of each month, the entity will know whether it may qualify for the exemption during the following month.

aggregate effective notional amount of the swaps or security-based swaps is less than the thresholds noted above).⁴² For purposes of determining the number of counterparties, we preliminarily believe that counterparties who are members of an affiliated group would generally count as one counterparty, given that the purpose of the limit is to measure the scope of dealer's interaction with separate counterparties.⁴³

Finally, the proposed rule would provide that, to take advantage of the de minimis exemption, the entity could not have entered into more than 20 swaps or security-based swaps (as applicable) as a dealer during the prior 12 months.⁴⁴ As is the case for the limitation on the number of counterparties, the Commissions preliminarily believe that an entity that enters into a larger number of swaps or security-based swaps, in a dealer capacity, would, if registered, help achieve Title VII's orderly market goals, and thus cannot be said to engage in a de minimis quantity of dealing. For these purposes, we would expect that each separate transaction the entity enters into under a swap or security-based swap master agreement in general would count as entering into a swap or security-based swap, but that an amendment of an existing swap or security-based swap in which the counterparty remained the same and the underlying item remained substantially the same would not count as a new swap or security based swap.⁴⁵

⁴² Similarly, because all the de minimis factors must be satisfied, a person who enters into only a single swap or security-based swap, as a swap dealer, with a single counterparty could not qualify for the de minimis exemption if that swap or security-based swap exceeds the effective notional amount threshold.

⁴³ For this purpose, an affiliated group would be defined as any group of entities that is under common control and that reports information or prepares its financial statements on a consolidated basis.

⁴⁴ See proposed CEA rule 1.3(ppp)(4)(iv); proposed Exchange Act rule 3a71-2(d).

⁴⁵ For these purposes only, an amendment to an existing swap or security-based swap would not need to be counted as a new swap or security-based swap if the underlying item is substantially the same as the original item. This may occur, for example, to reflect the effect of a

The proposed rule would not distinguish between different types of swaps or security-based swaps into which entities may enter (e.g., rate swaps versus other commodity swaps, or credit default swaps versus equity swaps). The Commissions preliminarily do not believe that the ceiling for distinguishing de minimis dealing activities from other dealing activities appropriately turns upon the particular type of swap or security-based swap.⁴⁶

The Commissions request comment on the proposed rule regarding the de minimis exemption. Commenters particularly are requested to address whether certain of the proposed factors should be modified or eliminated; for example, should the proposed \$100 million limit on annual notional swaps or security-based swaps entered into in a dealer capacity be raised or lowered to better implement the intended scope of the de minimis exemption – i.e., to exclude entities for which dealer regulation would not be warranted? Should we adopt different thresholds that would appropriately limit the exemption so it encompasses only those entities whose dealing activities are such that dealer regulation is not warranted? To what extent would certain entities be expected to reduce or otherwise adjust their dealing activity to fall within the scope of the de minimis exemption? Would there be any adverse implications for market participants if this happens? To what extent could the proposed factors potentially reduce dealing activity, and in doing so reduce the liquidity available in the swap or security-based swap market?

corporate action such as a merger. An amendment would be counted as a new swap or security-based swap, however, to the extent that the change in the underlying item modifies the economic risk reflected by the swap or security-based swap.

⁴⁶ The Exchange Act's definition of "dealer" does not include a de minimis exemption. Thus, an entity that engages in dealing activity involving securities (other than security-based swaps with eligible contract participants) would be required to register as a "dealer" under the Exchange Act, and comply with the Exchange Act's requirements applicable to dealers, absent some other exception or exemption from registration.

Commenters also are requested to address whether the rule should seek to identify only certain types of counterparties with which a person could engage in dealing activities under the exemption. We also particularly request comment on the proposed \$25 million notional threshold for dealer transactions with "special entities," including whether that proposed threshold should be raised or lowered, and whether an entity that enters into dealing transactions with "special entities" should be able to take advantage of the exemption at all. In addition, we request comment on whether the proposed threshold for transactions with "special entities" would provide a disincentive to dealers entering into transactions with such entities.

Commenters further are requested to address whether the factors may appropriately account for the size of the swap or security-based swap activities compared to the size of the entity; how an entity's swaps or security-based swaps with affiliated counterparties should be treated for purposes of the test; and whether the exemption's factors should vary depending on the type of swap or security-based swap at issue.

In addition, commenters are requested to address the significance of the fact that the statutory *de minimis* exemption specifically references transactions with or on behalf of a customer. Does that mean the exemption was intended to specifically address dealing activity as an accommodation to an entity's customers? If so, should the exemption be conditioned on the presence of an existing relationship between the entity and the counterparty that does not entail swap or security-based swap dealing activity, and if so, which types of relationships should be treated as creating a "customer" relationship?

Commenters also are requested to address whether the de minimis exemption should excuse an entity from having to comply with certain regulatory requirements imposed on swap dealers or security-based swap dealers, while also mandating compliance with other dealer requirements. In addition, commenters are requested to address whether, in lieu of the self-executing approach proposed here, the Commissions instead should require that entities which seek relief under this de minimis exemption must submit exemptive requests to the relevant agency for the agency's consideration and action. Commenters further are requested to address whether the proposed notional threshold for the de minimis exception should be subject to a formula that permits automatic periodic adjustments to the threshold, such as to reflect changes in market size or in the size of typical contracts.

C. Statutory exclusion for swaps in connection with originating a loan

The "swap dealer" definition excludes an insured depository institution ("IDI") "to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer."⁴⁷ This exclusion does not appear in the definition of "security-based swap dealer."

1. Comments regarding the exclusion for swaps in connection with loans

Three IDIs commented on this aspect of the definition, stating that the exclusion should encompass any swap entered into contemporaneously with a loan that is related to any of the borrower's activities that affect the ability to repay the loan and can be hedged. Thus, in their view, the exclusion should cover exchange rate and physical commodity swaps in addition to interest rate swaps. The IDIs also said the exclusion should apply to

⁴⁷ See CEA section 1a(49)(A).

amendments, restructurings and workouts of loans, and to lenders that act through a syndicate.

Another commenter expressed similar views, and also asked for clarification whether the exclusion applies to all aspects of the definition, or if it applies only to whether a person is commonly known in the trade as a swap dealer. The CFTC preliminarily believes the exclusion applies to all aspects of the swap dealer definition.

2. Proposed rule regarding the exclusion for swaps in connection with loans

The CFTC preliminarily interprets the word "offer" in this exclusion to include scenarios where the IDI requires the customer to enter into a swap, or the customer asks the IDI to enter into a swap, specifically in connection with a loan made by that IDI. Also, the proposed rule provides that, in order to prevent evasion, the statutory exclusion does not apply where (i) the purpose of the swap is not linked to the financial terms of the loan; (ii) the IDI enters into a "sham" loan; or (iii) the purported "loan" is actually a synthetic loan such as a loan credit default swap or loan total return swap.

The proposed rule would apply the statutory exclusion only to swaps that are connected to the financial terms of the loan, such as, for example, its duration, interest rate, currency or principal amount. Although commenters urged that this exclusion be extended to other aspects of the lending relationship, we preliminarily believe that it would not be appropriate that this exclusion from the swap dealer definition encompass swaps that are connected to the borrower's other business activities, even if the loan agreement requires that the borrower enter into such swaps or otherwise refers to them. We preliminarily believe that a broader reading of the exclusion could encompass all swap activity between an IDI and its borrowers, which we do not think is intended.

The origination of commercial loans is a complex process, and the CFTC preliminarily believes that this exclusion should be available to all IDIs that are a source of funds to a borrower. For example, all IDIs that are part of a loan syndicate providing a loan to a borrower could claim this exclusion with respect to swaps entered into with the borrower that are connected to the financial terms of the loan. Similarly, the proposed exclusion could be claimed with respect to such swaps entered into by any IDI that participates in or obtains a participation in such loan by means of a transfer or otherwise.⁴⁸ Also, an IDI that is a source of funds for the refinancing of a loan (whether directly or through a syndicate, participation or otherwise) could claim the exclusion if it enters into a swap with the refinancing borrower.

We emphasize that this proposed exclusion, by its statutory terms, is available only to IDIs. If an IDI were to transfer its participation in a loan to a non-IDI, then the non-IDI would not be able to claim this exclusion, regardless of the terms of the loan or the manner of the transfer. Similarly, a non-IDI that is part of a loan syndicate with IDIs would not be able to claim the exclusion.

In sum, the proposed exclusion may be claimed by a person that meets the following three conditions: (i) the person is an IDI; (ii) the person is the source of funds to a borrower in connection with a loan (either directly or through syndication, participation, refinancing or otherwise); and (iii) the person enters into a swap with the borrower that is connected to the financial terms of the loan (so long as the loan is not a sham or a synthetic loan).

⁴⁸ The CFTC preliminarily believes that the proposed exclusion could be claimed by any IDI that participates in a loan through any means that involves a payment to a lender to take the place of that lender, including an "English style" participation.

The CFTC requests comment on the proposed rule relating to the statutory exclusion for swaps in connection with originating a loan, and in particular on whether this statutory exclusion should be extended beyond swaps that are connected to the financial terms of the loan, and if so, why. The CFTC also requests comment on whether this exclusion should apply only to swaps that are entered into contemporaneously with the IDI's origination of the loan (and if so, how "contemporaneously" should be defined for this purpose), or whether this exclusion should also apply to swaps entered into during part or all of the duration of the loan.

D. Designation as a dealer for certain types, classes, or categories of swaps, security-based swaps, or activities

The statutory definitions include a provision stating that a person may be designated as a dealer for one or more types, classes or categories of swaps, security-based swaps, or activities without being considered a swap dealer or security-based swap dealer for other types, classes or categories of swaps, security-based swaps, or activities. This provision is permissive and does not require the Commissions to designate persons as dealers for only a limited set of types, classes or categories of swaps, security-based swaps, or activities.

1. Comments regarding limited designation as a swap dealer or security-based swap dealer

One commenter stated that the Commissions should allow a person to register as a swap dealer or security-based swap dealer for only a limited set of types, classes or categories of swaps or security-based swaps. Another commenter expressed the view that a person designated as a swap dealer or security-based swap dealer should be designated as such for all types of swaps or security-based swaps, respectively.

2. Proposed rule regarding limited designation as a swap dealer or security-based swap dealer

In general, the Commissions propose that a person that satisfies the definition of swap dealer or security-based swap dealer would be a dealer for all types, classes or categories of swaps or security-based swaps, or activities involving swaps or security-based swaps, in which the person engages.⁴⁹ Thus, the person would be subject to all regulatory requirements applicable to dealers for all swaps or security-based swaps into which it enters. We propose this approach because it may be difficult for swap dealers and security-based swap dealers to separate their dealing activities from their other activities involving swaps or security-based swaps.⁵⁰

The proposed rule also states, however, that the Commissions may provide for a person to be designated as a swap dealer or security-based swap dealer for only specified categories of swaps, security-based swaps, or activities, without being classified as a dealer for all categories.⁵¹ This proposed rule would afford persons an opportunity to seek, on an appropriate showing, a limited designation based on facts and circumstances applicable to their particular activities. The Commissions anticipate that a swap dealer could seek a limited designation at the same time as, or at a later time subsequent to, the person's initial registration as a swap dealer.

⁴⁹ See proposed CEA rule 1.3(ppp)(3); proposed Exchange Act rule 3a71-1(c).

⁵⁰ For example, in order to efficiently impose the dealer requirements on only the person's dealing activities, it may be necessary for the person to have separate books and records and a separate compliance regime for its dealing activities.

⁵¹ CEA section 1a(49)(B); Exchange Act section 3(a)(71)(B). As discussed below, the Commissions preliminarily believe that there are four major categories of swaps and two major categories of security-based swaps. See part IV.A, *infra*. The designation as a swap dealer or security-based swap dealer may, for example, be limited in terms of these categories or in terms of particular activities of the person.

The CFTC understands that there may potentially be non-financial entities, such as physical commodity firms, that conduct swap dealing activity through a division of the entity, and not a separately-incorporated subsidiary. In these instances, the entity's swap dealing activity would not be a core component of the entity's overall business. If this type of entity registered as a swap dealer, the CFTC anticipates that certain swap dealer requirements would apply to the swap dealing activities of the division, but not necessarily to the swap activities of other parts of the entity.

The Commissions request comment on the proposed rules regarding limited designation as a swap dealer or security-based swap dealer. Commenters particularly are requested to address the circumstances in which such limited purpose designations would be appropriate, the factors that the Commissions should consider when addressing such requests, and the type of information requestors should provide in support of their request. For example, would it be appropriate to grant such limited purpose designations only to entities that do not otherwise fall within the definition of a financial entity, and whose dealing activity is below a defined threshold of the entity's overall activity? At what level should the Commissions set such a threshold? Which of the requirements applicable to dealers should or should not apply to such entity's non-dealing activities in swaps and security-based swaps?

In addition, commenters are requested to address whether the Commissions should provide for limited purpose designations of swap dealers or security-based swap dealers through some other mechanism as an alternative to, or in addition to, case-by-case evaluations of individual applications. If so, what criteria and procedures would be appropriate for making limited purpose designations through this type of approach?

Also, should the limited purpose designation apply on a provisional basis starting at the time that the entity makes an application for a limited purpose designation?

Finally, commenters also are asked to address whether such limited purpose designations should be conditioned in any way, such as by the provision of information of the type that would be required with respect to an entity's swaps or security-based swaps involving the particular category or activity for which they are not designated as a dealer.

E. Certain Interpretative Issues

1. Affiliate issues

We preliminarily believe that the word "person" in the swap dealer and security-based swap dealer definitions should be interpreted to mean that the designation applies with respect to a particular legal person. That is, for example, we would not view a trading desk or other discrete business unit that is not a separately organized legal person as a swap dealer; rather, the legal person of which it is a part would be the swap dealer. Also, an affiliated group of legal persons under common control could include more than one dealer. Within such a group, any legal person that engages in swap or security-based swap dealing activities would be a swap dealer or security-based swap dealer, as applicable.

In determining whether a particular legal person is a swap dealer or security-based swap dealer, we preliminarily believe it would be appropriate for the person to consider the economic reality of any swaps and security-based swaps it enters into with affiliates (i.e., legal persons under common control with the person at issue), including whether those swaps and security-based swaps simply represent an allocation of risk within a

corporate group.⁵² Swaps and security-based swaps between persons under common control may not involve the interaction with unaffiliated persons that we believe is a hallmark of the elements of the definitions that refer to holding oneself out as a dealer or being commonly known as a dealer. To the extent, however, that an entity seeks to use transactions between persons under common control to avoid one of the dealer definitions, the Commissions have the authority to prohibit practices designed to evade the requirements applicable to swap dealers and security-based swap dealers.⁵³

The Commissions invite comment as to how the swap dealer and security-based swap dealer definitions should be applied to members of an affiliated group. Commenters particularly are invited to address how the Commissions should interpret common control for these purposes, and whether this interpretation should be limited to wholly-owned affiliates.

2. Application to particular swap markets

The swap markets are diverse and encompass a variety of situations in which parties enter into swaps with each other. We believe it is helpful to the understanding of the rule to discuss some of these situations, particularly those that have been raised by commenters, here. The situations discussed below include persons who enter into swaps as aggregators, as part of their participation in physical markets, or in connection with the

⁵² Such swaps and security-based swaps should be considered in this way only for purposes of determining whether a particular person is a swap dealer or security-based swap dealer and does not necessarily apply in the context of the Exchange Act's general definition of "dealer." The swaps and security-based swaps, moreover, would continue to be subject to all laws and requirements applicable to such swaps and security-based swaps.

⁵³ See Dodd-Frank Act sections 721(b)(2), 761(b)(3). For example, it would not be permissible for an entity that provides liquidity on one side of the market to use affiliated entities to provide liquidity on the other side in an attempt to avoid having to register as a swap or security-based swap dealer.

generation and transmission of electricity. We invite comment as to what aspects of the parties' conduct in these situations should, or should not, be considered swap dealing activities, and whether the parties involved in these situations are swap dealers.

a. Aggregators

Commenters explained that some persons enter into swaps with other parties in order to aggregate the swap positions of the other parties into a size that would be more amenable to entering into swaps in the larger swap market, or otherwise to make entering into such swaps more efficient. For example, certain cooperatives enter into swaps with smaller cooperatives, smaller businesses or their members in order to establish a position in a commodity that is large enough to be traded on a swap or futures market. Similarly, one smaller financial institution explained that it enters into swaps with counterparties whose swap positions would not be large enough to be of interest to larger financial institutions. This institution stated that it enters into offsetting swaps with larger financial institutions so that it is in a neutral position between the counterparties and the larger financial institutions.

The result of these arrangements is that such persons engage in activities that are similar in many respects to those of a swap dealer as set out in the definition – the person enters into swaps to accommodate demand from other parties, it enters into swaps with a relatively large number of non-dealers, and it holds itself out as willing to enter into swaps. It may be that the swap dealing activities of these aggregators would not exceed the de minimis threshold, and therefore they would not be swap dealers. The CFTC, in particular, requests comment as to how the de minimis threshold would apply to such persons. If their activity would exceed the de minimis threshold set forth in the proposed

rule, the Commissions request comment on the application of the swap dealer definition to their activity.

b. Physical market participants

The markets in physical commodities such as oil, natural gas, chemicals and metals are complex and varied. They involve a large number of market participants that, over time, have developed highly customized transactions and market practices that facilitate efficiencies in their market in unique ways. Some of these transactions would be encompassed by the statutory definition of "swap," and some participants in these markets engage in swap dealing activities that are above the proposed de minimis threshold. The Commissions invite comment as to any different or additional factors that should be considered in applying the swap dealer definition to participants in these markets.

c. Electricity generation and transmission

The use of swaps in the generation and transmission of electricity is highly complex because electricity cannot be stored and therefore is generated, transmitted and used on a continuous, real-time basis. Also, the number and variety of participants in the electricity market is very large and some electricity services are provided as a public good rather than for profit. Nevertheless, some participants engage in swap dealing activities as described above that are above the de minimis threshold set forth in the proposed rule. The Commissions invite comment as to any different or additional factors that should be considered in applying the swap dealer definition to participants in the generation and transmission of electricity. Specifically, the Commissions invite comment on whether there are special considerations, including without limitation special

considerations arising from section 201(f) of the Federal Power Act, related to non-profit, public power systems such as rural electric cooperatives and entities operating as political subdivisions of a state, and the applicability of the exemptive authority in section 722(f) of the Dodd-Frank Act to address those considerations.

III. Amendments to Definition of Eligible Contract Participant

A. Overview

The Commodity Futures Modernization Act of 2000 ("CFMA")⁵⁴ generally excluded or exempted transactions between eligible contract participants ("ECPs") from most provisions of the CEA.⁵⁵ Section 723(a)(1)(A) of the Dodd-Frank Act repeals those exclusions and exemptions. ECP status remains important, however, because Section 723(a)(2) of the Dodd-Frank Act renders it unlawful for a non-ECP to enter into a swap other than on, or subject to the rules of, a designated contract market ("DCM").⁵⁶ Section 763(e) of the Dodd-Frank Act also renders it unlawful for a non-ECP to enter into a security-based swap unless such transaction is effected on a national securities exchange registered pursuant to Section 6(b) of the Exchange Act.⁵⁷ In addition, Section 768(b) of

⁵⁴ Pub. L. No. 106-554, 114 Stat. 2763 (Dec. 21, 2000).

⁵⁵ See CEA sections 2(d) (Excluded Derivative Transactions), 2(e) (Excluded Electronic Trading Facilities), 2(g) (Excluded Swap Transactions) and 2(h) (Legal Certainty for Certain Transactions in Exempt Commodities) (7 U.S.C. 2(d), (e), (g), (h)). The CFMA also excluded swap agreements from the definitions of "security" in Section 3(a)(10) of the Exchange Act and Section 2(a)(1) of the Securities Act. See Section 3A of the Exchange Act, 15 U.S.C. 78c-1, and Section 2A of the Securities Act, 15 U.S.C. 77b-1 (both of which have been modified by the Dodd-Frank Act). The CFMA, however, provided that the SEC had antifraud authority over security-based swap agreements.

⁵⁶ Section 723(a)(2) of the Dodd-Frank Act adds new subsection (e) to CEA section 2 (7 U.S.C. 2(e)). New CEA section 2(e) provides that "[i]t shall be unlawful for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market under section 5."

⁵⁷ Section 763(e) of the Dodd-Frank Act adds paragraph (l) to Exchange Act section 6. New Exchange section 6(l) provides that "[i]t shall be unlawful for any person to effect a

the Dodd-Frank Act makes it unlawful for a non-ECP to enter into a security-based swap unless a registration statement is in effect. While this means that non-ECPs cannot enter into swaps on SEFs or on a bilateral, off-exchange basis, it also opens swaps to non-ECPs, so long as the swaps are entered into on, or subject to the rules of, a DCM.

Similarly, while non-ECPs cannot enter into security-based swaps unless the transaction is effected on a national securities exchange and the security-based swap has an effective registration statement, it also opens security-based swaps to non-ECPs.

Congress also amended⁵⁸ the ECP definition in Section 721(a)(9) of the Dodd-Frank Act by: (1) raising a threshold that governmental entities may use to qualify as ECPs, in certain situations, from \$25 million in discretionary investments to \$50 million in such investments; and (2) replacing the “total asset” standard for individuals to qualify as ECPs with a discretionary investment standard.⁵⁹

B. Commenters’ views

The ECP definition elicited comment from nine commenters. The comments ranged from requests not to increase the monetary thresholds for governmental employee

transaction in a security-based swap with or for a person that is not an eligible contract participant, unless such transaction is effected on a national securities exchange registered pursuant to subsection (b).”

⁵⁸ The changes to the ECP definition made by the Dodd-Frank Act originated in the Administration’s “White Paper” on financial regulatory reform. See *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation*, available at http://www.financialstability.gov/docs/regs/FinalReprot_web.pdf, at 48-49 (June 17, 2009) (“Current law seeks to protect unsophisticated parties from entering into inappropriate derivatives transactions by limiting the types of counterparties that could participate in those markets. But the limits are not sufficiently stringent.”).

⁵⁹ The monetary component of ECP status for individuals remains the same under the amended ECP definition: more than \$10 million (but now in discretionary investments, not in total assets), or \$5 million if the transactions for which ECP status is necessary are for risk management of an asset or liability the individual owns or incurs, or is reasonably likely to own or incur.

benefit plans in certain instances to suggestions to dramatically raise them across the board, and from requests not to change the definition in a way that would limit the commenter's access to swaps to specific proposals to address such otherwise limited access.

In the Dodd-Frank Act, Congress addressed aspects of the ECP definition that it found to be of particular concern regarding governmental entities and individuals. Otherwise, though, persons who qualified for exclusions or exemptions to enter into bilateral, off-exchange swaps prior to the Dodd-Frank Act will still qualify to do so with respect to non-standardized swaps under the Dodd-Frank Act, with the exceptions discussed below. We have not identified any legislative history suggesting that Congress intended the Commissions to undertake a wholesale revision of the ECP definition. Accordingly, the Commissions are limiting the further definition of the term ECP to the discrete issues discussed below.

C. New ECP categories

The CEA definition of ECP generally is comprised of regulated persons;⁶⁰ entities defined as ECPs based on a total asset test (e.g., a corporation, partnership, proprietorship, organization, trust, or other entity with total assets exceeding \$10 million)⁶¹ or an alternative monetary test coupled with a non-monetary component (e.g., an entity with a net worth in excess of \$1 million and engaging in business-related

⁶⁰ CEA section 1a(18)(A)(i), (ii), (iii), (iv), (viii), (ix), (x) (7 U.S.C. 1a(18)(A)(i), (ii), (iii), (iv), (viii), (ix), (x)), as redesignated by Section 721(a)(9) of the Dodd-Frank Act.

⁶¹ CEA section 1a(18)(A)(v)(I) (7 U.S.C. 1a(18)(A)(v)(I)), as redesignated by Section 721(a)(9) of the Dodd-Frank Act.

hedging;⁶² or certain employee benefit plans, the investment decisions of which are made by one of four enumerated types of regulated entities⁶³); and certain governmental entities and individuals that meet defined thresholds.⁶⁴

Persons in the new major swap participant, major security-based swap participant, swap dealer and security-based swap dealer categories are likely to be among the most active and largest users of swaps and security-based swaps. Accordingly, the Commissions propose to further define the term ECP to include these new categories, which will permit such persons to enter into swaps and security-based swaps on SEFs and on a bilateral basis (where otherwise permitted under the Dodd-Frank Act and regulations thereunder).

We seek comment on this proposed expansion of the ECP definition.

D. Relationship between retail foreign currency and ECP status in the context of a commodity pool

Prior to the Dodd-Frank Act, clause (A)(iv) of the ECP definition provided that a commodity pool was an ECP if the pool and its operator met certain requirements (*i.e.*, the commodity pool has \$5 million in total assets and is operated by a commodity pool operator regulated under the CEA or subject to foreign regulation), regardless of whether each pool participant was itself an ECP.⁶⁵ Section 741(b)(10) of the Dodd-Frank Act amended clause (A)(iv) of the ECP definition to provide that a commodity pool engaging

⁶² CEA section 1a(18)(A)(v)(III) (7 U.S.C. 1a(18)(A)(v)(III)), as redesignated by Section 721(a)(9) of the Dodd-Frank Act.

⁶³ CEA section 1a(18)(A)(vi) (7 U.S.C. 1a(18)(A)(vi)), as redesignated by Section 721(a)(9) of the Dodd-Frank Act.

⁶⁴ CEA sections 1a(18)(A)(vii) and (xi) (7 U.S.C. 1a(18)(A)(vii) and (xi)), as redesignated by Section 721(a)(9) of the Dodd-Frank Act.

⁶⁵ CEA section 1a(12)(A)(iv) (7 U.S.C. 1a(12)(A)(iv)).

in retail foreign currency transactions of the type described in CEA sections 2(c)(2)(B) or 2(c)(2)(C)⁶⁶ (“retail forex” and such pools, “Retail Forex Pools”) no longer qualifies as an ECP for those purposes if any participant in the pool is not independently an ECP.

The Commissions believe that in some cases commodity pools unable to satisfy the conditions of clause (A)(iv) of the ECP definition may rely on clause (A)(v) to qualify as ECPs instead for purposes of retail forex. Clause (A)(v) of the ECP definition applies to business entities irrespective of their form of organization (i.e., corporations, partnerships, proprietorships, organizations, trusts and other entities), and contains a \$1 million net worth test where such an entity “enters into an agreement, contract, or transaction in connection with the conduct of the entity’s business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity’s business.”⁶⁷

The Commissions believe that permitting Retail Forex Pools with one or more non-ECP participants to achieve ECP status by relying on clause (A)(v) of the ECP definition would frustrate the intent of Congress in denying ECP status to Retail Forex Pools under clause (A)(iv). Consequently, the Commissions propose to further define the term ECP to preclude a Retail Forex Pool with one or more non-ECP participants from qualifying as an ECP by relying on clause (A)(v) of the ECP definition if such Retail Forex Pool is not an ECP due to the language added to clause (A)(iv) of the ECP

⁶⁶ 7 U.S.C. 2(c)(2)(B) and (C). See generally “Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries,” 75 FR 55410 (Final Rule; Sept. 10, 2010) (discussing the new CFTC retail forex regulatory regime); “Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries,” 75 FR 3282 (Proposed Rule; Jan. 20, 2010) (providing historical background on the regulation of retail forex transactions).

⁶⁷ CEA section 1a(18)(A)(v) (7 U.S.C. 1a(18)(A)(v), as redesignated by Section 721(a)(9) of the Dodd-Frank Act.

definition by section 741(b)(10) of the Dodd-Frank Act (i.e., because the pool contains one or more non-ECP participants). Because commodity pools can be structured in various ways and can have one or more feeder funds and/or pools, many with their own participants, the Commissions propose to preclude a Retail Forex Pool from being an ECP pursuant to clause (A)(iv) of the ECP definition if there is a non-ECP participant at any investment level (e.g., a participant in the pool itself (a direct participant), an investor or participant in a fund or pool that invests in the pool in question (an indirect participant), an investor or participant in a fund or pool that invests in that investor fund or pool (also an indirect participant), etc.).

Similarly, the Commissions believe that some commodity pools unable to satisfy the total asset or regulated status components of clause (A)(iv) of the ECP definition may rely on clause (A)(v) to qualify as ECPs instead. The Commissions are of the view that a commodity pool that cannot satisfy the monetary and regulatory status conditions prescribed in clause (A)(iv) should not qualify as an ECP in reliance on clause (A)(v) of the ECP definition. Therefore, the Commissions propose to further define the term ECP to prevent such an entity from qualifying as an ECP pursuant to clause (A)(v) of the ECP definition.

E. Request for comment

The Commissions request comment on all aspects of the proposed amendments to the definition of "eligible contract participant." Are the proposed interpretations with respect to Retail Forex Pools and other commodity pools appropriate? Do entities described in the various enumerated ECP categories (other than commodity pools) rely on clause (A)(v) to qualify as ECPs? If so, should an entity that would be described in

one of the clauses of paragraph (A) of the ECP definition, but cannot satisfy the conditions prescribed in that clause, be prohibited from relying on clause (A)(v) of the ECP definition?

In addition, should the Commissions further narrow any or all of the ECP categories? Why or why not? If so, what additional conditions would be appropriate? Should the Commissions define the term "discretionary basis," as requested by one commenter, either solely for purposes of clause (A)(vii) or clause (A)(xi), or for both clauses? Alternatively, should the Commissions add any additional categories of ECPs, such as the following categories suggested by commenters: commercial real estate developers; energy or agricultural cooperatives or their members; or firms using swaps as hedges pursuant to the terms of the CFTC's Swap Policy Statement? If so, which ones and why?

IV. Definitions of "major swap participant" and "major security-based swap participant"

The definitions of "major swap participant" and "major security-based swap participant" (also jointly referred to as the "major participant" definitions) respectively focus on the market impacts and risks associated with an entity's swap and security-based swap positions. In this respect, the major participant definitions differ from the definitions of "swap dealer" and "security-based swap dealer," which focus on an entity's activities and account for the amount or significance of those activities only in the context of the de minimis exception.

Despite those differences in focus, persons that meet the major participant definitions in large part must follow the same statutory requirements that apply to swap

dealers and security-based swap dealers.⁶⁸ In this way, the statute applies comprehensive regulation to entities whose swap or security-based swap activities do not cause them to be dealers, but nonetheless could pose a high degree of risk to the U.S. financial system generally.⁶⁹

The major participant definitions are similar in their key provisions, although one exception, as discussed below, is available only in connection with the “major swap participant” definition. Both major participant definitions encompass persons that satisfy any of three alternative tests:⁷⁰

- The first test encompasses persons that maintain a “substantial position” in any of the “major” categories of swaps or security-based swaps, as those categories are determined by the CFTC or SEC as applicable. This test excludes both “positions held for hedging or mitigating commercial risk,” and positions maintained by or contracts held by any employee benefit plan (as defined in paragraphs (3) and

⁶⁸ In particular, under CEA section 4s and Exchange Act section 15F, dealers and major participants in swaps or security-based swaps generally are subject to the same types of margin, capital, business conduct and certain other requirements, unless an exclusion applies. See CEA section 4s(h)(4), (5); Exchange Act section 15F(h)(4), (5).

⁶⁹ As discussed below, the tests of the major participant definitions use terms – particularly “systemically important,” “significantly impact the financial system” or “create substantial counterparty exposure” – that denote a focus on entities that pose a high degree of risk through their swap and security-based swap activities. In addition, the link between the major participant definition and risk was highlighted during the Congressional debate on the statute. See 156 Cong. Rec. S5907 (daily ed. July 15, 2010) (dialogue between Senators Hagen and Lincoln, discussing how the goal of the major participant definition was to “focus on risk factors that contributed to the recent financial crisis, such as excessive leverage, under-collateralization of swap positions, and a lack of information about the aggregate size of positions”).

⁷⁰ Also, neither major participant definition encompasses an entity that meets the respective swap dealer or security-based swap dealer definition. See CEA section 1a(33)(A); Exchange Act section 3(a)(67)(A)(i).

(32) of section 3 of ERISA (29 U.S.C. 1002)) for the primary purpose of hedging or mitigating risks directly associated with the operation of the plan.⁷¹

- The second test encompasses persons whose outstanding swaps or 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.”⁷²
- The third test encompasses any “financial entity” that 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 agency” and that maintains a “substantial position” in swaps or security-based swaps for any of the “major” categories of swaps or security-based swaps.⁷³

The statute directs the CFTC or the SEC to define “substantial position” for the respective definition at the threshold that it determines to be “prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States.” The definitions further provide that when defining “substantial position,” the CFTC or SEC “shall consider the person’s relative position in uncleared as opposed to cleared [swaps or security-based swaps] and may take into consideration the value and quality of collateral held against counterparty exposures.”⁷⁴

⁷¹ See CEA section 1a(33)(A)(i); Exchange Act section 3(a)(67)(A)(ii)(I).

⁷² See CEA section 1a(33)(A)(ii); Exchange Act section 3(a)(67)(A)(ii)(II).

⁷³ See CEA section 1a(33)(A)(iii); Exchange Act section 3(a)(67)(A)(ii)(III).

⁷⁴ See CEA Section 1a(33)(B); Exchange Act section 3(a)(67)(B).

Both major participant definitions provide that a person may be designated as a major participant for one or more categories of swaps or security-based swaps without being classified as a major participant for all classes of swaps or security-based swaps.⁷⁵

Finally, the definition of “major swap participant” – but not the definition of “major security-based swap participant” – includes an exception for any “entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company.”⁷⁶

Although the two major participant definitions are similar, they address instruments that reflect different types of risks and that can be used by end-users and other market participants for different purposes. Interpretation of the definitions must appropriately account for those differences.

The Commissions are proposing rules to further define the “major swap participant” and “major security-based swap participant” definitions, by specifically addressing: (a) the “major” categories of swaps or securities-based swaps; (b) the meaning of “substantial position”; (c) the meaning of “hedging or mitigating commercial risk”; (d) the meaning of “substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets”; and (e) the meanings of “financial entity” and “highly leveraged.” We also are proposing rules to specify the use of a daily average methodology for identifying whether

⁷⁵ See CEA section 1a(33)(C); Exchange Act section 3(a)(67)(C).

⁷⁶ See CEA section 1a(33)(D).

a person meets one of the major participant definitions, provide for a reevaluation period for certain entities that exceed the relevant daily average by a small amount, and provide for a minimum length of time before a person may no longer be deemed a major participant.

We further propose that the CFTC or SEC may limit an entity's designation as a major participant to only certain types, classes or categories of swaps or security-based swaps. We also address certain additional interpretive issues that commenters have raised. Finally, while the Commissions also are not proposing any exclusions from the major participant definitions, we are soliciting comment as to whether certain types of entities should be excluded from the definitions' application.⁷⁷

A. "Major" categories of swaps and securities-based swaps

The first and third tests of the statutory major participant definitions encompass entities that have a substantial position in a "major" category of swaps or security-based swaps. The Commissions are responsible for designating these "major" categories.⁷⁸

The Commissions propose to designate "major" categories of swaps and security-based swaps in a manner that reflects the risk profiles of these various instruments and

⁷⁷ In light of the significant and novel issues raised by the major participant definitions, the Commissions recognize the importance of monitoring the swap and security-based swap markets following adoption of major participant rules. This will help us evaluate whether the rules appropriately reflect how market participants use these instruments, and will help us consider the impact of market evolution and the ways in which market participants may change their practices in response to the rules, so we may identify potential improvements to the rules or other actions to enhance enforcement of major participant regulation.

⁷⁸ See CEA section 1a(33)(A)(i), (iii); Exchange Act section 3(a)(67)(a)(2)(i), (iii). One commenter suggested that we determine these categories by reference to the types of instruments specifically listed in the statutory definition of "swap." See Northwestern Mutual letter (suggesting that, for regulatory consistency, each type of swap listed in the definition and options on each of those swaps should be considered to be an individual major category). The statutory definition of "swap" lists 22 different types of swaps.

the different purposes for which end-users make use of the various instruments. We preliminarily believe that it is important not to parse these "major" categories so finely as to base the "substantial position" thresholds on unduly narrow risks that would reduce those thresholds' effectiveness as risk measures. The "major" categories will apply only for purposes of the major participant definitions and are not necessarily determinative with respect to any other provision of the Dodd-Frank Act or the regulations adopted thereunder.

1. Major categories of swaps

We propose to designate four "major" categories of swaps for purposes of the "major swap participant" definition. The four categories are rate swaps, credit swaps, equity swaps and other commodity swaps.⁷⁹ The first category would encompass any swap which is primarily based on one or more reference rates, such as swaps of payments determined by fixed and floating interest rates, currency exchange rates, inflation rates or other monetary rates. The second category would encompass any swap that is primarily based on instruments of indebtedness; including but not limited to any swap primarily based on one or more indices related to debt instruments, or any swap that is an index credit default swap or total return swap on one or more indices of debt instruments. The third category would encompass any swap that is primarily based on equity securities, such as any swap primarily based on one or more indices of equity securities, or any total return swap on one or more equity indices. The fourth category would encompass any swap not included in any of the first three categories. This fourth category would

⁷⁹ See proposed CEA rule 1.3(rrr). For the avoidance of doubt, the term "swap" as it is used in the definitions of the major swap categories in rule 1.3(rrr) has the meaning set forth in section 1a(47) of the CEA and the rules promulgated thereunder.

generally include, for example and not by way of limitation, any swap for which the primary underlying item is a physical commodity or the price or any other aspect of a physical commodity.⁸⁰

The four major categories of swaps are intended to cover all swaps. Each swap would be in the category that most closely describes the primary item underlying the swap. If a swap is based on more than one underlying item of different types, the swap would be in the category that describes the underlying item that is likely to have the most significant effect on the economic return of the swap. The proposed categories are consistent with market statistics that distinguish between these general types of swaps, as well as market infrastructures that have been established for these types of swaps.

We request comment on this proposed method of allocating swaps among “major” categories. Commenters particularly are asked to address whether there are any types of swaps that would have unclear status under this proposal, as well as whether all swaps instead should be placed into a single “major” category for purposes of the “major swap participant” definition, or whether there should be additional “major” categories of swaps. Commenters are also asked to address whether the rate swap category should be divided into two separate categories – one for swaps based on rates of exchange between different currencies, and another for swaps based on interest rates, inflation rates and other monetary rates – and if so, in which category cross-currency rate swaps should be included. Also, should the major swap category for other commodity swaps be divided

⁸⁰ The term “commodity” as defined in Section 1a(9) of the CEA, 7 U.S.C. 1a(9), and CFTC Rule 1.3(e), 17 C.F.R. 1.3(e) includes interest rates, foreign exchange rates, and equity and debt indices as well as physical commodities. Thus, the fourth category of swaps is entitled “other commodity swaps” because it includes any swap not included in the other three categories.

into two separate categories – one for swaps based on agricultural commodities, and another for swaps based on all other commodities not included in the other categories?

2. Major categories of security-based swaps

We propose to designate two “major” categories of security-based swaps for purposes of the “major security-based swap definition.” The first category would encompass any security-based swap that is based, in whole or in part, on one or more instruments of indebtedness (including loans), or a credit event relating to one or more issuers or securities, including but not limited to any security-based swap that is a credit default swap, total return swap on one or more debt instruments, debt swap, debt index swap, or credit spread.⁸¹ The second category would encompass any other security-based swaps not included in the first category; this category would include, for example, equity swaps.⁸²

The proposed categories reflect the fact that entities that transact in security-based swaps for non-speculative purposes would be expected to use the respective instruments for different purposes. For example, swaps based on instruments of indebtedness, such as credit derivatives, can be used to hedge the risks associated with the default of a counterparty or debt obligation. Equity swaps can be used, among other ways, to hedge the risks associated with equity ownership or gain synthetic exposure to equities.⁸³ The proposed categories also are consistent with market statistics that currently distinguish

⁸¹ This category does not encompass a security-based swap that is based on an instrument of indebtedness solely in connection with the swap’s financing leg.

⁸² See proposed Exchange Act rule 3a67-2.

⁸³ At the same time, we note that the distinctions between these proposed “major” categories of “security-based swaps” arguably are less significant than the distinctions among the proposed major categories of “swaps” (such as, for example, the distinction between other commodity swaps and rate swaps).

between those general types of security-based swaps, as well as market infrastructures, including separate trade warehouses, that have been established for credit default swaps and equity swaps.

We request comment on this proposed method of allocating security-based swaps between two "major" categories. In particular, we request comment on whether there are any types of security-based swaps that would have unclear status under this proposal, as well as whether all security-based swaps instead should be placed into a single "major" category for purposes of the "major security-based swap participant" definition, or whether there should be additional "major" categories of security-based swaps.

B. "Substantial position"

As noted above, the Commissions are required to define the term "substantial position" as a threshold that is "prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States."⁸⁴ This raises two fundamental issues: (i) what types of measures should be used to identify the risks posed by an entity's swap or security-based swap positions; and (ii) for each of those measures, how much risk should be required to evidence a "substantial position"?

1. Commenters' views

Commenters have expressed diverse views as to what should constitute a substantial position. A number of commenters suggested the use of a test based on the current uncollateralized mark-to-market exposure posed by an entity's swap or security-based swap positions, after taking bilateral netting agreements into account. Two

⁸⁴ See CEA section 1a(33)(B); Exchange Act section 3(a)(67)(B).

commenters suggested specific dollar amounts of uncollateralized exposure to use as the substantial position threshold.⁸⁵ Several commenters expressed the view that positions subject to central clearing should be entirely excluded from the analysis, or at least should be discounted for purposes of the analysis.⁸⁶

Some commenters opposed using the notional amount of swap or security-based swap positions to set the threshold, stating that the notional amount is not indicative of the risks associated with a position. Some commenters similarly opposed using measures of swap or security-based swap volume to set the threshold, contending that the number of trades does not reflect risk.⁸⁷

A few commenters addressed the possibility that the threshold could take into account the potential future risks associated with a position, in addition to the risks associated with uncollateralized current exposure.⁸⁸ Some commenters suggested that the threshold take into account the potential riskiness of the particular type of instrument at issue. Some commenters maintained that the threshold should take into account the

⁸⁵ See letter from Timothy W. Cameron, Esq., Managing Director, SIFMA Asset Management Group, dated September 20, 2010 ("SIFMA AMG letter") (suggesting a standard of \$2.5 billion average exposure in any calendar quarter based on the entity's entire portfolio of swaps and security-based swaps, other than foreign exchange swaps and forwards); letter from Gus Sauter, Chief Investment Officer, Vanguard, dated September 20, 2010 ("Vanguard letter") (suggesting that the applicable threshold be \$500 million in uncollateralized exposure for any single major swap category or \$1 billion aggregate exposure across all major categories).

⁸⁶ See letter from Jennifer J. Kalb, Associate General Counsel, Metropolitan Life Insurance Company, dated September 20, 2010 ("MetLife letter") (suggesting that cleared trades be subject to a lesser "charge" for purposes of the substantial position calculation, or be excluded entirely).

⁸⁷ But see letter from Christopher A. Klem, Ropes & Gray, dated September 2, 2010 (test should account for frequency of trading and frequency of trading with non-dealers).

⁸⁸ See letter from Andrew Baker, Chief Executive Officer, Alternative Investment Management Association, dated September 24, 2010 ("AIMA letter") (discussing possible methods of estimating the maximum risk of loss related to positions); letter from Warren Davis, Of Counsel, Sutherland Asbill & Brennan LLP on behalf of the Federal Home Loan Banks, dated September 20, 2010 (in addressing "substantial counterparty exposure" test, noting the possibility of accounting for the potential exposure of a portfolio).

number of counterparties an entity has; the size of an entity's positions compared to the size of the market, the size of an entity's swap or security-based swap positions compared to the entity's ability to absorb losses of that magnitude, or the financial strength of an entity's counterparties. Several commenters stated that the threshold should be based on an average measure over time, so that short-term spikes in measures such as exposure would not by themselves cause an entity to meet the major participant definitions. Some commenters suggested that the substantial position threshold should reflect an amount of "systemic risk."⁸⁹

2. Proposed substantial position thresholds

The Commissions recognize that it is important for the substantial position thresholds to be set using objective numerical criteria. Objective criteria should permit regulators, market participants and entities that may be subject to the regulations to readily evaluate whether swap or security-based swap positions meet the thresholds, and should promote the predictable application and enforcement of the requirements governing major participants.

⁸⁹ See letter from Edward J. Rosen, Cleary Gottlieb Steen & Hamilton LLP, dated September 21, 2010 ("Cleary letter") (suggesting that the threshold should be akin to the amount that is required for a non-financial entity to be designated as systemically important under Title I of the Dodd-Frank Act).

Section 113 of the Dodd-Frank Act provides that the Financial Stability Oversight Council ("FSOC") may determine that a non-bank financial company shall be supervised by the Federal Reserve Board, subject to prudential standards, if the FSOC "determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States." In making that determination, the FSOC is to consider: leverage; off-balance sheet exposures; transactions and relationships with other significant non-bank financial companies and bank holding companies; importance as a source of credit and liquidity; extent to which assets are managed rather than owned; the nature, scope, size, scale, concentration, interconnectedness and mix of activities; presence of a primary financial regulator; assets and liabilities; and any other appropriate risk-related factors.

In determining the substantial position thresholds – in light of what is “prudent for the effective monitoring, management, and oversight” of entities that are systemically important or can significantly impact the U.S. financial system – the Commissions are mindful that tests based on current uncollateralized exposure and tests based on potential future exposure both have respective advantages and disadvantages. We thus are proposing tests that would account for both types of exposure.

A test that focuses solely on the current uncollateralized exposure associated with an entity’s swap and security-based swap positions should provide a reasonable measure of the theoretical amount of potential risk that an entity would pose to its counterparties if the entity currently were to default.⁹⁰ Such a test also should be relatively clear-cut for market entities to implement, and would be based on calculations that we expect that market entities would perform as a matter of course.

At the same time, a focus solely on current uncollateralized exposure could be overly narrow by failing to identify risky entities until some time after they begin to pose the level of risk that should subject them to regulation as major participants. Because exposure can change significantly over short periods of time, and a swap or security-based swap position that may pose large potential exposures nonetheless would often have a mark-to-market exposure of zero at inception, an entity’s positions may already pose significant risk to counterparties and to the market even before its uncollateralized mark-to-market exposure increases up to the applicable threshold. A test that focuses

⁹⁰ In practice, however, this measure may underestimate the amount of risk that an entity poses to its counterparties, given that it may take multiple days to liquidate a defaulting entity’s swap or security-based swap positions, during which time prices may move against the defaulting entity.

solely on current uncollateralized exposure thus would not appear to be sufficient to satisfy the systemic importance standard required by the statute.

Tests based on measures of potential future exposure – which would address an estimate of how much the value of a swap or security-based swap might change against an entity over the remaining life of the contract – could address the gap left by a current uncollateralized exposure test. Potential future exposure tests, however, would reflect only an estimate of that type of risk, and would only be as effective as the factors used by the test.

While we have considered several other types of tests that could be used to determine the substantial position threshold, we preliminarily do not believe that the advantages of those tests justify their disadvantages. For example, while a threshold based on the number of an entity's counterparties could help identify highly interconnected entities (a factor that some have argued is important for identifying an entity's systemic risk), it also has been argued that a large number of counterparties could mean that the losses associated with that entity's default would be divided and absorbed by many counterparties without broader market effects.⁹¹ While a threshold that is based on an entity's financial strength would help account for the possibility of an entity's default as well as the effects of such a default, it would not address swap-related risks to the market that are not directly linked to the entity's default. In other words, an entity that has large out-of-the-money swap or security-based swap positions and faces a margin

⁹¹ See AIMA letter ("An entity that has only a small number of counterparties may only affect a small number of entities directly, should it fail, but the impact could be significant if the position is large and the counterparty is a systemically important entity. A diversified exposure to multiple entities could affect more entities but is likely to be smaller and thus shares the losses in the industry and having less systemic impact.").

call may cause significant price movements in the swaps or security-based swaps and in the related reference entities or assets if the entity chooses to unwind its positions, even if the entity itself does not appear to present a large threat of default. These movements may be exacerbated if other entities have similar positions.

Moreover, although substantial position thresholds based on the financial strength of an entity's counterparties would help measure the potential that an entity's default would have a broader impact, such thresholds could result in disparate results between two entities with identical positions, and also could encourage concentration of exposure or potential future exposure within a few counterparties. While tests that are based on the volume of an entity's swaps or security-based swaps may be helpful in identifying significant swap or security-based swap activity, such tests would not directly be germane to the current or potential future exposure posed by an entity's swap and security-based swap positions. Finally, while we have considered the feasibility of tests that take specific contract features into account (e.g., triggers that require the payment of mark-to-market margin if an entity's credit rating is lowered), we preliminarily believe that simpler tests of exposure can more efficiently identify the risks associated with particular swap or security-based swap positions.

After considering these alternatives, the Commissions are proposing two tests to define "substantial position." One test would focus exclusively on an entity's current uncollateralized exposure; the other would supplement a current uncollateralized exposure measure with an additional measure that estimates potential future exposure. A position that satisfies either test would be a "substantial position."

The Commissions, however, request comment on whether it would be appropriate to use other types of approaches for determining whether an entity has a substantial position – as an alternative to, or in addition to, the two proposed tests.

a. Proposed current exposure test

The proposed first substantial position test, which would focus solely on current uncollateralized exposure, in general would set the substantial position threshold by reference to the sum of the uncollateralized current exposure, obtained by marking-to-market using industry standard practices, arising from each of the person's positions with negative value in each of the applicable "major" category of swaps or security-based swaps (other than positions excluded from consideration, such as positions for the purpose of "hedging or mitigating commercial risk").⁹²

A person would apply this proposed substantial position test on a major category-by-major category basis, examining its positions with each counterparty with which the person has swaps or security-based swaps in the particular category. For each counterparty, the person would determine the dollar value of the aggregate current exposure arising from each of its swap or security-based swap positions with negative

⁹² See proposed CEA rule 1.3(sss)(2); proposed Exchange Act rule 3a67-3(b)(1). In other words, the test would measure the portion of the exposure that is not offset by the posting of collateral. If a position was collateralized only partially, the value of the collateral posted would be offset against the total exposure, and the test would measure the residual part of the exposure. We recognize that there may be operational delays between changes in exposure and the resulting exchanges of collateral, and in general we would not expect that operational delays associated with the daily exchange of collateral would be considered to lead to uncollateralized exposure for these purposes.

As noted above, the statutory definitions require us to consider the presence of central clearing in setting the substantial position threshold. This test would account for the risk-mitigating effects of central clearing in that centrally cleared swaps and security-based swaps are subject to mark-to-market margining that would largely eliminate the uncollateralized exposure associated with a position, effectively resulting in cleared positions being excluded from the analysis.

value (subject to the netting provisions described below) in that major category by marking-to-market using industry standard practices, and deduct from that amount the aggregate value of the collateral the person has posted with respect to the swap or security-based swap positions. The aggregate uncollateralized outward exposure would be the sum of those uncollateralized amounts over counterparty with which the person has entered into swaps or security-based swaps in the applicable major category.⁹³

The proposed test would not prescribe any particular methodology for measuring current exposure or the value of collateral posted,⁹⁴ and instead would provide that the method should be consistent with counterparty practices and industry practices generally.⁹⁵

⁹³ See proposed CEA rule 1.3(sss)(2); proposed Exchange Act rule 3a67-3(b)(2).

⁹⁴ Depending on the particular circumstances of the swap or security-based swap, such collateral may be posted to a third-party custodian, directly to the counterparty, or in accordance with the rules of a derivatives clearing organization or clearing agency.

⁹⁵ Consistent with industry practices, we would expect that entities may value exposure based on measures that take into account the amounts that would be payable if the transaction were terminated. Also, to the extent the valuation of collateral posted in connection with swaps or security-based swaps is subject to other rules or regulations, we would expect that the valuation of collateral for purposes of the major participant calculations would be consistent with those applicable rules.

At the same time, we recognize that there can be disputes or uncertainty as to an entity's exposure in connection with swap and security-based swap positions, and as to the valuation of the collateral it has posted in connection with those positions. In some circumstances this could lead to uncertainty as to whether the entity is a major participant. As addressed below, we are requesting comment as to the potential significance of these issues, and as to whether we should set forth additional guidance or mandate the use of specific standards with respect to these valuations.

Also, it is important to recognize that while we expect that other regulatory requirements applicable to the valuation of swap or security-based swap positions and collateral would be relevant to certain calculations relating to major participant status, our proposed rules would not be relevant for other purposes, such as in the context of capital and margin requirements.

This proposed test would account for the risk mitigating effects of netting agreements⁹⁶ by permitting an entity to calculate its exposure on a net basis, by applying the terms of master netting agreements entered into between the entity and a single counterparty.⁹⁷ When calculating the net exposure the entity may take into account offsetting positions with that particular counterparty involving swaps, security-based swaps and securities financing transactions (consisting of securities lending and borrowing, securities margin lending and repurchase and reverse repurchase agreements) to the extent that is consistent with the offsets provided by the master netting agreement.⁹⁸

The Commissions preliminarily believe that this approach is appropriate because it avoids identifying a position's exposure as being "uncollateralized" when there is no current counterparty risk associated with it due to offsets under a netting agreement with

⁹⁶ Section 362(b)(17) of the United States Bankruptcy Code generally provides derivatives contracts with a safe harbor from the Bankruptcy Code's automatic stay, thus allowing parties to these contracts to enforce their contractual rights, including those associated with netting and offsets, even after a counterparty has filed for bankruptcy.

In addition, Section 210(c)(8)(A) of the Dodd-Frank Act reaffirms the enforceability of netting and offset provisions in certain derivatives contracts with insolvent counterparties that have been placed under the receivership of the Federal Deposit Insurance Corporation ("FDIC"). However, the Dodd-Frank Act also places certain limitations on the timing by which netting rights may be exercised when the FDIC has been appointed as the receiver of an insolvent counterparty. See Dodd-Frank Act section 210(c)(10)(B).

⁹⁷ To the extent that the two counterparties maintain multiple netting agreements (e.g., separate agreements for dollar-denominated and euro-denominated instruments), the calculation would account only for the netting permitted under the netting agreement that is relevant to the swap or security-based swap at issue.

⁹⁸ See proposed CEA rule 1.3(sss)(2)(iii)(A); proposed Exchange Act rule 3a67-3(b)(3)(A). As is the case for the proposed rules on valuation, the proposed rules regarding possible offsets of various positions are for purposes of determining major participant status only. Other rules proposed by the Commissions may address the extent to which, if any, persons such as dealers and major participants may offset positions for other purposes.

the counterparty.⁹⁹ In calculating current uncollateralized exposure, however, the entity may not take into account the market risk offsets associated with holding positions with multiple counterparties.¹⁰⁰ Also, the entity may not “double count” any offset or collateral – once any item of collateral or any position with positive value has been applied against current exposure, the same item cannot be applied for purposes of this test against any other exposure.

The proposal to permit this type of netting, however, raises questions as to how an entity’s net out-of-the-money exposure with a counterparty, and the collateral posted with respect to its positions with the counterparty, should be allocated among swap positions, security-based swap positions and other positions specified in the rule.¹⁰¹ In particular, when an entity has not fully collateralized its net current exposure to a particular counterparty with which it has a netting agreement, there may be questions regarding how to attribute the net out-of-the-money positions and associated collateral to its swap or security-based swap positions. We preliminarily believe that an entity that has net uncollateralized exposure to a counterparty should, for purposes of the test, allocate that net uncollateralized exposure pro rata in a manner that reflects the exposure associated with each of its out-of-the-money swap positions, security-based swap positions and non-

⁹⁹ If, for example, an entity was \$X out of the money in connection with a security-based swap, but was \$X in the money with the same counterparty in connection with a swap, there would be no economic need for the entities to exchange collateral in connection with those offsetting positions. A test that fails to account for this netting of exposure could lead the entities to engage in needless offsetting exchanges of collateral.

¹⁰⁰ See proposed CEA rule 1.3(sss)(2)(iii)(C); proposed Exchange Act rule 3a67-3(b)(2)(iii). While recognizing that offsetting positions of that type would reduce the market risk facing the entity, the offsets would not be expected to directly mitigate the risks that the entity’s counterparties would face if the entity were to default.

¹⁰¹ This issue does not arise to the extent that an entity’s net positions with a counterparty are fully collateralized.

swap positions.¹⁰² This allocation would be intended to cause the measure of uncollateralized exposure connected with swaps or security-based swaps for purposes of the test to reasonably reflect the relative contribution of those instruments to an entity's total overall uncollateralized exposure.

For purposes of the definition of "major swap participant," the Commissions are proposing to set the current uncollateralized exposure threshold at a daily average of \$1 billion in the applicable major category of swaps, except that the threshold for the rate swap category would be a daily average of \$3 billion. For purposes of the definition of "major security-based swap participant," this threshold would be based on a daily average of \$1 billion in the applicable major category of security-based swaps.¹⁰³ We preliminarily believe that these proposed thresholds are appropriate for identifying entities that, through their swap and security-based swap activities, have a significant potential to pose the systemic importance or risks to the U.S. financial system that the major participant definition and associated statutory requirements were intended to address, but we also recognize that it is possible that the appropriate threshold should be higher or lower. In proposing these specific thresholds, we have sought to take into account several factors: (i) the ability of the financial system to absorb losses of a

¹⁰² In other words, if an entity's out-of-the-money rate swap positions have \$W exposure, its out-of-the-money other commodity swap positions have \$X exposure, its out-of-the-money security-based swap positions have \$Y exposure, and its other out-of-the-money positions covered by that netting agreement have \$Z exposure, fractions of the collateral equal to $W/(W+X+Y+Z)$ should be allocated to the rate swap positions, $X/(W+X+Y+Z)$ to the other commodity swap positions and $Y/(W+X+Y+Z)$ to the security-based swap positions. A similar process should be used for allocating net out-of-the-money exposure across the categories of swaps and security-based swaps that have out-of-the-money exposure when one or more categories are in-the-money.

¹⁰³ See proposed CEA rule 1.3(sss)(1); proposed Exchange Act rule 3a67-3(a)(1).

particular size;¹⁰⁴ (ii) the appropriateness of setting “prudent” thresholds that are materially below the level that could cause significant losses to the financial system as it would not be appropriate for the substantial position test to encompass entities only after they pose significant risks to the market through their swap or security-based swap activity;¹⁰⁵ and (iii) the need to account for the possibility that multiple market participants may fail close in time, rather than focusing narrowly on the potential impact of a single participant’s default.¹⁰⁶ Based on these factors, we preliminarily believe that the proposed substantial position thresholds would reasonably be expected to apply to entities that have the potential of satisfying the statutory criteria of systemic importance or significant impact to the U.S. financial system. As discussed below, however, we welcome comments on the appropriateness of the proposed threshold.

These proposed thresholds would be evaluated by reference to a calculation of the mean of an entity’s uncollateralized exposure measured at the close of each business day, beginning on the first business day of each calendar quarter and continuing through the

¹⁰⁴ In this regard, the Commissions preliminarily believe that the “Tier 1” capital of major dealer banks provides relevant information about the ability of the financial system to absorb losses of a particular size. We note that, among U.S. banks that are dealers in credit derivatives, the six largest banks account for the vast majority of dealing activities. We understand that the most liquid “Tier 1” regulatory capital for those six banks ranges from \$14 billion to \$113 billion.

¹⁰⁵ In other words, the proposed thresholds are intended to be low enough to provide for the appropriately early regulation of an entity whose swap or security-based swap positions have a reasonable potential of posing significant counterparty risks and risks to the market that stress the financial system, while being high enough that it would not unduly burden entities that are materially less likely to pose these types of risks.

¹⁰⁶ For example, the proposed \$1 billion threshold for swaps and security-based swaps would reflect a potential loss of \$3 billion if three large swap or security-based swap entities were to fail close in time. That \$3 billion could represent a significant impairment of the ability of some major dealers to absorb losses, as reflected by their Tier 1 capital.

We also are mindful of the views expressed by the two commenters that suggested particular dollar values for the threshold. See note 85, *supra*.

last business day of that quarter.¹⁰⁷ In this regard, the Commissions have taken into account commenters' concerns that an entity's exposure should not be evaluated based on a single point in time, as short-term market fluctuations may not fairly reflect the risks of the entity's positions. The use of a daily average approach should help address commenters' concerns about the impact of short-term price fluctuations, and also help preclude the possibility that an entity may seek to use short-term transactions to distort the measure of exposure.

The Commissions request comment on the proposed current uncollateralized exposure test. Commenters particularly are requested to address whether the proposed threshold amounts of current uncollateralized exposure are appropriate, and, if not, what alternative higher or lower threshold amounts would appropriately identify entities that pose the types of risks that the definition was intended to address. In this regard, commenters specifically are requested to address whether bank Tier 1 capital provides a good indicative reference of the ability of major dealers to absorb losses of a particular size, or whether alternative reference points for the analysis (*e.g.*, the size of the swap market or security-based swap market) would also be applied. Commenters are requested to address whether uncollateralized mark-to-market exposure is the appropriate way to measure current exposure, and if not, what alternative approach is more appropriate, and why. Commenters also are requested to address whether the proposed thresholds reasonably address the need to set the threshold at a prudent level so as to avoid the possibility that the substantial position test would encompass entities only after they pose significant risks to the market, whether the proposed thresholds reasonably address the

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See proposed CEA rule 1.3(sss)(4); proposed Exchange Act rule 3a67-3(d).

possibility that multiple market entities could fail close in time, and whether the proposed thresholds reasonably address the fact that swap or security-based swap activities would comprise only part of the risks to the market posed by an entity. To what extent would this proposed definition of "substantial position" have an effect on the activities of entities that potentially may be deemed to be major participants? What impact could these types of effects have on liquidity, on risk-taking or risk-reducing activities, or on other aspects of the relevant markets?

Also, more fundamentally, we request comment on whether the substantial position analysis also should encompass a test that does not account for the collateral posted in connection with an entity's exposure, given that tests that account for the posting of collateral would not encompass entities that have very large swap or security-based swap positions that are fully collateralized (either by the posting of bilateral collateral or by virtue of central clearing). In that light, should the analysis seek to capture entities that have very large positions in light of potential market disruptions such entities could cause, regardless of whether the positions are collateralized?

Commenters further are requested to address whether such thresholds should also account for entities that have large in-the-money positions that may indicate their potential significance to the market. In this regard, commenters also are asked to address whether the thresholds should specifically address entities with large in-the-money positions that lead them to receive large amounts of collateral posted by their counterparties, particularly to the extent that such collateralized in-the-money positions could later turn and lead the entity to incur losses.

In addition, commenters are requested to address whether and how it would be appropriate to adjust the threshold amounts over time, including whether these proposed current uncollateralized exposure thresholds should periodically be adjusted by formula to reflect changes in the ability of the market to absorb losses over time, or changes in other criteria over time. Commenters further are requested to address whether the test will be practical for potential major participants to use. Moreover, commenters are requested to address whether the proposed current exposure test should be modified to account for the risks associated with the expected time lag between an entity's default and the liquidation of its swap or security-based swap positions.

Commenters also are requested to address whether we should set forth additional guidance or mandate the use of specific standards with respect to the measure of exposure or valuing collateral posted, or should specify particular procedures in the event of valuation disputes. What particular industry standard documentation and other methodologies could be used to measure exposure and value collateral? Also, how could regulatory requirements applicable to the valuation of collateral be relevant to the valuation of collateral for purposes of the major participant definitions?

Commenters are invited to address whether the rule should provide that, in measuring their current uncollateralized exposure, entities must value collateral in a way that is at least as conservative as such collateral would be valued according to applicable haircuts or other adjustments dictated by applicable regulations. Commenters further are requested to address whether the test should exclude certain types of collateral that cannot readily be valued. Also, commenters are requested to address whether the proposed method of evaluation – the mean of an entity's uncollateralized exposure

measures at the close of each business day, beginning on the first business day of each calendar quarter and continuing through the last business day of that quarter – would be unduly burdensome or potentially subject to gaming or evasion.

Should the proposed approach for measuring uncollateralized current exposure be amended or supplemented, such as by establishing requirements for how exposure should be measured or collateral should be valued in certain circumstances (e.g., requiring the valuation of certain types of collateral to be conservative during times of rapid price changes in the relevant asset class)? Should current exposure and collateral be required to be valued in accordance with US generally accepted accounting principles? Would measurement according to such principles differ in any respects from measurement under the proposal, and, if so, how?

In addition, commenters are requested to address the proposed netting provisions of this test, including: whether the proposed test would reasonably permit the measure of uncollateralized exposure to account for bilateral netting agreements; whether additional types of positions should be included within the netting provisions; whether the proposal appropriately takes into account the netting of exposures and collateral involving positions in financial instruments other than swaps, security-based swaps and securities financing transactions and if so, whether any limitations to such offsetting would be necessary or appropriate; whether the netting provisions should accommodate offsetting positions involving the net equity balance in an entity's securities account (e.g., free credit balances, other credit balances, and fully paid securities), and if so, whether any limitations to such offsetting would be necessary or appropriate; whether the netting provisions should accommodate offsets for exposures, or collateral connected with the

positions that an entity has with the affiliate of a counterparty; and whether the proposed method of allocating the uncollateralized portion of exposures among the different types of financial instruments that are all subject to a single netting agreement is appropriate.

Commenters also are requested to address whether the proposed current uncollateralized exposure test would pose significant monitoring burdens upon entities that have swap or security-based swap positions that are significant enough to potentially meet the current uncollateralized exposure threshold. Should we provide guidance as to policies and procedures that such an entity should be able to follow to demonstrate that it does not meet the applicable thresholds?

b. Proposed current exposure plus potential future exposure test

The second proposed test would account both for current uncollateralized exposure (as discussed above) and for the potential future exposure associated with swap or security-based swap positions in the applicable "major" category of swaps or security-based swaps. This additional test would allow the major participant analysis to take into account estimates of how the value of an entity's swap or security-based swap positions may move against the entity over time.

The potential future exposure portion of this proposed test would be based on an entity's "aggregate potential outward exposure," which would reflect the potential exposure of the entity's swap or security-based swap positions in the applicable "major" category of swap or security-based swaps, subject to certain adjustments. Bank capital standards also make use of this type of test,¹⁰⁸ and this proposal builds upon those

¹⁰⁸ See 12 CFR Part 3, app. C, Section 32 (Office of the Comptroller of the Currency bank capital standards).

standards but modifies them to focus on the risk that an entity poses to its counterparties (rather than on the risk that counterparties pose to an entity). In doing so, this proposal seeks to use a test that can be implemented by a range of market participants, and that can be expected to lead to reproducible results across market participants with identical swap or security-based swap portfolios, rather than relying on alternative tests (e.g., value at risk measures or stress testing methodologies) that may be costly for market participants to implement and that would not be expected to lead to reproducible results across participants.

The exposure measures in general would be based on the total notional principal amount of those positions, adjusted by certain risk factors that reflect the type of swap or security-based swap at issue and the duration of the position.¹⁰⁹ For positions in which

¹⁰⁹ For example, consistent with the bank standards, the multiplier for equity swaps would range from 0.06 for equity swaps of one year or less to 0.10 for equity swaps with a maturity of more than five years. See proposed Exchange Act rule 3a67-3(c)(2)(i)(A). For security-based swaps based on the credit of a reference entity, the multiplier would be 0.1.

The current bank capital standards contain a distinction based on whether the credit derivative is on "investment grade" or "non-investment grade" reference entities, providing a 0.1 multiplier for the former and a lower 0.05 multiplier for the latter. We preliminarily do not believe that a test that distinguishes among reference entities by reference to their credit ratings would be appropriate for purposes of these definitions; particularly in light of the fact that the Dodd-Frank Act mandates the substitution of credit ratings with other standards of creditworthiness in U.S. regulations. See Dodd-Frank Act section 939A.

The multipliers in part will be a function of the remaining maturity of the swap or security-based swap. If the swap or security-based swap, however, is structured such that on specified dates the outstanding exposure is settled and the terms are reset so the market value is zero, the remaining maturity would equal the time until the next reset date.

Although we recognize that these risk multipliers may suggest a lower than expected volatility of credit or equity derivatives of that duration, this may be offset by the fact that the proposed calculations of potential future exposure do not directly account for portfolio netting or collateral updates that could mitigate future exposure. We preliminarily believe that the use of these thresholds (and proposed related calculations) for purposes of identifying major participants are consistent with similar bank capital standards and are therefore suitable for use as an estimate of potential future exposure. We are also cognizant that requiring a more complete calculation of potential future exposure may be costly and burdensome for participants, especially those who

the stated notional amount is leveraged or enhanced by the particular structure, this calculation would be based on the position's effective notional amount.¹¹⁰

At the same time, the proposed measures would contain adjustments for certain types of positions that pose relatively lower potential risks.¹¹¹ In addition, the general risk-adjusted notional measures of potential future exposure would be reduced to reflect the risk mitigation effects of master netting agreements, in a manner consistent with bank capital standards.¹¹²

would otherwise not meet the thresholds for major swap or security-based swap participant and would not have systems in place to perform a more complete calculation.

¹¹⁰ See proposed CEA rule 1.3(sss)(3)(ii); proposed Exchange Act rule 3a67-3(c)(2)(i)(B). For purposes of this rule, in the case of positions that represent the sale of an option on a swap or security-based swap (other than the sale of an option permitting the person exercising the option to purchase a credit default swap), we would view the effective notional amount of the option as being equal to the effective notional amount of the underlying swap or security-based swap, and we would view the duration used for purposes of the formula as being equal to the sum of the duration of the option and the duration of the underlying swap or security-based swap.

¹¹¹ The analysis would exclude swap or security-based swap positions that constitute the purchase of an option, such that the person has no additional payment obligations under the position, as well as other positions on which the person has prepaid or otherwise satisfied all of its payment obligations. See proposed Exchange Act rule 3a67-3(c)(2)(i)(C).

For similar reasons, the potential outward exposure associated with a position by which a person buys credit protection using a credit default swap would be capped at the net present value of the unpaid premiums. See proposed CEA rule 1.3(sss)(3)(ii)(A)(4); proposed Exchange Act rule 3a67-3(c)(2)(i)(D).

¹¹² In particular, for swaps or security-based swaps subject to master netting agreements the potential exposure associated with the person's swap or security-based swaps with each counterparty would equal a weighted average of the potential exposure in the applicable "major" category of swaps or security-based swaps with a particular counterparty as calculated without reference to netting, and that amount reduced by the ratio of net current replacement cost to gross current replacement cost of all swap and security-based swap positions with that counterparty, consistent with the following equation: $P_{Net} = 0.4 \times P_{Gross} + 0.6 \times NGR \times P_{Gross}$

Under this formula, P_{Net} is the potential exposure in the applicable "major" category of swaps or security-based swaps adjusted for bilateral netting; P_{Gross} is the potential exposure in that category without adjustment for bilateral netting; and NGR is the ratio of net current replacement cost to gross current replacement cost. See proposed CEA rule 1.3(sss)(3)(ii)(B); proposed Exchange Act rule 3a67-3(c)(2)(ii).

The "NGR" ratio is intended to serve as a type of proxy for the impact of netting on potential future exposure, but does not serve as a precise indicator of future changes in net

The proposed measures of potential future exposure would contain further downward adjustments to account for the risk mitigation effects of central clearing and mark-to-market margining. In particular, if the swap or security-based swap positions are cleared by a registered clearing agency or subject to daily mark-to-market margining,¹¹³ the measures of potential future exposure would further be adjusted to equal twenty percent of the potential future exposure calculated using the methodology described above.¹¹⁴ The Commissions preliminarily believe that a significant downward adjustment would be appropriate because clearing and daily mark-to-market margining would be expected to reduce the potential future risks posed by an entity's swap or security-based swap positions. Also, it is appropriate to incentivize the use of central clearing and daily mark-to-market margining as practices for helping to control risks. We are not proposing to entirely eliminate such cleared and margined positions from the analysis of potential future exposure, however, because clearing may not entirely

exposure relative to gross exposure, as the ratio and potential exposure can be influenced by many idiosyncratic properties of individual portfolios. See Basle Committee on Banking Supervision, "The Treatment of the Credit Risk Associated with Certain Off-Balance-Sheet Items" (July 1994).

¹¹³ For these purposes, a swap or security-based swap would be considered to be subject to daily mark-to-market margining if, and for as long as, the counterparties follow the daily practice of exchanging collateral to reflect changes in exposure (after taking into account any other positions addressed by a netting agreement between the parties). If a person is permitted to maintain an uncollateralized "threshold" amount under the agreement, that amount (regardless of actual exposure) would be considered current uncollateralized exposure for purposes of the test. Also, if the agreement provides for a minimum transfer amount in excess of \$1 million, the entirety of that amount would be considered current uncollateralized exposure. See proposed CEA rule 1.3(sss)(3)(iii)(B); proposed Exchange Act rule 3a67-3(c)(3)(ii).

In this way, the measure of potential future exposure would reflect for the risk mitigating benefits of daily margining, while specifically accounting for industry practices that limit those benefits. Of course, to take advantage of this adjustment it is not enough to the agreement to provide for daily mark-to-market margining – the parties must actually follow that practice.

¹¹⁴ See proposed CEA rule 1.3(sss)(3)(iii)(A); proposed Exchange Act rule 3a67-3(c)(3).

eliminate the risks posed by an entity's potential default,¹¹⁵ and daily mark-to-market margining would not eliminate the risks associated with large intra-day price movements. While the proposed amount of the adjustment seeks to balance these competing factors, we recognize that alternative higher or lower downward adjustments may also be appropriate.

For purposes of the "major swap participant" definition, the substantial position threshold would be \$2 billion in daily average current uncollateralized exposure plus aggregate potential outward exposure in the applicable major swap category, except that the threshold for the rate swap category would be a daily average of \$6 billion. For purposes of the "major security-based swap participant" definition, the substantial position threshold would be \$2 billion in daily average current uncollateralized exposure plus aggregate potential outward exposure in any major security-based swap category.¹¹⁶ These proposed amounts reflect the same factors discussed above in the context of the current uncollateralized exposure test,¹¹⁷ but are raised to reflect the fact that potential future exposure is a measure of potential risk over time, and hence is less likely to pose a direct, immediate impact on the markets than current measures of uncollateralized exposure. We recognize that alternative risk thresholds may also be appropriate, and we welcome comment on potential alternatives.

¹¹⁵ For example, the central counterparties that clear credit default swaps do not necessarily become the counterparties of their members' customers (although even absent direct privity those central counterparties benefit customers by providing for protection of collateral they post as margin, and by providing procedures for the portability of the customer's positions in the event of a dealer's default). As a result, central clearing may not eliminate the counterparty risk that the customer poses to the dealer. Even then, however, required mark-to-market margining should help control that risk, and central clearing thus would be expected to reduce the likelihood that an entity's default would lead to broader market impacts.

¹¹⁶ See proposed Exchange Act rule 3a67-3(a)(2).

¹¹⁷ See notes 103 to 106, *supra*, and accompanying text.

In light of the amount of this threshold and the underlying risk adjustments, we preliminarily do not believe that an entity would need to calculate its potential future exposure for purposes of the test unless the entity has large notional positions. For example, in light of the proposed risk adjustment of 0.10 for credit derivatives, an entity that does not have any uncollateralized current exposure would have to have notional positions of at least \$20 billion to potentially meet the \$2 billion threshold, even before accounting for the discounts associated with netting agreements. If those swaps or security-based swaps are cleared or subject to mark-to-market margining, the additional 20 percent risk adjustment would mean that the entity without current uncollateralized exposure would have to have cleared notional positions of at least \$100 billion to possibly meet that threshold.¹¹⁸

The Commissions request comment on this proposed use of a current exposure plus potential future exposure test to determine the substantial position threshold. Commenters particularly are requested to address the appropriateness of using potential exposure risk adjustments derived from bank capital rules; and the appropriateness of using bank capital methodologies for addressing positions subject to netting agreements. Also, should this test be supplemented by a test that accounts for the notional amount of an entity's swap or security-based swap positions without risk-adjustments, to focus on entities that have very large swap or security-based swap positions?

Commenters are requested to address whether the proposed threshold amounts for the proposed current exposure plus potential future exposure test are appropriate, and if

¹¹⁸ Based on these thresholds, we preliminarily believe that only relatively few entities would regularly have to perform these potential future exposure calculations with regard to their security-based swaps. See notes 181 and 182, *infra*, and accompanying text.

not, what alternative threshold amounts would be more appropriate, and why. In addition, commenters are requested to address the proposed method of discounting the potential future exposure associated with cleared positions or positions subject to daily mark-to-market margining to equal 20 percent of what the measure of potential future exposure would be otherwise. Would a larger or smaller discount be appropriate? Is there data available that may assist with reaching the appropriate discount factor? Also, in that regard, should both sets of discounts be equal, or should cleared positions be subject to more of a discount than uncleared positions subject to daily mark-to-market margining? Commenters also are invited to address whether the proposed discounts for cleared positions or positions that are marked-to-market would make it unnecessary or duplicative for this test separately to account for netting agreements. Also, if an entity currently has posted excess collateral in connection with a position, should the amount of that current overcollateralization be deducted from its measure of potential future exposure?

Commenters also are requested to address whether the proposed test in connection with purchases of credit protection – which would cap the measure of exposure at the net present value of unpaid premiums – would raise problems in implementation, and whether we should propose any particular discount rate to be used in conducting the calculation (and, if so, what discount rate should be appropriate). Also, should the measure of potential future exposure in connection with purchases of credit protection and options also account for collateral that a counterparty has posted in connection with an entity's in-the-money positions, given that such collateralized in-the-money positions could later turn and cause losses to an entity? In addition, for positions that represent the

sale of options on swaps or security-based swaps, would the effective notional amount of the option for purposes of the calculation properly be deemed to be the notional amount of the underlying instrument (or should the notional amount of the option vary based on the link between the changes in the value of the option and changes in the value of the underlying); and would the duration of the option properly be deemed to be the sum of the duration of the option and the duration of the underlying swap or security-based swap?

Commenters also are requested to address whether the risk adjustment for credit derivatives should reflect the riskiness of the underlying reference entity, and, if so, how should that be accomplished in a way that does not rely on the use of credit ratings.

The proposed test of potential future exposure is based in part on the application of fixed multipliers to the notional amounts, or effective notional amounts, of swaps and security-based swaps. In this regard, commenters are invited to discuss whether there are alternative tests that would be more effective to determine potential future exposure or otherwise to supplement an uncollateralized current exposure test, and whether such alternative tests may be more effectively developed in the near future, when additional data regarding swap and security-based swap positions are likely to be available. In particular, commenters are requested to identify any tests based on non-proprietary risk models that could be uniformly applied by all potential major participants to measure potential future exposure. Commenters who propose alternative tests are asked to address how the tests would provide consistent results across different types of swaps and security-based swaps, including customized instruments, in the different major categories. Commenters are also invited to address, on the other hand, whether a single

test based on uncollateralized current exposure (i.e., without any test of potential future exposure) would be adequate for identifying entities whose swap or security-based swap positions pose a relatively high degree of risk to counterparties and to the markets. In addition, commenters are invited to identify any tests or thresholds below which a party would be deemed not to be a major swap participant, without needing to calculate the exposure tests set forth in the proposed rule.

Commenters further are requested to address whether and how it would be appropriate to adjust the threshold amounts over time, including whether these proposed thresholds should periodically be adjusted by formula to reflect changes in the ability of the market to absorb losses over time, or changes in other criteria over time. In addition, commenters are requested to address whether the proposed use of a daily average measure for purposes of this test would be burdensome for potential major participants to implement, and, if so, how often should potential participants have to measure these amounts. Commenters also are requested to address whether any such tests should seek to reflect the maximum level of exposure associated with a position, rather than risk-adjusted estimates of exposure proposed here.

In addition, commenters are requested to address whether this proposed test would pose significant monitoring burdens upon entities that have swap or security-based swap positions that are significant enough to potentially meet the combined current uncollateralized exposure and potential future exposure test. Should we provide guidance as to policies and procedures that such an entity should be able to follow to be able to demonstrate that it does not meet the applicable thresholds?

C. “Hedging or mitigating commercial risk”

The first test of the major participant definitions excludes positions held for “hedging or mitigating commercial risk” from the substantial position analysis.¹¹⁹

Commenters took the position that this exclusion from the major participant definitions should encompass a variety of uses of swaps and security-based swaps to hedge risks faced by non-financial entities.¹²⁰ Some commenters also suggested that the exclusion should be interpreted to address risks such as “balance sheet risk,” the “risk of under-diversification,” and hedges undertaken on a portfolio basis. Some commenters favored interpreting this exclusion to permit its use by insurers and banks. One commenter emphasized the need to avoid taking interpretations that would encourage commercial entities not to manage risks that they otherwise would manage.¹²¹

Commenters also took the position that the addition of the word “mitigating” was intended to expand the exclusion beyond what would have been encompassed had only the term “hedging” been used.¹²²

¹¹⁹ See CEA section 1a(33)(A)(i)(I); Exchange Act section 3(a)(67)(A)(i)(I).

¹²⁰ See, e.g., letter from Coalition for Derivatives End-Users, dated September 20, 2010 (discussing, inter alia, a supplier’s use of credit derivatives in connection with a cash receivable, and a company’s use of equity derivatives in connection with a stock repurchase program).

¹²¹ See Cleary letter (also urging inclusion of “all risks” arising in connection with a company’s business activities, including risks incidental to a company’s ordinary course of business).

¹²² See MetLife letter (addition of mitigation “plainly indicates that this exclusion intends an expansive definition of hedging and can also encompass non-speculative derivatives positions used to manage economic risk, including potentially diversification and synthetic asset strategies, such as the conservative ‘replication’ strategy permitted under state insurance laws”); letter from Joanne R. Medero, Managing Director, BlackRock, dated September 20, 2010 (addressing the parallel context of the exclusion for ERISA plan positions).

1. Proposed interpretation

In interpreting the meaning of “hedging or mitigating commercial risk” for purposes of the first test of the major participant definitions, the Commissions first note that virtually identical language is found in the Dodd-Frank provisions granting an exception from the mandatory clearing requirement to non-financial entities that are using swaps or security-based swaps to hedge or mitigate commercial risk.¹²³ Because Congress used virtually identical language in both instances, the Commissions intend to interpret the phrase “hedging or mitigating commercial risk” with respect to the participant definitions in the same manner as the phrase “hedge or mitigate commercial risk” in the exception from the mandatory clearing requirement.¹²⁴ The Commissions also note that although only non-financial entities that are using swaps or security-based swaps to hedge or mitigate commercial risk generally may qualify for the clearing exemption, no such statutory restriction applies with respect to the exclusion for hedging positions in the first major participant test. Accordingly, with respect to the first major participant test, it appears that positions established to hedge or mitigate commercial risk

¹²³ See CEA section 2(h)(7)(A); Exchange Act section 3C(g)(1)(B) (exception from mandatory clearing requirements when one or more counterparties are not “financial entities” and are using swaps or security-based swaps “to hedge or mitigate commercial risk”). The definition of commercial risk here is for purposes of only the major participant definitions and, to the extent the interpretation is similar, for purposes of the end-user exception from the mandatory clearing requirement. The concept of commercial risk may be interpreted differently for other purposes under the CEA and the Exchange Act.

¹²⁴ There is a technical difference in the way those provisions use the concept of hedging and mitigating commercial risk – in that the major participant definitions specifically refer to “positions held for hedging and mitigating commercial risk” while the end-user exception refers to a counterparty that “is using [swaps or security-based swaps] to hedge or mitigate commercial risk.” That difference is consistent with the different language used in the two places (particularly the use of “substantial position” in the major participant definitions) and we do not see a reason why the use of the term in the context of the major participant definitions should be construed differently than its use in the comparable clearing exception

may qualify for the exclusion, regardless of the nature of the entity – i.e., whether a financial entity (including a bank) or a non-financial entity.¹²⁵

In general, we are premising the proposed exclusion on the principle that swaps or security-based swaps necessary to the conduct or management of a person's commercial activities should not be included in the calculation of a person's substantial position.¹²⁶

In this regard, the Commissions preliminarily believe that whether an activity is commercial should not be determined solely by the person's organizational status as a for-profit company, a non-profit organization or a governmental entity. Rather, the determinative factor should be whether the underlying activity to which the swap relates is commercial in nature.¹²⁷

¹²⁵ The presence of the third major participant test suggests that financial entities generally may not be precluded from taking advantage of the hedging exclusion in the first test. The third test, which does not account for hedging, specifically applies to non-bank financial entities that are highly leveraged and have a substantial position in a major category of swaps or security-based swaps. That test would be redundant if the hedging exclusion in the first major participant test were entirely unavailable to financial entities.

Also, had the statute intended the phrase "hedge or mitigate commercial risk" to apply only to activities of or positions held by non-financial entities, it would not have been necessary to include an additional provision in the statute generally restricting the availability of the clearing exception to non-financial entities.

¹²⁶ The scope of the proposed exclusion is based on our understanding that when a swap or security-based swap is used to hedge an entity's commercial activities, the gains or losses associated with the swap or security-based swap itself will be offset by losses or gains in the entity's commercial activities, and hence the risks posed by the swap or security-based swap to counterparties or the industry generally will be mitigated.

¹²⁷ We do not concur with the suggestion that the use of the word "mitigating" within the major participant definitions was intended to mean something significantly more than hedging. Other provisions of the Dodd-Frank Act appear to use the terms "hedging" and "mitigating" interchangeably; for example, certain provisions of the Dodd-Frank Act refer to "risk-mitigating hedging activities." See Dodd-Frank Act section 619 (adding Section 13 to the Bank Holding Company Act of 1956); Dodd-Frank Act section 619 (adding Section 27B to the Securities Act of 1933). Title VII also refers to "[h]edging and other similar risk mitigating activities." Dodd-Frank Act section 716(d)(1).

a. Proposed exclusion in the "major swap participant" definition

As a general matter, the CFTC preliminarily believes that whether a position hedges or mitigates commercial risk should be determined by the facts and circumstances at the time the swap is entered into, and should take into account the person's overall hedging and risk mitigation strategies. At the same time, the swap position could not be held for a purpose that is in the nature of speculation, investing or trading. Although the line between speculation, investing or trading, on the one hand, and hedging, on the other, can at times be difficult to discern, the statute nonetheless requires such determinations.¹²⁸ The CFTC expects that a person's overall hedging and risk management strategies will help inform whether or not a particular position is properly considered to hedge or mitigate commercial risk. Although the definition includes swaps that are recognized as hedges for accounting purposes or as bona fide hedging for purposes of an exemption from position limits under the CEA, the swaps included within the proposed exclusion are not limited to those categories. Rather, the proposal covers swaps hedging or mitigating any of a person's business risks, regardless of their status under accounting guidelines or the bona fide hedging exemption.

¹²⁸ We preliminarily believe that swap positions that are held for the purpose of speculation or trading are, for example, those positions that are held primarily to take an outright view on the direction of the market, including positions held for short term resale, or to obtain arbitrage profits. Swap positions that hedge other positions that themselves are held for the purpose of speculation or trading are also speculative or trading positions.

We preliminarily believe that swap positions that are held for the purpose of investing are, for example, those positions that are held primarily to obtain an appreciation in value of the swap position itself, without regard to using the swap to hedge an underlying risk. In contrast, a swap position related to a non-swap investment (such as the purchase of an asset that a commercial enterprise will use to produce income or otherwise advance its commercial interests) may be a hedging position if it otherwise qualifies for the definition of hedging or mitigating commercial risk.

The CFTC invites comment on whether swaps qualifying for the hedging or risk mitigation exclusion should be limited to swaps where the underlying hedged item is a non-financial commodity. Commenters may also address whether swaps subject to this exception should hedge or mitigate commercial risk on a single risk or an aggregate risk basis, and on a single entity or a consolidated basis. The CFTC also invites comment on whether risks such as the foreign exchange, currency, or interest rate risk relating to offshore affiliates, should be covered; whether industry-specific rules on hedging, or rules that apply only to certain categories of commodity or asset classes are appropriate at this time; whether swaps facilitating asset optimization or dynamic hedging should be included; and whether hedge effectiveness should be addressed. Commenters are requested to discuss both the policy and legal bases underlying their comments.

b. Proposed exclusion in the "major security-based swap participant" definition

The proposed meaning of "hedging or mitigating commercial risk" for purposes of the "major security-based swap participant" definition would require that a security-based swap position be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where they arise from the potential change in the value of assets, liabilities and services connected with the ordinary course of business of the enterprise.¹²⁹ This standard is intended to exclude from the first major

¹²⁹ See proposed Exchange Act rule 3a67-4(a). The concept of "economically appropriate" already is found in rules under the CEA pertaining to the definition of "bona fide hedging" for purposes of an exemption from position limits. See CEA rule 1.3(z). In the context of the definition of "major security-based swap participant," we may take into account existing interpretations of that term under the CEA, but only to the extent that such interpretations would appropriately be applied to the use of security-based swaps for hedging.

The SEC preliminarily plans to interpret the concept of "economically appropriate" based on whether a reasonably prudent person would consider the security-based swap to be appropriate

participant test security-based swaps that pose limited risk to the market and to counterparties because the positions would be substantially related to offsetting risks from an entity's commercial operations.¹³⁰ The security-based swaps included within the proposed rule would not be limited to those recognized as hedges for accounting purposes; rather, the proposal has been drafted to cover security-based swaps used in the broader range of transactions commonly referred to as economic hedges, regardless of their status under accounting guidelines.

At the same time, the security-based swap position could not be held for a purpose that is in the nature of speculation or trading.¹³¹ In addition, the security-based swap position could not be held to hedge or mitigate the risk of another security-based swap position or swap position unless that other position itself is held for the purpose of hedging or mitigating commercial risk as defined by the rule or CEA rule 1.3(ttt).¹³²

We look forward to commenters' views on whether the proposed standard strikes an appropriate balance in determining which positions may be excluded for purposes of

for managing the identified commercial risk. The SEC also preliminarily believes that for a security-based swap to be deemed "economically appropriate" in this context, it should not introduce any new material quantum of risks (i.e., it cannot reflect over-hedging that could reasonably have a speculative effect) and it should not introduce any basis risk or other new types of risk (other than the counterparty risk that is attendant to all security-based swaps) more than reasonably necessary to manage the identified risk.

¹³⁰ These hedging positions would include activities, such as the management of receivables, that arise out of the ordinary course of an entity's commercial operations, including activities that are incidental to those operations.

¹³¹ See proposed Exchange Act rule 3a67-4(b)(1). For these purposes, we preliminarily believe that security-based swap positions that are held for the purpose of speculation or trading are those positions that are held intentionally for short-term resale and/or with the intent of benefiting from actual or expected short-term price movements or to lock in arbitrage profits, as well as security-based swap positions that hedge other positions that themselves are held for the purpose of speculation or trading. Thus, for example, positions that would be part of a "trading book" of an entity such as a bank would not constitute hedging positions that may be excluded for purposes of the first major participant test.

¹³² See proposed Exchange Act rule 3a67-4(b)(2).

the first major participant test. We recognize that there are other reasonable views as to what positions may appropriately be considered to be for the purposes of hedging or mitigating commercial risk. We also recognize the importance of providing as clear guidance as possible as to what is or is not a hedging position for these purposes.

The proposal also would condition the entity's ability to exclude these security-based swap positions on the entity engaging in certain specified activities related to documenting the underlying risks and assessing the effectiveness of the hedge in connection with the positions.¹³³ These activities are intended to help ensure that positions excluded for purposes of the first major participant test would not extend to positions that are not entered into to reduce or hedge commercial risks, or that at a later time no longer substantially serve to reduce or mitigate such risks.¹³⁴

We preliminarily believe that this proposed approach would facilitate the following types of security-based swap positions:

- positions established to manage the risk posed by a customer's, supplier's or counterparty's potential default in connection with: financing provided to a

¹³³ See proposed Exchange Act rule 3a67-4(a)(3). The proposal particularly would require the person to: identify and document the risks that are being reduced by the security-based swap position; establish and document a method of assessing the effectiveness of the security-based swap as a hedge; and regularly assess the effectiveness of the security-based swap as a hedge.

We expect that market participants that have security-based swap activities significant enough that they may be major participants would already engage in risk assessment activities for their hedging positions, either formally or informally, and thus we do not believe that the proposed requirements would disrupt existing business practices. Instead, the proposal is intended to create standards that will allow market participants to confirm their compliance with the rule by formalizing risk assessment activities that should already be part of an effective hedging program.

¹³⁴ This condition does not mandate that an entity follow a particular set of procedures to take advantage of the exclusion. We would expect that an entity that already engages in these types of risk assessment procedures in connection with its existing business activities to be able to rely on those procedures to satisfy the condition. These conditions also could be satisfied by the entity's use of a third-party to assist with these risk assessment activities.

customer in connection with the sale of real property or a good, product or service; a customer's lease of real property or a good, product or service; a customer's agreement to purchase real property or a good, product or service in the future; or a supplier's commitment to provide or sell a good, product or service in the future;¹³⁵

- positions established to manage the risk posed by a financial counterparty (different from the counterparty to the hedging position at issue) in connection with a separate transaction (including a position involving a credit derivative, equity swap, other security-based swap, interest rate swap, commodity swap, foreign exchange swap or other swap, option, or future that itself is for the purpose of hedging or mitigating commercial risk pursuant to the rule or CEA rule 1.3(tt));
- positions established to manage equity or market risk associated with certain employee compensation plans, including the risk associated with market price variations in connection with stock-based compensation plans, such as deferred compensation plans and stock appreciation rights;
- positions established to manage equity market price risks connected with certain business combinations, such as a corporate merger or consolidation or similar plan or acquisition in which securities of a person are exchanged for securities of any other person (unless the sole purpose of the transaction is to change an issuer's domicile solely within the United States), or a transfer of

¹³⁵ The references here to customers and counterparties do not include swap or security-based swap counterparties.

assets of a person to another person in consideration of the issuance of securities of such other person or any of its affiliates;

- positions established by a bank to manage counterparty risks in connection with loans the bank has made; and
- positions to close out or reduce any of those positions.

2. Request for comments

We request comment on the proposed definition of “hedging or mitigating commercial risk” for purposes of both the “major swap participant” and the “major security-based swap participant” definitions. Commenters particularly are requested to address whether the proposed definitions would adequately limit the types of swaps or security-based swaps that are encompassed by the definition, such that the definitions do not encompass positions that serve speculative, trading or other non-hedging purposes. In this regard, do the proposed definitions appropriately exclude from the scope of the definition swaps and security-based swaps that would be less likely to pose risks to counterparties and the market, by virtue of gains or losses on those swaps being offset by losses or gains associated with an entity’s commercial operations? Commenters further are requested to address whether the proposed “economically appropriate” standard would effectively limit the positions encompassed by the definition. If not, what alternative standards (e.g., standards derived from accounting principles) would more effectively identify hedging positions and distinguish those from positions held for other purposes? In that regard, is the concept of “economically appropriate” well-understood, and, if not, is there another concept that would more effectively delimit the nature of the relationship between the swap or security-based swap position and the risk being hedged

or mitigated? Also, in the context of the definition of this term for purposes of security-based swaps, should existing interpretive guidance pertaining to the concept of "economically appropriate" with respect to the CEA's bona fide hedging exemption for position limits be considered, and, if so, to what extent? We further request comment on possible alternative approaches to the test identifying positions entered into for the purpose of hedging or mitigating commercial risk. For example, should the test require the entity excluding a position to have a reasonable basis to believe, and to actually believe, that the excluded swap would be a "highly effective," "reasonably effective" or "economically appropriate" hedge of a specified commercial risk? Should the test be generally identical to the proposed test, but with the substitution of the phrase "highly effective" or "reasonably effective" (or another standard) for "economically appropriate"? Should the test be based on accounting principles for hedging treatment (i.e., a quantitative test requiring the hedge to be within a certain band of effectiveness)?

Commenters also are requested to address the proposed restrictions on positions in the nature of speculation or trading. Is it appropriate not to permit any speculative or trading positions from being deemed for the purpose of hedging or mitigating commercial risk? What would be the impact of such an interpretation on an entity's risk mitigation practices? Also, is the dividing line between speculative and trading positions on the one hand, and positions eligible to be considered to be hedging positions on the other hand, sufficiently clear? Is such a line appropriately based on whether the position is intended to be held for the short-term versus long-term intent? Would some alternative criteria be preferable in terms of setting forth objective standards for identifying risk reducing hedging positions and distinguishing them from other positions? Also, would additional

standards or other guidance be appropriate to help ensure that positions used in connection with speculative or trading purposes do not fall within the definition?

We further request comment on the proposal that a swap or security-based swap would not fall within the definition of "hedging or mitigating commercial risk" if it is held to hedge or mitigate the risk of another swap or security-based swap, unless that other position itself is held for the purpose of hedging or mitigating commercial risk.

One consequence of this approach might be that a particular swap or security-based swap hedging a particular type of risk would be included or excluded based solely on whether that risk arises from another swap or security-based swap or from a different type of transaction.¹³⁶ Is this the appropriate approach? What would be the consequences of this approach for different types of entities? How would the proposed approach affect the risk management practices of entities that are close to the proposed threshold? Is it appropriate to include both positions within the major participant calculations? If this general approach in the proposed rule were adopted, should there be any exceptions to the approach? What alternative approaches might be considered? For example, would it be appropriate to exclude a swap or security-based swap that hedges another swap or security-based swap from the calculation? What would be the advantages and disadvantages of this approach?

Moreover, commenters are requested to address whether the definition should encompass a quantitative test that would limit the total value of swaps and security-based

¹³⁶ For example, under this proposal an entity may exclude from the first major participant test a security-based swap used to manage the credit risk posed by a customer's default in connection with financing that an entity provides to that customer. The entity may not exclude an identical security-based swap, however, if that security-based swap is used to hedge the credit risk associated with a second swap or security-based swap that itself is not for the purpose of hedging or mitigating commercial risk.

swaps that an entity may include under this rule to be no more than the total value of underlying risk identified by such entity. If so, what measurement should be used for determining an entity's total value of swaps and security-based swaps and total value of underlying risk, and what methods or procedures should entities be required to follow when calculating and comparing the two values?

In addition, commenters are requested to address whether the proposed procedural requirements, in the context of this definition for purposes of the "major security-based swap participant" analysis, are appropriate. In this regard, commenters are requested to discuss whether there are any advantages or disadvantages to providing more specific procedural requirements; whether the proposed procedural requirements will alter business practices to the extent that a transition period is necessary before they are implemented; and whether specific guidance is required to address how the proposed procedural requirements will affect existing positions. In addition, commenters are requested to address whether the proposed procedural requirements should include a requirement to quantify the underlying risk and the effectiveness of the hedge, and whether such quantitative assessments would impose significant systems costs or other costs. Also, should an assessment of hedging effectiveness be required at all, in light of the costs that may be associated with such a requirement?

More generally, would the proposed standards for identifying positions for the purpose of hedging or mitigating commercial risk suffice to allow a person holding a security-based swap position to identify and document the commercial risks that are being hedged or mitigated by that position, and if not, what additional requirements are needed? Should additional guidance be provided regarding whether components of risks

(in assets, liabilities or services) or whether risks in portfolios (of assets, liabilities or services) may be identified as the commercial risks that are being hedged or mitigated by the position, and, if so, which components? Also, should additional guidance be provided with respect to the form of documentation or the elements of the hedging relationship that should be documented, and, if so, which elements? Moreover, if a swap or security-based swap that was hedging at inception were no longer to serve a hedging purpose over time, should it no longer fall within the definition of hedging or mitigating commercial risk?

In addition, should the rule specify the frequency with which an entity should assess the effectiveness of the hedge? Also, should we provide additional guidance on the acceptable methods of assessing effectiveness? Is a qualitative assessment adequate to assess effectiveness or should a quantitative assessment also be required? Should the rule establish a level of offset between the position and the hedged risk, below which the position would not be considered to be effective at reducing risk, and, if so, what is the level of offset (or range of levels) below which the position should not be considered to be effective? Are there methods for assessing effectiveness that should not be permitted for these purposes?

Commenters also are requested to address whether the proposal also should encompass certain activities in which an entity hedges an affiliate's risks.

We further request comment on how the definition should apply to hedging activities by financial entities. Commenters particularly are invited to address whether financial entities should be able to rely on this exclusion, or whether financial entities should face special limits in the context of this exclusion. Commenters further are

requested to address how the proposed provisions excluding positions in the nature of speculation or trading from the definition would apply to activities by banks, including permissible trading activities by banks, and, in particular, whether it is appropriate to exclude positions that are part of an entity's "trading book."

Commenters also are requested to address the application of the proposal to registered investment companies, including whether additional guidance would be appropriate with respect to which uses of security-based swaps by registered investment companies would fall within the exclusion.

D. "Substantial counterparty exposure"

The second test of the major participant definitions addresses entities whose swaps and 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."¹³⁷ Unlike the first test of the major participant definitions, this test does not focus on positions in a "major" category of swaps or security-based swaps. Also, unlike the first test, this test does not explicitly exclude hedging positions or certain ERISA plan positions from the analysis.

Some commenters suggested that the second major participant definition test should be interpreted in a manner similar to the first test. Many commenters stated that the analysis should also reflect netting agreements and the posting of collateral. Some commenters stated that the test should exclude hedging positions, and cleared positions.

We preliminarily believe that the second major participant definition test's focus on the counterparty risk associated with an entity's swap or security-based swap positions

¹³⁷ See CEA section 1a(33)(A)(ii); Exchange Act section 3(a)(67)(A)(ii)(II).

is similar enough to the “substantial position” risks embedded in the first test that the second test appropriately takes into account the same measures of current uncollateralized exposure and potential future exposure that are used in our proposal for the first test. For the second test, however, the thresholds must focus on the entirety of an entity’s swap positions or security-based swap positions, rather than on positions in any specific “major” category. In addition, this second test does not explicitly account for positions for hedging commercial risk or ERISA positions.

Accordingly, these proposed calculations of substantial counterparty exposure would be performed in largely the same way as the calculation of substantial position in the first major participant definition tests, except that the amounts would be calculated by reference to all of the person’s swap or security-based swap positions, rather than by reference to a specific “major” category of such positions.¹³⁸

For purposes of the “major swap participant” definition, the CFTC proposes that the second major participant definition test be satisfied by a current uncollateralized exposure of \$5 billion, or a combined current uncollateralized exposure and potential future exposure of \$8 billion, across the entirety of an entity’s swap positions.¹³⁹ For purposes of the “major security-based swap participant” definition, the SEC proposes that the second test be satisfied by a current uncollateralized exposure of \$2 billion, or a combined current uncollateralized exposure and potential future exposure of \$4 billion, across the entirety of an entity’s security-based swap positions.¹⁴⁰ We look forward to

¹³⁸ See proposed CEA rule 1.3(uuu)(2); proposed Exchange Act rule 3a67-5(b)(1).

¹³⁹ See proposed CEA rule 1.3(uuu)(1).

¹⁴⁰ See proposed Exchange Act rule 3a67-5(a).

commenters' views as to whether alternative thresholds would be more appropriate to achieve the statutory goals.

These proposed thresholds in part are based on the same factors that underpin the proposed "substantial position" thresholds.¹⁴¹ The proposed thresholds, however, also reflect the fact that this test must account for an entity's positions across four major swap categories or two major security-based swap categories.¹⁴² These proposed thresholds, moreover, have further been raised to reflect the fact that this second test (unlike the first major participant test) encompasses certain hedging positions that, in general, we would expect to pose fewer risks to counterparties and to the markets as a whole than positions that are not for purposes of hedging.

We request comment on this proposal. Commenters particularly are requested to address whether the proposed use of current uncollateralized exposure and potential future exposure tests (including the parts of those tests that account for positions that are cleared or subject to mark-to-market margining) are appropriate, and whether the proposed thresholds are set at an appropriate level. Should the thresholds be higher or lower? If so, what alternative threshold amounts would be more appropriate, and why? Commenters also are requested to address whether the test should exclude commercial risk and ERISA hedging positions, on the grounds that those hedging positions may not raise the same degree of risk to counterparties as other swap or security-based swap positions. Comments are also requested on whether the test of substantial counterparty exposure, given its focus on the systemic risks arising from the entirety of a person's

¹⁴¹ See notes 103 to 106 and 117, *supra*, and accompanying text.

¹⁴² Thus, these proposed thresholds in part would account for an entity that has large positions in more than one major category of swaps or security-based swaps, but that does not meet the substantial position threshold for either.

portfolio, should include a measure to take into account the person's combined swap positions and security-based swap positions.

E. "Financial entity" and "highly leveraged"

The third test of the major participant definitions addresses any "financial entity," other than one subject to capital requirements established by an appropriate Federal banking agency,¹⁴³ that is "highly leveraged relative to the amount of capital" the entity holds, and that maintains a substantial position in a "major" category of swaps or security-based swaps. This test does not permit an exclusion for positions held for hedging.

As discussed below, we are proposing specific definitions of the terms "financial entity" and "highly leveraged." In addition, we request comment on whether we should include additional regulators within the proposed interpretation of what is an appropriate Federal banking agency.

1. Meaning of "financial entity"

While the third major participant definition test does not explicitly define "financial entity," Title VII of the Dodd-Frank Act defines "financial entity" in the context of the end-user exception from mandatory clearing (an exception that generally is

¹⁴³ Sections 721 and 761 of the Dodd-Frank Act add a definition of the term "appropriate Federal banking agency" in sections 1a and 3(a) of the CEA and the Exchange Act, respectively, 7 U.S.C. 1a(2), 15 U.S.C. 78c(a)(72). The Commissions propose to refer to those statutory definitions for purposes of the rules.

not available to those entities).¹⁴⁴ Some commenters have pointed out that using that definition here would produce circular results.¹⁴⁵

We preliminarily do not believe there is a basis to define "financial entity" for purposes of the major participant definitions in a way that materially differs from the definition used in the end-user exception from mandatory clearing. Using the same basic definition also would appear to be consistent with the statute's intent to treat non-financial end-users differently than financial entities. Accordingly, other than technical changes to avoid circularity, we propose to use the same definition in the major participant definitions.¹⁴⁶

Commenters are requested to address our proposed definition of "financial entity."

¹⁴⁴ See CEA section 2(h)(7)(C)(i); Exchange Act section 3C(g)(3)(A).

¹⁴⁵ See Cleary letter (also addressing status of broker-dealers and futures commission merchants as part of the analysis).

The circularity would result because, for purposes of the end-user clearing exception, "financial entity" is defined to include swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants.

¹⁴⁶ See proposed CEA rule 1.3(vv)(1); proposed Exchange Act rule 3a67-6(a). To avoid circularity, the meaning of "financial entity" for purposes of the "major swap participant" definition would not encompass any "swap dealer" or "major swap participant" (but would encompass "security-based swap dealers" and "major security-based swap participants"). The meaning of "financial entity" for purposes of the "major security-based swap participant" definition would not encompass any "security-based swap dealer" or "major security-based swap participant" (but would encompass "swap dealers" and "major swap participants"). For both definitions, "financial entity" would include any: commodity pool (as defined in section 1a(10) of the CEA); private fund (as defined in section 202(a) of the Investment Advisers Act of 1940); employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974; and person predominantly engaged in activities that are in the business of banking or financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956).

2. Meaning of "highly leveraged"

Some commenters have stated that the term "highly leveraged" should be interpreted by looking at the leverage associated with other firms in an entity's line of business, rather than by applying an across-the-board measure of leverage.¹⁴⁷ One commenter suggested that higher leverage may be warranted for entities with a smaller capital base, and another commenter suggested that we look at analogous banking regulations rather than creating a new regime for measuring leverage. Some commenters suggested ways of addressing specific items for purposes of determining leverage.¹⁴⁸

The Commissions recognize that traditional balance sheet measures of leverage have limitations as tools for evaluating an entity's ability to meet its obligations. In part this is because such measures of leverage do not directly account for the potential risks posed by specific instruments on the balance sheet, or financial instruments that are held off of an entity's balance sheet (as may be the case with an entity's swap and security-based swap positions). At the same time, we preliminarily do not believe that it is necessary to use more complex measures of risk-adjusted leverage here, particularly given that the third test in the major participant definitions already addresses those types

¹⁴⁷ See letter from Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, Inc., dated September 20, 2010 (suggesting that "leverage ratio limits to which banks and other regulated entities are subject would be unsuitably low for other enterprises"); letter from Steve Martinie, Assistant General Counsel and Assistant Secretary, The Northwestern Mutual Life Insurance Company, dated September 20, 2010 ("Northwestern Mutual letter") (suggesting that financial firms require less cushion than other entities because financial firms are able to match their assets and liabilities more closely).

¹⁴⁸ See Northwestern Mutual letter (suggesting that the Commissions recognize that liabilities such as bank deposits and insurance policy reserves are not leverage); Vanguard letter (suggesting that leverage should relate to debt financing and should not encompass potential leveraging effects posed by derivatives); SIFMA AMG letter (suggesting that the Commissions take into account the difference between non-recourse and recourse obligations, the difference between notional amounts payable and actual payable obligations, and the difference between actual financial obligations and leverage embedded in a derivative that affects returns but does not result in a payment obligation).

of risks by considering whether an entity has a substantial position in a major category of swaps or security-based swaps. We are also mindful of the costs that entities would face if forced to undertake a complex risk-adjusted leverage calculation, especially for entities that would not already be performing this type of analysis.¹⁴⁹ Additionally, we preliminarily do not believe that it is necessary for the leverage standard to account for the degree of leverage associated with different types of financial entities.

Although the third test of the major participant definitions does not define "highly leveraged," we note that Congress addressed the issue of leverage in Title I of the Dodd-Frank Act. There, Congress provided that the Board of Governors of the Federal Reserve System must require a bank holding company with total consolidated assets equal to or greater than \$50 billion, or a nonbank financial company supervised by the Board of Governors, to maintain a debt to equity ratio of no more than 15 to 1 if the FSOC determines "that such company poses a grave threat to the financial stability of the United States and that the imposition of such requirement is necessary to mitigate the risk that such company poses to the financial stability of the United States."¹⁵⁰

¹⁴⁹ The Basel Committee on Banking Supervision recently proposed one method for calculating risk-adjusted leverage in its Consultative Document entitled: "Strengthening the resilience of the banking sector" (Dec. 2009). This proposal would create a new leverage ratio based on a comparison of capital to total exposure. Total exposure for these purposes would be measured by, among other things, including the notional value of all written credit protection, severely limiting the recognition given to netting, and calculating the risks associated with off-balance sheet derivatives transactions, as measured by the current exposure method for calculating future risks outlined in Basel II. The Consultative Document drew over 150 comments from the international financial community, which included both those in support of, and those that questioned the inclusion of a risk-adjusted leverage ratio within the Basel framework. The Basel Committee on Banking Supervision expects to deliver a full package of reforms by the end of 2010, based on the Consultative Document released in December 2009 and comments received thereon.

¹⁵⁰ See Dodd-Frank Act section 165(j)(1).

This requirement in Title I suggests potential alternative approaches to the definition of "highly leveraged" for purposes of the major participant definitions. On the one hand, the 15 to 1 limit may represent an upper limit of acceptable leverage, indicating that the limit for the major participant definitions should be lower so as to create a buffer between entities at that upper limit and entities that are not highly leveraged. On the other hand, the Title I requirement, which applies only when the entity in question poses a "grave threat" to financial stability, may indicate that the 15 to 1 leverage ratio is also the appropriate test of whether an entity poses the systemic risk concerns implicated by the major participant definitions.

For these reasons, we propose two possible definitions of the point at which an entity would be "highly leveraged" – either an entity would be "highly leveraged" if the ratio of its total liabilities to equity is in excess of 8 to 1, or an entity would be "highly leveraged" if the ratio of its total liabilities to equity is in excess of 15 to 1. In either case, the determination would be measured at the close of business on the last business day of the applicable fiscal quarter. To promote consistent application of this leverage test, entities that file quarterly reports on Form 10-Q and annual reports on Form 10-K with the SEC would determine their total liabilities and equity based on the financial statements included with such filings.¹⁵¹ All other entities would calculate the value of total liabilities and equity consistent with the proper application of U.S. generally accepted accounting principles.

We believe that the 15 to 1 ratio could be consistent with the use of that ratio in Title I, which, as noted above, provides that the 15 to 1 leverage ratio would be applied to

¹⁵¹ These entities would include those that submit periodic reports on a voluntary basis to the SEC, as well as those that are required to file periodic reports with the SEC.

a bank holding company or nonbank financial company subject to Title I as a maximum only if it is determined that the company poses a "grave threat" to financial stability. Commenters are requested to address whether the proposed 15 to 1 standard used in Title I suggests that a standard higher than 15 to 1 should be used here, given that the Title I standard is applicable only to large entities that also pose a "grave threat" to financial stability and thus may suggest that a higher standard is appropriate for entities that do not pose the same degree of threat. Alternatively, the 8 to 1 ratio could be consistent with the exemption in the third test of the major participant definitions for financial institutions that are subject to capital requirements set by the Federal banking agencies, as it is possible that financial institutions were specifically excluded from the third test based on the presumption that they generally are highly leveraged, and hence would have been covered by the third test if they were not expressly exempted. Based on our analysis of financial statements it appears that those institutions generally have leverage ratios of approximately 10 to 1, which may suggest that the "highly leveraged" threshold would have to be lower for those institutions to be potentially subject to the third test. Such an approach would help to ensure that the third test of the major participant definition applies to financial entities that are not subject to capital requirements set by the Federal banking agencies, but that have leverage ratios similar to institutions that are subject to those requirements.

The Commission's request comment on the proposed alternative definitions of "highly leveraged." Commenters particularly are requested to specifically address the

relative merits of the proposed alternative 8 to 1 and 15 to 1 standards, as well as other standards that they believe would be appropriate for these purposes.¹⁵²

Commenters further are requested to address whether a risk-adjusted leverage ratio should be used, and, if so, how the ratio should be calculated (including whether particular items should be included or excluded when making this calculation), and whether a risk-adjusted leverage ratio could be developed relying on measures already calculated by entities as a matter of course.¹⁵³ Commenters further are requested to address whether the leverage ratio should be revised to require that the amount of potential future exposure (as outlined in the "substantial position" discussion above) be combined with total liabilities before such number is compared to equity for purposes of calculating the ratio, and, if so, whether the proposed ratios would still be appropriate; whether the rule should more specifically address issues as to how certain types of positions or liabilities should be accounted for when calculating leverage; whether the proposed timing of the measurement – the close of business on the last business day of the applicable fiscal quarter – would be potentially subject to gaming or evasion; and

¹⁵² In this regard, we recognize that under Exchange Act rule 15c3-1, a broker-dealer may determine its required minimum net capital, among other ways, by applying a financial ratio that provides that its aggregate indebtedness shall not exceed 1500% of its net capital (i.e., a 15 to 1 aggregate indebtedness to net capital ratio). Exchange Act Rule 17a-11 further requires that broker-dealers that use such method to establish their required minimum net capital must provide notice to regulators if their aggregate indebtedness exceeds 1200% of their net capital (i.e., a 12 to 1 aggregate indebtedness to net capital ratio). We recognize that these measures, however, reflect a different ratio of total liabilities to equity; for example, the calculation of aggregate indebtedness in rule 15c3-1 excludes certain liabilities, and the calculation of net capital includes certain subordinated debt – meaning that these measures would respectively be equivalent to ratios higher than 15:1 or 12:1 when converted to a balance sheet ratio of liabilities to equity such as that used under the proposed rule.

¹⁵³ For example, would adjustments akin to those discussed above in the context of broker-dealer net capital provide a more useful measure of leverage for these purposes?

whether the rule text should particularly prescribe how separate categories of entities calculate leverage.

F. Implementation standard, reevaluation period and minimum duration of status

While the analysis of whether an entity is a major participant is backward looking, an entity that meets the criteria for being a major participant is required to register with the CFTC and/or the SEC, and comply with the requirements applicable to major participants. We recognize that these entities will need time to complete their applications for registration and to come into compliance with the applicable requirements. We thus propose that an unregistered entity that meets the major participant criteria as a result of its swap or security-based swap activities in a fiscal quarter would not be deemed to be a major participant until the earlier of the date on which it submits a complete application for registration pursuant to CEA Section 4s(b) or Exchange Act Section 15F(b), or two months after the end of that quarter.¹⁵⁴ We preliminarily believe that this would provide entities with an appropriate amount of time to apply for registration and, with the time between the submission of an application and the effectiveness of the registration, to comply with the requirements applicable to major participants, without permitting undue delay.

We also propose to provide a reevaluation for entities that meet one or more of the applicable major participant thresholds, but only by a modest amount.¹⁵⁵ In

¹⁵⁴ See proposed CEA rule 1.3(qq)(4)(i); proposed Exchange Act rule 3a67-7(a). The Commissions are proposing separate rules regarding the registration requirements and processes for major participants.

¹⁵⁵ Commenters raised concerns over an entity qualifying as a major participant due to an unusual event. See, e.g., letter from American Benefits Council and Committee on the Investment of Employee Benefit Assets, dated September 20, 2010 (stating that quirky volatility may affect the determinations).

particular, an unregistered entity that has met these criteria as a result of its swap or security-based swap activities in a fiscal quarter, but without exceeding any applicable threshold by more than twenty percent, would not immediately be subject to the timing requirements discussed above. Instead, that entity would become subject to those requirements if the entity exceeded any of the applicable daily average thresholds in the next fiscal quarter.¹⁵⁶ We preliminarily believe this type of reevaluation period would avoid applying the major participant requirements to entities that meet the major participant criteria for only a short time due to unusual activity.

In addition, we propose that any entity that is deemed to be a major participant would retain that status until such time that it does not exceed any of the applicable thresholds for four consecutive quarters after the entity becomes registered.¹⁵⁷

Commentators raised concerns about the possibility of entities moving in and out of the status on a rapid basis,¹⁵⁸ and we believe that this proposal appropriately addresses that concern in a way that would help promote the predictable application and enforcement of the requirements governing major participants.

The Commissions request comment on these proposals. Commenters particularly are requested to address: whether two months is an adequate amount of time for entities that have met the criteria to submit an application for registration; whether there is an adequate amount of time to make the necessary internal changes to come into compliance with the requirements applicable to major participants before being subject to those

¹⁵⁶ See proposed CEA rule 1.3(qqq)(4)(ii); proposed Exchange Act rules 3a67-7(b).

¹⁵⁷ See proposed CEA rule 1.3(qqq)(5); proposed Exchange Act rules 3a67-7(c)(1).

¹⁵⁸ See Vanguard letter (suggesting that entities should remain in the status after qualification for an extended defined period such as one calendar year); AIMA letter (noting that recategorization of entities could be disruptive for entities' business models and could be administratively burdensome for the Commissions).

requirements as a result of a registration becoming effective; whether twenty percent is the appropriate threshold for applicability of the reevaluation period; whether there would be any risks arising from delaying registration as a major participant for an entity that exceeds the thresholds, but qualifies for the reevaluation period; and whether four consecutive quarters of not meeting the criteria for major participant status after registration is granted is the appropriate amount of time that a major participant should be required to stay in the status.

In addition, we request comment on the appropriateness of the proposed reevaluation period. Commenters particularly are requested to address whether it is likely that unusual market conditions could cause an entity to exceed the proposed thresholds over the course of a quarter (based on a daily average) without generally raising the types of risks that the thresholds were intended to identify. Also, should the use of the reevaluation period be conditioned on requiring any entity relying on the reevaluation period to make a representation, or otherwise demonstrate, that it exceeded the threshold due to a one-time extraordinary event, and that it will be below the threshold at the next time of measurement?

G. Limited purpose designations

In general, a person that meets the definition of major participant will be considered to be a major participant with respect to all categories of swaps or security-based swaps, as applicable, and with regard to all activities involving those instruments.¹⁵⁹ As discussed above, however, the statutory definitions provide that a person may be designated as a major participant for one or more categories of swaps or

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See proposed CEA rule 1.3(qqq)(2); proposed Exchange Act rule 3a67-1(c).

security-based swaps without being classified as a major participant for all categories.¹⁶⁰ Thus, as with the definitions of “swap dealer” and “security-based swap dealer,” we propose to provide that major participants who engage in significant activity with respect to only certain types, classes or categories of swaps or security-based swaps may apply for relief with respect to other types of swaps or security-based swaps from certain of the requirements that are applicable to major participants. The Commissions anticipate that a major participant could seek a limited designation at the same time as, or at a later time subsequent to, the person’s initial registration as a major participant. Because of the variety of situations in which major participants may enter into swaps or security-based swaps, it is difficult to set out at this time the conditions, if any, which would allow a person to be designated as a major participant with respect to only certain types, classes or categories of swaps or security-based swaps.

The Commissions request comment on the proposed rules regarding limited designation as a major participant. Commenters particularly are requested to address the circumstances in which such limited purpose designations would be appropriate, and to address the factors that the Commissions should consider when addressing such requests, and the type of information requestors should provide in support of their request. Commenters also are asked to address whether such limited purpose designations should be conditioned in any way, such as by the provision of information of the type that would be required with respect to an entity’s swaps or security-based swaps involving the particular category or activity for which they are not designated as a major participant.

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CEA section 1a(33)(C); Exchange Act section 3(a)(67)(C).

H. Additional interpretive issues

Commenters have raised additional issues related to the major participant definitions.

1. Exclusion for ERISA plan positions

As discussed above, the first test of the major participant definitions excludes from the analysis “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 ERISA (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan.” Some commenters suggested that the exclusion should encompass activities such as portfolio rebalancing and diversification, and gaining exposure to alternative asset classes, and that this type of exclusion also should apply to certain other types of entities.¹⁶¹

We preliminarily do not believe that it is necessary to propose a rule to further define the scope of this exclusion. In this regard, we note that this ERISA plan exclusion, unlike the other exclusion in the first major participant test, is not limited to “commercial” risk, which may be construed to mean that hedging by ERISA plans should be broadly excluded.

While the Commissions are not proposing to make this type of exclusion available to additional types of entities, we request comment on whether we should do so. If so, what type of entities should receive this type of exclusion, and why do the concerns that

¹⁶¹ See Cleary letter (addressing welfare plans or entities holding assets of such plans, such as voluntary employee beneficiary associations, employer group trusts or bank-maintained collective trusts); see also letter from Jane Hamblen, State of Wisconsin Investment Board, dated September 20, 2010.

led to the enactment of the major participant requirements in the Dodd-Frank Act not apply to such entities?

2. Application of major participant definitions to managed accounts

Some commenters have stated that asset managers and investment advisers should not be deemed to be major participants by virtue of the swap and security-based swap positions held by the accounts they manage. These commenters have emphasized that asset managers and investment advisers are separate legal entities from the accounts that they administer, the accounts themselves are the counterparties to the swaps and security-based swaps, and managers and advisers do not maintain capital to support the trades of their clients. One commenter also expressed the view that the positions of individual accounts under the advisement of a single asset manager should not be aggregated for the purpose of the major participant definitions because different accounts managed by an asset manager may use the same positions for different purposes.¹⁶²

Preliminarily, we do not believe that the major participant definitions should be construed to aggregate the accounts managed by asset managers or investment advisers to determine if the asset manager or investment adviser itself is a major participant. The major participant definitions apply to the entities that actually “maintain” substantial positions in swaps and security-based swaps or that have swaps or security-based swaps that create substantial counterparty exposure. The Commissions have the authority to adopt anti-evasion rules to address the possibility that persons who enter into swaps and

¹⁶² In addition, a colloquy on the Senate floor addressed the status of managed accounts for purposes of the major participant definitions, particularly focusing on whether the analysis should “look at the aggregate positions of funds managed by asset managers or at the individual fund level?” In response, it was stated that, “[a]s a general rule, the CFTC and the SEC should look at each entity on an individual basis when determining its status as a major swap participant.” See 156 Cong. Rec. S5907 (daily ed. July 15, 2010) (colloquy between Senators Hagan and Lincoln).

security-based swaps may attempt to allocate the swaps and security-based swaps among different accounts (thereby attempting to treat such other accounts as the entity that has entered into the swaps or security-based swaps) for the purpose of evading the regulations applicable to major participants.¹⁶³ In addition, we note that since the major participant definitions focus on the entity that enters into swaps or security-based swaps, all of the managed positions of which a person is the beneficial owner are to be aggregated (along with such beneficial owner's other positions) for purposes of determining whether such beneficial owner is a major participant.¹⁶⁴

The Commissions request comment on the application of the major participant definitions to managed accounts. Commenters particularly are requested to address: whether additional guidance is necessary to address issues relating to the application of the major participant definition to managed accounts; whether there are areas of potential abuse, and if so, what they may be. Commenters further are requested to address whether the Commissions should adopt anti-evasion rules to address areas of potential abuse, and if so, how such rules should be crafted.

In addition, commenters are requested to discuss any implementation concerns that may arise if the beneficial owner of a managed account meets one of the major participant definitions; for example, would the beneficial owner face any impediments in terms of identifying whether it falls within the major participant definitions? Also, what implementation issues would arise with respect to applying the major participant

¹⁶³ See Dodd-Frank Act sections 721(b)(2), 761(b)(3).

¹⁶⁴ This guidance relates only to the application of the major participant definitions to managed accounts. It is not intended to apply to the treatment of managed accounts with respect to any other rules promulgated by the CFTC or SEC to implement Title VII of the Dodd-Frank Act or to any other applicable rules or requirements.

definitions to managed accounts and/or their beneficial owners if the accounts' advisers or managers are not subject to regulation as major participants?

3. Application of major participant definitions to positions of affiliated entities

The issues discussed above with regard to managed accounts also are related to the separate issue of whether the major participant tests should, in some circumstances, aggregate the swap and security-based swap positions of entities that are affiliated. Absent that type of aggregation, an entity could seek to evade major participant status by allocating swap or security-based swap positions among a number of affiliated entities.

In situations in which a parent is the majority owner of a subsidiary entity, we preliminarily believe that the major participant tests may appropriately aggregate the subsidiary's swaps or security-based swaps at the parent for purposes of the substantial position analyses.¹⁶⁵ Attributing those positions to a parent appears consistent with the concepts of "substantial position" and "substantial counterparty exposure," given that the parent would effectively be the beneficiary of the transaction. In those circumstances, however, there still may be questions as to whether the requirements applicable to major participants – e.g., capital, margin and business conduct – should be placed upon the parent or the subsidiary. We recognize that it may be appropriate at times to apply such requirements upon the subsidiary to the extent that the subsidiary is acting on behalf of the parent.¹⁶⁶

¹⁶⁵ Arguably, the basis for this type of attribution would be even stronger if the parent wholly owns the subsidiary. An attribution rule that only addresses 100 percent ownership situations, however, may readily be susceptible to gaming if the parent were to sell a very small interest in the subsidiary to another party.

¹⁶⁶ It may also be appropriate to address these issues in connection with the rule proposals addressing the substantive requirements applicable to major participants.

Commenters particularly are invited to discuss when it would be appropriate to apply the major participant definitions to entities that are the majority owner of subsidiaries that enter into swaps or security-based swaps, or whether attribution of a subsidiary's security-based swap positions is generally inappropriate. Also, to the extent this type of attribution is appropriate, to what extent should the subsidiary retain responsibilities for complying with the capital, margin, business conduct and other requirements applicable to major participants?

Commenters further are requested to address whether the swaps or security-based swaps of corporate subsidiaries in some circumstances should be attributed to an entity that itself is not the majority owner of the direct counterparty to a swap or security-based swap. Moreover, should this type of attribution apply when one entity controls another entity, and, if so, how should the concept of control be defined for these purposes? In addition, commenters are requested to address whether, as an alternative approach, this type of attribution would be appropriate specifically when a parent provides guarantees on behalf of its subsidiaries, or third parties provide guarantees on behalf of unaffiliated entities.

Commenters further are requested to address any issues that would arise with regard to the effective implementation of the requirements applicable to major participants in the context of this type of attributions.

4. Application of major participant definitions to inter-affiliate swaps and security-based swaps

Several commenters have suggested that swaps and security-based swaps between affiliated counterparties should not be considered within the analysis of whether an entity's swap or security-based swap positions cause it to be a major participant. Such

inter-affiliate swaps and security-based swaps may be used to achieve various operational and internal efficiency objectives.

The Commissions preliminarily believe that when a person analyzes its swap or security-based swap positions under the major participant definitions, it would be appropriate for the person to consider the economic reality of any swaps or security-based swaps it enters into with wholly owned affiliates, including whether the swaps and security-based swaps simply represent an allocation of risk within a corporate group.¹⁶⁷ Such swaps and security-based swaps among wholly-owned affiliates may not pose the exceptional risks to the U.S. financial system that are the basis for the major participant definitions. As discussed above in the context of managed accounts, however, an entity would not be able to evade the requirements applicable to major participants by allocating among multiple affiliates swap or security-based swap positions of which it is the beneficial owner.

The Commissions request comment on the treatment of inter-affiliate swaps and security-based swaps between wholly-owned affiliates of the same corporate parent in connection with the major participant definitions. Commenters also are requested to address whether similar interpretations should apply to swaps and security-based swaps between entities within a consolidated group as determined in accordance with U.S. generally accepted accounting principles. Commenters further are requested to discuss whether the major participant definition should be interpreted to encompass an entity (including an affiliate of the named counterparty to the swap or security-based swap) that

¹⁶⁷ Such swaps and security-based swaps should be considered in this way only for purposes of determining whether a particular person is a major participant. The swaps and security-based swaps would continue to be subject to all laws and requirements applicable to such swaps and security-based swaps.

provides a guarantee of the named counterparty's obligations, either in the form of a guarantee or through some other form of credit support whereby the guarantor agrees to satisfy margin obligations of the named counterparty and/or periodic payment obligations of the named counterparty.

5. Legacy portfolios

Some commenters have stated that certain entities that maintain legacy portfolios of credit default swaps that previously had been entered into in connection with the activities of monoline insurers and "credit derivative product companies" should not be considered major participants. The commenters argued that these entities would be unable to comply with the capital and margin requirements applicable to major participants, and that regulation as major participants is unnecessary given that the entities are not writing any additional swaps or security-based swaps.

We request comment on whether the rules further defining major swap participant and major security-based swap participant should exclude such entities from the major participant definition if their swap and security-based swap positions are limited to those types of legacy positions. The exclusion from the definition could be conditional, and any such excluded entity would be required to provide the Commissions with position information of the type that registered major participants would be required to provide. We invite comment on any other conditions that might be appropriate to an exclusion of such legacy portfolios from the major participant definitions.

6. Potential exclusions

Some commenters stated that the major participant definitions should not be interpreted to apply to entities such as investment companies,¹⁶⁸ ERISA plans, registered broker-dealers and/or registered futures commission merchants,¹⁶⁹ and long-term investors such as sovereign wealth funds.¹⁷⁰

These comments, and the rationale behind the comments, raise the issue of whether we should exclude, conditionally or unconditionally, certain types of entities from the major participant definitions, on the grounds that such entities do not present the risks that underpin the major participant definitions and/or to avoid duplication of existing regulation. While we are not proposing any such exclusions, we request comment as to whether we should exclude certain types of entities, including those noted above, as well as to entities subject to bank capital rules, state-regulated insurers, private and state pension plans, and registered derivatives clearing organizations or clearing agencies.

Commenters particularly are requested to address whether such exclusions are necessary and appropriate in light of the proposed rules that would be applicable to major

¹⁶⁸ See letter from Karrie McMillan, General Counsel, Investment Company Institute, dated September 20, 2010 (registered investment companies should be excluded from the major participant (and dealer) definitions; or else the terms of the definitions should be interpreted to clarify that mutual funds generally will not be major participants).

¹⁶⁹ See letter from The Swaps & Derivatives Marketing Ass'n, dated September 20, 2010 (certain hedged positions of broker-dealers and futures commission merchants with customers should not be considered as part of the substantial position analysis); Cleary letter (registered and well-capitalized broker-dealers and futures commission merchants should not fall within the scope of the third major participant test).

¹⁷⁰ See letter from Lee Ming Chua, General Counsel, Government of Singapore Investment Corp., dated September 20, 2010 (stating that the major participant definitions were not intended to apply to long-term financial investors); see also letter from Richard M. Whiting, The Financial Services Roundtable, dated September 20, 2010 (major participant definitions should exclude firms that solely act as investors).

participants, whether any conditions would be appropriate for such exclusions, and whether modifying those proposed rules would more effectively address these issues than granting specific exclusions from the major participant definitions for specific types of entities. Commenters also are particularly requested to discuss whether banks should be excluded from the major participant definitions because of the regulation to which they already are subject. Commenters also are requested to discuss whether registered investment companies should be excluded from the major participant definitions because of the regulations to which they already are subject, and whether registered investment companies would be able to comply with capital and margin requirements applicable to major participants.

Commenters also particularly are requested to address whether sovereign wealth funds or other entities linked to foreign governments should be excluded from the major participant definitions, particularly in light of the provisions of the Dodd-Frank Act governing its territorial reach, and whether the answer in part should be determined based on whether the entity's obligations are backed by the full faith and credit of the foreign government.

V. Administrative Law Matters – CEA revisions (definitions of “swap dealer” and “major swap participant,” and amendments to definition of “eligible contract participant”)

A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.¹⁷¹ The

¹⁷¹ 5 U.S.C. 601 et seq.

rules proposed by the CFTC provide definitions that will largely be used in future rulemakings and which, by themselves, impose no significant new regulatory requirements. Accordingly, the Chairman, on behalf of the CFTC, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed rules will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The proposed rule will not impose any new recordkeeping or information collection requirements, or other collections of information that require approval of the Office of Management and Budget under the Paperwork Reduction Act.¹⁷² The CFTC invites public comment on the accuracy of its estimate that no additional recordkeeping or information collection requirements or changes to existing collection requirements, would result from the rules proposed herein.

C. Cost-Benefit Analysis

Section 15(a) of the CEA¹⁷³ requires the CFTC to consider the costs and benefits of its actions before issuing a rulemaking under the CEA. By its terms, Section 15(a) does not require the CFTC to quantify the costs and benefits of a rule or to determine whether the benefits of the rulemaking outweigh its costs; rather, it requires that the CFTC "consider" the costs and benefits of its actions. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The CFTC may

¹⁷² 44 U.S.C. 3501 et seq.

¹⁷³ 7 U.S.C. 19(a).

in its discretion give greater weight to any one of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the CEA.

1. Summary of proposed requirements

The proposed regulations would further define the terms "swap dealer," "eligible contract participant," "major swap participant," and related terms, including "substantial position" and "substantial counterparty exposure." The proposed regulations regarding eligible contract participants are clarifying changes that are not expected to have substantive effects on market participants. The proposed regulations further defining swap dealer and major swap participant are significant because any entity determined to be a swap dealer or major swap participant would be subject to registration, margin, capital, and business conduct requirements set forth in the Dodd-Frank Act, as those requirements are implemented in rules proposed or to be proposed by the CFTC. Those requirements will likely lead to compliance costs, capital holding costs, and margin posting costs, which have been or will be addressed in the CFTC's proposals to implement those requirements. On the other hand, those requirements will likely lead to benefits in the form of increased market transparency, reduced counterparty risk and a lower incidence of systemic crises and other market failures. This discussion concerns the costs and benefits arising from the proposed definitional tests themselves, in terms of the burden on market participants to determine how the proposed definitions apply, and the benefits arising from the specificity of the proposals.

2. Proposed regulations regarding "eligible contract participant"

The proposal regarding "eligible contract participant" would provide that swap dealers and major swap participants would qualify as eligible contract participants. The CFTC believes this proposal is in line with the expectations of market participants and would impose virtually no costs while providing the benefit of greater certainty. The proposal would also provide that certain commodity pools could not qualify as eligible contract participants under certain provisions specified in the proposal. The CFTC believes that this proposal clarifies the interpretation of this aspect of the eligible contract participant definition and would prevent the commodity pools from using a provision of the definition that was not intended to apply to the commodity pools. Thus, while the proposal would potentially impose some costs on the commodity pools that could no longer rely on certain provisions of the definition, benefits would arise from preventing the misinterpretation of the definition.

3. Proposed regulations regarding "swap dealer"

The proposal regarding "swap dealer" would further define the term by providing that any person that engages in specified activities is a swap dealer. The proposal describes these activities qualitatively and in relatively general terms that apply in the same way to all parts of the swap markets. With regard to the de minimis exemption from the definition, the proposal sets out bright-line quantitative tests to determine if a person's swap dealing activity is de minimis. For the exclusion of swaps in connection with originating a loan by an insured depository institution, the proposal describes the scope of the exclusion qualitatively in terms that depend primarily on the terms of the swaps that would be eligible for the exclusion and the identity of the parties to the swap.

Also, the proposal includes a voluntary process by which a swap dealer may request that the CFTC limit the swap dealer designation to certain aspects of the person's activity.

a. Costs

The costs to a market participant from the proposed regulations further defining "swap dealer" would arise primarily from its need to review its activities and determine, as a qualitative matter, whether its activities are of the type described in the proposal. As its activities change from time to time, it would be necessary to repeat this review, and ongoing compliance costs may arise if the market participant determines that it should adapt its activities so as to not be encompassed by the definition. Because the proposed regulations are qualitative and on relatively general terms, there may be multiple interpretations of the general criteria by market participants. A market participant whose activities fall within the realm of those described in the proposal may have to incur the costs of a more focused review to determine whether or not it is encompassed by the definition.

The proposal regarding the de minimis exemption, on the other hand, would impose lower costs because of the precise, quantitative nature of the proposed exemption. A market participant would incur only the cost of determining the applicable quantities, such as notional value, number of swaps, number of counterparties, and so forth set out in the proposal. The CFTC believes that relatively few market participants would have to determine whether the de minimis exemption applies to their activities, and there would be only a low number of instances where application of the quantitative tests would be uncertain. Similarly, the CFTC believes that insured depository institutions would incur relatively low costs to apply the proposed exclusion of swaps in connection with

originating loans because the proposed criteria relate to matters in which the institution is directly involved.

Last, the costs of the voluntary process for a request for a limited designation as a swap dealer are difficult to predict because they would depend on the complexity of the person making the request and the particular factors that are relevant to the limited designation. The CFTC believes that the person making the request would have broad discretion in determining how to do so and thereby could control the costs of the request to some extent.

b. Benefits

The benefits of the proposed regulations further defining "swap dealer" include that they set out a single set of criteria to be applied by all market participants. Thus, the proposed regulations create a level playing field that permits all market participants to determine, on an equal basis, which activities would potentially lead to designation as a swap dealer. The proposed regulations are set out in plain language terms that may be understood and applied by all market participants without relying on the technical expertise that may be required to implement more elaborate tests. The CFTC believes that the proposal can be fairly applied by substantially all market participants who could potentially be swap dealers.

Regarding the proposals regarding the de minimis exemption and the exclusion of swaps in connection with the origination of loans, benefits arise from the relatively specific, quantitative nature of the proposals. Since these proposals are expected to be applied by relatively few market participants in limited situations, more detailed regulations are appropriate. The CFTC believes that these detailed criteria will permit

market participants to make a relatively quick and low-cost determination of whether the exemption or exclusion apply. The proposal for requests for a limited swap dealer designation provides the benefit of flexibility to allow each market participant making this request to determine how to do so.

4. Proposed regulations regarding "major swap participant"

The proposal regarding "major swap participant" would further define the term by setting out quantitative thresholds against which a market participant would compare its swap activities to determine whether it is encompassed by the definition. The proposal would require that potential major swap participants analyze their swaps in detail to determine, for example, which of their swaps are subject to netting agreements or mark-to-market collateralization and the amount of collateral posted with respect to the swaps. The proposal includes a general, qualitative definition of the swaps that may be excluded from the comparison because they are used to "hedge or mitigate commercial risk." Like the swap dealer proposal, there is a voluntary process by which a major swap participant may request that the CFTC limit the major swap participant designation to certain aspects of the person's activity.

a. Costs

The costs to a market participant from the proposed regulations further defining "major swap participant" would arise primarily from its need to analyze its swaps and determine whether it has a "substantial position" or "substantial counterparty exposure" as defined in the proposal. The proposed rule defines potential future exposure by a factor of the dollar notational value of the swap. The Commission also considered market-based tests of potential future exposure such as margin requirements or other

valuations of the outstanding position. The Commission decided in favor of a more easily implementable test rather than market-based criteria for potential future exposure, given that daily variation in market prices is captured by the current exposure calculation. The CFTC believes that because the proposed quantitative thresholds are high, only very few market participants would have to conduct a detailed analysis to determine whether they are encompassed by the proposed definition. The cost of the detailed analysis would vary for each market participant, depending on the particular characteristics of its swaps. Similarly, the costs to a market participant of determining whether it uses swaps to hedge or mitigate commercial risk would depend on how the market participant uses swaps. It is possible that for some market participants with complex positions in swaps, the costs of the analysis could be relatively high.

As is the case for the similar proposal regarding swap dealers, the costs of the voluntary process for a request for a limited designation as a major swap participant are difficult to predict because they would depend on the complexity of the particular case. The CFTC believes that the person making the request would have broad discretion in determining how to do so and thereby could control the costs of the request to some extent.

b. Benefits

The benefits of the proposed regulations further defining "major swap participant" include that they set out a quantitative, bright-line test that can be applied at a relatively low cost. Also, the definition of "hedging or mitigating commercial risk" is stated in general terms that may be flexibly applied by potential major swap participants. In preparing this proposal, the CFTC considered other methods of defining "major swap

participant,” including multi-factor analyses, stress tests and adversary processes. The CFTC believes that these other methods would impose significantly higher costs for both the market participants that would have to apply them and for the CFTC (and, indirectly, the taxpayer), without providing additional benefits. The costs would result primarily from the need to retain qualified experts who would devote significant time and other resources to a detailed analysis of multiple aspects of the potential major swap participant’s swap positions. The benefits that could justify more costly proposals include reductions in arbitrary differences in results and greater consistency and predictability. However, other potential methods of further defining “major swap participant” do not appear likely to provide such benefits to an extent that would justify the higher costs.

5. Request for Comment

The CFTC invites public comment on its cost-benefit considerations. Commenters are also invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposed rules with their comments.

D. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”)¹⁷⁴ the CFTC must advise the Office of Management and Budget as to whether the proposed rules 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;

¹⁷⁴ 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).

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. We do not believe that any of the proposed rules, in their current form, would constitute a major rule.

We request 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 competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VI. Administrative Law Matters – Exchange Act rules (definitions of “security-based swap dealer” and “major security-based swap participant”)

A. Paperwork Reduction Act Analysis

Certain provisions of the proposed rules may impose new “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).¹⁷⁵ The SEC 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 “Procedural Requirements Associated with the Definition of ‘Hedging or Mitigating Commercial Risk.’” 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.

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44 U.S.C. 3501 et seq.

1. Summary of Collection of Information

Proposed Exchange Act rule 3a67-4 would define the term "hedging or mitigating commercial risk."¹⁷⁶ Security-based swap positions that meet this proposed definition would be excluded from the "substantial position" analysis under the first test of the proposed definition of major security-based swap participant.

For a security-based swap position to be held for the purpose of hedging or mitigating commercial risk under proposed rule 3a67-4, the person holding the position must satisfy several conditions, including the following:

- (i) the person must identify and document the risks that are being reduced by the security-based swap position;
- (ii) the person must establish and document a method of assessing the effectiveness of the security-based swaps as a hedge; and
- (iii) the person must regularly assess the effectiveness of the security-based swap as a hedge.

2. Proposed Use of Information

The collections of information in proposed rule 3a67-4 are designed to help prevent abuse of the exclusion and to help ensure that the exclusion is only available to those entities that are engaged in legitimate hedging or risk mitigating activities.

¹⁷⁶ As noted previously, the concept of "hedging or mitigating commercial risk" also is found in the statutory provisions granting an exception to end-users from the mandatory clearing requirement in connection with swaps and security-based swaps. See CEA section 2(h)(7)(A); Exchange Act section 3C(g)(1)(B) (exception from mandatory clearing requirements when one or more counterparties are not "financial entities" and are using swaps or security-based swaps "to hedge or mitigate commercial risk"). If the proposed rule 3a67-4 definition of "hedging or mitigating commercial risk" is used any future SEC rulemakings, including rulemaking with respect to the end-user exception, any necessary discussion of administrative law matters relating to the use of proposed rule 3a67-4 will be provided at that time.

3. Respondents

The collections of information in proposed rule 3a67-4 would apply to those entities seeking to exclude the security-based swap positions held for hedging or mitigating commercial risk from the substantial position calculation. As discussed below in Section VI.B.4., based on the current market, we estimate that approximately 10 entities have security-based swap positions of a magnitude that they could potentially reach the major security-based swap participant thresholds. Accordingly, we estimate that approximately 10 entities would seek to avail themselves of the exclusion from the substantial position calculation for security-based swap positions held for hedging or mitigating commercial risk.

4. Total Annual Reporting and Recordkeeping Burden

We do not anticipate that the proposed collection of information in proposed rule 3a67-4 would cause the estimated 10 entities to incur any new costs. We believe that only highly sophisticated market participants would potentially meet the proposed thresholds for the major security-based swap participant designation and thus have a need to take advantage of the exclusion for positions held for hedging or mitigating commercial risk (and be required to meet the attendant collection requirements). We understand from our staff's discussions with industry participants that the entities that have security-based swap positions and exposures of this magnitude currently create and maintain the documentation proposed to be required in rule 3a67-4, as part of their ordinary course business and risk management practices.¹⁷⁷ Thus, we do not believe that

¹⁷⁷ Some entities follow these types of procedures so that their hedging transactions will qualify for hedge accounting treatment under generally accepted accounting principles, which requires procedures similar to those in proposed rule 3a67-4. Hedging relationships involving security-based swaps that qualify for the hedging or mitigating commercial risk exception in the

any new burdens or costs will be imposed on the approximately 10 entities that may seek to use the exclusion. We therefore estimate the total annual reporting and recordkeeping burden associated with proposed rule 3a67-4 to be minimal.

5. Collection of Information is Mandatory

The collections of information in proposed rule 3a67-4 would be mandatory for those entities seeking to exclude positions they hold for hedging or mitigating commercial risk from the substantial position calculation.

6. Confidentiality

There is no proposed requirement that the collections of information in proposed rule 3a67-4 be provided to the SEC or a third party on a regular, ordinary course basis. In a situation where the SEC has obtained the information, the SEC would consider requests for confidential treatment on a case-by-case basis.

7. Record Retention Period

Proposed rule 3a67-4 does not contain a specific record retention requirement. Nonetheless, we would expect the approximately 10 entities that may seek to use the exclusion for positions held for hedging or mitigating commercial risk to maintain the records they create in connection with the exclusion. Because we understand from our staff's discussions with industry participants that the entities that have security-based swap positions and exposures of this magnitude currently create and maintain the

proposed rule are not limited to those recognized as hedges for accounting purposes. We believe that all of the estimated 10 entities that have security-based swap positions of a magnitude that they could potentially be deemed to be major security-based swap participants already identify and document their risk management activities (including their security-based swap positions used to hedge or mitigate commercial risks) and assess the effectiveness of those activities as a matter of their ordinary business practice – even if they are not seeking hedge accounting treatment.

documentation proposed to be required in rule 3a67-4, as part of their ordinary course business and risk management practices, we do not expect any new burdens or costs will be imposed to maintain the records.

8. Request for Comments

The SEC invites comments on these estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the SEC requests comments 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. S7-39-10. Requests for materials submitted to OMB by the SEC with regard to this collection of information should be in writing, with reference to File No. S7-39-10, 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.

B. Consideration of Benefits and Costs

1. Introduction

The Dodd-Frank Act added definitions of “security-based swap dealer” and “major security-based swap participant” to the Exchange Act in conjunction with other provisions that require entities meeting either of those definitions to register with the SEC and to be subject to capital, margin, business conduct and certain other requirements. Consistent with the direction of the Dodd-Frank Act, the SEC is proposing rules to further define “major security-based swap participant” along with additional terms used in that definition. The SEC also is proposing rules to further define “security-based swap dealer” and to set forth factors for determining the availability of the de minimis exception from that definition. We believe that these proposed rules are consistent with the purposes of the Dodd-Frank Act, and, as appropriate, set forth objective standards to facilitate market participants’ compliance with the amendments that the Dodd-Frank Act made to the Exchange Act. Market participants, however, may incur costs associated with certain of these proposed rules.

The SEC believes that there would be two categories of potential costs. First, there would be costs associated with the regulatory requirements that would apply to a “security-based swap dealer” or a “major security-based swap participant” (e.g., the registration, margin, capital, and business conduct requirements that would be imposed on security-based swap dealers and major security-based swap participants). While the

specific costs and benefits associated with these regulatory requirements are being addressed in the SEC's proposals to implement those requirements, we recognize that the costs and benefits of these proposed definitions are directly linked to the costs and benefits of the requirements applicable to dealers and major participants. We welcome comment on the costs and benefits of these proposed definitions in that broader context.

Second, there may be costs that entities incur in determining whether they qualify as a "security-based swap dealer" or a "major security-based swap participant" under the proposed definitional rules. These costs, along with the benefits associated with the proposed rules, are discussed below.

2. Proposed Exchange Act rule 3a67-1 – definition of "major security-based swap participant"

Proposed Exchange Act rule 3a67-1 would largely restate the statutory definition of "major security-based swap participant," to consolidate the definition and related interpretations for ease of reference.

A person that meets the definition of major security-based swap participant generally will be subject to the requirements applicable to major security-based swap participants without regard to the purpose for which it enters into a security-based swap, and without regard to the particular category of security-based swap.¹⁷⁸ However, the statutory definitions provide that a person may be designated as a major security-based swap participant for one or more categories of security-based swaps or for particular activities without being classified as a major security-based swap participant for all

¹⁷⁸ The specific costs associated with these regulatory requirements will be addressed in the SEC's proposals to implement those requirements.

categories or activities.¹⁷⁹ Proposed rule 3a67-1 would provide that a major security-based swap participant that engages in significant activity with respect to only certain types, classes or categories of security-based swaps or only in connection with specified activities, could obtain relief with respect to other types of security-based swaps from certain of the requirements that are applicable to major security-based swap participants. The rule would have the benefit of implementing the statutory provision and providing that major security-based swap participants may obtain relief from the SEC. A person that seeks to be considered to be a major security-based swap participant only with respect to one category of security-based swaps, or only with respect to certain activities, would be expected to incur costs in connection with requesting an order from the SEC. However, any such costs would be voluntarily incurred by any person seeking to take advantage of that limited designation, and thus we preliminarily do believe that those costs would be attributable to the statute and not to this rule.

3. Proposed Exchange Act rule 3a67-2 – “major” categories of security-based swaps

Proposed Exchange Act rule 3a67-2 would fulfill Congress’s mandate that the SEC designate “major” categories of security-based swaps by setting forth two such “major” categories – one consisting of credit derivatives and the other consisting of equity-swaps and other security-based swaps. We believe that these proposed categories would have the benefit of being consistent with the different ways in which those products are used, as well as market statistics and current market infrastructures (particularly the separate trade warehouses for credit default swaps and equity swaps). Although, as discussed below, this categorization is relevant to the “substantial position”

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See Exchange Act section 3(a)(67)(C).

tests of the “major security-based swap participant” definition, we believe that the categorization itself would not impose any costs on market participants. While the categorization may affect the costs that market participants will incur from particular statutory and regulatory requirements applicable to major security-based swap participants,¹⁸⁰ those costs are being addressed in our proposals to implement those requirements.

4. Proposed Exchange Act rule 3a76-3 – definition of “substantial position”

Proposed Exchange Act rule 3a67-3 would define the term “substantial position,” which is used in the first and third tests of the definition of “major security-based swap participant.” The Dodd-Frank Act requires the SEC to define this term. We have proposed two tests for identifying the presence of a substantial position – one test based on a daily average measure of uncollateralized mark-to-market exposure, and one based on a daily average measure of combined uncollateralized mark-to-market exposure and potential future exposure. Both of these daily measures would be calculated and averaged over a calendar quarter.

We believe that this proposed definition would have the benefit of providing objective criteria that reasonably would measure the risks associated with security-based swap positions, and reflect the counterparty risk and risk to the market factors that are embedded within the “major security-based swap participant” definition. We also believe that the proposed use of objective numerical criteria for the substantial position

¹⁸⁰ For example, distinguishing between categories of security-based swaps may cause some entities to incur additional costs to calculate their major security-based swap participant status with respect to each category. Similarly, categorization may affect whether an entity ultimately qualifies as a major security-based swap participant.

thresholds would promote the predictable application and enforcement of the requirements governing major security-based swap participants by permitting market participants to readily evaluate whether their security-based swap positions meet the thresholds.

The first "substantial position" test would encompass entities that have a daily average uncollateralized mark-to-market exposure of \$1 billion in a major category of security-based swaps. The second "substantial position" test would encompass entities that have a daily average combined uncollateralized mark-to-market exposure and potential future exposure of \$2 billion. Potential future exposure would be measured, consistent with bank capital rules, largely by multiplying notional positions by risk factors. Additional adjustments would reflect netting agreements, the presence of central clearing and the presence of daily mark-to-market margining practices.

As previously noted, there will be costs associated with the registration, margin, capital, business conduct, and other requirements that will be imposed on major security-based swap participants. Those costs are being addressed in the SEC's rule proposals to implement those requirements. We also believe that there will be costs incurred by entities in determining whether they meet the definition of major security-based swap participant. These costs are discussed below.

Based on the current over-the-counter derivatives market, we estimate that no more than 10 entities that are not otherwise security-based swap dealers would have either uncollateralized mark-to-market positions¹⁸¹ or combined uncollateralized current

¹⁸¹ We believe that an estimate of an entity's mark-to-market exposure associated with its security-based swap positions can be derived from the level of an entity's notional positions. We recognize that the ratio of exposure to notional amount will vary by market participant and by position. We understand that mark-to-market exposures associated with credit derivative

exposure and potential future exposure of a magnitude¹⁸² that may rise close enough to the levels of our proposed thresholds to necessitate monitoring to determine whether they meet those thresholds. Additionally, we preliminarily believe that all of these approximately 10 entities currently maintain highly sophisticated financial operations in order to achieve the large security-based swap positions necessitating their use of the tests.

We expect the costs associated with the proposed substantial position tests to be modest for these entities. We understand that the entities that have this magnitude of

positions on average are equal to approximately three percent of an entity's level of notional positions in credit derivatives. This estimate is based on second quarter 2010 U.S. bank market statistics involving credit derivatives, given that banks have credit derivative positions with gross positive fair value (which would equate to negative fair value for the banks' counterparties) of \$403 billion, compared to total notional credit derivative positions of \$13.9 trillion. See Office of the Comptroller of the Currency, "OCC's Quarterly Report on Bank Trading and Derivatives Activities" (Second Quarter 2010) at 4 & Table 12. This data suggests that, on average, an entity would need to have notional credit derivative positions of roughly \$33 billion to meet our proposed threshold for the first substantial position test, \$1 billion in mark-to-market exposure.

We understand, based on our staff's discussions with industry, that approximately 39 entities have credit default swap notional positions of roughly \$33 billion or above. We understand that the large majority of those entities are banks or hedge funds (which we would expect to fully collateralize their positions with dealers as a matter of course). We further understand that banks, securities firms, and hedge funds typically collateralize most or all of their mark-to-market exposure to U.S. banks as a matter of practice. See OCC's Quarterly Report on Bank Trading and Derivatives Activities (second quarter 2010) at 6. Therefore, it is not clear if any entities would have uncollateralized credit default swap positions near the proposed first substantial position threshold of \$1 billion uncollateralized outward exposure.

¹⁸² The proposed risk multiplier of 0.1 for credit derivatives would require an entity to have a notional position of \$20 billion in credit derivatives to reach the proposed \$2 billion potential future exposure threshold (even before accounting for netting adjustments). The proposed additional multiplier of 0.2 for security-based swaps cleared by a registered clearing agency or subject to daily mark-to-market margining would mean that an entity with credit derivative positions that are cleared or subject to daily mark-to-market margining would need a notional position in credit derivatives of at least \$100 billion to potentially reach the proposed \$2 billion potential future exposure threshold. In this example, we are assuming an uncollateralized outward exposure of zero.

We understand, based on our staff's discussions with industry, that there are approximately 10 non-dealer entities that have a notional position in credit derivatives of over \$50 billion.

security-based swap positions already monitor and collect all of the data necessary for the proposed substantial position tests. Preliminarily, we understand that these entities already use automated systems to gauge their positions and exposures and assist in their risk management. Accordingly, we estimate that each of the entities would incur a one-time programming cost,¹⁸³ as well as ongoing costs associated with the continuing use and monitoring of the testing.¹⁸⁴ We estimate that the one-time programming cost would be approximately \$13,444 per entity, and \$134,440 for all entities.¹⁸⁵ We estimate that

¹⁸³ For each of the entities, we estimate that the initial programming would require the following levels of work from a Compliance Attorney, Compliance Manager, Programmer Analyst, Senior Internal Auditor, and Chief Financial Officer. The estimated contributions are as follows: approximately 2 hours of work from a Compliance Attorney to advise the entity's compliance department on the legal requirements associated with the proposed tests; approximately 8 hours of work from a Compliance Manager to assist a Programmer Analyst in making the necessary changes to the entity's existing automated system and to oversee and manage the entire programming process; approximately 40 hours of work from a Programmer Analyst to make the necessary programming changes to the existing automated system and to test the system; approximately 8 hours of work from a Senior Internal Auditor to perform quality assurance to ensure that the automated system is properly performing the proposed tests; and approximately 3 hours of work from the entity's Chief Financial Officer to monitor the process. We estimate that the hourly wage of a Compliance Attorney, Compliance Manager, Programmer Analyst, Senior Internal Auditor, and Chief Financial Officer would be approximately \$291, \$294, \$190, \$195, and \$450, respectively. The \$291/hour figure for a Compliance Attorney, the \$294/hour figure for a Compliance Manager, the \$190/hour figure for a Programmer Analyst, and the \$195/hour figure for a Senior Internal Auditor are from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by SEC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. The \$450/hour figure for a Chief Financial Officer is from www.payscale.com, modified by SEC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. See www.payscale.com (last visited Nov. 1, 2010).

¹⁸⁴ We anticipate that each entity would incur ongoing monitoring costs to evaluate their test results and to ensure that the tests are properly run. We estimate that each entity would have a Senior Internal Auditor spend approximately 4 hours each quarter (or a total of 16 hours annually) to perform this quality assurance. We also estimate that each entity would need a Compliance Attorney, a Compliance Manager, and its Chief Financial Officer to each spend approximately 1 hour each quarter (or a total of 4 hours annually) to monitor the entity's test results and the entity's status under the proposed rule.

¹⁸⁵ The estimated one-time programming cost of approximately \$13,444 per entity and \$134,440 for all entities was calculated as follows: (Compliance Attorney at \$291 per hour for 2

the annual ongoing costs would be approximately \$7,260 per entity; and \$72,600 for all entities.¹⁸⁶

5. Proposed Exchange Act rule 3a67-4 – definition of “hedging or mitigating commercial risk”

Proposed Exchange Act rule 3a67-4 would define the term “hedging or mitigating commercial risk.” Security-based swap positions that meet that definition are excluded from the “substantial position” analysis under the first test of the major participant definition. The proposed rule is intended to be objective and promote the predictable application and enforcement of the requirements governing major security-based swap participants.

For a security-based swap position to be held for the purpose of hedging or mitigating commercial risk under proposed Exchange Act rule 3a67-4, the person holding the position must satisfy certain conditions:

- (i) the person must identify and document the risks that are being reduced by the security-based swap position;
- (ii) the person must establish and document a method of assessing the effectiveness of the security-based swap as a hedge; and
- (iii) the person must regularly assess the effectiveness of the security-based swap as a hedge.

hours) + (Compliance Manager at \$294 per hour for 8 hours) + (Programmer Analyst at \$190 per hour for 40 hours) + (Senior Internal Auditor at \$195 per hour for 8 hours) + (Chief Financial Officer at \$450 per hour for 3 hours) x (10 entities) = \$134,440.

¹⁸⁶ The estimated ongoing monitoring cost of approximately \$7,260 per year per entity and \$72,600 per year for all entities was calculated as follows: (Senior Internal Auditor at \$195 per hour for 16 hours) + (Compliance Attorney at \$291 per hour for 4 hours) + (Compliance Manager at \$294 per hour for 4 hours) + (Chief Financial Officer at \$450 per hour for 4 hours) x (10 entities) = \$72,600.

Proposed rule 3a67-4 would affect whether an entity will meet the definition of major security-based swap participant. The specific costs associated with these regulatory requirements are being addressed in the SEC's proposals to implement those requirements.

While we expect that there could be some potential costs associated with the procedural requirements of proposed rule 3a67-4, as described in Section VI.B.4., supra, we expect only highly sophisticated entities to hold security-based swap positions of a magnitude that would require use of the proposed tests. Thus, we do not anticipate that these proposed procedural requirements would cause market participants to incur costs that they do not incur already as a matter of their ordinary business and risk management practices. Accordingly, we do not expect that the proposed definition of "hedging or mitigating commercial risk" would impose any costs on the potentially affected entities beyond those already regularly incurred by these entities as a matter of course.

6. Proposed Exchange Act rule 3a67-5 – definition of "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets"

Proposed Exchange Act rule 3a67-5 would define "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets," a term that comprises part of the second test of the "major security-based swap participant" definition. This proposed rule would parallel the "substantial position" analysis discussed above, but would examine an entity's security-based swap positions as a whole (rather than focusing on a particular "major" category), and would not exclude certain hedging positions. Consistent with this broader scope, and the proposal that there be two "major" categories of security-based

swaps, the thresholds used in this test would be two times the comparable "substantial position" thresholds. We believe that this approach reasonably would measure the counterparty exposure associated with the entirety of an entity's security-based swap positions, consistent with the risk factors in the "major security-based swap participant" definition. Additionally, we believe that the proposed definition would provide objective criteria and promote the predictable application and enforcement of the requirements governing major security-based swap participants by permitting market participants to readily evaluate whether their security-based swap positions meet the proposed thresholds.

We believe that the same approximately 10 entities would calculate their substantial counterparty exposure under this rule as would undertake the substantial position calculation under proposed rule 3a67-3. Given that the threshold for this proposed rule is derived from the calculations of substantial position that would be mandated by proposed rule 3a67-3, we do not anticipate that it would create any costs outside of those already covered in the discussion of the estimated costs associated with the proposed definition of substantial position.

7. Proposed Exchange Act rule 3a67-6 – definitions of "financial entity" and "highly leveraged"

Proposed Exchange Act rule 3a67-6 would define the terms "financial entity" and "highly leveraged," both of which are used in the third test of the "major security-based swap participant" definition. The proposed definition of "financial entity" would be consistent with the use of that term in the Title VII exception from mandatory clearing for end-users of security-based swaps (subject to limited technical changes). One of the two alternative proposed definitions of "highly leveraged" would be consistent with a

standard used in Title I of the Dodd-Frank Act, while the other alternative is based on an understanding of typical leverage ratios for certain financial entities. We believe that these proposed alternative standards would apply reasonable objective criteria to implement and further define the third test. Additionally, we believe that the proposed use of these objective definitions and numerical criteria would promote the predictable application and enforcement of the requirements governing major security-based swap participants by permitting market participants to readily evaluate whether they meet the threshold for major security-based swap participant status.

We do not believe that the proposed definition of "financial entity" would impose any significant costs on market entities, given the objective nature of the definition. We also do not believe that the proposed definition of "highly leveraged" – a balance sheet test that would be based on the ratio of an entity's liabilities and equity, and that, in the case of entities subject to public reporting requirements, could be derived from financial statements filed with the SEC – would impose any significant costs on entities that have security-based swap positions large enough to potentially meet the "substantial position" requirement that is part of the third test.

8. Proposed Exchange Act rule 3a67-7 – timing requirements, reevaluation period and termination of status

Proposed Exchange Act rule 3a67-7 would set forth methods for specifying when an entity that satisfies the tests specified within the definition of "major security-based swap participant" would be deemed to meet that definition. The proposed rule also would address the termination of an entity's status as a major security-based swap participant. We believe that the proposed rule would set forth pragmatic standards for permitting entities that have security-based swap positions that require registration to go

through the registration process, and to terminate their status when appropriate. We believe that this proposed rule would impose no direct costs on market entities.¹⁸⁷

9. Proposed Exchange Act rule 3a71-1 – definition of “security-based swap dealer”

Proposed Exchange Act rule 3a71-1 largely would restate the statutory definition of “security-based swap dealer,” to consolidate the definition and related interpretations for market participants’ ease of reference. We are not proposing to further define the four specific tests set forth in the “security-based swap dealer” definition. However, our release contains interpretive language that would have the benefit of providing additional legal certainty to market participants. While market participants would incur certain costs to analyze whether their security-based swap activities cause them to be on the “dealer” side of the dealer-trader distinction (which would require them to register with the SEC and comply with the other requirements applicable to security-based swap dealers unless they can take advantage of the de minimis exception), these costs would be incurred because of the statutory change, rather than due to proposed rule 3a71-1. The Dodd-Frank Act determined that persons that engage in dealing activities involving security-based swaps should be subject to comprehensive regulation, and any such analytic costs arise from Congress’s determination to amend the Exchange Act.¹⁸⁸

¹⁸⁷ As noted above, we recognize that major security-based swap participants will incur costs associated with the registration and termination of registration processes. These costs will be addressed in the SEC rule’s proposals to implement those requirements.

¹⁸⁸ Based on our staff’s discussions with industry, we estimate that approximately 50 entities may be required to register as security-based swap dealers following implementation of these proposed rules. The specific costs associated with these regulatory requirements will be addressed in the SEC’s proposals to implement those requirements.

10. Proposed Exchange Act rule 3a71-2 – de minimis exception

Proposed Exchange Act rule 3a71-2 would set forth factors for determining whether a person that otherwise would be a security-based swap dealer can take advantage of the de minimis exception. The Dodd-Frank Act directed the SEC to promulgate these factors.¹⁸⁹ The proposed factors would account for an entity's annual notional security-based swap positions in a dealing capacity, its total notional security-based swap positions in a dealing capacity when the counterparty is a "special entity,"¹⁹⁰ and its total number of counterparties and security-based swaps as a dealer. We believe that these factors appropriately would focus on dealing activities that do not warrant an entity's regulation as a security-based swap dealer. We also believe that these objective numerical criteria for the de minimis exception would promote the predictable application and enforcement of the de minimis exception from security-based swap dealer status.

In general, we would expect a person that enters into security-based swaps in a dealing capacity would, as a matter of course, be aware of the notional amount of those positions, whether a particular counterparty is a "special entity," and the total number of counterparties and security-based swaps it has in a dealer capacity. As a result, we believe that there would be no new costs incurred by entities in assessing the availability of the de minimis exception. Moreover, any costs associated with ensuring that a person can take advantage of the de minimis exception would be voluntarily incurred by entities that engage in dealing activities that seek to take advantage of the exception.

¹⁸⁹ See Section 761(a)(6) of the Dodd-Frank Act.

¹⁹⁰ See Section 15F(h)(2)(C) of the Exchange Act.

11. Request for comments

The SEC requests comment on these estimated benefits and costs. Commenters particularly are requested to address: the accuracy of our estimate that there would be approximately 10 entities in the market (that would not otherwise be security-based swap dealers) that would have security-based swap positions of a magnitude that may rise close enough to the levels of our proposed thresholds to necessitate monitoring to determine whether they meet those thresholds; the accuracy of our estimate that there would be approximately 50 entities in the market that may be required to register as security-based swap dealers following implementation of the proposed rules; the accuracy of our estimates of the costs associated with entities performing the proposed substantial position tests; whether the entities that have security-based swap positions that are significant enough to potentially meet one or more of the tests in the "major security-based swap participant" definition would, as a matter of course, already have the data necessary to perform the two proposed substantial position tests, and if not, what additional data would they need and how much time and expense would gathering that data require; whether these same entities would, as a matter of course, already comply with the proposed procedural requirements associated with the exclusion for positions that are for the purpose of "hedging or mitigating commercial risk;" and whether entities would change their behavior to avoid meeting the proposed definitions of "security-based swap dealer" or "major security-based swap participant," and if so, what, if any, economic costs would be associated with such behavioral changes.

In addition, and more generally, we request comment on the costs and benefits of these proposed definitions in the broader context of the substantive rules, including

capital, margin and business conduct rules, applicable to dealers and major participants. Commenters particularly are requested to address whether the proposed scope of the dealer and major participant definitions are appropriate in light of the costs and benefits associated with those substantive rules.

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

Section 3(f) of the Exchange Act requires the SEC, 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.¹⁹¹ In addition, Section 23(a)(2) of the Exchange Act¹⁹² requires the SEC, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition. Section 23(a)(2) of the Exchange Act also prohibits the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We preliminarily do not believe that the proposed rules would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. We are proposing rules to further define “major security-based swap participant,” along with several terms used in that definition. We are also proposing rules to further define “security-based swap dealer” and to set forth factors for determining the availability of the de minimis exception from that definition. We believe that the proposed rules are consistent with the purposes of Title VII of the Dodd-Frank

¹⁹¹ 15 U.S.C. 78c(f).

¹⁹² 15 U.S.C. 78w(a)(2).

Act, and, as appropriate, set forth objective standards to facilitate market participants' compliance with the amendments that Title VII of the Dodd-Frank Act made to the Exchange Act. These amendments mandate that the SEC regulate major security-based swap participants and security-based swap dealers, which include some, but not all, entities that enter into security-based swaps. Although regulation of certain security-based swap market participants may result in competitive burdens to these entities when compared to unregulated security-based swap market participants, these burdens stem directly from Congress's decision to impose regulation on a specified set of security-based swap market participants through the Dodd-Frank Act.

While our decisions on how to further define the terms may have some effect on competition (e.g., our determinations regarding the proposed definition of substantial position will affect whether entities qualify as major security-based swap participants), we preliminarily do not believe that our decisions would impose additional competitive burdens on entities outside of those that Congress previously imposed through its decision in Title VII of the Dodd-Frank Act to regulate and differentiate security-based swap market participants. Moreover, we believe that defining substantial position will help provide market participants with legal certainty regarding their need to register as major security-based swap participants and is necessary and appropriate to implement the purposes of regulating security-based swap dealers and major security-based swap participants.

We also preliminarily believe that the proposed rules would promote efficiency. We believe that the proposed rules would set forth clear objective standards to facilitate market participants' compliance with the amendments that the Dodd-Frank Act made to

the Exchange Act. Moreover, we believe that the proposed rules would promote the predictable application and enforcement of the Exchange Act. We also have considered what effect, if any, our proposed rules would have on capital formation. We preliminarily do not believe that our proposed rules would have a negative effect on capital formation.

The SEC requests comment on the effect of the proposed rules on efficiency, competition, and capital formation. Commenters are particularly requested to address whether entities would change their behavior to avoid meeting the proposed definitions of "security-based swap dealer" or "major security-based swap participant," and if so, how. Commenters are also requested to address the effect, if any, that the proposed definitions of "substantial position," "hedging or mitigating commercial risk," "substantial counterparty exposure," "financial entity," or "highly leveraged," or the proposed categories of security-based swaps would have on business decisions, trading behavior, transaction costs, or capital allocation. We also request comment on the effect, if any that the proposed de minimis exception to the definition of security-based swap dealer would have on business decisions, trading behavior, transaction costs, or capital allocation, and if so, how. Commenters are particularly encouraged to provide quantitative information to support their views.

D. Consideration of Impact on the Economy

For purposes of SBREFA, the SEC must advise the Office of Management and Budget as to whether the proposed rules 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. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. We do not believe that any of the proposed rules, in their current form, would constitute a major rule.

We request 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 competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

E. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")¹⁹³ requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)¹⁹⁴ of the Administrative Procedure Act,¹⁹⁵ as amended by the RFA, generally requires the SEC to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."¹⁹⁶ Section 605(b) of the RFA provides that this requirement shall not apply to

¹⁹³ 5 U.S.C. 601 et seq.

¹⁹⁴ 5 U.S.C. 603(a).

¹⁹⁵ 5 U.S.C. 551 et seq.

¹⁹⁶ Although Section 601(b) of the RFA defines the term "small entity," the statute permits the Commissions to formulate their own definitions. The SEC has adopted definitions for the term small entity for the purposes of SEC 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 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982) (File No. AS-305).

any proposed rule or proposed rule amendment, which if adopted, would not have a significant economic impact on a substantial number of small entities.¹⁹⁷

For purposes of SEC 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,¹⁹⁸ 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,¹⁹⁹ 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.²⁰⁰ Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) for entities engaged in credit intermediation and related activities, entities with \$175 million or less in assets;²⁰¹ (ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with \$7 million or less in annual receipts;²⁰² (iii) for entities engaged in financial investments and related activities, entities

¹⁹⁷ See 5 U.S.C. 605(b).

¹⁹⁸ See 17 CFR 240.0-10(a).

¹⁹⁹ See 17 CFR 240.17a-5(d).

²⁰⁰ See 17 CFR 240.0-10(c).

²⁰¹ See 13 CFR 121.201 (Subsector 522).

²⁰² See *id.* at Subsector 522.

with \$7 million or less in annual receipts;²⁰³ (iv) for insurance carriers and entities engaged in related activities, entities with \$7 million or less in annual receipts;²⁰⁴ and (v) for funds, trusts, and other financial vehicles, entities with \$7 million or less in annual receipts.²⁰⁵

Based on feedback from industry participants about the security-based swap markets, the SEC preliminarily believes that entities that would 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. Thus, the SEC believes it is unlikely that the proposed rules would have a significant economic impact any small entity.

For the foregoing reasons, the SEC certifies that the proposed rules would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

The SEC encourages written comments regarding this certification. The SEC requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

VII. Statutory Basis and Rule Text

List of Subjects:

17 CFR Part 1

Definitions

17 CFR Part 240

²⁰³ See *id.* at Subsector 523.

²⁰⁴ See *id.* at Subsector 524.

²⁰⁵ See *id.* at Subsector 525.

Reporting and recordkeeping requirements, Securities.

Commodity Futures Trading Commission

Text of Proposed Rules

For the reasons stated in this release, the CFTC is proposing to amend 17 CFR part 1 as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

2. Amend §1.3 to revise paragraph (m) to read as follows:

§ 1.3 Definitions

* * * * *

(m) Eligible contract participant. This term has the meaning set forth in Section 1a(18) of the Commodity Exchange Act, except that:

- (1) A major swap participant, as defined in Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), is an eligible contract participant;
- (2) A swap dealer, as defined in Section 1a(49) of the Commodity Exchange Act and § 1.3(ppp), is an eligible contract participant;

(3) A major security-based swap participant, as defined in Section 3(a)(67) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(67)) and § 240.3a67-1 of this title, is an eligible contract participant;

(4) A security-based swap dealer, as defined in Section 3(a)(71) of the Securities and Exchange Act of 1934 (15 U.S.C. 78c(a)(71)) and § 240.3a71-1 of this title, is an eligible contract participant;

(5) A commodity pool with one or more direct or indirect participants that is not an eligible contract participant is not an eligible contract participant for purposes of Sections 2(c)(2)(B)(vi) and 2(c)(2)(C)(vii) of the Commodity Exchange Act; and

(6) A commodity pool that does not have total assets exceeding \$5,000,000 or that is not operated by a person described in clause (A)(iv)(II) of Section 1a(18) of the Commodity Exchange Act is not an eligible contract participant pursuant to clause (A)(v) of such Section.

* * * * *

3. Amend § 1.3 to add paragraphs (ppp) to (vvv) to read as follows:

§ 1.3 Definitions.

* * * * *

(ppp) Swap Dealer. (1) In general. The term "swap dealer" means any person who:

(i) Holds itself out as a dealer in swaps;

(ii) Makes a market in swaps;

(iii) Regularly enters into 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 swaps.

(2) Exception. The term "swap dealer" does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

(3) Scope. A person who is a swap dealer shall be deemed to be a swap dealer with respect to each swap it enters into, regardless of the category of the swap or the person's activities in connection with the swap. However, if a person makes an application to limit its designation as a swap dealer to specified categories of swaps or specified activities of the person in connection with swaps, the Commission shall determine whether the person's designation as a swap dealer shall be so limited. A person may make such application to limit its designation at the same time as, or at a later time subsequent to, the person's initial registration as a swap dealer.

(4) De minimis exception. A person shall not be deemed to be a swap dealer as a result of swap dealing activity involving counterparties that meets each of the following conditions:

(i) The swap positions connected with those activities into which the person enters over the course of the immediately preceding 12 months have an aggregate gross notional amount of no more than \$100 million, and have an aggregate gross notional amount of no more than \$25 million with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act). For purposes of this paragraph, if the stated notional amount of a swap is leveraged or

enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

(ii) The person has not entered into swaps in connection with those activities with more than 15 counterparties, other than swap dealers, over the course of the immediately preceding 12 months. In determining the number of counterparties, all counterparties that are members of a single group of persons under common control shall be considered to be a single counterparty.

(iii) The person has not entered into more than 20 swaps in connection with those activities over the course of the immediately preceding 12 months. For purposes of this paragraph, each transaction entered into under a master agreement for swaps shall constitute a distinct swap, but entering into an amendment of an existing swap in which the counterparty to such swap remains the same and the item underlying such swap remains substantially the same shall not constitute entering into a swap.

(5) Insured depository institution swaps in connection with originating loans to customers. Swaps entered into by an insured depository institution with a customer in connection with originating a loan with that customer shall not be considered in determining whether such person is a swap dealer.

(i) A swap shall be considered to have been entered into in connection with originating a loan only if the rate, asset, liability or other notional item underlying such swap is, or is directly related to, a financial term of such loan. The financial terms of a loan include, without limitation, the loan's duration, rate of interest, the currency or currencies in which it is made and its principal amount.

(ii) An insured depository institution shall be considered to have originated a loan with a customer if the insured depository institution:

(A) Directly transfers the loan amount to the customer;

(B) Is a part of a syndicate of lenders that is the source of the loan amount that is transferred to the customer;

(C) Purchases or receives a participation in the loan; or

(D) Otherwise is the source of funds that are transferred to the customer pursuant to the loan or any refinancing of the loan.

(iii) The term "loan" shall not include:

(A) Any transaction that is a sham, whether or not intended to qualify for the exclusion from the definition of the term "swap dealer" in this rule; or

(B) Any synthetic loan, including without limitation a loan credit default swap or loan total return swap.

(qqq) Major Swap Participant. (1) In general. The term "major swap participant" means any person:

(i) That is not a swap dealer; and

(ii)(A) That maintains a substantial position in swaps for any of the major swap categories, 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;

(B) Whose outstanding 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

(C) That is a financial entity that:

(1) 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 agency (as defined in Section 1a(2) of the Commodity Exchange Act); and

(2) Maintains a substantial position in outstanding swaps in any major swap category.

(2) Scope of designation. A person that is a major swap participant shall be deemed to be a major swap participant with respect to each swap it enters into, regardless of the category of the swap or the person's activities in connection with the swap. However, if a person makes an application to limit its designation as a major swap participant to specified categories of swaps or specified activities of the person in connection with swaps, the Commission shall determine whether the person's designation as a major swap participant shall be so limited. A person may make such application to limit its designation at the same time as, or at a later time subsequent to, the person's initial registration as a major swap participant.

(3) Timing requirements. A person that is not registered as a major swap participant, but that meets the criteria in this rule to be a major swap participant as a result of its swap activities in a fiscal quarter, will not be deemed to be a major swap participant until the earlier of the date on which it submits a complete application for registration as a major swap participant or two months after the end of that quarter.

(4) Reevaluation period. Notwithstanding paragraph (3), if a person that is not registered as a major swap participant meets the criteria in this rule to be a major swap participant in a fiscal quarter, but does not exceed any applicable threshold by more than twenty percent in that quarter:

(i) That person will not immediately be subject to the timing requirements specified in paragraph (3); but

(ii) That person will become subject to the timing requirements specified in paragraph (3) at the end of the next fiscal quarter if the person exceeds any of the applicable daily average thresholds in that next fiscal quarter.

(5) Termination of status. A person that is deemed to be a major swap participant shall continue to be deemed a major swap participant until such time that its swap activities do not exceed any of the daily average thresholds set forth within this rule for four consecutive fiscal quarters after the date on which the person becomes registered as a major swap participant.

(rrr) Category of swaps; major swap category. For purposes of Sections 1a(33) and 1a(49) of the Commodity Exchange Act and §§ 1.3(ppp) and 1.3(qqq), the terms "major swap category," "category of swaps" and any similar terms mean any of the categories of swaps listed below. For the avoidance of doubt, the term "swap" as it is used in this § 1.3(rrr) has the meaning set forth in Section 1a(47) of the Commodity Exchange Act and the rules thereunder.

(1) Rate swaps. Any swap which is primarily based on one or more reference rates, including but not limited to any swap of payments determined by fixed and floating interest rates, currency exchange rates, inflation rates or other monetary rates, any foreign

exchange swap, as defined in Section 1a(25) of the Commodity Exchange Act, and any foreign exchange option.

(2) Credit swaps. Any swap that is primarily based on instruments of indebtedness, including but not limited to any swap primarily based on one or more broad-based indices related to debt instruments, and any swap that is an index credit default swap or total return swap on one or more indices of debt instruments.

(3) Equity swaps. Any swap that is primarily based on equity securities, including but not limited to any swap based on one or more broad-based indices of equity securities and any total return swap on one or more equity indices.

(4) Other commodity swaps. Any swap that is not included in the rate swap, credit swap or equity swap categories.

(sss) Substantial position. (1) In general. For purposes of Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), the term "substantial position" means swap positions, other than positions that are excluded from consideration, that equal or exceed any of the following thresholds in the specified major category of swaps:

(i) For rate swaps:

(A) \$3 billion in daily average aggregate uncollateralized outward exposure; or

(B) \$6 billion in:

(1) Daily average aggregate uncollateralized outward exposure plus

(2) Daily average aggregate potential outward exposure.

(ii) For credit swaps:

(A) \$1 billion in daily average aggregate uncollateralized outward exposure; or

(B) \$2 billion in:

(1) Daily average aggregate uncollateralized outward exposure plus

(2) Daily average aggregate potential outward exposure.

(iii) For equity swaps:

(A) \$1 billion in daily average aggregate uncollateralized outward exposure; or

(B) \$2 billion in:

(1) Daily average aggregate uncollateralized outward exposure plus

(2) Daily average aggregate potential outward exposure.

(iv) For other commodity swaps:

(A) \$1 billion in daily average aggregate uncollateralized outward exposure; or

(B) \$2 billion in:

(1) Daily average aggregate uncollateralized outward exposure plus

(2) Daily average aggregate potential outward exposure.

(2) Aggregate uncollateralized outward exposure. (i) In general. Aggregate

uncollateralized outward exposure in general means the sum of the current exposure, obtained by marking-to-market using industry standard practices, of each of the person's swap positions with negative value in a major swap category, less the value of the collateral the person has posted in connection with those positions.

(ii) Calculation of aggregate uncollateralized outward exposure. In calculating this amount the person shall, with respect to each of its swap counterparties in a given major swap category, (A) determine the dollar value of the aggregate current exposure arising from each of its swap positions with negative value (subject to the netting provisions described below) in that major category by marking-to-market using industry standard practices; and (B) deduct from that dollar amount the aggregate value of the collateral

the person has posted with respect to the swap positions. The aggregate uncollateralized outward exposure shall be the sum of those uncollateralized amounts across all of the person's swap counterparties in the applicable major category.

(iii) Relevance of netting agreements. (A) If the person has a master netting agreement in effect with a particular counterparty, the person may measure the current exposure arising from its swaps in any major category on a net basis, applying the terms of the agreement. Calculation of net exposure may take into account offsetting positions entered into with that particular counterparty involving swaps (in any swap category) as well as security-based swaps and securities financing transactions (consisting of securities lending and borrowing, securities margin lending and repurchase and reverse repurchase agreements), to the extent these are consistent with the offsets permitted by the master netting agreement.

(B) Such adjustments may not take into account any offset associated with positions that the person has with separate counterparties.

(3) Aggregate potential outward exposure. (i) In general. Aggregate potential outward exposure in any major swap category means the sum of:

(A) The aggregate potential outward exposure for each of the person's swap positions in a major swap category that are not subject to daily mark-to-market margining and are not cleared by a registered clearing agency or derivatives clearing organization, as calculated in accordance with paragraph (3)(ii); and

(B) The aggregate potential outward exposure for each of the person's swap positions in such major swap category that are subject to daily mark-to-market margining or are

cleared by a registered clearing agency or derivatives clearing organization, as calculated in accordance with paragraph (3)(iii).

(ii) Calculation of potential outward exposure for swaps that are not subject to daily mark-to-market margining and are not cleared by a registered clearing agency or derivatives clearing organization:

(A) In general.

(1) For positions in swaps that are not subject to daily mark-to-market margining and are not cleared by a registered clearing agency or a derivatives clearing organization, potential outward exposure equals the total notional principal amount of those positions, adjusted by the following multipliers on a position-by-position basis reflecting the type of swap. For any swap that does not appropriately fall within any of the specified categories, the "other commodities" conversion factors are to be used:

Table 1—Conversion Factor Matrix for Swaps

Residual maturity	Interest rate	Foreign exchange rate and gold	Precious metals (except gold)	Other commodities
One year or less	0.00	0.01	0.07	0.10
Over one to five years	0.005	0.05	0.07	0.12
Over five years	0.015	0.075	0.08	0.15

Residual maturity	Credit	Equity
One year or less	0.10	0.06
Over one to five years	0.10	0.08
Over five years	0.10	0.10

If a swap is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the swap is zero, the remaining maturity equals the time until the next reset date.

(2) Use of effective notional amounts. If the stated notional amount on a position is leveraged or enhanced by the structure of the position, the calculation in paragraph (3)(ii)(A)(1) shall be based on the effective notional amount of the position rather than on the stated notional amount.

(3) Exclusion of certain positions. The calculation in paragraph (3)(ii)(A)(1) shall exclude:

(i) positions that constitute the purchase of an option, such that the person has no additional payment obligations under the position; and

(ii) other positions for which the person has prepaid or otherwise satisfied all of its payment obligations.

(4) Adjustment for certain positions. Notwithstanding paragraph (3)(ii)(A)(1), the potential outward exposure associated with a position by which a person buys credit protection using a credit default swap or index credit default swap is capped at the net present value of the unpaid premiums.

(B) Adjustment for netting agreements. Notwithstanding paragraph (3)(ii)(A), for positions subject to master netting agreements the potential outward exposure associated with the person's swaps with each counterparty equals a weighted average of the potential outward exposure for the person's swaps with that counterparty as calculated under paragraph (3)(ii)(A), and that amount reduced by the ratio of net current exposure to gross current exposure, consistent with the following equation as calculated on a counterparty-by-counterparty basis:

$$P_{Net} = 0.4 * P_{Gross} + 0.6 * NGR * P_{Gross}$$

Note to paragraph (3)(ii)(B). Where: P_{Net} is the potential outward exposure, adjusted for bilateral netting, of the person's swaps with a particular counterparty; P_{Gross} is that potential outward exposure without adjustment for bilateral netting; and NGR is the ratio of net current exposure to gross current exposure.

(iii) Calculation of potential outward exposure for swaps that are subject to daily mark-to-market margining or are cleared by a registered clearing agency or derivatives clearing organization. For positions in swaps that are subject to daily mark-to-market margining or cleared by a registered clearing agency or derivatives clearing organization:

(A) Potential outward exposure equals the potential exposure that would be attributed to such positions using the procedures in paragraph (3)(ii) multiplied by 0.2.

(B) For purposes of this calculation, a swap shall be considered to be subject to daily mark-to-market margining if, and for so long as, the counterparties follow the daily practice of exchanging collateral to reflect changes in the current exposure arising from the swap (after taking into account any other financial positions addressed by a netting agreement between the counterparties. If the person is permitted by agreement to maintain a threshold for which it is not required to post collateral, the total amount of that threshold (regardless of the actual exposure at any time) shall be added to the person's aggregate uncollateralized outward exposure for purposes of paragraph (1)(i)(B), (1)(ii)(B), (1)(iii)(B) or (1)(iv)(B), as applicable. If the minimum transfer amount under the agreement is in excess of \$1 million, the entirety of the minimum transfer amount shall be added to the person's aggregate uncollateralized outward exposure for purposes of paragraph (1)(i)(B), (1)(ii)(B), (1)(iii)(B) or (1)(iv)(B), as applicable.

(4) Calculation of daily average. Measures of daily average aggregate uncollateralized outward exposure and daily average aggregate potential outward exposure shall equal the arithmetic mean of the applicable measure of exposure at the close of each business day, beginning the first business day of each calendar quarter and continuing through the last business day of that quarter.

(ttt) Hedging or mitigating commercial risk. For purposes of Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), a swap position shall be deemed to be held for the purpose of hedging or mitigating commercial risk when:

(1) Such position:

(i) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from:

(A) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;

(B) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise; or

(C) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;

(D) The potential change in the value of assets, services, inputs, products, or commodities that a person owns, produces, manufactures, processes, merchandises,

leases, or sells, or reasonably anticipates owning, producing, manufacturing, processing, merchandising, leasing, or selling in the ordinary course of business of the enterprise;

(E) Any potential change in value related to any of the foregoing arising from foreign exchange rate movements associated with such assets, liabilities, services, inputs, products, or commodities; or

(F) Any fluctuation in interest, currency, or foreign exchange rate exposures arising from a person's current or anticipated assets or liabilities; or

(ii) Qualifies as bona fide hedging for purposes of an exemption from position limits under the Commodity Exchange Act; or

(iii) Qualifies for hedging treatment under Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133); and

(2) Such position is:

(i) Not held for a purpose that is in the nature of speculation, investing or trading;

(ii) Not held to hedge or mitigate the risk of another swap or securities-based swap position, unless that other position itself is held for the purpose of hedging or mitigating commercial risk as defined by this rule or § 240.3a67-4 of this title.

(uuu) Substantial counterparty exposure. (1) In general. For purposes of Section 1a(33) of the Act and § 1.3(qqq), the term "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets" means a swap position that satisfies either of the following thresholds:

(i) \$5 billion in daily average aggregate uncollateralized outward exposure; or

(ii) \$8 billion in:

(A) Daily average aggregate uncollateralized outward exposure plus

(B) Daily average aggregate potential outward exposure.

(2) Calculation methodology. For these purposes, the terms "daily average aggregate uncollateralized outward exposure" and "daily average aggregate potential outward exposure" have the same meaning as in § 1.3(sss), except that these amounts shall be calculated by reference to all of the person's swap positions, rather than by reference to a specific major swap category.

(vvv) Financial entity; highly leveraged. (1) For purposes of Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), the term "financial entity" means:

(i) A security-based swap dealer;

(ii) A major security-based swap participant;

(iii) A commodity pool as defined in Section 1a(10) of the Commodity Exchange Act;

(iv) A private fund as defined in Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a));

(v) An employee benefit 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); and

(vi) A person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in Section 4(k) of the Bank Holding Company Act of 1956.

(2) For purposes of Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), the term "highly leveraged" means the existence of a ratio of an entity's total liabilities to equity in excess of [8 to 1 or 15 to 1] as measured at the close of business on the last business day of the applicable fiscal quarter. For this purpose, liabilities and equity

should each be determined in accordance with U.S. generally accepted accounting principles.

Securities and Exchange Commission

Pursuant to the Exchange Act, 15 U.S.C. § 78a *et seq.*, and particularly, Sections 3 and 23 thereof, and Sections 712 and 761(b) of the Dodd-Frank Act, the SEC is proposing to adopt Rules 3a67-1, 3a67-2, 3a67-3, 3a67-4, 3a67-5, 3a67-6, 3a67-7, 3a71-1, and 3a71-2 under the Exchange Act.

Text of Proposed Rules

For the reasons stated in the preamble, the SEC is proposing to amend Title 17, Chapter II of the Code of the Federal Regulations 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:

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.*, 18 U.S.C. 1350; and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

Sections 3a67-1 through 3a67-7 and sections 3a71-1 and 3a71-2 are also issued under Pub. L. 111-203, §§712, 761(b), 124 Stat. 1841 (2010).

* * * * *

2. Add §§ 240.3a67-1 through 240.3a67-7 and §§ 240.3a71-1, 240.3a71-2 to

read as follows:

	* * * * *
240.3a67	1— Definition of “Major Security-based Swap Participant.”
240.3a67	2— Categories of Security-based Swaps.
240.3a67	3— Definition of “Substantial Position.”
240.3a67	4— Definition of “Hedging or Mitigating Commercial Risk.”
240.3a67	5— Definition of “Substantial Counterparty Exposure.”
240.3a67	6— Definitions of “Financial Entity” and “Highly Leveraged.”
240.3a67	7— Timing Requirements, Reevaluation Period and Termination of Status.
240.3a71	1— Definition of “Security-based Swap Dealer.
240.3a71	2— De Minimis Exception.

* * * * *

§ 240.3a67-1 Definition of “Major Security-based Swap Participant.”

(a) General. Major security-based swap participant means any person:

(1) That is not a security-based swap dealer; and

(2)(i) That maintains a substantial position in security-based swaps for any of the major security-based swap categories, 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:

(A) 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 agency (as defined in 15 U.S.C. 78c(a)(72)); and

(B) Maintains a substantial position in outstanding security-based swaps in any major security-based swap category.

(b) Scope of designation. A person that is a major security-based swap participant in general shall be deemed to be a major security-based swap participant with respect to each security-based swap it enters into, regardless of the category of the security-based swap or the person's activities in connection with the security-based swap, unless the Commission limits the person's designation as a major security-based swap participant to specified categories of security-based swaps or specified activities of the person in connection with security-based swaps.

§ 240.3a67-2 Categories of Security-based Swaps.

For purposes of sections 3(a)(67) and 3(a)(71) of the Act, 15 U.S.C. 78c(a)(67) and 78c(a)(71), and the rules thereunder, the terms major security-based swap category, category of security-based swaps and any similar terms mean either of the following categories of security-based swaps:

(a) Security-based credit derivatives. Any security-based swap that is based, in whole or in part, on one or more instruments of indebtedness (including loans), or on a credit event relating to one or more issuers or securities, including but not limited to any security-based swap that is a credit default swap, total return swap on one or more debt instruments, debt swap, debt index swap, or credit spread.

(b) Other security-based swaps. Any security-based swap not described in paragraph (a) of this section.

§ 240.3a67-3 Definition of "Substantial Position."

(a) General. For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term substantial position means security-based swap positions, other than positions that are excluded from consideration, that equal or exceed either of the following thresholds in any major category of security-based swaps:

(1) \$1 billion in daily average aggregate uncollateralized outward exposure; or

(2) \$2 billion in:

(i) Daily average aggregate uncollateralized outward exposure; plus

(ii) Daily average aggregate potential outward exposure.

(b) Aggregate uncollateralized outward exposure.

(1) General. Aggregate uncollateralized outward exposure in general means the sum of the current exposure, obtained by marking-to-market using industry standard practices, of each of the person's security-based swap positions with negative value in a major security-based swap category, less the value of the collateral the person has posted in connection with those positions.

(2) Calculation of aggregate uncollateralized outward exposure. In calculating this amount the person shall, with respect to each of its security-based swap counterparties in a given major security-based swap category:

(i) Determine the dollar value of the aggregate current exposure arising from each of its security-based swap positions with negative value (subject to the netting provisions

described below) in that major category by marking-to-market using industry standard practices; and

(ii) Deduct from that dollar amount the aggregate value of the collateral the person has posted with respect to the security-based swap positions. The aggregate uncollateralized outward exposure shall be the sum of those uncollateralized amounts across all of the person's security-based swap counterparties in the applicable major category.

(3) Relevance of netting agreements.

(A) If a person has a master netting agreement with a counterparty, the person may measure the current exposure arising from its security-based swaps in any major category on a net basis, applying the terms of the agreement. Calculation of net exposure may take into account offsetting positions entered into with that particular counterparty involving security-based swaps (in any swap category) as well as swaps and securities financing transactions (consisting of securities lending and borrowing, securities margin lending and repurchase and reverse repurchase agreements), to the extent these are consistent with the offsets permitted by the master netting agreement.

(B) Such adjustments may not take into account any offset associated with positions that the person has with separate counterparties.

(c) Aggregate potential outward exposure.

(1) General. Aggregate potential outward exposure means the sum of:

(i) The aggregate potential outward exposure for each of the person's security-based swap positions in a major security-based swap category that are not cleared by a

registered clearing agency or subject to daily mark-to-market margining, as calculated in accordance with paragraph (c)(2) of this section; and

(ii) The aggregate potential outward exposure for each of the person's security-based swap positions in a major security-based swap category that are cleared by a registered clearing agency or subject to daily mark-to-market margining, as calculated in accordance with paragraph (c)(3) of this section.

(2) Calculation of potential outward exposure for security-based swaps that are not cleared by a registered clearing agency or subject to daily mark-to-market margining.

(i) General.

(A) For positions in security-based swaps that are not cleared by a registered clearing agency or subject to daily mark-to-market margining, potential outward exposure equals the total notional principal amount of those positions, multiplied by the following factors on a position-by-position basis reflecting the type of security-based swap. For any security-based swap that is not of the "credit" or "equity" type, the "other" conversion factors are to be used:

Residual maturity	Credit	Equity	Other
One year or less	0.10	0.06	0.10
Over one to five years	0.10	0.08	0.12
Over five years	0.10	0.10	0.15

If a security-based swap is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the market value of the security-based swap is zero, the remaining maturity equals the time until the next reset date.

(B) Use of effective notional amounts. If the stated notional amount on a position is leveraged or enhanced by the structure of the position, the calculation in paragraph

(i)(A) of this section shall be based on the effective notional amount of the position rather than on the stated notional amount.

(C) Exclusion of certain positions. The calculation in paragraph (i)(A) of this section shall exclude:

(1) Positions that constitute the purchase of an option, such that the person has no additional payment obligations under the position; and

(2) Other positions for which the person has prepaid or otherwise satisfied all of its payment obligations.

(D) Adjustment for certain positions. Notwithstanding paragraph (i)(A) of this section, the potential outward exposure associated with a position by which a person buys credit protection using a credit default swap is capped at the net present value of the unpaid premiums.

(ii) Adjustment for netting agreements. Notwithstanding paragraph (2)(i) of this section, for positions subject to master netting agreements the potential outward exposure associated with the person's security-based swaps with each counterparty equals a weighted average of the potential outward exposure for the person's security-based swaps with that counterparty as calculated under paragraph (2)(i) of this section, and that amount reduced by the ratio of net current exposure to gross current exposure, consistent with the following equation as calculated on a counterparty-by-counterparty basis:

$$P_{Net} = 0.4 \times P_{Gross} + 0.6 \times NGR \times P_{Gross}$$

Note to paragraph (c)(2)(ii). Where: P_{Net} is the potential outward exposure, adjusted for bilateral netting, of the person's security-based swaps with a particular counterparty;

P_{Gross} is that potential outward exposure without adjustment for bilateral netting; and NGR is the ratio of net current exposure to gross current exposure.

(3) Calculation of potential outward exposure for security-based swaps that are cleared by a registered clearing agency or subject to daily mark-to-market margining. For positions in security-based swaps that are cleared by a registered clearing agency or subject to daily mark-to-market margining:

(i) Potential outward exposure equals the potential outward exposure that would be attributed to such positions using the procedures in paragraph (c)(2) of this section, multiplied by 0.2.

(ii) For purposes of this calculation, a security-based swap shall be considered to be subject to daily mark-to-market margining if, and for as long as, the counterparties follow the daily practice of exchanging collateral to reflect changes in the current exposure arising from the security-based swap (after taking into account any other financial positions addressed by a netting agreement between the counterparties). If the person is permitted by agreement to maintain a threshold for which it is not required to post collateral, the total amount of that threshold (regardless of the actual exposure at any time) shall be added to the person's aggregate uncollateralized outward exposure for purposes of paragraph (a)(2) of this section. If the minimum transfer amount under the agreement is in excess of \$1 million, the entirety of the minimum transfer amount shall be added to the person's aggregate uncollateralized outward exposure for purposes of paragraph (a)(2) of this section.

(d) Calculation of daily average. Measures of daily average aggregate uncollateralized outward exposure and daily average aggregate potential outward

exposure shall equal the arithmetic mean of the applicable measure of exposure at the close of each business day, beginning the first business day of each calendar quarter and continuing through the last business day of that quarter.

§ 240.3a67-4 Definition of "Hedging or Mitigating Commercial Risk."

For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, a security-based swap position shall be deemed to be held for the purpose of hedging or mitigating commercial risk when:

(a) Such position is economically appropriate to the reduction of risks that are associated with the present conduct and management of a commercial enterprise, or are reasonably expected to arise in the future conduct and management of the commercial enterprise, where such risks arise from:

(1) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;

(2) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise; or

(3) The potential change in the value of services that a person provides, purchases; or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;

(b) Such position is:

(1) Not held for a purpose that is in the nature of speculation or trading; and

(2) Not held to hedge or mitigate the risk of another security-based swap position or swap position, unless that other position itself is held for the purpose of hedging or mitigating commercial risk as defined by this section or 17 CFR § 1.3(ttt); and

(c) The person holding the position satisfies the following additional conditions:

(1) The person identifies and documents the risks that are being reduced by the security-based swap position;

(2) The person establishes and documents a method of assessing the effectiveness of the security-based swap as a hedge; and

(3) The person regularly assesses the effectiveness of the security-based swap as a hedge.

§ 240.3a67-5 Definition of "Substantial Counterparty Exposure."

(a) General. For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets means a security-based swap position that satisfies either of the following thresholds:

(1) \$2 billion in daily average aggregate uncollateralized outward exposure; or

(2) \$4 billion in:

(i) Daily average aggregate uncollateralized outward exposure; plus

(ii) Daily average aggregate potential outward exposure.

(b) Calculation. For these purposes, daily average aggregate uncollateralized outward exposure and daily average aggregate potential outward exposure shall be calculated the same way as is prescribed in § 240.3a67-3 of this chapter, except that these

amounts shall be calculated by reference to all of the person's security-based swap positions, rather than by reference to a specific major security-based swap category.

§ 240.3a67-6 Definitions of "Financial Entity" and "Highly Leveraged."

(a) For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term financial entity means:

- (1) A swap dealer;
- (2) A major swap participant;
- (3) A commodity pool as defined in section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10));
- (4) A private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a));
- (5) An employee benefit 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); and
- (6) A person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843k).

(b) For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term highly leveraged means the existence of a ratio of an entity's total liabilities to equity in excess of [8 to 1 or 15 to 1] as measured at the close of business on the last business day of the applicable fiscal quarter. For this purpose, liabilities and equity should each be determined in accordance with U.S. generally accepted accounting principles.

§ 240.3a67-7 Timing Requirements, Reevaluation Period and Termination of Status.

(a) Timing requirements. A person that is not registered as a major security-based swap participant, but that meets the criteria in § 240.3a67-1 of this chapter to be a major security-based swap participant as a result of its security-based swap activities in a fiscal quarter, will not be deemed to be a major security-based swap participant until the earlier of the date on which it submits a complete application for registration pursuant to 15 U.S.C. 78o-8 or two months after the end of that quarter.

(b) Reevaluation period. Notwithstanding paragraph (a) of this section, if a person that is not registered as a major security-based swap participant meets the criteria in § 240.3a67-1 of this chapter to be a major security-based swap participant in a fiscal quarter, but does not exceed any applicable threshold by more than twenty percent in that quarter:

(1) That person will not immediately be subject to the timing requirements specified in paragraph (a) of this section; but

(2) That person will become subject to the timing requirements specified in paragraph (a) of this section at the end of the next fiscal quarter if the person exceeds any of the applicable daily average thresholds in that next fiscal quarter.

(c) Termination of status. A person that is deemed to be a major security-based swap participant shall continue to be deemed a major security-based swap participant until such time that its security-based swap activities do not exceed any of the daily average thresholds set forth within § 240.3a67-1 of this chapter for four consecutive

fiscal quarters after the date on which the person becomes registered as a major security-based swap participant.

§ 240.3a71-1 Definition of "Security-based Swap Dealer."

(a) General. The term security-based swap dealer in general means any person who:

(i) Holds itself 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.

(b) Exception. The term security-based swap dealer does not include a person that enters into security-based swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

(c) Scope of designation. A person that is a security-based swap dealer in general shall be deemed to be a security-based swap dealer with respect to each security-based swap it enters into, regardless of the category of the security-based swap or the person's activities in connection with the security-based swap, unless the Commission limits the person's designation as a major security-based swap participant to specified categories of security-based swaps or specified activities of the person in connection with security-based swaps.

§ 240.3a71-2 De Minimis Exception.

For purposes of section 3(a)(71) of the Act, 15 U.S.C. 78c(a)(71), and § 240.3a71-1 of this chapter, a person shall not be deemed to be a security-based swap dealer as a result of security-based swap dealing activity involving counterparties that meets each of the following conditions:

(a) Notional amount of outstanding security-based swap positions. The security-based swap positions connected with those activities into which the person enters over the course of the immediately preceding 12 months have an aggregate gross notional amount of no more than \$100 million and have an aggregate gross notional amount of no more than \$25 million with regard to security-based swaps in which the counterparty is a "special entity" (as that term is defined in 15 U.S.C. 78o-8). For purposes of this paragraph (a), if the stated notional amount of a security-based swap is leveraged or enhanced by the structure of the security-based swap, the calculation shall be based on the effective notional amount of the security-based swap rather than on the stated notional amount.

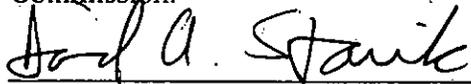
(b) No more than 15 counterparties. The person does not enter into security-based swaps in connection with those activities with more than 15 counterparties, other than security-based swap dealers, over the course of the immediately preceding 12 months. In determining the number of counterparties, all counterparties that are members of a single affiliated group shall be considered to be a single counterparty.

(c) No more than 20 security-based swaps. The person has not entered into more than 20 security-based swaps in connection with those activities over the course of the immediately preceding 12 months. For purposes of this paragraph, each transaction

entered into under a master agreement for security-based swaps shall constitute a distinct security-based swap, but entering into an amendment of an existing security-based swap in which the counterparty to such swap remains the same and the notional item underlying such security-based swap remains substantially the same shall not constitute entering into a security-based swap.

By the Commodity Futures Trading

Commission.



David A. Stawick
Secretary

Date: December 1, 2010

By the Securities and Exchange Commission.



Elizabeth M. Murphy
Secretary

Date: December 7, 2010

Additional Statement by the Commodity Futures Trading Commission Regarding the Joint Proposed Rule Entitled "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant,' and 'Eligible Contract Participant.'"

On this matter, Chairman Gensler and Commissioners Dunn and Chilton voted in the affirmative; Commissioners Sommers and O'Malia voted in the negative.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63474 / December 8, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-14156

In the Matter of

**Ministor Peripherals International Ltd.,
Modatech Systems, Inc.,
Modena 5, Inc.,
Modena 6, Inc.,
Modern Times Group MTG, Inc.,
Monarch Media and Entertainment
Group, Inc.,
The Murdock Group Career Satisfaction
Corp. (n/k/a The Murdock Group
Holding Corp.),
Mustang.com, Inc.,
MycoBiotech Ltd.,
MyPlan USA, Inc., and
MyTurn.com, Inc.,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE PROCEEDINGS
AND NOTICE OF HEARING
PURSUANT TO SECTION 12(j) OF
THE SECURITIES EXCHANGE ACT
OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Ministor Peripherals International Ltd., Modatech Systems, Inc., Modena 5, Inc., Modena 6, Inc., Modern Times Group MTG, Inc., Monarch Media and Entertainment Group, Inc., The Murdock Group Career Satisfaction Corp. (n/k/a The Murdock Group Holding Corp.), Mustang.com, Inc., MycoBiotech Ltd., MyPlan USA, Inc., and MyTurn.com, Inc.

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II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Ministor Peripherals International Ltd. (CIK No. 922871) is a Bermuda corporation located in San Jose, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ministor Peripherals International 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, 1994, which reported a net loss of \$22,831,000 for the prior twelve months. On March 4, 1995, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of California, and the case was terminated on January 11, 2000.

2. Modatech Systems, Inc. (CIK No. 857166) 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). Modatech is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended November 30, 1994, which reported a net loss of \$13,697,843 for the prior twelve months.

3. Modena 5, Inc. (CIK No. 1271079) 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). Modena 5 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, 2004, which reported a net loss of \$1,350 for the prior nine months.

4. Modena 6, Inc. (CIK No. 1271080) is a void Delaware corporation located in Philadelphia, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Modena 6 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, 2008.

5. Modern Times Group MTG Corp. (CIK No. 1045303) is a Swedish corporation located in Stockholm, Sweden with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Modern Times Group MTG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a net loss of \$7,700 for the prior twelve months. As of December 6, 2010, the company's stock (symbol "MTGBF") was traded on the over-the-counter markets.

6. Monarch Media & Entertainment Group, Inc. (CIK No. 1082314) is a permanently 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). Monarch Media is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the

period ended June 30, 2001, which reported a net loss of \$54,909 for the prior six months.

7. The Murdock Group Career Satisfaction Corp. (n/k/a The Murdock Group Holding Corp.) (CIK No. 1054512) is a terminated Utah corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Murdock Group Career Satisfaction is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2001, which reported a net loss of \$11,186,944 for the prior six months. As of December 6, 2010, the company's stock (symbol "TMGH") was traded on the over-the-counter markets.

8. Mustang.com, Inc. (CIK No. 940986) is a California corporation located in Bakersfield, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mustang.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2000, which reported a net loss of \$244,525 for the prior three months. On February 22, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was terminated on January 4, 2010.

9. MycoBiotech Ltd. (CIK No. 1203457) is a Singapore corporation located in Singapore with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MycoBiotech is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A on May 13, 2003, which reported a net loss of over \$2 million for the nine months ended September 30, 2002. As of December 6, 2010, the company's stock (symbol "MYBI") was traded on the over-the-counter markets.

10. MyPlan USA, Inc. (CIK No. 1157995) is a Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MyPlan USA 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 January 31, 2002, which reported a net loss of \$217,481 since the company's inception on August 2, 2001.

11. MyTurn.com, Inc. (CIK No. 1028079) is a void Delaware corporation located in Alameda, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MyTurn.com 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 \$128,360,574 for the prior nine months. On March 2, 2001, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of California, and the case was terminated on December 13, 2005. As of December 6, 2010, the company's stock (symbol "MYTNQ") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

12. 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.

13. 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.

14. 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

*Chairman Shapiro
not participating
Commissioner Casey
Disapproved*

ADMINISTRATIVE PROCEEDING
FILE NO. 3-13847

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
December 8, 2010

In the Matter of

MORGAN ASSET MANAGEMENT, INC.,
MORGAN KEEGAN & COMPANY, INC.,
JAMES C. KELSOE, JR., and
JOSEPH THOMPSON WELLER, CPA

ORDER DENYING
INTERLOCUTORY REVIEW

The Office of Compliance Inspections and Examinations ("OCIE") seeks interlocutory review of an administrative law judge's orders dated July 20 and August 3, 2010, granting in part, and denying in part, its motion to quash a subpoena duces tecum. For the reasons set forth below, we have determined to deny interlocutory review.

I.

On April 7, 2010, the Commission instituted administrative and cease-and-desist proceedings against Morgan Asset Management, Inc. ("Morgan Asset"), a registered investment adviser; Morgan Keegan & Company, Inc. ("Morgan Keegan"), a registered broker-dealer; James C. Kelsoe, Jr., Morgan Asset's portfolio manager and Morgan Keegan's managing director; and Joseph Thompson Weller, CPA ("Weller"), Morgan Keegan's controller and head of its Fund Accounting Department (collectively, "Respondents"). Morgan Asset, through Kelsoe, managed the Helios Select Fund, Inc., Helios High Income Fund, Inc., Helios Multi-Sector High Income Fund, Inc., Helios Strategic Income Fund, Inc., and Helios Advantage Income Fund, Inc. (collectively, the "Funds") from at least November 2004 through July 2008. The Order Instituting Proceedings ("OIP") alleged that from January 2007 through July 2007, the daily net asset value of each Fund was materially inflated as a result of Respondents' fraudulent conduct. For relief, the OIP requested, among other things, cease-and-desist orders, disgorgement, civil penalties, and a practice bar against Weller.

On May 28, 2010, the law judge issued a subpoena requiring OCIE to produce certain documents by June 16, 2010. The subpoena contained four requests:

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- (1) examination or inspection reports for Respondents and the Funds at issue in this proceeding from 2002 to the present ("Request No. 1");
- (2) documents relating to OCIE's examination or review of fair value procedures of the same entities during the same period ("Request No. 2");
- (3) documents pertaining to the pricing or valuation of the 389 securities at issue in this proceeding ("Request No. 3"); and
- (4) materials relating to a sweep discussed by a Division of Investment Management senior official in a newspaper article ("Request No. 4").

On June 16, 2010, the date on which responsive documents were due, OCIE filed a motion to quash the subpoena, arguing that it was overly broad and unduly burdensome; that the majority of requested documents were irrelevant; and that the documents were protected from discovery by one or more claims of privilege, including the attorney-client privilege, the deliberative process privilege, and the attorney work product doctrine.¹

As part of its motion to quash, OCIE filed a privilege log with respect to Request No. 1, but not with respect to Request Nos. 2 through 4. OCIE argued that it was unable to provide a document-by-document privilege log for documents responsive to Request Nos. 2 through 4 because the subpoena required review of more than 14,000 examination files, many of which were in storage or located in regional offices, thereby imposing an undue burden on the staff. OCIE argued that it was likely that the "majority" of documents responsive to Request Nos. 2 through 4 were protected from disclosure by the attorney-client privilege, deliberative process privilege, and the attorney work product doctrine. OCIE submitted a sworn declaration by OCIE's Associate Director and Chief Counsel in support of its motion to quash. The declaration identified the categories of documents that might be found in the requested files and the various privileges that would apply to the documents in those categories. OCIE further argued that Request No. 4 "potentially" sought "highly confidential business information belonging to third-party registrants [provided to OCIE in a risk-targeted examination sweep] that OCIE [was] not authorized to disclose."

Respondents opposed OCIE's motion to quash. Respondents argued that the requested documents were critical to their defenses and ability to cross-examine the Division of Enforcement's ("Division") two OCIE witnesses, one of whom participated in the investigation

¹ Among other things, OCIE stated that there were 32 final examination reports (arising out of 37 examinations) "touching upon" Respondents and/or the Funds. However, only 17 of those reports dealt with valuation issues and several were conducted after Respondents had received the relevant deficiency letters. OCIE also noted that many of the documents in the file likely came from, or were sent to, Respondents or the Funds, and therefore were already available to Respondents.

resulting in this proceeding. According to Respondents, the information sought by Request Nos. 1 and 2 was relevant to their understanding of the alleged inadequacy of the Funds' valuation procedures and necessary to rebut the Division's claims of fraud; the information sought by Request No. 3 was likely to be exculpatory; and the information sought by Request No. 4 was crucial to their defenses that the Funds' valuation procedures were consistent with industry practice and Commission guidance and that the prices of their fair valued securities were reasonable.

On July 20, 2010, the law judge issued an order granting in part, and denying in part, OCIE's motion to quash (hereinafter, the "July 20 Order"). The law judge ruled that, regarding Request Nos. 1 and 2, OCIE did not have to produce reports it specifically identified as relating to anti-money laundering compliance and a branch office examination involving suitability and excessive trading issues. Nor did it have to produce two documents prepared and submitted to the Commission that arose out of a particular examination. In all other respects, the law judge denied the motion to quash Request Nos. 1 and 2.

Regarding Request No. 3, the law judge found that it was unduly burdensome and granted the motion to quash it.

Regarding Request No. 4, the law judge granted the motion to quash as to two memoranda prepared for the Commission that, in OCIE's words, related to a risk-targeted sweep examination of ten fund groups focusing on pricing/valuation of certain "difficult-to-value" securities beginning on May 29, 2008. But the law judge rejected OCIE's claim that the remainder of responsive documents were not relevant to the present proceeding. The law judge also rejected OCIE's claims of undue burden and its blanket claims of the attorney-client and deliberative process privileges.² The law judge further stated that, "to the extent that documents responsive to Request No. 4 may contain confidential business information relating to third parties, Respondents are willing to enter into a protective order restricting their use of the confidential business information. No more is required. I now impose a protective order and direct that Respondents shall use any documents produced in response to Request No. 4 only for purposes of the present proceeding."

² The law judge stated that there was "no such thing as an SEC examination privilege." The Commission declines at this time to address whether, as OCIE suggests, an SEC examination privilege exists. *See generally Putnam Inv. Mngmt., LLC*, Securities Exchange Act Rel. No. 50039 (July 20, 2004), 83 SEC Docket 1262, 1265-66 ("The existence and scope of a privilege relating to the conduct of Commission examinations raise serious issues and present a wide range of public interest factors which must be considered and weighed carefully. We believe that such issues should be reviewed in a litigated context in which two parties offer competing views. The development of a full and complete evidentiary record is necessary to reach a correct legal conclusion.").

On July 27, 2010, OCIE filed a motion for reconsideration of the July 20 Order or, in the alternative, certification of the July 20 Order for interlocutory review and a stay of the July 20 Order. Respondents opposed OCIE's motion. The Division of Enforcement filed a limited response stating that it did not take a position on OCIE's motion. On August 3, 2010, the law judge denied OCIE's motion for reconsideration, certification, and a stay.

On August 18, 2010, OCIE petitioned the Commission for interlocutory review and a stay of the July 20 Order. On August 27, 2010, pending our consideration of OCIE's petition, we granted a thirty-day interim stay to September 13, 2010. We subsequently extended the interim stay to December 13, 2010. At the end of September 2010, the law judge who was assigned to this case retired, and a new law judge was designated to preside over the proceedings.

II.

Rule of Practice 400(a) provides that a "ruling submitted to the Commission for interlocutory review must be certified . . . by the hearing officer," but that the Commission "may, at any time, on its own motion, direct that any matter be submitted to it for review."³ Under Rule of Practice 400(a), petitions for interlocutory review are "disfavored," and the Commission "ordinarily will grant a petition to review a hearing officer ruling prior to its consideration of an initial decision only in extraordinary circumstances."⁴ The Commission may decline to consider a petition "if it determines that interlocutory review is not warranted or appropriate."⁵ The Commission adopted Rule of Practice 400(a) to make clear that petitions for interlocutory review will rarely be granted.⁶

We have carefully reviewed the arguments raised by OCIE. The thrust of its petition is that OCIE should not have to produce any documents responsive to the subpoena because to do so would be unduly burdensome. The Commission has previously found no "extraordinary circumstances" and denied interlocutory review on the ground that complaints about production of documents do not warrant interference with the orderly hearing process.⁷ Similarly, here, there are no extraordinary circumstances justifying our intervention at this time.

³ 17 C.F.R. § 201.400(a).

⁴ *Id.*

⁵ *Id.*

⁶ *Adoption of Amendments to the Rules of Practice and Delegations of Authority of the Commission*, Exchange Act Rel. No. 49412 (Mar. 12, 2004), 82 SEC Docket 1744, 1749.

⁷ *See Michael Sassano*, Exchange Act Rel. No. 56874 (Nov. 30, 2007), 92 SEC Docket 111, 114.

Although we are denying OCIE's petition for interlocutory review, we nevertheless believe it appropriate for us to address certain procedural issues that have arisen in connection with the petition.⁸ We believe that the law judge has sufficient authority to resolve disputes arising under the subpoena. Rule of Practice 111 gives the law judge "the authority to do all things necessary to discharge his or her duties."⁹ Rules of Practice 111(b), (c), and (d) grant the law judge broad powers to issue and quash subpoenas, rule on the admissibility of evidence, and regulate the course of the proceedings.¹⁰ Rule of Practice 232(e)(2) gives the law judge the power to quash a subpoena that is "unreasonable, oppressive or unduly burdensome."¹¹ We ask that the law judge consider the following issues.

OCIE has expressed concern that the law judge "held that OCIE could not assert any claims of privilege for documents reflecting internal pre-decisional deliberations among Commission staff, attorney work-product, or attorney-client communications (with the exception of four documents)."¹² We note that, at the time OCIE filed its motion to quash, it was unclear how many documents OCIE would have to review. OCIE objected that many of the documents were irrelevant and then filed a privilege log with respect to Request No. 1, but the law judge failed to address the issues raised by the log. With respect to Request Nos. 2 through 4, OCIE made blanket claims that the attorney-client privilege, deliberate process privilege, and attorney work product doctrine would protect the majority of responsive documents from disclosure. If OCIE, at this stage of the proceedings, wishes to assert specific objections to the production of any particular documents responsive to the subpoena, it must do so on a document-by-document basis, setting forth the basis for its objections. As noted above, the law judge has appropriate authority to consider and determine all objections in the first instance.

In addition, OCIE has expressed concern that, pursuant to Request No. 4, it must produce confidential, proprietary information of third parties, some of whom are Respondents' competitors. We believe that it is appropriate for the parties and the law judge to delineate an expanded and more detailed order for confidential treatment of any third-party documents deemed to be properly produced, setting forth their authorized use, the authorized users, and appropriate control mechanisms.

⁸ The Rules of Practice grant us broad discretion, upon our determination that "to do so would serve the interests of justice and not result in prejudice to the parties to the proceeding," to "direct, in a particular proceeding, that an alternative procedure shall apply." 17 C.F.R. § 201.100(c)

⁹ 17 C.F.R. § 201.111.

¹⁰ *Id.*; see also 5 U.S.C. § 556(c) (delineating law judge powers).

¹¹ 17 C.F.R. § 201.232(e)(2).

¹² The Commission is the holder of these privileges.

OCIE has further represented that, "[i]n all but two instances, that information has been provided to OCIE with the express request that it not be disclosed outside the Commission and that the entity providing the information be notified if it were to be disclosed to third parties." The law judge should ensure that the interests of third parties are adequately protected and that OCIE has sufficient opportunity to give appropriate notice to the subject registrants (and any other persons who provided documents to the Commission pursuant to a confidential treatment request) before disclosure of their information is made to Respondents.¹³

Finally, the OIP specified a period of 300 days from service of the OIP as the deadline for filing an initial decision in this proceeding. In light of the period this proceeding has been stayed, we consider it appropriate that the 300-day period be tolled during the pendency of our consideration of OCIE's request for interlocutory review.¹⁴ OCIE states that it has searched for and collected non-privileged documents that may be responsive to the subpoena, and that it is in the process of reviewing additional documents. Respondents state that no responsive, non-privileged documents have been produced to date. We consider it appropriate to toll the 300-day period for an additional 120 days to permit the parties to produce and review documents and make and respond to any objections.

Accordingly, it is ORDERED that OCIE's motion for interlocutory review and a stay of the administrative law judge's July 20, 2010 order be, and it hereby is, denied; and it is further

ORDERED that OCIE produce subpoenaed records or assert any objections within sixty days from the date of this Order, and Respondents be given a subsequent sixty days to review documents made available and respond to any objections; and it is further

ORDERED that the law judge ensure that OCIE has sufficient opportunity to give appropriate notice to registrants (and any other persons who provided documents to the Commission pursuant to a confidential treatment request) before disclosure of their information is made to Respondents; and it is further

¹³ See generally 17 C.F.R. § 201.322(a) (stating that "[i]n any proceeding as defined in Rule 101(a), a party; any person who is the owner, subject or creator of a document subject to subpoena or which may be introduced as evidence; or any witness who testifies at a hearing may file a motion requesting a protective order to limit from disclosure to other parties or to the public documents or testimony that contain confidential information").

¹⁴ 17 C.F.R. § 201.360(a)(2).

ORDERED that the law judge issue a protective order as directed in this Order; and it is further

ORDERED that the 300-day period for rendering an initial decision in this proceeding be, and it hereby is, tolled for the period of the Commission's consideration of OCIE's motion and for an additional 120 days beyond that period.

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. 63473 / December 8, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3216 / December 8, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14155

In the Matter of

PAUL R. BECKWITH (CPA),

Respondent.

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

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Paul R. Beckwith, CPA ("Respondent" or "Beckwith") 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.

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Beckwith, age 38, is and has been a certified public accountant licensed to practice in the State of Utah. He served as an assistant controller of TheraDoc, Inc. ("TheraDoc"), a subsidiary of Hospira, Inc. ("Hospira"), from at least February 2009 until September 28, 2010.

2. Hospira is a Delaware corporation with its principal place of business in Lake Forest, Illinois. Hospira is a global specialty pharmaceutical and medication delivery company with worldwide sales of approximately \$3.9 billion. Hospira acquired TheraDoc in December 2009 for a purchase price of \$63.3 million. At all relevant times, Hospira's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

3. On October 14, 2010 a final judgment was entered against Beckwith, permanently enjoining him from future violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, and aiding and abetting violations of Section 13(b)(2)(A) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Paul R. Beckwith, et al., Civil Action Number 1:10-CV-00162, in the United States District Court for the District of Utah.

4. The Commission's complaint alleged, among other things, that beginning in at least July 2009, Beckwith began systematically withdrawing funds from TheraDoc's operating account and depositing them into an account under the name of Paul Beckwith CPA's. Upon transferring the misappropriated funds to Beckwith CPA's account, the complaint alleged that Beckwith then made further transfers from that account into his personal checking and savings accounts and then transferred funds to an account maintained at a national broker-dealer for his personal use. The complaint further alleges that Beckwith provided false reconciliation records to Hospira's internal accounting department and generated false reconciliation spreadsheets that did not reflect his withdrawals and deposits and also provided Hospira's accountants with bank records that deleted the records of the withdrawals that he made.

IV.

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

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

Beckwith is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63460 / December 8, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3121 / December 8, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14154

In the Matter of

**GARTMORE
INVESTMENT
LIMITED,**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 21C OF THE SECURITIES
EXCHANGE ACT OF 1934 AND SECTION
203(e) OF THE INVESTMENT ADVISERS
ACT OF 1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND
A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Gartmore Investment Limited ("Gartmore" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making

Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. These proceedings arise out of a violation of Rule 105 of Regulation M of the Exchange Act by Gartmore, a registered investment adviser based in London, United Kingdom. Rule 105 prohibits short selling of equity securities during a restricted period prior to a public offering and then purchasing the same securities in the public offering. Gartmore violated Rule 105 in May 2009 in connection with certain short sales it effected within the Rule 105 restricted period preceding its participation in a public offering by BB&T Corp. ("BB&T"), resulting in profits of \$928,117.83.

Respondent

2. Gartmore is a registered investment adviser (registered with the Commission since 2006) and is also subject to regulation by the Financial Services Authority of the United Kingdom. Gartmore is a London-based subsidiary of Gartmore Group Limited, a London Stock Exchange-listed entity with in excess of \$30 billion under management as of June 30, 2010. During the relevant time period, Gartmore was the investment adviser to a number of investment funds, and the trading described in this Order was conducted by Gartmore on behalf of one of those funds, the AlphaGen RhoCas Fund Limited ("RhoCas").

Background

3. As amended in 2007, Rule 105 of Regulation M provides in pertinent part:

In connection with an offering of equity securities for cash pursuant to a registration statement or a notification on Form 1-A . . . or Form 1-E . . . filed under the Securities Act of 1933 ("offered securities"), it shall be unlawful for any person to sell short . . . the security that is the subject of the offering and purchase the offered securities from an underwriter or broker or dealer participating in the offering if such short sale was effected during the period ("Rule 105 restricted period") . . . [b]eginning five business days before the pricing of the offered securities and ending with such pricing.

17 C.F.R. § 242.105(a); Short Selling in Connection With a Public Offering, Exchange Act Release No. 56,206, 72 Fed. Reg. 45,094, 45,107 (Aug. 10, 2007).

4. The Commission adopted Rule 105 in an effort to prevent manipulative short selling prior to a public offering and, therefore, "to foster secondary and follow-on offering prices that are determined by independent market dynamics." Id. At 45,094. Rule 105 prohibits

the conduct irrespective of the short seller's intent in effectuating the short sale. "The prohibition on purchasing offered securities ... provides a bright line demarcation of prohibited conduct consistent with the prophylactic nature of Regulation M." *Id.*: At 45,096.

5. Between May 6 and May 12, 2009, Gartmore sold short a total of 172,405 shares of common stock of BB&T for RhoCas at prices ranging between \$25.22 and \$27.38 per share.

6. On May 11, 2009, following the close of the market, BB&T announced a public secondary offering of common stock (the "Offering"), which was priced on May 12, 2009.

7. On May 12, 2009, Gartmore purchased a total of 145,000 shares of BB&T common stock in the Offering for RhoCas at \$20.00 per share. Gartmore covered a portion of its short position in BB&T stock with shares bought in the Offering.

8. Because Gartmore sold short shares of BB&T during the restricted period and then purchased shares in the Offering, Gartmore violated Rule 105. The difference between Gartmore's proceeds from the first 145,000 shares of short sales and the amount paid for the offering shares was \$928,117.83.

9. At the time of the violation, Gartmore had no policies, procedures or controls in place designed to detect or prevent Rule 105 violations.

10. As a result of the conduct described above, Gartmore willfully¹ violated Rule 105 of Regulation M of the Exchange Act.

11. After Gartmore learned of its Rule 105 violation, it developed and implemented policies, procedures and training programs relating to its Rule 105 compliance. In determining to accept the Offer, the Commission considered Gartmore's remedial efforts.

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

¹ 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)).

A. Gartmore shall cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Gartmore is censured;

C. Gartmore shall, within 14 days of the entry of this Order, pay a civil money penalty of \$375,000, disgorgement of \$928,117.83, and prejudgment interest of \$44,134.68 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by 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 Gartmore 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 St., N.E., Washington, D.C. 20549-5720A.

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63516 / December 10, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14159

In the Matter of

**GOLDEN GOOSE RESOURCES,
INC. (f/k/a MUSCOCHO
EXPLORATIONS, LTD.);**

Respondent.

**ORDER INSTITUTING PROCEEDINGS, MAKING
FINDINGS, AND REVOKING REGISTRATION OF
SECURITIES 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 proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Golden Goose Resources, Inc. (f/k/a Muscocho Explorations, Ltd.) ("Golden Goose" 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, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

A. Golden Goose (CIK Nos. 771963 and 1276189) is a Quebec corporation located in Montreal, Quebec, Canada. At all times relevant to this proceeding, the

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securities of Golden Goose have been registered under Exchange Act Section 12(g). As of October 8, 2010, the company's stock (symbol "GGOSF") was traded on the over-the-counter markets.

B. Golden Goose has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-16 thereunder because it has not filed any periodic reports with the Commission since the period ended December 31, 1988.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Elizabeth M. Murphy
Secretary

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. 9162 / December 10, 2010**

**Securities Exchange Act of 1934
Release No. 63526 / December 10, 2010**

**ORDER APPROVING PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
SUPPLEMENTAL BUDGET REQUEST TO ESTABLISH AN OFFICE OF OUTREACH
AND SMALL BUSINESS LIAISON IN 2010**

The Sarbanes-Oxley Act of 2002¹ (the "Sarbanes-Oxley Act") established the Public Company Accounting Oversight Board (the "PCAOB") to oversee the audits of companies and related matters, to protect investors, and to further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB is to accomplish these goals through registration of public accounting firms and standard setting, inspection, and disciplinary programs. Section 109 of the Sarbanes-Oxley Act directs the PCAOB to establish a budget for each fiscal year in accordance with the PCAOB's internal procedures, subject to approval by the Securities and Exchange Commission (the "Commission").

The Commission's Rules of Practice related to its Informal and Other Procedures includes a rule to facilitate the Commission's review and approval of PCAOB budgets.² This budget rule provides, among other things, a timetable for the preparation and submission of the PCAOB budget, limits on the PCAOB's ability to incur expenses and obligations except as provided in the approved budget, and procedures relating to supplemental budget requests. In

¹ 17 U.S.C. 7202 *et seq.*

² 17 CFR 202.190. See Release No. 33-8724 (July 18, 2006) [71 FR 41998 (July 24, 2006)].

accordance with the Commission's budget rule, the PCAOB submitted to the Commission a budget for calendar year 2010 that was approved by the Commission on December 22, 2009.³

Effective July 21, 2010, Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act⁴ (the "Dodd-Frank Act") amended the Sarbanes-Oxley Act to authorize the PCAOB, among other things, to establish, subject to approval by the Commission, auditing and related attestation, quality control, ethics, and independence standards to be used by registered public accounting firms with respect to the preparation and issuance of audit reports to be included in broker-dealer filings with the Commission.⁵ In light of this new authority, the PCAOB reassessed its communications and outreach strategy.

As a result of this reassessment, the PCAOB intends to enhance its outreach function by establishing a new Office of Outreach and Small Business Liaison ("Office of Outreach") to act as a liaison between the PCAOB and any PCAOB-registered public accounting firm, or any other person affected by the Board's regulatory activities, including in particular, entities in the small business community, such as the auditors of broker-dealers. In order to establish this office in 2010, the PCAOB is required under the budget rule to submit a supplemental budget request for Commission approval.⁶ Pursuant to the procedures set forth in the budget rule, on October 28, 2010, the PCAOB submitted to the Commission a supplemental budget request seeking approval to establish the Office of Outreach in 2010.⁷

³ See Release No. 34-61212 (Dec. 22, 2009).

⁴ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

⁵ 15 U.S.C. 78a *et seq.*

⁶ See 17 CFR 240.190(b)(10).

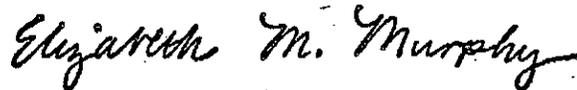
⁷ 17 CFR 202.190(f).

The Board believes that the creation of the Office of Outreach would not result in a net cost increase in 2010. To the extent that any unanticipated costs emerge, the PCAOB proposes to accommodate them from within available funds currently budgeted for the Office of Communications in 2010. Costs associated with the Office of Outreach in future years will be considered by the Commission as part of its review of the PCAOB budgets for those years.

Staff from the Commission's Offices of the Chief Accountant and Executive Director reviewed and analyzed the PCAOB's supplemental budget request and did not identify any matters that are inconsistent with Section 109 of the Sarbanes-Oxley Act or the Commission's budget rule. Upon considering the staff's review and analysis, the Commission has determined that the PCAOB's request to create the Office of Outreach in 2010 is consistent with Section 109 of the Sarbanes-Oxley Act and the Commission's budget rule. Accordingly,

IT IS ORDERED, pursuant to Section 109 of the Sarbanes-Oxley Act, that the PCAOB's supplemental budget request to create the Office of Outreach in 2010 is approved.

By the Commission.



Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9163 / December 14, 2010

SECURITIES EXCHANGE ACT OF 1934
Release No. 63543 / December 14, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14163

In the Matter of

MMR INVESTMENT
BANKERS, LLC (d/b/a MMR,
INC.),
WILLIAM G. MARTIN, JR.,
EUGENE R. RANKIN,
JOHN A. HUBERT, and
AARON D. FIMREITE,

Respondents.

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

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 MMR Investment Bankers, LLC (d/b/a MMR, Inc.) ("MMR"), William G. Martin, Jr. ("Martin"), Eugene R. Rankin ("Rankin"), John A. Hubert ("Hubert"), and Aaron D. Fimreite ("Fimreite") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

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A. RESPONDENTS

1. MMR, located in Wichita, Kansas, registered with the Commission as a broker-dealer on November 29, 1985 and was so registered at all relevant times. MMR was formed to raise funds for churches, which was its primary business through 2004.

2. Martin, age 62, resides in Andover, Kansas and is the president and majority owner of MMR. He has the ultimate decision-making authority for MMR, deciding which offerings MMR would underwrite, and reviewing the majority of customer sales. Martin holds Series 24, 27, 53, and 63 licenses.

3. Rankin, age 47, resides in Andover, Kansas. He is the vice-president and assistant compliance officer of MMR. He holds Series 7 and 63 licenses.

4. Hubert, age 66, resides in Andover, Kansas. He is a registered representative at MMR. He holds Series 7 and 63 licenses.

5. Fimreite, age 40, resides in Wichita, Kansas. He is a registered representative at MMR. He holds Series 7 and 63 licenses.

B. SUMMARY

6. Beginning in 2005, MMR, Martin, Rankin, Hubert, and Fimreite fraudulently recommended, offered and sold eleven best-efforts, no minimum private placement debenture offerings for eight small start-up companies, raising a total of more than \$12 million. MMR charged sales commissions and other forms of compensation on the offerings totaling upwards of 10% of the offering proceeds. The debenture offerings for all but one of the eight issuers are now in default on payments of interest and/or principal. The disclosure documents for the debenture offerings failed to disclose the manner in which Martin, Rankin, Hubert and Fimreite were personally profiting from the offerings and operations of the issuers, which was material to an evaluation of the objectivity of their recommendation of the securities. In addition, the disclosure documents failed to disclose certain sales commissions received for two of the offerings by the Respondents. The Respondents made other material misrepresentations and omissions regarding the business of one of the issuers and the fact that the issuer had defaulted with respect to earlier investors. MMR, Martin, Hubert, and Fimreite also failed to determine that the debentures were suitable for their customers before recommending the debentures. The debentures were unsuitable for numerous MMR customers given the level of risk in light of the customers' investment objectives, advanced age, annual income, and net worth. In addition, MMR and Martin failed reasonably to supervise Hubert and Fimreite with a view to preventing their violations of the securities laws.

C. BACKGROUND

7. In 1985, Martin and his father formed MMR as a broker-dealer intended to raise funds for churches. MMR primarily sold church bonds for 20 years. MMR developed a large customer base throughout the United States.

8. In 2004, MMR's market for church bonds was depleted. As a result of MMR's nearly exclusive reliance on church bonds for its business, it was unable to meet at least 50% of its 2004 payroll.

9. Beginning in early 2005, MMR changed its business model and underwrote eleven best-efforts debenture offerings. The offerings promised a 10% to 11% annual return and had no minimum amount to be sold. The offerings were as follows:

- a. Dynamic Distribution, Inc. ("Dynamic"), October 2006 – September 2007, raising \$697,000;
- b. El Pegasus Developmental, Inc. ("El Pegasus"), March 2005 – February 2006, raising \$2,493,000;
- c. Equity Capital Source, Inc. ("ECSI"), October 2006 – September 2007, raising \$1,924,000;
- d. Havoc Distribution, Inc. ("Havoc"), March 2006 – February 2007, raising \$2,118,000;
- e. MLP Associates, LLC ("MLP"), October 2005 – September 2007, raising \$2,036,000 and October 2008 – September 2009, raising \$1,391,996 consisting of \$245,000 in new funds and the remainder in rollovers from the first MLP offering;
- f. Partners in Care ("PIC"), June 2007 – December 2007, raising \$600,000 and August 2008 – July 2009, raising \$999,999 consisting of \$399,999 in new funds and the remainder in rollovers from the first PIC offering;
- g. Southfield Energy Corp. ("Southfield"), August 2006 – November 2007, raising \$758,000 and December 2007 – present, raising \$954,000; and
- h. Vending Ventures, Inc. ("Vending Ventures"), December 2007 – November 2008, raising \$354,000.

10. The debenture companies were all created by acquaintances of Martin and they encompassed a multitude of business endeavors. Dynamic and Vending Ventures were created to distribute Havoc Energy Drink, which was manufactured by Havoc. El Pegasus and MLP were created to provide interim funding for residential home construction, and MLP was also to provide interim funding for construction of income-producing properties. ECSI was created to contract

with faith-based organizations to develop senior housing projects. PIC was formed to supply specialty nurses to hospitals with personnel shortages. Southfield was created to invest in and hold fractional interests in exploration, development, and production of oil and gas.

11. Hubert and Fimreite were the MMR registered representatives who sold most of the debentures. Martin was their supervisor and was responsible for performing due diligence on the offerings. Rankin was the assistant compliance officer; he also was responsible for performing due diligence on the offerings, and he drafted the disclosure memoranda for all but two of the offerings.

12. MMR earned a total of \$1,377,835 from the sale of \$12,200,000 in debentures, consisting of \$915,227 in commissions, \$392,858 in non-accountable allowances, and \$69,750 in technical assistance fees.

13. Many of MMR's customers were financially conservative, older investors, either retired or near retirement. Many had limited net worth and/or limited annual income.

14. Each debenture company, other than Southfield, is in default as to repayment upon maturity and/or for interest payments due on the debentures.

15. Martin and Rankin created Sunflower Management Group LLC, ("Sunflower"), a non-registered entity, near the time of the first debenture offering. Sunflower was created to manage the proceeds of the debenture sales. It set up accounts to deposit invested funds, disburse proceeds to the issuer, track the amount raised, pay interest when due, and eventually repay principal.

16. Sunflower's monthly management fees, which were charged to the debenture companies, were 1/12 of 1% of the total outstanding debentures. Sunflower earned a total of \$233,370 for managing the proceeds of the eleven debenture offerings.

17. Martin and Rankin each own 40% of Sunflower. Fimreite owns 10% and Sherril Hubert, who is Martin's sister and Hubert's wife, owns the remaining 10%. The Respondents profited from Sunflower's management fees which were tied to the amount of debentures MMR placed.

D. MISREPRESENTATIONS AND OMISSIONS TO INVESTORS AND PROSPECTIVE INVESTORS IN THE DEBENTURE OFFERINGS

18. The Respondents made material misstatements and omissions in relation to each debenture offering.

19. In relation to the 2008 MLP offering, the Respondents failed to disclose that:

a. MLP's business model changed materially from 2005 to 2008.

b. MLP had defaulted on maturing debentures from its 2005 offering. MLP defaulted on repayment of principal in October 2008, the same month MMR began to sell debentures in the 2008 offering.

20. With respect to all of the offerings, Respondents failed to disclose the extent to which they would benefit from investors' purchases of the debentures, which was a material omission in light of their recommendation of the debentures. In relation to their compensation and ownership, Respondents failed to disclose:

a. Their ownership interest in Sunflower.

b. The amount of Sunflower's management fee.

c. That Havoc, Dynamic, Vending Ventures, Southfield, and PIC all issued shares to Sunflower and/or its assigns, pursuant to the management agreements between those companies and Sunflower. Only for the Vending Ventures offering was Sunflower's ownership interest disclosed.

d. That Martin, Rankin, Hubert and Fimreite, through Sunflower, would be receiving shares of the debenture issuers pursuant to Sunflower's management agreements with the debenture companies. In fact, they received the following shares:

1) Martin received 680,000 Havoc shares, 900,000 Dynamic shares, 360,000 Southfield shares, and 700,000 PIC shares;

2) Rankin received 320,000 Havoc shares, 670,000 Dynamic shares, 237,000 Southfield shares, and 550,000 PIC shares;

3) Hubert received 100,000 Havoc shares, 200,000 Dynamic shares, 60,000 Southfield shares, 980,000 Vending Ventures shares, and 100,000 PIC shares; and

4) Fimreite received 150,000 Havoc shares, 687,280 Dynamic shares, 60,000 Southfield shares, 1,727,500 Vending Ventures shares, and 100,000 PIC shares.

e. That Martin and Rankin each owned units in ECSI. The original offering memorandum did not disclose the ownership interest. MMR did not issue an addendum to the offering memorandum disclosing the ownership interest until after an SEC examination in 2007.

21. Respondents failed to disclose that Sunflower would be managing the offering proceeds for the initial Southfield offering:

22. The Respondents knew or were reckless in not knowing of these material misrepresentations and omissions.

E. THE DEBENTURE OFFERINGS WERE UNSUITABLE FOR MMR'S CUSTOMERS

23. Apart from one church bond offering for a limited period of time, from 2005 through 2008, MMR had no investments to offer its customers other than the debentures, which were illiquid and high risk investments in start-up ventures that needed funding.

24. Martin, Hubert, and Fimreite were aware of their obligation to determine whether a security that they recommended was suitable for their customers. MMR's Written Supervisory Procedures required the registered representatives to have reasonable grounds to believe a recommendation was not unsuitable for a customer.

25. MMR's Written Supervisory Procedures further required each sale to be evidenced by the "initials of the President, Vice-President, or Compliance Officer on the Purchase Order Form." This provision required the officer to make an independent determination of suitability. Further, as President, Martin was responsible for drafting MMR's Written Supervisory Procedures and for implementing a system to ensure compliance with those procedures.

26. Martin, Hubert, and Fimreite knew or were reckless in not knowing that the debentures were high risk investments. The offering documents for the debentures expressly stated that the debentures were "speculative and an investment in debentures involves a high degree of risk." The documents further stated that the debentures should not be purchased by investors who could not withstand a "substantial loss." Fimreite and Hubert admitted that the debentures would only be suitable for someone with a high yield investment objective.

27. The debentures were unsuitable for numerous MMR customers to whom the investment was recommended by Hubert or Fimreite and the sales in most cases were approved by Martin. Nearly all of these customers were long-term MMR customers who relied upon Hubert's and Fimreite's recommendations. In 2005, when MMR sold the first debentures, over half of the customers were over 70 and 11 were in their 80's. Ten had annual income under \$25,000, and the vast majority had annual income under \$50,000. Twenty-four had net worth of less than \$500,000, a minimum Martin later required for the sale of debentures. In 15 instances MMR placed as much as 20% or more of a customer's net worth in the debentures. Eight households or individuals held more than 25% of their net worth in debentures. In looking at the customers' investment objectives, ten investors had low risk investment objectives (retirement, pre-retirement, and income) for which the debentures were plainly unsuitable. Twenty-six investors had an investment objective of growth, but there was almost no prospect for growth in this investment because it was a debt instrument paying a fixed rate of return. Finally, although account documents for 15 investors reflected high yield as their stated investment objective, that designation did not genuinely reflect their investment objectives because MMR and its registered representatives caused the designation to be made without disclosing to customers the risks inherent in such designation at the time the firm caused the designation to be made.

F. MMR AND MARTIN FAILED REASONABLY TO SUPERVISE HUBERT AND FIMREITE

28. MMR had in place supervisory procedures relevant to suitability determinations. Under these procedures, the firm gathered customer information that could have been used to make suitability determinations, and registered representatives were affirmatively required to make suitability determinations. A principal of the firm was responsible for making an independent suitability assessment for each transaction, which in most instances was Martin. While these procedures appeared reasonably designed to assess suitability, MMR and Martin, as president, failed to establish reasonable systems to implement the procedures. As a result, MMR's supervisory procedures were not adequately implemented and MMR and Martin failed reasonably to supervise Hubert and Fimreite.

G. VIOLATIONS

29. As a result of the conduct described above, MMR, Martin, Rankin, Hubert, and Fimreite willfully violated 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.

30. Alternatively, as a result of the conduct above, Martin, Rankin, Hubert and Fimreite willfully aided and abetted and caused MMR's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder based on the false and misleading disclosure documents for the debentures.

31. As a result of the conduct described above, MMR willfully violated Section 15(c) of the Exchange Act, which similarly prohibits fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities by broker-dealers. Martin, Rankin, Hubert, and Fimreite willfully aided and abetted and caused MMR's violation of Section 15(c) of the Exchange Act.

32. As a result of the conduct described above, MMR willfully violated Section 17(a) of the Exchange Act and Rule 17a-3(a)(17)(i)(B)(1) thereunder, which requires that customers receive an explanation of the terms regarding investment objectives. Martin, Rankin, Hubert, and Fimreite willfully aided and abetted and caused MMR's violation of Section 17(a) of the Exchange Act.

33. As a result of the conduct described above, MMR and Martin failed reasonably to supervise Hubert and Fimreite with a view to preventing their violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, within the meaning of Sections 15(b)(4) and 15(b)(6) of the Exchange Act.

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 MMR, Martin, Rankin, Hubert, and Fimreite 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, based upon their willful violations and willful aiding and abetting violations alleged above;

C. What, if any, remedial action is appropriate in the public interest against MMR and Martin 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, based upon their failure reasonably to supervise Hubert and Fimreite as alleged above;

D. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, all of the Respondents should be ordered to cease and desist from committing or causing violations and any future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(c) of the Exchange Act and Rule 10b-5 thereunder, and whether all of the Respondents should be ordered to pay disgorgement plus prejudgment interest thereon pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act; and

E. Whether, pursuant to Section 308 of the Sarbanes-Oxley Act, a Fair Fund should be established for the benefit of defrauded investors to distribute to affected investors any disgorgement, prejudgment interest, and civil penalty payments that may be made.

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

Release No. 34-63557; File No. S7-44-10

RIN 3235- AK87

Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: In accordance with Section 763(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Securities and Exchange Commission ("Commission") is proposing rules under the Securities Exchange Act of 1934 ("Exchange Act") to specify the process for a registered clearing agency's submission for review of any security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing, the manner of notice the clearing agency must provide to its members of such submission and the procedure by which the Commission may stay the requirement that a security-based swap is subject to mandatory clearing while the clearing of the security-based swap is reviewed. The Commission also is proposing to specify that when a security-based swap is required to be cleared, the submission of the security-based swap for clearing must be for central clearing to a clearing agency that functions as a central counterparty. In addition, the Commission is proposing rules to define and describe when notices of proposed changes to rules, procedures or operations are required to be filed by designated financial market utilities in accordance with Section 806(e) of Title VIII of the Dodd-Frank Act and to set forth the process for filing such notices with the Commission. Furthermore, the Commission is

proposing rules to make conforming changes as required by the amendments to Section 19(b) of the Exchange Act contained in Section 916 of the Dodd-Frank Act.

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 S7-44-10 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, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-44-10. 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 also are 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: Kim Allen, Attorney Fellow, Catherine Moore, Senior Special Counsel, Kenneth Riitho, Special Counsel or Andrew Bernstein, Attorney-Advisor, at (202) 551-5710; Office of Clearance and Settlement, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

The Dodd-Frank Act seeks to ensure that, wherever possible and appropriate, derivatives contracts formerly traded exclusively in the over-the-counter (“OTC”) market be cleared.¹ One key way in which the Dodd-Frank Act promotes clearing of such contracts is by setting forth a process by which the Commission would determine whether a security-based swap is required to be cleared; if the Commission makes a determination that a security-based swap is required to be cleared, then parties may not engage in such security-based swap without submitting it for clearing unless an exception applies.

The Commission may determine that a security-based swap is required to be cleared based on a review of a clearing agency’s submission regarding a security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept

¹ See, e.g., Report of the Senate Committee on Banking, Housing, and Urban Affairs regarding The Restoring American Financial Stability Act of 2010, S. Rep. No. 111-176 at 34 (stating that “[s]ome parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, uncleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible.”).

for clearing (i.e., a Security-Based Swap Submission (as defined below)).² If the Commission determines that a security-based swap is not required to be cleared, such security-based swap may still be cleared on a non-mandatory basis by the clearing agency if the clearing agency has rules that permit it to clear such security-based swap.³ In addition, paragraph (b)(1) of new Section 3C of the Exchange Act, as added by Section 763(a) of the Dodd-Frank Act (“Exchange Act Section 3C”) provides that “[t]he Commission on an ongoing basis shall review each security-based swap, or any group, category, type, or class of security-based swaps to make a determination that such security-based swap, or group, category, type, or class of security-based swaps should be required to be cleared” (“Commission-initiated Review”).⁴

Consistent with the policy objective of the Dodd-Frank Act to bring security-based swaps into a central clearing environment where appropriate, the Commission is proposing to amend Rule 19b-4 under the Exchange Act to incorporate two new requirements applicable to clearing agencies under Exchange Act Section 3C, and under Section 806(e) of the Dodd-Frank Act (“Section 806(e)"). The proposed amendments to Rule 19b-4 would mandate that submissions required under Exchange Act Section 3C for a security-based swap, or any group, category, type or class of security-based swaps, that a clearing agency plans to accept for clearing (“Security-Based Swap Submissions”) and advance notices required under Section 806(e) of proposed changes to rules, procedures or operations of financial market utilities (“Advance Notices”) be

² See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(2)(C)) (“[t]he Commission shall . . . review each submission made under subparagraphs (A) and (B), and determine whether the security-based swap, or group, category, type, or class of security-based swaps, described in the submission is required to be cleared.”).

³ See 15 U.S.C. 78s(b) and 12 U.S.C. 5465(e).

⁴ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(1)). The Dodd-Frank Act does not require rulemaking with respect to Commission-initiated Reviews.

filed with the Commission on Form 19b-4. The proposed amendments to Rule 19b-4 also would specify the manner of notice the clearing agency must provide to its members of Security-Based Swap Submissions.

Additionally, the Commission is proposing two related rules under Exchange Act Section 3C. Proposed Rule 3Ca-1 would establish the procedure by which the Commission, at the request of a counterparty or on its own initiative, may stay the requirement that a security-based swap is subject to mandatory clearing. Proposed Rule 3Ca-2 is intended to prevent evasions of the clearing requirement by specifying that security-based swaps required to be cleared must be submitted for central clearing to a clearing agency that functions as a central counterparty. Finally, the Commission is proposing technical, conforming and clarifying amendments to Rule 19b-4 and Form 19b-4 to conform the rule and form with new deadlines and approval, disapproval and temporary suspension standards with respect to proposed rule changes filed under Section 19(b) of the Exchange Act, as modified by Section 916 of the Dodd-Frank Act ("Exchange Act Section 19(b)").

I. Introduction

On July 21, 2010, the President signed the 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 and by providing for enhanced regulation and oversight of institutions designated as systemically important.⁶ Title VII and Title VIII of the Dodd-Frank Act are intended to further these goals and to mitigate systemic risk in part by imposing new requirements with respect to clearance and settlement systems.

⁵ The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, H.R. 4173).

⁶ See Pub. L. No. 111-203, Preamble.

Title VII of the Dodd-Frank Act ("Title VII") provides the Commission and the Commodity Futures Trading Commission ("CFTC") with enhanced authority to regulate OTC derivatives following the recent financial crisis.⁷ The Dodd-Frank Act is intended to bolster the existing regulatory structure and provide 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. Title VII provides that the CFTC will regulate "swaps," the Commission will regulate "security-based swaps," and the CFTC and the Commission will jointly regulate "mixed swaps."⁸

⁷ See, e.g., Report of the Senate Committee on Banking, Housing, and Urban Affairs regarding The Restoring American Financial Stability Act of 2010, S. Rep. No. 111-176 at 29 (2010) (stating that "[m]any factors led to the unraveling of this country's financial sector and the government intervention to correct it, but a major contributor to the financial crisis was the unregulated [OTC] derivatives market.")

⁸ 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, 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, 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 security-based swaps, 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 Board, 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 have requested comment from interested parties. See Securities Exchange Act Release No. 62717 (Aug. 13, 2010), 75 FR 51429 (Aug. 20, 2010) (Advance Joint Notice of Proposed Rulemaking Regarding Definitions Contained in Title VII of the Dodd-Frank Act).

The OTC derivatives markets traditionally have been characterized by privately negotiated transactions entered into by two counterparties, in which each assumes the credit risk of the other counterparty.⁹ Clearing of swaps and security-based swaps was at the heart of Congressional reform of the derivatives markets in Title VII of the Dodd Frank Act.¹⁰ Clearing agencies are broadly defined under the Exchange Act and undertake a variety of functions.¹¹ One such function is to act as a central counterparty (“CCP”), which is an entity that interposes itself between the counterparties to a trade.¹² For example, when an OTC derivatives contract between two counterparties that are members of a CCP is executed and submitted for clearing, it is typically replaced by two new contracts – separate contracts between the CCP and each of the two original counterparties. At that point, the original counterparties are no longer

⁹ See, e.g., Financial Stability Board, Implementing OTC Derivatives Market Reforms (Oct. 25, 2010) available at http://www.financialstabilityboard.org/publications/r_101025.pdf.

¹⁰ As previously noted, the Dodd-Frank Act seeks to ensure that, wherever possible and appropriate, derivatives contracts formerly traded exclusively in the OTC market be cleared. See Letter from Christopher Dodd, Chairman, Committee on Banking, Housing and Urban Affairs, United States Senate and Blanche Lincoln, Chairman, Committee on Agriculture, Nutrition, and Forestry, United States Senate, to Barney Frank, Chairman, Financial Services Committee, United States House of Representatives and Colin Peterson, Chairman, Committee on Agriculture, United States House of Representatives (June 30, 2010) (on file with the United States Senate).

¹¹ The term “clearing agency” means any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for the comparison of data regarding the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates. 15 U.S.C. 78c(a)(23)(A).

¹² See *id.* An entity that acts as a CCP for securities transactions is a clearing agency as defined in the Exchange Act and is required to register with the Commission.

counterparties to each other. Instead, each acquires the CCP as its counterparty, and the CCP assumes the counterparty credit risk of each of the original counterparties that are members of the CCP.¹³ Structured and operated appropriately, CCPs may improve the management of counterparty risk and may provide additional benefits such as multilateral netting of trades.

Exchange Act Section 3C sets forth a mandatory clearing requirement for security-based swaps. This section requires the Commission to adopt rules for submissions for review of security-based swaps that a clearing agency plans to accept for clearing for a determination by the Commission of whether the security-based swap (or group, category, type or class of security-based swaps) is required to be cleared, *i.e.*, is subject to mandatory clearing.¹⁴ The Commission is proposing amendments to Rule 19b-4 under the Exchange Act to implement the requirement in Exchange Act Section 3C that a clearing agency submit for Commission review each security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing and provide notice to its members of such Security-Based Swap Submission. The Commission also is proposing new Rules 3Ca-1 and 3Ca-2 under the Exchange Act. Proposed Rule 3Ca-1 specifies the procedure for staying the clearing requirement applicable to a security-based swap, based either on an application of a counterparty to a security-based swap or on the Commission's own initiative, until the Commission completes a review of the terms of the security-based swap and the clearing arrangement. Proposed Rule 3Ca-2 establishes a rule designed to prevent evasions of the clearing requirement by specifying that security-based swaps required to be cleared must be submitted for central clearing to a clearing agency that functions as a central counterparty.

¹³ See Cecchetti, Gyntelberg and Hollanders, Central counterparties for over-the-counter derivatives, BIS Quarterly Review, September 2009, available at http://www.bis.org/publ/qtrpdf/r_qt0909f.pdf.

¹⁴ Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(2)(C)).

The Commission also is proposing rules to implement a filing requirement applicable to certain clearing agencies under Title VIII of the Dodd-Frank Act ("Title VIII"). Title VIII provides for enhanced regulation of financial market utilities, which include clearing agencies, that manage or operate a multilateral system for the purpose of transferring, clearing or settling payments, securities or other financial transactions among financial institutions or between financial institutions and the financial market utility.¹⁵ The regulatory regime in Title VIII will only apply, however, to financial market utilities that the Financial Stability Oversight Council ("Council") designates as systemically important.¹⁶

Section 806(e)(1)(A) of Title VIII requires any financial market utility designated by the Council under Section 804 of the Dodd-Frank Act as systemically important to file 60 days advance notice of changes to its rules, procedures or operations that could materially affect the

¹⁵ The definition of "financial market utility" in Section 803(6) of the Dodd-Frank Act contains a number of exclusions including but not limited to certain designated contract markets, registered futures associations, swap data repositories, swap execution facilities, national securities exchanges, national securities associations, alternative trading systems, security-based swap data repositories, security-based swap execution facilities, brokers, dealers, transfer agents, investment companies and futures commission merchants. 12 U.S.C. 5462(6)(B).

¹⁶ Pursuant to Section 803(9) of the Dodd-Frank Act, a financial market utility is systemically important if the failure of or a disruption to the functioning of such financial market utility could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States. 12 U.S.C. 5462(9). Under Section 804 of the Dodd-Frank Act, the Council has the authority, on a non-delegable basis and by a vote of not fewer than two-thirds of the members then serving, including the affirmative vote of its chairperson, to designate those financial market utilities that the Council determines are, or are likely to become, systemically important. The Council may, using the same procedures as discussed above, rescind such designation if it determines that the financial market utility no longer meets the standards for systemic importance. Before making either determination, the Council is required to consult with the Board and the relevant Supervisory Agency (as determined in accordance with Section 803(8) of the Dodd-Frank Act). Finally, Section 804 of the Dodd-Frank Act sets forth the procedures for giving entities a 30-day notice and the opportunity for a hearing prior to a designation or rescission of the designation of systemic importance. 12 U.S.C. 5463.

nature or level of risk presented by the financial market utility.¹⁷ In addition, Section 806(e)(1)(B) requires each Supervisory Agency¹⁸ to adopt rules, in consultation with the Board of Governors of the Federal Reserve System (“Board”), that define and describe when designated financial market utilities are required to file Advance Notices with their Supervisory Agency.¹⁹

Clearing agencies registered with the Commission are financial market utilities, as defined in Section 803(6) of Title VIII;²⁰ thus, the Commission may be the Supervisory Agency of a clearing agency that is designated as systemically important by the Council (“designated clearing agency”).²¹ A clearing agency must begin filing Advance Notices pursuant to Section 806(e) once the Council designates the clearing agency as systemically important.²² The Commission is proposing to implement the Section 806(e) filing requirement by amending Rule 19b-4 to define and determine when Advance Notices must be filed by designated clearing agencies and to require that Advance Notices be filed on Form 19b-4.

¹⁷ 12 U.S.C. 5465(e)(1)(A).

¹⁸ Section 803(8) of the Dodd-Frank Act defines the term “Supervisory Agency” in reference to the primary regulatory authority for the financial market utility. For example, Section 803(8) of the Dodd-Frank Act provides that the Commission is the Supervisory Agency for any financial market utility that is a Commission-registered clearing agency. See 12 U.S.C. 5462(8). To the extent that an entity is both a Commission-registered clearing agency and registered with another agency, such as a CFTC-registered derivatives clearing organization, the statute requires the two agencies to agree on one agency to act as the Supervisory Agency, and if the agencies cannot agree on which agency has primary jurisdiction, the Council shall decide which agency is the Supervisory Agency for purposes of the Dodd-Frank Act. 12 U.S.C. 5462(8).

¹⁹ 12 U.S.C. 5465(e)(1)(B).

²⁰ 12 U.S.C. 5462(6).

²¹ See supra note 18 discussing the definition of “Supervisory Agency” under the Dodd-Frank Act.

²² Pursuant to Section 814 of the Dodd Frank Act, Title VIII took effect on the date of enactment.

The Commission is proposing that Security-Based Swap Submissions and Advance Notices be filed with the Commission on Form 19b-4 using the existing Electronic Form 19b-4 Filing System ("EFFS"). Currently, EFFS is used by self-regulatory organizations ("SROs"), which include registered clearing agencies,²³ to file proposed rule changes electronically with the Commission pursuant to Exchange Act Section 19(b).²⁴ The Commission is proposing to require clearing agencies to use EFFS for the filing of Security-Based Swap Submissions and Advance Notices because registered clearing agencies already use EFFS for Exchange Act Section 19(b) filings and because there are similarities between the requirement to file proposed rule changes under Exchange Act Section 19(b) and the new requirements under the Dodd-Frank Act to file Security-Based Swap Submissions and Advance Notices. For example, a proposed rule change under Exchange Act Section 19(b) includes a change in a "stated policy, practice, or interpretation" of an SRO rule. A "stated policy, practice, or interpretation" is defined in Exchange Act Section 19(b) as "any material aspect of the operation of the facilities of the SRO; or any statement made generally available to the membership of, to all participants in, or to persons having or seeking access . . . to facilities of, the self-regulatory organization ("specified persons"); or to a group or category of specified persons, that establishes or changes any standard, limit, or guideline with respect to (1) the rights, obligations, or privileges of specified persons . . . ; or (2) the meaning, administration, or enforcement of an existing rule."²⁵ In cases

²³ The definition of SRO in Section 3(a)(26) of the Exchange Act includes any registered clearing agency. 15 U.S.C. 78c(a)(26). All SROs are required to file proposed rule changes with the Commission under Exchange Act Section 19(b). 15 U.S.C. 78s(b).

²⁴ SROs are required to file with the Commission, in accordance with rules prescribed by the Commission, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of the SRO (collectively referred to as a "proposed rule change"). 15 U.S.C. 78s(b)(1).

²⁵ 17 CFR 240.19b-4(c).

where accepting a security-based swap (or group, category, type or class of security-based swaps) for clearing constitutes a change in a “stated policy, practice, or interpretation” of the clearing agency, the clearing agency also would be required to file a proposed rule change. Similarly, if a change that a designated clearing agency proposes to make that would require an Advance Notice would also constitute a change in a “stated policy, practice, or interpretation” of the clearing agency, the clearing agency would be required to file a proposed rule change in addition to the Advance Notice.

The Commission also is proposing to amend Rule 19b-4 and Form 19b-4 to conform to the requirements specified in Exchange Act Section 19(b), as amended by Section 916 of the Dodd Frank Act.²⁶ Section 916 provides new deadlines by which the Commission must publish and act upon proposed rule changes submitted by SROs and new standards for approval, disapproval and temporary suspension of proposed rule changes.²⁷ In addition, the Commission is proposing a number of technical and clarifying amendments to Rule 19b-4 and Form 19b-4.

In proposing these rules, the Commission is mindful that there are differences between the security-based swap market and the other securities markets that the Commission regulates. The Commission also is mindful that over time and as a result of Commission proposals to implement the Dodd-Frank Act, further development of the security-based swap market may alter the policy objectives and considerations relating to the clearing of security-based swaps. During the process of implementing the Dodd-Frank Act and beyond, the Commission therefore will closely monitor developments in the security-based swap market, including how the Security-Based Swap Submission and clearing processes interact with the evolving business and practices of security-based swap clearing agencies and other entities.

²⁶ Pub. L. No. 111-203, section 916 (amending Exchange Act Section 19(b)(2)).

²⁷ Id.

II. Discussion of the Proposed Rules

The Commission is proposing to adopt rules to implement the new requirements imposed by Title VII and Title VIII discussed above. In accordance with the requirements set forth in Exchange Act Section 3C (found in Title VII), the Commission is proposing amendments to Rule 19b-4 and Form 19b-4 and new Rule 3Ca-1 under the Exchange Act to establish processes for (i) clearing agencies registered with the Commission to submit for review each security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing for a determination by the Commission of whether the security-based swap (or group, category, type or class of security-based swaps) is required to be cleared, and to determine the manner of notice the clearing agency must provide to its members of such submission and (ii) how the Commission may stay the requirement that a security-based swap is subject to mandatory clearing. The Commission also is proposing new Rule 3Ca-2 to prevent evasions of the clearing requirement. In addition, the Commission is proposing amendments to Rule 19b-4 and Form 19b-4 to implement the requirement, pursuant to Section 806(e), that any designated clearing agency for which the Commission is the Supervisory Agency will be required to provide advance notice to the Commission of changes to its rules, procedures or operations that could materially affect the nature or level of risks presented by the designated clearing agency. This release also discusses the filing requirements in Exchange Act Section 19(b), Exchange Act Section 3C, and Section 806(e) and a clearing agency's obligation to fully comply with and seek a determination pursuant to each separate statutory requirement, when applicable.

A. Security-Based Swap Submissions

Exchange Act Section 3C creates, among other things, a clearing requirement with respect to security-based swaps. Specifically, the section provides that "[i]t shall be unlawful for

any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency that is registered under this Act or a clearing agency that is exempt from registration under this Act if the security-based swap is required to be cleared.”²⁸

Exchange Act Section 3C requires the Commission, not later than one year after the date of the enactment of the Dodd-Frank Act, to adopt rules for a clearing agency’s Security-Based Swap Submissions and to determine the manner of notice the clearing agency must provide to its members of such Security-Based Swap Submission.²⁹ In connection with rulemaking related to Security-Based Swap Submissions, the Commission is proposing rules related to (i) the process for making Security-Based Swap Submissions to the Commission, (ii) the substance of Security-Based Swap Submissions and (iii) the timing related to Security-Based Swap Submissions. The Commission also is proposing a process and timing for clearing agencies to provide notice to their members of Security-Based Swap Submissions.

1. Process for Making Security-Based Swap Submissions to the Commission

A clearing agency that plans to accept a security-based swap for clearing must file a Security-Based Swap Submission with the Commission for a determination by the Commission

²⁸ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(a)(1)). The requirement that a security-based swap be cleared stems from a determination by the Commission. Such determination may be made in connection with the review of a clearing agency’s submission regarding a security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing (i.e., a Security-Based Swap Submission). See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(2)(C)) (“[t]he Commission shall . . . review each submission made under subparagraphs (A) and (B), and determine whether the security-based swap, or group, category, type, or class of security-based swaps, described in the submission is required to be cleared.”). In addition, Exchange Act Section 3C(b)(1) provides that “[t]he Commission on an ongoing basis shall review each security-based swap, or any group, category, type, or class of security-based swaps to make a determination that such security-based swap, or group, category, type, or class of security-based swaps should be required to be cleared.”

²⁹ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(2)(A)).

of whether a security-based swap, or a group, category, type or class of security-based swaps, is required to be cleared. As discussed in Section I, in cases where accepting a security-based swap (or group, category, type or class of security-based swaps) for clearing constitutes a change in a "stated policy, practice, or interpretation" of the clearing agency, the clearing agency also would be required to file a proposed rule change. In such cases, the Commission must determine (i) whether to approve the clearing agency's proposed rule change to clear the applicable security-based swap and (ii) whether the security-based swap would be subject to the mandatory clearing requirement.

The Commission is proposing to require clearing agencies to use EDFS and Form 19b-4 for Security-Based Swap Submissions. Clearing agencies, as SROs, are already required to file proposed rule changes on Form 19b-4 on EDFS. Using the same filing process for Security-Based Swap Submissions would leverage existing technology and reduce the resources clearing agencies would have to expend on meeting Commission filing requirements. In addition, the Commission anticipates that a submission to clear a security-based swap, or any group, category, type or class of security-based swaps, may be required to be filed under both Exchange Act Section 19(b) and Exchange Act Section 3C. This is because a submission that must be filed with the Commission for a determination under new Exchange Act Section 3C also may qualify as a proposed rule change that must be filed with the Commission under Exchange Act Section 19(b).³⁰ In other words, the two filing requirements are not mutually exclusive. Because a clearing agency may be required to file the same proposal under Exchange Act Section 3C and

³⁰ A clearing agency rule is defined broadly in the Exchange Act to include the constitution, articles of incorporation, by-laws, and rules, or instruments corresponding to the foregoing. 15 U.S.C. 78c(a)(27). The Commission anticipates that a proposal to clear a new type, category or class of security-based swap will in many cases also be a change to the rules of a registered clearing agency that must be filed with the Commission for approval pursuant to Exchange Act Section 19(b).

Exchange Act Section 19(b), the Commission preliminarily believes that the most efficient use of the Commission's and clearing agencies' resources would be to require clearing agencies to use the existing Form 19b-4 filing process for both types of filings. Accordingly, the proposed rules related to the Security-Based Swap Submission process would be added to existing Rule 19b-4, which currently governs the process for filing proposed rule changes.

The Commission's proposed approach would eliminate the need for multiple submissions to the Commission and could be accomplished by adding a box to Form 19b-4 that clearing agencies would check to indicate that they are making a Security-Based Swap Submission. As a practical matter, the Commission believes that when a security-based swap is submitted for review under Exchange Act Section 3C and concurrently filed under Exchange Act Section 19(b) as a proposed rule change, the two reviews will be carried out in tandem. In circumstances where no proposed rule change filing would be required, such as a case where a clearing agency's rules already permit it to clear the security-based swap in question, EFTS and Form 19b-4 still would be used for the Security-Based Swap Submission.

a. Substance of Security-Based Swap Submissions: Consistency with Exchange Act Section 17A

In reviewing a Security-Based Swap Submission, the Commission is required to review whether the submission is consistent with Exchange Act Section 17A.³¹ Accordingly, the Commission is proposing that each Security-Based Swap Submission contain a statement regarding how the submission is consistent with Exchange Act Section 17A.³² Exchange Act Section 17A specifies, among other things, that the Commission is directed, having due regard for the public interest, the protection of investors, the safeguarding of securities and funds and

³¹ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(4)(A)).

³² Proposed Rule 19b-4(o)(3)(i).

maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents, to use its authority to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities.³³

The Commission must review whether a proposed rule change filed by an SRO pursuant to Exchange Act Section 19(b) is consistent with Exchange Act Section 17A.³⁴ In connection with proposed rule changes, an SRO is required to "explain why the proposed rule change is consistent with the requirements of the [Exchange] Act and the rules and regulations thereunder applicable to the [SRO]. A mere assertion that the proposed rule change is consistent with those requirements is not sufficient."³⁵ Presently, in complying with this requirement, registered clearing agencies, among other things, specify how the proposed rule change is consistent with the requirements under Exchange Act Section 17A(b)(3). All registered clearing agencies must comply with the standards in Exchange Act Section 17A, which include requirements under Exchange Act Section 17A(b)(3) to maintain rules for promoting the prompt and accurate clearance and settlement of securities transactions, assuring the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, fostering cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, removing impediments to and perfecting the mechanism of a national

³³ 15 U.S.C. 78q-1.

³⁴ See 15 U.S.C. 78s(b)(2)(C)(i), which provides that the Commission shall approve a proposed rule change of an SRO if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations issued thereunder that are applicable to such organization.

³⁵ Item 3(b) of Form 19b-4. 17 CFR 240.819. Exchange Act Section 19(b) has a similar but not identical requirement. It requires that an SRO provide a statement of the basis of the proposed rule change and provides that the Commission shall only approve a proposed rule change if it finds that it is consistent with the requirements of the Exchange Act and the rules and regulations thereunder. 15 U.S.C. 78s(b).

system for the prompt and accurate clearance and settlement of securities transactions, and, in general, protecting investors and the public interest.³⁶ A registered clearing agency is also required under Exchange Act Section 17A(b)(3) to provide fair access to clearing and to have the capacity to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions for which it is responsible, as well as to safeguard securities and funds in its custody or control or for which it is responsible.³⁷ Under the proposed amendments to Rule 19b-4, a clearing agency would be required to specify how the Security-Based Swap Submission is consistent with Exchange Act Section 17A and specifically the requirements applicable under subsection 17A(b)(3).

b. Substance of Security-Based Swap Submissions: Quantitative and Qualitative Factors

The Dodd-Frank Act requires the Commission to take into account several factors in addition to consistency with Exchange Act Section 17A in reviewing a clearing agency's Security-Based Swap Submission.³⁸ The Commission is proposing to require clearing agencies to provide information relevant to these factors through the proposed amendments to Rule 19b-4 and Form 19b-4. Specifically, clearing agencies would be required to submit quantitative and qualitative information to assist the Commission in the consideration of the five factors Exchange Act Section 3C requires the Commission to take into account in reviewing a Security-Based Swap Submission, which include:

- (i) The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data.

³⁶ See 15 U.S.C. 78q-1(b)(3)(F).

³⁷ 15 U.S.C. 78q-1(b)(3)(A), (B) and (F).

³⁸ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(4)(B)(i)-(v)).

- (ii) The availability of a rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.
- (iii) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract.
- (iv) The effect on competition, including appropriate fees and charges applied to clearing.
- (v) The existence of reasonable legal certainty in the event of the insolvency of the relevant clearing agency or one or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property.³⁹

Each Security-Based Swap Submission would be required to address the factors listed above to the extent they are applicable to the security-based swap, the clearing agency and the market.

For example, in connection with the discussion responsive to factor (i) above, the clearing agency could address pricing sources, models and procedures demonstrating an ability to obtain price data to measure credit exposures in a timely and accurate manner, as well as measures of historical market liquidity and trading activity, and expected market liquidity and trading activity if the security-based swap is required to be cleared (including information on the sources of such measures). With respect to the discussion of factor (ii) above, the statement describing the availability of a rule framework could include a discussion of the rules, policies or

³⁹ Proposed Rule 19b-4(o)(3)(ii).

procedures applicable to the clearing of the relevant security-based swap. Additionally, the discussion of credit support infrastructure could include the methods to address and communicate requests for, and posting of, collateral. With respect to factor (iii) above, the discussion of systemic risk could include a statement on the clearing agency's risk management procedures, including among other things the measurement and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures and default management procedures. With respect to factor (iv) above, the discussion of fees and charges could address any volume incentive programs that may apply or impact the fees and charges. With respect to factor (v) above, the discussion could address segregation of accounts and all other customer protection measures under insolvency.

In describing the security-based swap, or any group, category, type or class of security-based swaps, that a clearing agency plans to accept for clearing, the clearing agency could include the relevant product specifications, including copies of any standardized legal documentation, generally accepted contract terms,⁴⁰ standard practices for managing and communicating any life cycle events associated with the security-based swap and related adjustments,⁴¹ and the manner in which the information contained in the confirmation of the security-based swap trade is transmitted. The clearing agency also could discuss its financial and operational capacity to provide clearing services to all customers subject to the clearing requirements as applicable to the particular security-based swap. Finally, the clearing agency

⁴⁰ For example, for some security-based swaps, industry standard documentation would include the applicable International Swaps and Derivatives Association, Inc. Master Agreement and any related asset-class-specific definitions.

⁴¹ The Commission has proposed Regulation SBSR, which contains a definition of "life cycle event." See Exchange Act Release No. 63346 (Nov. 19, 2010), 75 FR 75208 (Dec. 2, 2010) ("Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information").

could include an analysis of the effect of a clearing requirement on the market for the group, category, type, or class of security-based swaps, both domestically and globally, including the potential effect on market liquidity, trading activity, use of security-based swaps by direct and indirect market participants and any potential market disruption or benefits. This analysis could include whether the members of the clearing agency are operationally and financially capable of absorbing clearing business (including indirect access market participants) that may result from a determination that the security-based swap (or group, category, type or class of security-based swaps) is required to be cleared.

c. Substance of Security-Based Swap Submissions: Open Access

New Exchange Act Section 3C also requires that the rules of a clearing agency that clears security-based swaps subject to the clearing requirement provide for open access.⁴² In the course of reviewing a Security-Based Swap Submission, the Commission may assess whether a clearing agency's rules provide for open access, particularly with respect to the relevant Security-Based Swap Submission. Accordingly, the proposed rule provides that the Security-Based Swap Submission must include a statement regarding how a clearing agency's rules:

- (i) prescribe that all security-based swaps submitted to the clearing agency with the same terms and conditions are economically equivalent within the clearing agency and may be offset with each other within the clearing agency; and

⁴² See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(a)(2) (“[t]he rules of a clearing agency described in paragraph (1) shall — (A) prescribe that all security-based swaps submitted to the clearing agency with the same terms and conditions are economically equivalent within the clearing agency and may be offset with each other within the clearing agency; and (B) provide for non-discriminatory clearing of a security-based swap executed bilaterally or on or through the rules of an unaffiliated national securities exchange or security-based swap execution facility.”)).

- (ii) provide for non-discriminatory clearing of a security-based swap executed bilaterally or on or through the rules of an unaffiliated national securities exchange or security-based swap execution facility.⁴³

In making a determination, the Commission proposes to take into account the factors specified in Exchange Act Section 3C and any additional information the Commission determines to be appropriate. The proposed rule also requires a clearing agency to provide any additional information requested by the Commission as necessary to make a determination.⁴⁴ The Commission believes that such a requirement would provide appropriate flexibility to facilitate our regulatory responsibilities. In making a determination of whether or not the clearing requirement would apply to the security-based swap, or any group, category, type, or class of security-based swaps, described in the submission, the Commission may require such terms and conditions as the Commission determines to be appropriate in the public interest.⁴⁵

d. Timing related to Security-Based Swap Submissions

Under Exchange Act Section 3C, as added by Section 763(a) of the Dodd-Frank Act, the Commission is required to make its determination of whether a security-based swap described in a clearing agency's Security-Based Swap Submission is required to be cleared not later than 90 days after receiving such Security-Based Swap Submission.⁴⁶ The 90-day determination

⁴³ Proposed Rule 19b-4(o)(3)(ii).

⁴⁴ Proposed Rule 19b-4(o)(6)(i).

⁴⁵ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(4)(C)) and Proposed Rule 19b-4(o)(6)(ii).

⁴⁶ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(3)). Further, pursuant to proposed Rule 19b-4(o)(2), if any information submitted to the Commission by a clearing agency on Form 19b-4 were not complete or otherwise in compliance with Rule 19b-4 and Form 19b-4, such information would not be considered a Security-Based Swap Submission and the Commission would be required to inform the clearing agency within twenty-one business days of such submission.

period may be extended with the consent of the clearing agency making such Security-Based Swap Submission.⁴⁷ The Commission is required to make available to the public any Security-Based Swap Submission it receives and to provide at least a 30-day public comment period “regarding its determination whether the clearing requirement shall apply to the submission.”⁴⁸ This 30-day comment period enables the public to have an opportunity to comment on the Security-Based Swap Submission and to provide information for the Commission to consider as part of making its determination whether the clearing requirement should apply to the submission. Accordingly, the Commission proposes to make the Security-Based Swap Submission available for a 30-day public comment period within the 90-day determination period. The Commission would publish notice of the Security-Based Swap Submission in the Federal Register and publish notice on the Commission’s publicly-available website at www.sec.gov. Such notice would include the solicitation of public comment. This proposed publication process would be consistent with the current process that is in place for proposed rule changes under Exchange Act Section 19(b)(2) and Rule 19b-4.

e. Notice to clearing agency members

New Exchange Act Section 3C requires that a clearing agency provide notice to its members, in a manner determined by the Commission, of its Security-Based Swap Submissions.⁴⁹ To meet the requirement of providing notice of Security-Based Swap Submissions to members, the Commission is proposing amendments to Rule 19b-4 that would require clearing agencies to post on their websites such submissions to the Commission, and any

⁴⁷ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(3)).

⁴⁸ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(2)(C)).

⁴⁹ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(2)(A)).

amendments thereto.⁵⁰ This public posting would be required to be completed within two business days following the Security-Based Swap Submission to the Commission. This timeframe is consistent with the notice requirement that currently applies to proposed rule changes,⁵¹ and the Commission believes that such timeframe would provide members of the clearing agency and the public with timely notice of the submission. The clearing agency would be required to maintain such material on its website until the Commission makes a determination regarding the Security-Based Swap Submission, the clearing agency withdraws the Security-Based Swap Submission or the clearing agency is notified that the Security-Based Swap Submission is not properly filed.⁵² These requirements should help ensure that submissions that are being actively considered by the Commission are readily available to the members of the clearing agency and the public and help provide for a more transparent process.

The Commission notes that the current instructions for Form 19b-4 require an SRO to file with the Commission copies of notices issued by the SRO soliciting comment on the proposed rule change and copies of all written comments on the proposed rule change received by the SRO (whether or not comments were solicited) from its members or participants. Any correspondence the SRO receives after it files a proposed rule change, but before the Commission takes final

⁵⁰ Proposed Rule 19b-4(o)(5).

⁵¹ Commission rules currently require SROs to post on their websites a copy of any proposed rule change the SRO filed with the Commission, and any amendments thereto. Such posting is required within two business days after filing the proposed rule change with the Commission. See 17 CFR 240.19b-4(l). In adopting this rule, the Commission stated that all market participants, investors and other interested parties should have access to proposed rule changes filed with the Commission, and any amendments, as soon as practicable, and that it did not believe that a two-business-day timeframe would be impractical or unduly burdensome on SROs. See Securities Exchange Act Release No. 50486 (Oct. 4, 2004), 69 FR 60287 (Oct. 8, 2004) (Final Rules Regarding Proposed Rule Changes of Self-Regulatory Organizations).

⁵² Proposed Rule 19b-4(o)(5).

action on the proposed rule change, also is required to be filed with the Commission.⁵³ The SRO is required to summarize the substance of all such comments received and respond in detail to any significant issues raised in the comments about the proposed rule change.⁵⁴ The Commission is proposing that in connection with Security-Based Swap Submissions, clearing agencies would be subject to these same requirements. The Commission preliminarily believes that its proposal to apply such requirements in the instructions to Form 19b-4 to Security-Based Swap Submissions would provide the Commission with an opportunity to consider the various viewpoints expressed by commenters by making sure relevant comments are included in the materials provided to the Commission.

f. Submissions of a Group, Category, Type or Class of Security-Based Swaps

The proposed amendments to Rule 19b-4 and Form 19b-4 would require that clearing agencies submit security-based swaps for review by group, category, type, or class to the extent it is practicable and reasonable to do so.⁵⁵ Any aggregation would be required to be clearly described in a Security-Based Swap Submission so that market participants and the public know which security-based swaps may be subject to a clearing requirement. The Commission preliminarily believes that including multiple security-based swaps in each submission – to the extent that such groupings are practicable and reasonable (e.g., by taking into consideration appropriate risk management issues applicable to the aggregation) – would streamline the

⁵³ See Items 5 and 9 (Exhibit 2) of Form 19b-4. 17 CFR 240.819.

⁵⁴ Item 5 of Form 19b-4. 17 CFR 240.819.

⁵⁵ Proposed Rule 19b-4(o)(4). In its release proposing rules to implement Section 723 of the Dodd-Frank Act, the CFTC has proposed a similar rule. 75 FR 67277 (November 2, 2010).

submission process for Commission staff and the clearing agencies. This in turn would allow more security-based swaps to be reviewed in a timely manner.

Request for Comments

The Commission generally requests comments on all aspects of the proposed amendments to Rule 19b-4 that would incorporate the process for making Security-Based Swap Submissions. In addition, the Commission requests comments on the following specific issues:

- Are there specific considerations that the Commission should weigh more heavily in reviewing whether a Security-Based Swap Submission is consistent with Exchange Act Section 17A? If so, what are such considerations?
- Should the information included in this release as examples of the kinds of information the clearing agency should include in its Security-Based Swap Submission be required in all cases and incorporated into the rules?
- To describe the security-based swap, or any group, category, type or class of security-based swaps, that a clearing agency plans to accept for clearing, should a clearing agency be required to include in its Security-Based Swap Submissions specific product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing and communicating any life cycle events associated with the security-based swap and related adjustments, and the manner in which the information contained in the confirmation of the security-based swap trade is transmitted? If not, why not? Is there other information relating to the description of the security-based swaps that clearing agencies should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?

- What specific information should a clearing agency be required to include in its Security-Based Swap Submissions regarding pricing sources, models and procedures demonstrating an ability to obtain price data to measure credit exposures in a timely and accurate manner, as well as measures of historical market liquidity and trading activity, and expected market liquidity and trading activity if the security-based swap is required to be cleared (including information on the sources of such measures)? Is there other information relating to pricing that clearing agencies should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?
- What specific information should a clearing agency be required to include in its Security-Based Swap Submissions pertaining to the rules, policies or procedures applicable to the clearing of the relevant security-based swap? Is there other information relating to rule framework, capacity, operational expertise and resources the clearing agency should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?
- Is there specific information a clearing agency should be required to include in its Security-Based Swap Submissions regarding the methods to address and communicate requests for, and posting of, collateral? Is there other information relating to collateral that the clearing agency should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?
- What specific information should a clearing agency be required to include in its Security-Based Swap Submissions regarding the clearing agency's risk management procedures, pertaining to among other things the measurement and monitoring of credit exposures,

initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures and default management procedures? Is there other information relating to risk management that the clearing agency should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?

- Should a clearing agency, in connection with each submission or in some circumstances, be required to include an independent validation of its margin methodology and its ability to maintain sufficient financial resources? Why or why not, or in which circumstances? If independent validation is required, how should the Commission assess the independence and technical expertise of the party providing the independent validation? What are the critical techniques, risk factors and components that should be covered by the model validation and why? If the clearing of the security-based swap described in the Security-Based Swap Submission would not require a change in the clearing agency's margin methodology, do commenters believe it would be sufficient for the Commission to permit the clearing agency to refer to an applicable independent validation of the clearing agency's margin methodology previously provided to the Commission with a statement explaining why the existing methodology does not require a change in connection with clearing the new security-based swap and how the current validation is still applicable in the context of the security-based swap the clearing agency plans to clear? If not, why not?
- What information should a clearing agency be required to include in its Security-Based Swap Submissions regarding fees and charges and address any volume incentive programs that may apply or impact the fees and charges? Is there other information

relating to fees and charges that the clearing agency should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?

- Should a clearing agency be required to include in its Security-Based Swap Submission information regarding segregation of accounts and all other customer protection measures under insolvency? If not, why not? Is there other information relating to insolvency of the clearing agencies' members the clearing agency should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?
- Should a clearing agency be required to include in its Security-Based Swap Submission information on whether cross-margining is available to the clearing agency's members with respect to their positions at other clearing agencies? If not, why not? What types of effects on competition are such cross-margining arrangements likely to have? Is there any specific information regarding cross-margining arrangements that the Commission should collect? If not, why not? If so, what information and why? Should this information be required in all cases and incorporated into the rules?
- What information should a clearing agency be required to include in its Security-Based Swap Submission regarding its financial and operational capacity to provide clearing services to all customers subject to the clearing requirements as applicable to the particular security-based swap? Should this information be required to include an analysis of the effect of a clearing requirement on the market for the group, category, type, or class of security-based swaps, both domestically and globally, including the potential effect on market liquidity, trading activity, use of security-based swaps by direct

and indirect market participants and any potential market disruption or benefits? Should it be required to include an analysis of whether the members of the clearing agency are operationally and financially capable of absorbing clearing business (including indirect access market participants) that may result from a determination that the security-based swap (or group, category, type or class of security-based swaps) is required to be cleared? If not, why not? Is there other information relating to capacity that the clearing agency should be required to provide? If so, what information and why? Should this information be required in all cases and incorporated into the rules?

- Is the process for notice to clearing agency members by posting on the clearing agency website, as proposed by the Commission, adequate as a notice mechanism for members? If not, what should change? Is the two-day posting requirement appropriate to provide timely notice to members? Would a shorter or longer period be appropriate?
- What other method of notice to clearing agency members could or should be required rather than website posting?
- Should the Commission utilize the proposed rule change filing system for Security-Based Swap Submissions? What other methods of submitting Security-Based Swap Submissions to the Commission should the Commission consider and why?
- What alternatives should the Commission consider to requiring clearing agencies to submit security-based swaps for review by group, category, type, or class, to the extent it is practicable and reasonable to do so?
- Should the Commission consider consolidating multiple Security-Based Swap Submissions from one clearing agency into a group, category, type, or class of Security-

Based Swap Submissions, or subdividing a clearing agency's submission of a group, category, type, or class of security-based swaps, as appropriate, for review?

- What information should the clearing agency include in its Security-Based Swaps Submissions to identify the scope of the group, category, type or class of security-based swaps it plans to clear that will provide sufficient parameters to put people on notice that a security-based swap may be required to be cleared?
- What characteristics of security-based swaps should be common among security-based swaps in order to aggregate them by group, category, type or class? Would these characteristics be the same across asset classes such as security-based equities derivatives, credit derivatives and loan-based swaps? Should the Commission specify those attributes in the rule?
- Are there any factors that would make aggregation more difficult? Would these be the same or different across asset classes?
- Are there factors that may be clearing-agency specific with respect to aggregation? If so, what are those factors?

As discussed above, Exchange Act Section 3C provides, among other things, for a determination by the Commission of whether security-based swaps are required to be cleared.⁵⁶ The Commission may determine that a security-based swap is required to be cleared based on a review of a clearing agency's submission regarding a security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing (i.e., a Security-Based Swap Submission).⁵⁷ Consistent with proposal, if the

⁵⁶ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(a)(1)).

⁵⁷ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(2)(C)) (“[t]he Commission shall . . . review each submission made under subparagraphs (A) and

Commission determines that a security-based swap is not required to be cleared, such security-based swap may still be cleared on a non-mandatory basis by the clearing agency if the clearing agency has rules that permit it to clear such security-based swap.⁵⁸ In addition, Exchange Act Section 3C(b)(1) provides that “[t]he Commission on an ongoing basis shall review each security-based swap, or any group, category, type, or class of security-based swaps to make a determination that such security-based swap, or group, category, type, or class of security-based swaps should be required to be cleared” (i.e., a Commission-initiated Review).⁵⁹

The proposed addition of paragraph (o) to Rule 19b-4 and related amendments to Form 19b-4 are intended to provide a process for Security-Based Swap Submissions. The Commission is required under the Dodd-Frank Act to adopt rules specifying the process for Security-Based Swap Submissions. As part of the process of review of each Security-Based Swap Submission (and in each Commission-initiated Review), the Commission must take into account the five factors specified in Exchange Act Section 3C(b)(4)(B):

- (i) The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data.
- (ii) The availability of a rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

(B), and determine whether the security-based swap, or group, category, type, or class of security-based swaps, described in the submission is required to be cleared.”)

⁵⁸ See 15 U.S.C. 78s(b) (proposed rule changes) and 12 U.S.C. 5465(e) (Advance Notices).

⁵⁹ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(1)). The Dodd-Frank Act does not require rulemaking with respect to Commission-initiated Reviews.

- (iii) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract.
- (iv) The effect on competition, including appropriate fees and charges applied to clearing.
- (v) The existence of reasonable legal certainty in the event of the insolvency of the relevant clearing agency or one or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property.⁶⁰

Proposed Rule 19b-4(o) and related amendments for Form 19b-4 would require clearing agencies to include in their Security-Based Swap Submissions information that will assist the Commission in the quantitative and qualitative assessment of the statutory factors listed above. The proposal also set forth examples of the information clearing agencies should include in addressing these five factors.⁶¹

Promoting clearing is a critical component of the reform mandated by the Dodd-Frank Act, which seeks to bring transactions and counterparties into a robust, conservative and transparent risk management framework.⁶² Exchange Act Section 3C(b)(4)(B)⁶³ sets forth the

⁶⁰ Proposed Rule 19b-4(o)(3)(ii).

⁶¹ See Section II.A.1.b for a discussion of the types of information that should be included in a Security-Based Swap Submission.

⁶² See Letter from Christopher Dodd, Chairman, Committee on Banking, Housing and Urban Affairs, United States Senate and Blanche Lincoln, Chairman, Committee on Agriculture, Nutrition, and Forestry, United States Senate, to Barney Frank, Chairman, Financial Services Committee, United States House of Representatives and Colin Peterson, Chairman, Committee on Agriculture, United States House of Representatives (June 30, 2010) (on file with the United States Senate) (“Congress determined that clearing is at the heart of reform – bringing transactions and counterparties into a robust, conservative and transparent risk management framework. Congress also acknowledged

factors the Commission is required to take into account in determining whether a security-based swap is required to be cleared or should be required to be cleared in connection with a Security-Based Swap Submission or Commission-initiated Review, respectively. The Commission recognizes that in interpreting and applying these factors, it should be guided by the general principles underlying the Dodd-Frank Act, including in particular the goal of promoting clearing where appropriate. At the same time, the Commission is mindful that its application of these factors may have a significant effect on the market for individual security-based swaps. In addition, an overly broad or narrow application of the mandatory clearing requirement could undermine the policy objectives of the Dodd-Frank Act. For example, a premature determination that a security-based swap is subject to mandatory clearing may, in certain circumstances, limit the ability of certain market participants to utilize that product (including for risk management purposes) which in turn could ultimately result in less clearing and more limited use of the security-based swap than might otherwise have been the case if it had been permitted to trade without being subject to a mandatory clearing requirement for a longer period of time.

On the other hand, an overly narrow application of the mandatory clearing requirement would undermine the potential benefits of centralized clearing for counterparties and the marketplace generally that Exchange Act Section 3C was intended to provide. Moreover, because security-based swaps that are subject to the clearing requirement also are required to be

that clearing may not be suitable for every transaction or every counterparty. End users who hedge their risks may find it challenging to use a standard derivative contract to exactly match up their risks with counterparties willing to purchase their specific exposures. Standardized derivative contracts may not be suitable for every transaction.”). Additionally, and as discussed herein in Section II.A.1.a, Exchange Act Section 3C(b)(4)(A) requires the Commission to review whether a Security-Based Swap Submission is consistent with Exchange Act Section 17A.

⁶³ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(4)(B)).

executed on a national securities exchange or a swap execution facility if such an exchange or facility makes the security-based swap available to trade, imposing a clearing requirement could have a substantial impact generally on the trading environment of the relevant instruments, which in turn could affect the relative transparency and liquidity of those instruments in ways that may promote, or detract from, the overall goals of the Dodd-Frank Act.

In short, the Commission recognizes, as did Congress, that a determination that clearing is required could have ancillary consequences. The Dodd-Frank Act includes an exception from the mandatory clearing requirement to help address concerns regarding circumstances when clearing may not be appropriate.⁶⁴

However, because the Commission must still apply the statutory factors, in light of the policy goals of the Dodd-Frank Act, to determine whether clearing is required, the Commission is seeking comment generally on how the factors identified in the statute should be applied in making determinations as to whether particular security-based swaps are or should be required to be cleared.

Request for Comments

- Are there specific considerations that the Commission should weigh more heavily in making a determination that a security-based swap is, or should be, required to be

⁶⁴ See S. Rep. No. 111-176 at 34 (stating that “[s]ome parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, uncleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible. Also, OTC (contracts not cleared centrally) should still be subject to reporting, capital, and margin requirements so that regulators have the tools to monitor and discourage potentially risky activities, except in very narrow circumstances. These exceptions should be crafted very narrowly with an understanding that every company, regardless of the type of business they are engaged in, has a strong commercial incentive to evade regulatory requirements.”).

cleared? If so, what are such considerations and why should they be given greater weight?

- In a Commission-initiated review, should the Commission consider information that is different from the information the Commission has proposed for a clearing agency to provide in a Security-Based Swap Submission to enable the Commission to make a determination regarding a clearing requirement? If so, what information should be considered and why?
- How should the Commission measure “significant outstanding notional exposures”? Should the Commission consider a threshold or a range for what qualifies as “significant outstanding notional exposures”? If so, should this threshold or range vary depending on the asset class?
- How should the Commission analyze whether pricing data is adequate?
- In taking into account the effect of requiring a security-based swap (or group, category, type or class of security-based swaps) to be cleared on the mitigation of systemic risk, how should the Commission evaluate the resources of the clearing agency available to clear the security-based swaps?
- In considering the existence of legal certainty in the event of the insolvency of the relevant clearing agency or one or more of its clearing members, are there specific factors that the Commission should take into account? Would seeking information from third-party sources such as legal opinions be appropriate? Are there any cross-border considerations that should be considered?

- How should the Commission analyze the pool of potential counterparties to a security-based swap (or group, category, type or class of security-based swaps) subject to the clearing requirement?
- How should the Commission analyze the potential effect, including the potential effect on liquidity, trading activity, use of security-based swaps by direct and indirect market participants and any potential disruption or benefit to the market for a security-based swap (or group, category, type, or class of security-based swaps) required to be cleared?
- Is there information reported to the swap data repository that is otherwise not available to the public that a clearing agency would require to prepare its Security-Based Swap Submission? If so, what information would be required, and why?

2. Prevention of Evasion of the Clearing Requirement.

Exchange Act Section 3C directs the Commission to prescribe rules (and interpretations of rules) the Commission determines to be necessary to prevent evasions of the clearing requirements.⁶⁵ The term “clearing agency” is defined broadly under the Exchange Act,⁶⁶ and clearing agencies may offer a spectrum of clearing services. Specifically, the Commission has identified the following entities and activities as falling within the definition of clearing agency: (i) clearing corporations; (ii) securities depositories; and (iii) matching services.⁶⁷ As a result,

⁶⁵ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(d)(1), which states that “[t]he Commission shall prescribe rules under this section (and issue interpretations of rules prescribed under this section), as determined by the Commission to be necessary to prevent evasions of the mandatory clearing requirements under this Act.”).

⁶⁶ See supra note 11 discussing the definition of “clearing agency” pursuant to Exchange Act Section 3(a)(23)).

⁶⁷ See Securities Exchange Act Release Nos. No. 20221 (Sept.23, 1983), 48 FR 45167 (October 3, 1983), (Order Approving the Clearing Agency Registration of Four Depositories and Four Clearing Corporations) and 39829 (April 6, 1998), 63 FR 17943 (April 13, 1998) (Confirmation and Affirmation of Securities Trades; Matching).

there may be entities that operate as registered clearing agencies for security-based swaps that do not provide central clearing and act as a CCP. The Commission preliminarily believes that the broad definition of the term “clearing agency” could be used by market participants to evade the clearing requirement of Exchange Act Section 3C(a)(1), which states that “[i]t shall be unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency that is registered under this Act or a clearing agency that is exempt from registration under this Act if the security-based swap is required to be cleared.”⁶⁸ For example, market participants seeking to evade the requirement to clear a security-based swap set forth in Exchange Act Section 3C(a)(1) could submit the security-based swap for matching services (rather than for central clearing) to a clearing agency that is either registered with the Commission or exempt from registration under the Exchange Act.

The Commission preliminarily believes that other types of clearing functions and services offered by clearing agencies would not achieve the goal of central clearing contemplated under the Dodd-Frank Act – improving the management of counterparty risk.⁶⁹ The Commission preliminarily believes that proposed Rule 3Ca-2 would prevent potential evasions of the clearing requirement by requiring market participants to submit security-based swaps to a clearing agency for central clearing as opposed to other clearing functions or services. Accordingly, proposed Rule 3Ca-2 would clarify the reference to “submits such security-based swap for clearing to a clearing agency” in Exchange Act Section 3C(a)(1) to mean that the security-based swap must be

⁶⁸ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(a)(1)).

⁶⁹ The Commission has identified the following entities and activities as falling within the definition of clearing agency: (i) clearing corporations; (ii) securities depositories; and (iii) matching services. Structured and operated appropriately, CCPs may improve the management of counterparty risk and may provide additional benefits such as multilateral netting of trades. See *supra* note 67 and Section I.A.

submitted for central clearing to a clearing agency that functions as a CCP.⁷⁰ Submission to a clearing agency for clearing services other than central clearing as a CCP would not meet the clearing requirement.

Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 3Ca-2. In addition, the Commission requests comments on the following specific issues:

- Should the Commission require security-based swaps to be submitted for central clearing to a clearing agency that acts as a CCP to meet the clearing requirement?
- Are there clearing agency functions or services that are not CCP functions performed by a clearing agency but that may provide comparable benefits to those of a CCP? If so, please identify such functions or services and the benefits they provide.

B. Stay of the Clearing Requirement and Review by the Commission

Exchange Act Section 3C states that, after making a determination that a security-based swap (or group, category, type or class of security-based swaps) is required to be cleared, the Commission, on application of a counterparty to a security-based swap or on the Commission's own initiative, may stay the clearing requirement until the Commission completes a review of the terms of the security-based swap and the clearing arrangement.⁷¹ In connection with a stay of the clearing requirement and subsequent review of the terms of the security-based swap and the clearing arrangement, the Commission is required to adopt rules for reviewing a clearing agency's clearing of a security-based swap, or any group, category, type or class of security-

⁷⁰ Proposed Rule 3Ca-2. The definitional section of the Exchange Act provides that defined terms may have different meanings in different contexts. See Exchange Act Section 3(a) ("When used in this title, unless the context otherwise requires . . ."). 15 U.S.C. 78c(a)

⁷¹ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(c)(1)).

based swaps, that the clearing agency has accepted for clearing.⁷² Proposed Rule 3Ca-1 would establish a procedure for staying the clearing requirement and the Commission's subsequent review of the terms of the security-based swap and the clearing arrangement.

Under proposed Rule 3Ca-1, a counterparty to a security-based swap subject to the clearing requirement wishing to apply for a stay of the clearing requirement would be required to submit a written statement to the Commission that includes (i) a request for a stay of the clearing requirement, (ii) the identity of the counterparties to the security-based swap and a contact at the counterparty requesting the stay, (iii) the identity of the clearing agency clearing the security-based swap, (iv) the terms of the security-based swap subject to the clearing requirement and a description of the clearing arrangement and (v) the reasons a stay should be granted and the security-based swap should not be subject to a clearing requirement, specifically addressing the same factors a clearing agency must address in its Security-Based-Swap Submission pursuant to proposed Rule 19b-4(o).⁷³ The Commission preliminarily believes that such information would assist the Commission in determining whether to grant the stay. Under proposed Rule 3Ca-1, the counterparty's statement to the Commission requesting the stay of the clearing requirement would be made available to the public on the Commission's website in order to provide the public with notice of the submission of the stay. A stay of the clearing requirement may be applicable to the counterparty requesting the stay or more broadly, to the security-based swap, or any group, category, type or class of security-based swaps, subject to the clearing requirement. The Commission would provide notice to the public regarding a stay of the clearing requirement that is generally applicable.

Pursuant to Exchange Act Section 3C, in undertaking its review of the clearing

⁷² See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(c)(4)).

⁷³ Proposed Rule 3Ca-1(b).

requirement subsequent to granting a stay, the Commission would consider the clearing agency's clearing of the security-based swap (or group, category, type or class of security-based swaps) for consistency with the determination criteria under Exchange Act Section 3C(b)(4).⁷⁴ The Commission also may take into consideration the clearing agency's rules for open access as related to the security-based swap (or group, category, type or class of security-based swaps) subject to review.⁷⁵ The Commission may determine that it requires additional information in the possession of the clearing agency (as distinguished from the information it received from the counterparty). Accordingly, proposed Rule 3Ca-1 requires the application for the stay to identify the clearing agency that is clearing the security-based swap⁷⁶ and also requires that any clearing agency that has accepted for clearing the security-based swap, or any group, category, type or class of security-based swaps, subject to the stay, provide information requested by the Commission in the course of its review during the stay.⁷⁷ Exchange Act Section 3C also requires the Commission to complete such clearing review not later than 90 days after issuance of the stay, unless the clearing agency that clears the security-based swap agrees to an extension of the time limit.⁷⁸

Proposed Rule 3Ca-1 provides that, upon completion of its review, the Commission may determine unconditionally, or subject to such terms and conditions as the Commission determines to be appropriate in the public interest, that the security-based swap (or group,

⁷⁴ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(c)(3)(A)).

⁷⁵ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(a)(2)).

⁷⁶ Proposed Rule 3Ca-1(b)(3).

⁷⁷ Proposed Rule 3Ca-1(d).

⁷⁸ See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(c)(2)).

category, type or class of security-based swaps) must be cleared.⁷⁹ Alternatively, the Commission may determine that the clearing requirement does not apply to the security-based swap (or group, category, type or class of security-based swaps).⁸⁰ If the Commission were to make a determination that the clearing requirement does not apply to a security-based swap (or group, category, type or class of security-based swaps), the proposed rule makes clear that clearing may continue on a non-mandatory basis.⁸¹ As previously noted, moving security-based swaps into clearing in a gradual manner through non-mandatory clearing may in certain circumstances be appropriate. For example, a premature determination that a product is subject to mandatory clearing may, in certain circumstances, limit the ability of certain market participants to utilize that product (including for risk management purposes) which in turn could ultimately result in less clearing and more limited use of the product than might otherwise have been the case if it had been permitted to trade without being subject to a mandatory clearing requirement for a longer period of time.

Request for Comments

The Commission generally requests comments on all aspects of proposed Rule 3Ca-1. In addition, the Commission requests comments on the following specific issues:

- Does the proposal provide sufficient guidance regarding the process for a stay? Are there any alternative approaches the Commission should consider?
- Should the Commission require a counterparty applying for a stay to provide information that is broader or in addition to the information the Commission has proposed? If so,

⁷⁹ Proposed Rule 3Ca-1(e)(1) and Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(c)(3)(A)).

⁸⁰ Proposed Rule 3Ca-1(e)(2) and Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(c)(3)(B)).

⁸¹ See proposed Rule 3Ca-1(e)(2).

what information should be added to the requirement?

- Should the informational requirement imposed on a counterparty applying for a stay be narrower than that which the Commission has proposed? If so, what information should be eliminated from the requirement?
- Are there any terms or conditions that the Commission should generally consider imposing as part of a stay?
- Under what circumstances would it be reasonable for the Commission to determine that clearing is not required after making an initial determination that clearing is required?
- Should a Commission determination to allow clearing of a securities-based swap on a non-mandatory basis be subject to ongoing review or limited by a certain timeframe? What type of timeframe may be appropriate?

C. Title VIII Notice Filing Requirements for Designated Clearing Agencies

The Commission is proposing to add a new paragraph (n) to Rule 19b-4 to implement the filing requirement in Section 806(e). New paragraph (n) would require that an Advance Notice be submitted to the Commission electronically on Form 19b-4. In addition, new paragraph (n) would define when a proposed change to a clearing agency's rules, procedures or operations could materially affect the nature or level of risks presented by the designated financial market utility. This definition would determine when an Advance Notice under Section 806(e) must be filed with the Commission. The Commission also is proposing corresponding amendments to Form 19b-4 as discussed in more detail in Section II.D.

As with Security-Based Swap Submissions filed pursuant to Exchange Act Section 3C, the Commission anticipates that in many cases a proposed change may be required to be filed as an Advance Notice under Section 806(e) and as a proposed rule change under Exchange Act

Section 19(b).⁸² This is because a proposal that qualifies as a proposed change to a rule, procedure or operation that materially affects the nature or level of risk presented by the designated clearing agency under Section 806(e) may also qualify as a proposed rule change under Exchange Act Section 19(b). As a result, a designated clearing agency may be required to file a proposal as an Advance Notice and as a proposed rule change. Designated clearing agencies, as SROs, will already be required to file proposed rule changes on Form 19b-4 using EDFS.⁸³ Accordingly, and similar to the proposal for Security-Based Swap Submissions, the Commission is proposing to require clearing agencies to use the existing filing system, EDFS, and Form 19b-4 for the filing of Advance Notices under Section 806(e). This would allow designated clearing agencies to comply with the notice requirement in Section 806(e) using the same system they use for submitting proposed rule changes under Exchange Act Section 19(b) and, as applicable, Security-Based Swap Submissions under Exchange Act Section 3C. Leveraging the existing filing system, EDFS, for the submission of Advance Notices is intended to utilize efficiently Commission and designated clearing agency resources.

1. Standards for Determining When Advance Notice is Required

Section 806(e)(1)(A) requires a designated financial market utility to provide 60 days advance notice to its Supervisory Agency of any proposed change to its rules, procedures or operations that could materially affect the nature or level of risks presented by the designated

⁸² If the proposed change is related to clearing a type, group, class, or category of security-based swap, it may also be required to be filed as a Security-Based Swap Submission under Exchange Act Section 3C.

⁸³ As discussed below in Section I.F., the processes under Exchange Act Section 19(b) and Section 806(e) may not always overlap. For example, certain changes to the operations of a designated clearing agency may not require a rule filing under Exchange Act Section 19(b), which does not specifically apply to changes in operations. Such changes may, however, trigger a requirement to file an Advance Notice if they would materially affect the nature or level of risks presented by the designated clearing agency. Nevertheless, the two processes are sufficiently similar as to warrant using the same method for filing.

financial market utility.⁸⁴ The Commission is proposing that for purposes of this requirement, the phrase “materially affect the nature or level of risks presented”⁸⁵ would be defined to mean the existence of a reasonable possibility that the change could affect the performance of essential clearing and settlement functions or the overall nature or level of risk presented by the designated clearing agency.⁸⁶ The proposed definition is designed to include all changes that would affect the risk management functions performed by the clearing agency that are related to systemic risk, as well as changes that could affect the clearing agency’s ability to continue to perform its core clearance and settlement functions.⁸⁷

In order to help designated clearing agencies determine whether an Advance Notice is required, the Commission is proposing to include in the rule a list of categories of changes to rules, procedures or operations that the Commission preliminarily believes could materially affect the nature or level of risks presented by a designated clearing agency. The proposed list of such changes may include, but are not limited to, changes that materially affect participant and product eligibility, daily or intraday settlement procedures, default procedures, system safeguards, governance or financial resources of the designated clearing agency, or otherwise generally affect risk management processes or capabilities.⁸⁸ The Commission preliminarily believes that changes in these areas pertain to core functions of a clearing agency and, as a result, may affect the ability of a designated clearing agency to manage its risks appropriately and to

⁸⁴ 12 U.S.C. 5465(e)(1)(A).

⁸⁵ Id.

⁸⁶ Proposed Rule 19b-4(n)(2)(i).

⁸⁷ Core clearance and settlement functions may include, but are not limited to, the processing, comparison, netting, or guaranteeing of securities transactions as well as any processes or procedures, such as internal risk management controls, that support these functions.

⁸⁸ Proposed Rule 19b-4(n)(2)(ii).

continue to conduct systemically important clearance and settlement services. For example, participant and product eligibility requirements of a designated clearing agency are designed to ensure that the clearing agency's members have sufficient financial resources and operational capacity to meet obligations arising from participation in the clearing agency, and to ensure that the products cleared by the clearing agency are sufficiently liquid and adequate pricing data is available. In addition, a designated clearing agency's default procedures exist to ensure that, should a default occur, the clearing agency has the financial resources, liquidity and operational abilities to continue to make payments to non-defaulting participants on time. Additional examples of the types of matters that would fall within the categories listed above include changes to the methods for making margin calculations, liquidity arrangements and significant new services of the clearing agency.

Moreover, while a broad interpretation of the materiality threshold is consistent with the underlying principles of Title VIII and desirable to permit a review of all matters that impact the risks presented by clearing agencies, not every change to a designated clearing agency's rules, procedures or operations will be material. Accordingly, the Commission has included two broad categories of examples in the proposed rule of changes to rules, procedures or operations that the Commission preliminarily believes would not materially affect the nature or level or risks presented by a designated clearing agency and therefore, would not require the filing of an Advance Notice. The first category includes, but is not limited to, changes to an existing procedure, control, or service that do not modify the rights or obligations of the designated financial market utility or persons using its payment, clearing, or settlement services and that do not adversely affect the safeguarding of securities, collateral, or funds in the custody or control of the designated financial market utility or for which it is responsible. The second category

includes, but is not limited to, changes concerned solely with the administration of the designated clearing agency or related to the routine, daily administration, direction and control of employees.⁸⁹

The Commission preliminarily believes that the proposed definition of “materially affect the nature or level of risks presented” provides sufficient information for designated clearing agencies to know when advance notice under Section 806(e) is required while allowing flexibility to capture all relevant proposed changes as specific circumstances warrant. However, as this would be a new requirement, the Commission expects that designated clearing agencies may discuss, at least initially, proposed changes with Commission staff prior to determining if advance notice under Section 806(e) is required to be filed with respect to a proposed change to the clearing agency’s rules, procedures or operations.

2. Providing Notice of the Matters Included in an Advance Notice to the Board and Interested Persons

Given the role of clearing agencies in supporting financial markets, the Commission recognizes that members of the public may have an interest in proposed changes to the rules, procedures or operations of systemically important clearing agencies. Accordingly, new paragraph (n) of Rule 19b-4 would provide that, upon the filing of any Advance Notice by a designated clearing agency, the Commission would publish notice thereof in the Federal Register, together with the terms of the substance of the proposed change to the rules, procedures, or operations of the designated clearing agency and a description of the subjects and issues involved.⁹⁰ This requirement is consistent with the existing procedures for proposed rule changes under Exchange Act Section 19(b) and the proposed procedures for Security-Based

⁸⁹ Proposed Rule 19b-4(n)(2)(iii).

⁹⁰ Proposed Rule 19b-4(n)(1).

Swap Submissions under Exchange Act Section 3C. In addition, the Commission is proposing that designated clearing agencies post Advance Notices and any amendments thereto on their websites within two business days of filing the notice or amendments in order to ensure that interested parties have timely and transparent access to the matters discussed therein, particularly in circumstances where a proposed change is not required to be filed under Exchange Act Section 19(b) and, as a result, would not otherwise be published for comment.⁹¹ Consistent with the use and proposed use of Form 19b-4, the purpose of this proposed rule would be to allow the Commission to give interested persons an opportunity to review and to submit written data, views and arguments concerning the matters referred to in the Advance Notice.⁹² Comments and other information received would be considered by the Commission in determining whether to object to an Advance Notice.

Section 806(e)(3) requires that the Commission provide the Board with a complete copy of any information it receives in connection with the Advance Notice.⁹³ To satisfy this requirement, new paragraph (n) would require a designated clearing agency to provide to the Board copies of all materials submitted to the Commission relating to an Advance Notice contemporaneously with such submission to the Commission.⁹⁴ Such copies would be provided to the Board in triplicate and in hard copy format, pursuant to proposed changes to the instructions of Form 19b-4.

⁹¹ Proposed Rule 19b-4(n)(3).

⁹² Under the Commission's current practice with respect to Exchange Act Section 19(b), proposed rule changes are generally published with a twenty-one day comment period. The Commission expects that Advance Notices will be published for the same comment period.

⁹³ 12 U.S.C. 5465(e)(3). In addition, the Commission is required to provide the Board with any information it issues or submits in connection therewith.

⁹⁴ Proposed Rule 19b-4(n)(5).

The Commission also is proposing that a designated clearing agency be required to post a notice on its website that the proposed change described in an Advance Notice has been permitted to take effect within two business days of such date as determined in accordance with the timeframe set forth in Section 806(e).⁹⁵ The purpose of this proposed rule is to provide a means for public notice when a proposed change under Title VIII is permitted to become effective, since the Commission will not affirmatively approve an Advance Notice under Section 806(e) – i.e., it will not issue a public order granting approval as it does with proposed rule changes under Exchange Act Section 19(b). As a result, there will not be a Commission action to indicate when an Advance Notice has been permitted to take effect. Moreover, the designated clearing agency also would be required to post notice on its website of the time at which the proposed change becomes effective if that date is different from the date on which the proposed change is permitted to become effective. To be consistent with the notice requirements applicable to proposed rule changes under Exchange Act Section 19(b) and to give interested parties timely notice of the change, this notice would be required to be posted within two business days of the effective date.⁹⁶ Once the notice of the effectiveness of the proposed change has been posted, the designated clearing agency would be permitted to remove its original posting of the Advance Notice and any amendments thereto from its website. A designated clearing agency also could remove the Advance Notice from its website if it withdrew the notice or if it was notified that such notice was not properly filed.⁹⁷

⁹⁵ Proposed Rule 19b-4(n)(4)(i).

⁹⁶ Proposed Rule 19b-4(n)(4)(ii).

⁹⁷ Proposed Rule 19b-4(n)(3).

3. Timing and Determination of Advance Notices Pursuant to Section 806(e)

Section 806(e) does not require the Commission to approve affirmatively a proposed change referred to in the Advance Notice; however, Section 806(e) requires that the Commission notify the designated clearing agency of any objection to the proposed change. Section 806(e)(1)(E) provides that an objection must be made within 60 days of the Commission's receipt of the Advance Notice, unless the Commission requests additional information in consideration of the notice, in which case the 60-day period will recommence on the date such information is received by the Commission.⁹⁸ Additionally, pursuant to Section 806(e)(1)(H), the Commission may extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject to the Commission providing the designated clearing agency with prompt written notice of the extension.⁹⁹ Finally, Section 806(e)(4) requires that the Commission consult with the Board before taking any action on, or completing its review of, the change referred to in the Advance Notice.¹⁰⁰ The timeframes set forth in Section 806(e) determine when a proposed change to a designated clearing agency's rules, procedures or operations will become effective, and the Commission is not proposing any rules related to these timeframes.

4. Implementation of Proposed Changes and Emergency Changes Pursuant to Section 806(e)

Section 806(e)(1)(F) provides generally that a designated clearing agency may not implement a proposed change filed as an Advance Notice if the Commission notifies it of an

⁹⁸ 12 U.S.C. 5465(e)(1)(E).

⁹⁹ 12 U.S.C. 5465(e)(1)(H).

¹⁰⁰ 12 U.S.C. 5465(e)(4).

objection during the applicable review period.¹⁰¹ Section 806(e), however, provides two exceptions to this prohibition. First, Section 806(e)(1)(I) permits the designated clearing agency to implement a change before the 60-day review period (or such longer period as extended in accordance with the statute) expires if the Commission notifies the designated clearing agency in writing that it does not object to the proposed change to the designated clearing agency's rules, procedures or operations and authorizes the designated clearing agency to implement the change on an earlier date, subject to any conditions imposed by the Commission.¹⁰² As noted above, however, before taking any action on, or completing its review of, a change proposed by a designated clearing agency in an Advance Notice, the Commission is required to consult with the Board.¹⁰³

Second, Section 806(e)(2) allows a designated clearing agency to implement a change that would otherwise require providing an Advance Notice if it determines that (i) an emergency exists and (ii) immediate implementation of the change is necessary for the designated clearing agency to continue to provide its services in a safe and sound manner.¹⁰⁴ If a designated clearing agency determines to implement an emergency change, it must provide notice to the Commission as soon as practicable, and in no event later than 24 hours after implementation of the relevant change.¹⁰⁵ Such emergency notice must contain all of the information otherwise required to be in an Advance Notice as well as a description of (i) the nature of the emergency and (ii) the reason the change was necessary in order for the designated clearing agency to continue to

¹⁰¹ 12 U.S.C. 5465(e)(1)(F).

¹⁰² 12 U.S.C. 5465(e)(1)(I).

¹⁰³ 12 U.S.C. 5465(e)(4).

¹⁰⁴ 12 U.S.C. 5465(e)(2)(A).

¹⁰⁵ 12 U.S.C. 5465(e)(2)(B).

provide its services in a safe and sound manner.¹⁰⁶ In reviewing the emergency notice, the Commission may require modification or rescission of the relevant change if it determines that the change is not consistent with the purposes of Title VIII, including all applicable rules, orders, or the risk management standards prescribed under Section 805(a) of Title VIII.¹⁰⁷ The procedures for implementing a proposed change to a designated clearing agency's rules, procedures or operations before the expiration of the standard review period or on an emergency basis are set forth in Section 806(e). The Commission is not proposing any rules related to these implementation procedures.

Request for Comments

The Commission generally requests comments on all aspects of the proposed amendments to Rule 19b-4 to incorporate the process for designated clearing agencies to file Advance Notices with the Commission pursuant to Section 806(e). In addition, the Commission requests comments on the following specific issues:

- Do the proposed rules sufficiently define and describe when advance notice of proposed changes to rules, procedures or operations are required to be filed by designated financial market utilities in accordance with Section 806(e)?
- Is the proposed definition for the term "materially affect the nature or level of risks presented" by a designated clearing agency broad enough to capture all types of changes that could materially affect the nature or level of risks presented by a designated clearing

¹⁰⁶ 12 U.S.C. 5465(e)(2)(C).

¹⁰⁷ 12 U.S.C. 5465(e)(2)(D). Pursuant to Section 806(e)(3), the Commission is required to provide the Board concurrently with a complete copy of any notice, request or other information it receives. However, the Commission is proposing that the designated clearing agency file copies of any such notice, requests or other information with the Board in order to help meet this requirement.

agency? Alternatively, should the definition include a greater degree of specificity regarding the proposed changes that must be filed as Advance Notices with the Commission?

- Should additional examples be provided regarding the categories of changes that may materially affect the nature or level of risks presented by a designated clearing agency and, as a result, would be required to be filed with the Commission under Section 806(e)? Should additional examples be provided regarding the categories of changes that may not materially affect the nature or level of risks presented by a designated clearing agency and, as a result, would not be required to be filed with the Commission under Section 806(e)? If so, what additional examples should be provided?
- Should the Commission utilize the proposed rule change filing system under Rule 19b-4 for Advance Notices required to be filed by designated clearing agencies under Section 806(e)? Do commenters have suggestions for other methods of filing Advance Notices with the Commission?
- Should the Commission specify any additional requirements to those already in Section 806(e) with respect to Advance Notices implemented on an emergency basis? If so, please specify such requirements. Is the proposed rule's requirement for proposed changes implemented on an emergency basis too onerous? If so, please specify changes that should be made.
- Is there any specific additional information that should be included in the Advance Notice filing requirement regarding the nature or level of risks presented by the designated clearing agency?

D. Amendments to Form 19b-4

In conjunction with the proposed Rule 19b-4 amendments, the Commission is proposing to amend Form 19b-4 to include Security-Based Swap Submissions and Advance Notices. Specifically, the Commission is proposing to amend the cover page of Form 19b-4 to add additional checkboxes so that a clearing agency may indicate that the filing is being submitted as a Security-Based Swap Submission or an Advance Notice (in the case of a designated clearing agency) as well as a proposed rule change under Exchange Act Section 19(b). A clearing agency would be able to select more than one filing type, check the appropriate box or boxes to indicate the filing type and submit all related information as a single filing. In other words, in cases where a proposed change must be filed pursuant to more than one filing requirement, the clearing agency would be able to meet all applicable filing requirements by submitting a single Form 19b-4 electronically on the existing filing system, EFTS, to the Commission.

The Commission also is proposing to amend the General Instructions for Form 19b-4 regarding the filing requirements for Security-Based Swap Submissions and Advance Notices. The Commission is proposing to amend the instructions to include specific information that is required to be filed as part of a Security-Based Swap Submission or an Advance Notice.

With respect to Security-Based Swap Submissions, the proposed amendments to the Form 19b-4 General Instructions would require clearing agencies to include a statement that includes, but is not limited to: (i) how the submission is consistent with Exchange Act Section 17A; (ii) information that will assist the Commission in the quantitative and qualitative assessment of the factors specified in Exchange Act Section 3C; and (iii) how the rules of the clearing agency meet the criteria for open access. Additionally, in order to facilitate the Commission's review of a Security-Based Swap Submission, the proposed instructions provide

examples of the types of information the clearing agency should provide relating to product specifications; pricing sources, models and procedures; risk management procedures; measures of market liquidity and trading activity; credit support; the effect of a clearing requirement on the market for the swap; applicable rules, policies, or procedures; terms and trading conventions on which the swap is currently traded; and financial and operational capacity.

With respect to Advance Notices, the proposed amendments to the Form 19b-4 General Instructions would require the designated clearing agency to provide a description of the nature of the proposed change and the expected effects on risks to the designated clearing agency, its participants, or the market and it must provide a description of how the designated clearing agency will manage any identified risks. A designated clearing agency also would be instructed to provide any additional information requested by the Commission necessary to assess the effect the proposed change would have on the nature or level of risks associated with the designated clearing agency's payment, clearing or settlement activities and the sufficiency of any proposed risk management techniques.

The Commission is proposing to provide a new Exhibit 1A to the General Instructions for the Federal Register notice template used by clearing agencies as an exhibit to the Form 19b-4 filing. New Exhibit 1A would be used only by clearing agencies. All other SROs would continue to use the current Exhibit 1 to prepare the Federal Register notice for proposed rule changes. The Commission is proposing a separate exhibit for clearing agencies because the proposed rule to require notice of Security-Based Swap Submissions and Advance Notices to be published in the Federal Register would apply only to clearing agencies. Instructions on preparing a Federal Register notice for Security-Based Swap Submissions and Advance Notices would be unnecessary for all other SROs. In order to avoid any confusion, the Commission is

proposing to provide clearing agencies with Exhibit 1A to use to prepare a Federal Register notice for a proposed rule change, Security-Based Swap Submission, or Advance Notice, or any combination of the three. The proposed amendments to the General Instructions for Form 19b-4 also would incorporate the statutory timeframes and other procedural requirements that are in Exchange Act Section 3C and Section 806(e).

Moreover, pursuant to existing Rule 19b-4(j), SROs are required to sign Form 19b-4 electronically in connection with filing a proposed rule change and to retain a copy of the signature page in accordance with Rule 17a-1. Under the proposed rules, Rule 19b-4(j) would be modified such that it would apply also to Security-Based Swap Submissions filed in accordance with Exchange Act Section 3C and Advance Notices filed in accordance with Section 806(e).

In addition, the proposed changes to the General Instructions for Form 19b-4 would reflect the new deadlines by which the Commission must publish and act upon proposed rule changes submitted by SROs and the new standards for approval, disapproval or suspension of proposed rule changes pursuant to the amendments to Exchange Act Section 19(b) contained in Section 916 of the Dodd-Frank Act. The Commission is proposing a number of technical and clarifying amendments to Rule 19b-4 and Form 19b-4 to make the instructions consistent with the new requirements in Section 916 of the Dodd-Frank Act and with current practices of SRO filers.¹⁰⁸

Section 916 of the Dodd-Frank Act also modified Exchange Act Section 19(b)(3)(A), which permits certain types of proposed rule changes to take effect immediately upon filing with the Commission and without the notice and approval procedures required by Exchange Act Section 19(b)(2), to make clear that any rule establishing or changing a fee, due or other charge

¹⁰⁸ See proposed amendments to the General Instructions for Form 19b-4.

imposed by the SRO qualifies for this designation, regardless of whether the fee, due or other charge is applicable only to a member.¹⁰⁹ The General Instructions for Form 19b-4 have been modified to reflect this clarification.

The Commission requests comment on all aspects of the proposed amendments to Form 19b-4. In addition, the Commission requests comments on the following specific issues:

- Do the proposed amendments to Form 19b-4 adequately capture the filing requirements in Exchange Act Section 3C and Section 806(e) while allowing clearing agencies to meet the requirements for filing notice of proposed rule changes under Exchange Act Section 19(b)? If not, why not?
- Would additional changes to Rule 19b-4 or Form 19b-4 be useful in order to accommodate the filing of Advance Notices under Section 806(e)? If so, what specific changes should the Commission consider?

E. Amendments to Rule 19b-4 relating to Section 916 of the Dodd-Frank Act

Under Exchange Act Section 19(b)(2)(E),¹¹⁰ as amended by the Dodd-Frank Act, the Commission is required to send the SRO notice to the Federal Register for publication thereof within 15 days of the date on which the SRO's website publication is made. The Commission is proposing to amend Rule 19b-4 to provide that if a SRO does not post a proposed rule change on its website on the same day that it files the proposal with the Commission, then the SRO shall inform the Commission of the date on which it posted such proposal on its website. The purpose of this change is to advise the Commission of the date the SRO posted the proposed rule change filing to its website, as such posting initiates the timing for the requirement of the Commission to

¹⁰⁹ 15 U.S.C. 78s(b)(3)(A).

¹¹⁰ 15 U.S.C. 78s(b)(2)(E).

send notice of the proposed rule change to the Federal Register.

The Commission requests comment on all aspects of the proposed amendments to Rule 19b-4 relating to Section 916 of the Dodd-Frank Act. In addition, the Commission requests comments on the following specific issues:

- Should the Commission specify the manner and form by which the SRO should inform the Commission of the date on which it posted the proposed rule change on its website? If so, what manner and form should the notification take?

F. New Requirements Under Exchange Act Section 3C and Section 806(e) and the Existing Filing Requirement in Exchange Act Section 19(b)

The proposed amendments to Rule 19b-4 and Form 19b-4 incorporate two new requirements under the Dodd-Frank Act that are similar to the existing filing requirement for proposed rule changes under Exchange Act Section 19(b). The first is the requirement to file Security-Based Swap Submissions under new Exchange Act Section 3C. The second is the requirement to file Advance Notices under new Section 806(e). As discussed previously, the Commission anticipates that in many cases a clearing agency may take an action that would trigger more than one of these filing requirements¹¹¹ and it seeks to streamline the filing

¹¹¹ Title VII contains a clause, which provides in pertinent part, that “[u]nless otherwise provided by its terms, [Subtitle B] does not divest . . . the Securities and Exchange Commission. . . of any authority derived from any other provision of applicable law.” See Section 771 of the Dodd-Frank Act. Similarly, Section 811 of the Dodd-Frank Act provides that “[u]nless otherwise provided by its terms, this title does not divest any appropriate financial regulator, any Supervisory Agency, or any other Federal or State agency, of any authority derived from any other applicable law, except that any [risk management] standards prescribed by the [Board] under section 805 shall supersede any less stringent requirements established under other authority to the extent of any conflict.” Accordingly the new requirements under Titles VII and VIII do not supersede the existing requirements under the Exchange Act that would require clearing agencies (which are all SROs) to file a proposed rule change when the change proposed in a Security-Based Swap Submission or Advance Notice also meets the criteria for a proposed rule change.

processes for Exchange Act Section 3C, Section 806(e) and Exchange Act Section 19(b) by proposing that all such filings be made electronically on Form 19b-4.

The amendments to Rule 19b-4 and to Form 19b-4 are being proposed to avoid duplicative filings and to streamline the process and burden on clearing agencies and the Commission. However, the filing requirements of Exchange Act Section 3C, Section 806(e) and Exchange Act Section 19(b) are distinct from each other and subject to different statutory standards for Commission review. As a result, a clearing agency that files a proposal pursuant to more than one of these sections must meet the requirements of each applicable regulatory scheme before the applicable change may become effective.

Accordingly, it is likely that many proposals made by clearing agencies may be filed and require review under more than one of the three Commission review procedures discussed herein. For example, a designated clearing agency may be required to submit an Advance Notice in connection with its Security-Based Swap Submission if the requirement to clear the security-based swap described in the submission would materially affect the nature or level of risks presented by the designated clearing agency. Moreover, if the designated clearing agency did not have existing authority under its rules to clear the relevant security-based swap, such action likely also would require a proposed rule change filing under Exchange Act Section 19(b).

In other cases, only one of the three Commission-review procedures may apply because the scope of proposals requiring review under each of Section 806(e) and Exchange Act Section 3C is in some ways broader and in other ways narrower in comparison to Exchange Act Section 19(b). There is, for example, the potential that certain changes to the operations of a designated clearing agency may not require a proposed rule change filing under Exchange Act Section 19(b) or a Security-Based Swap Submission under Exchange Act Section 3C, but may

trigger a requirement to file an Advance Notice under Section 806(e). By contrast, because the notice requirement under Section 806(e) applies only to matters that materially affect the nature or level of risk presented by a designated clearing agency, it is also possible that a rule change filing would be required under Exchange Act Section 19(b) but not trigger the advance notice requirement under Section 806(e).

When a clearing agency submits a filing for more than one purpose (*i.e.*, proposed rule change, Security-Based Swap Submission and/or Advance Notice), the Commission will endeavor to evaluate such filings in tandem as part of a parallel process. Although the timing for review under each of Exchange Act Section 3C, Section 806(e) and Exchange Act Section 19(b) is different,¹¹² all three processes contain some degree of flexibility, and the Commission will attempt to streamline the review processes to avoid any unnecessary delays or duplicative requests for information.

However, each of the three processes would remain distinct from the other processes. Each proposed rule change filing, Security-Based Swap Submission and Advance Notice would be reviewed and evaluated independently by the Commission in accordance with the applicable

¹¹² Assuming the Commission utilizes its maximum allotment of time under Exchange Act Section 19(b)(2), including with respect to any extensions of time requiring the consent of the SRO, the Commission must either approve, disapprove or institute proceedings with respect to a proposed rule change filing within approximately 105 days after receipt. See Pub. L. No. 111-203, section 916 (amending Exchange Act Section 19(b)(2)). 15 U.S.C. 78s(b)(2). Similarly, the Commission must make its determination on a Security-Based Swap Submission within 90 days after receipt, unless the clearing agency agrees to an extension of this time limitation. See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(b)(3)). The Commission is not required to approve affirmatively a proposed change filed as an Advance Notice under Section 806(e), but it must notify the designated clearing agency of any objection to the proposed change within 60 days after receiving the notice filing, unless the Commission requests additional information in consideration of the notice, in which case the 60-day period will recommence on the date such information is received by the Commission. 12 U.S.C. 5465(e)(1)(G).

statute and regulatory authority. Moreover, the proposed imposition of new requirements to file Advance Notices with the Commission and to make Security-Based Swap Submissions would not replace Exchange Act Section 19(b) notice process provision, nor will a filing made under one of the two new requirements eliminate the need to satisfy the requirements of the other process to the extent they are applicable. The Commission review required by Exchange Act Section 3C is different from the review required under Section 806(e), which in turn is different from the review required under Exchange Act Section 19(b).

Section 806(e) requires an analysis of the risk management issues that may impact the clearing agency, its participants, or the market. Exchange Act Section 19(b), by contrast, requires a broader evaluation and an analysis as to whether the proposed rule change meets the requirements of the Exchange Act and the rules thereunder. Finally, Exchange Act Section 3C only applies when a clearing agency plans to accept for clearing a security-based swap (or a group, category, type or class of security-based swaps), and the standard for review is based on a number of specified factors, including but not limited to: (i) how the submission is consistent with Exchange Act Section 17A and (ii) the factors specified in Exchange Act Section 3C relating to the security-based swap, the market for the security-based swaps, and the clearing agency.

The Commission preliminarily believes that these distinct reviews make it possible for a submission made on Form 19b-4 to be acceptable under the standards for review for one of the three purposes but not under the others.¹¹³ Accordingly, under the proposal, where a proposed change is required to be filed pursuant to more than one filing requirement, the change would not become effective until determinations are obtained under each of the other applicable statutory

¹¹³ For example, a rule proposal may provide for sound risk management practices but have an anticompetitive aspect that would not satisfy the requirements of the Exchange Act.

provisions. In cases where only the requirements of one of Exchange Act Section 19(b), Exchange Act Section 3C or Section 806(e) are implicated, only the applicable process would need to be completed before the proposal could become effective.

III. General Request for Comment

The Commission seeks comment generally on all aspects of the proposed amendments to Rule 19b-4 and Form 19b-4 and proposed Rules 3Ca-1 and 3Ca-2. Commenters are encouraged to provide empirical data or economic studies to support their views and arguments related to the proposed rules. In addition to the questions above, commenters are welcome to offer their views on any other matter raised by the proposed rules. With respect to any comments, we note that they are of greatest assistance to the Commission 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.

In addition, Title VII requires that the Commission consult and coordinate to the extent possible with the CFTC for the purposes of assuring regulatory consistency and comparability, to the extent possible,¹¹⁴ and states that in adopting rules, the CFTC and Commission shall treat functionally or economically similar products or entities in a similar manner.¹¹⁵

The CFTC is required to adopt rules related to the process for review of swaps for mandatory clearing as required under Section 723 of the Dodd-Frank Act.¹¹⁶ Understanding that the Commission and the CFTC regulate different products and markets, and as such,

^{114.} Pub. L. No. 111-203, section 712(a)(7).

¹¹⁵ Id.

¹¹⁶ See Pub. L. No. 111-203, section 723 (amending Section 2 of the Commodity Exchange Act). See also supra note 55 discussing the CFTC's proposed rules pursuant to Section 723 of the Dodd-Frank Act.

appropriately may be proposing alternative regulatory requirements, we request comments on the impact of any differences between the Commission and CFTC approaches to the process for submissions for review of security-based swaps and swaps for mandatory clearing. Specifically, do the regulatory approaches under the Commission's proposed rulemaking pursuant to Exchange Act Section 3C and the CFTC's proposed rulemaking pursuant to Section 723 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 the approaches proposed by the Commission and the CFTC to regulate the process for review of security-based swaps and swaps for mandatory clearing are comparable? If not, why not? Do commenters believe there are approaches that would make the regulation of the process for review of security-based swaps for mandatory clearing more comparable? If so, what are they? 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? We request commenters to provide data, to the extent possible, supporting any such suggested approaches.

Similarly, the CFTC is required to adopt rules related to the process, pursuant to Section 806(e), by which any financial market utility designated by the Council as systemically important (and for which the CFTC is the Supervisory Agency) will be required to provide advance notice to the CFTC of changes to its rules, procedures or operations that could materially affect the nature or level of risks presented by such financial market utility.¹¹⁷ The Commission requests comments on the impact of any differences between the Commission and CFTC approaches to the process for submitting proposed changes to rules, procedures or

¹¹⁷ 75 FR 67282 (November 2, 2010).

operations for review pursuant to Section 806(e). Specifically, do the regulatory approaches under the Commission's proposed rulemaking and the CFTC's proposed rulemaking pursuant to Section 806(e) 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 the approaches proposed by the Commission and the CFTC with respect to the process for submitting advance notice of proposed changes to rules, procedures or operations for review pursuant to Section 806(e) are comparable? If not, why not? Do commenters believe there are approaches that would make the regulation of the process for submitting for advance review notices of proposed changes to rules, procedures or operations pursuant to Section 806(e) more comparable? If so, what are they? 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? We request commenters to provide data, to the extent possible, supporting any such suggested approaches.

IV. Paperwork Reduction Act

Rule 19b-4, Form 19b-4 and Rule 3Ca-1 contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").¹¹⁸ Accordingly, the Commission has submitted the 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 Commission is proposing to submit the current collection of information titled "Rule 19b-4 Filings with Respect to Proposed Rule Changes by Self-Regulatory Organizations" (OMB Control No. 3235-0045). The Commission is proposing to submit the current collection of

¹¹⁸ 44 U.S.C. 3501 et seq.

information titled "Form 19b-4 under the Securities Exchange Act of 1934" (OMB Control No. 3235-0045). The Commission also is proposing to submit a new collection of information titled "Rule 3Ca-1 Stay of Clearing Requirement and Review by the Commission under the Securities Exchange Act of 1934". 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. Any information submitted to the Commission will be made publicly available.

A. Summary of Collection of Information

1. Proposed Amendments to Rule 19b-4 and Form 19b-4

Rule 19b-4 currently requires an SRO seeking Commission approval for a proposed rule change to provide the information stipulated in Form 19b-4. Form 19b-4 currently requires a description of the terms of a proposed rule change, the proposed rule change's impact on various market segments and the relationship between the proposed rule change and the SRO's existing rules. Form 19b-4 also requires an accurate statement of the authority and statutory basis for, and purpose of, the proposed rule change, the proposal's impact on competition and a summary of any written comments received by the SRO from SRO members. An SRO also is required to submit Form 19b-4 to the Commission electronically, post a proposed rule change on its website within two business days of its filing, and to post and maintain a current and complete set of its rules on its website.

The Commission is proposing to require two new collections of information on Form 19b-4 related to new filing requirements applicable to clearing agencies under the Dodd-Frank Act. The proposed amendments would not otherwise change the collection of information requirements currently in Rule 19b-4 and Form 19b-4. These new reporting requirements are in addition to the information currently required by Rule 19b-4 and Form 19b-4.

The proposed rule would require clearing agencies to file information with the Commission under Exchange Act Section 3C and Section 806(e) on Form 19b-4. Exchange Act Section 3C requires clearing agencies to submit for a Commission determination of whether mandatory clearing applies, any security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing and provide notice to its members of such submission. Section 806(e) requires that a clearing agency designated as systemically important by the Council file with the Commission advance notice of proposed changes to its rules, procedures or operations that could materially affect the nature or level of risk presented by the designated clearing agency.

The Commission anticipates that in many cases, a clearing agency would be required to file a proposal under Exchange Act Section 3C or Section 806(e) when it is already required to file a proposed rule change under Exchange Act Section 19(b). Accordingly, clearing agencies would be able to submit on a Form 19b-4, proposals under Exchange Act Section 3C or Section 806(e) that they are already required to submit under Exchange Act Section 19(b). In some cases, however, a clearing agency would be required to file a proposal under Exchange Act Section 3C or Section 806(e) and not under Exchange Act Section 19(b), for example where a proposal materially affects the nature or level of risks presented by the clearing agency but does not change the rules of the clearing agency.

In addition, Exchange Act Section 3C and Section 806(e) each require information to be provided as part of the filing that is in addition to the information required to be filed with a proposed rule change under Exchange Act Section 19(b). A clearing agency would be required to include as part of the Security-Based Swap Submission a statement that includes, but is not limited to: (i) how the submission is consistent with Exchange Act Section 17A; (ii) information

that will assist the Commission in the quantitative and qualitative assessment of the factors specified in Exchange Act Section 3C; and (iii) how the rules of the clearing agency meet the criteria for open access.

Section 806(e) provides that the Advance Notice include a description of the nature of the proposed change and the expected effects on risks to the designated clearing agency, its participants, or the market and it must provide a description of how the designated clearing agency will manage any identified risks. A designated clearing agency also would be required to provide any additional information requested by the Commission necessary to assess the effect the proposed change would have on the nature or level of risks associated with the designated clearing agency's payment, clearing or settlement activities and the sufficiency of any proposed risk management techniques.

The proposed amendments to Rule 19b-4 also would require a clearing agency to post certain information on its website, and require a SRO that does not post a proposed rule change on its website on the same day that it filed the proposal with the Commission to inform the Commission of the date on which it posted such proposal on its website.¹¹⁹ Security-Based Swap Submissions and Advance Notices, and any amendments thereto, would be required to be posted on the clearing agency's website within two business days of filing the information with the Commission. The information generally shall remain posted on the clearing agency's website until a determination is made with respect to the Security-Based Swap Submission or the Advance Notice becomes effective. A clearing agency also would be required to post notice on its website of the effectiveness of any change to its rules, procedures, or operations referred to in an Advance Notice within two business days of the effective date determined in accordance with

¹¹⁹ Proposed Rule 19b-4(l).

Section 806(e).

2. Stay of Clearing Requirement

Proposed Rule 3Ca-1 provides that the Commission, on application of a counterparty to a security-based swap, or on the Commission's own initiative, may stay the clearing requirement until the Commission completes a review of the terms of the security-based swap (or group, category, type, or class of security-based swaps) and the clearing of the security-based swap (or group, category, type, or class of security-based swaps) that the clearing agency has accepted for clearing. A counterparty to a security-based swap that applies for a stay of the clearing requirement for a security-based swap, or any group, category, type, or class of security-based swaps, would be required to submit to the Commission the information set forth in proposed Rule 3Ca-1(b).

Any clearing agency that has accepted for clearing a security-based swap, or any group, category, type or class of security-based swaps, that is subject to the stay of the clearing requirement would be required to provide information requested by the Commission as it determines to be necessary and appropriate to assess any of the factors in the course of the Commission's review. The Commission preliminarily believes such information would likely include updates to the information the clearing agency provided in the Security-Based Swap Submission relating to the security-based swap then subject to the stay under review.

B. Proposed Use of Information

1. Proposed Amendments to Rule 19b-4 and Form 19b-4

The information currently required under Rule 19b-4 and reported on Form 19b-4 is used by the Commission to review rule change proposals filed by SROs pursuant to Exchange Act

Section 19(b)(1)¹²⁰ and to provide notice of the proposals to the general public. The Commission relies upon the information received in SRO filings, as well as public comment regarding the information, in reviewing and reaching decisions about whether to approve a proposed rule change.

The information to be provided by clearing agencies pursuant to the proposed amendments to Rule 19b-4 and Form 19b-4 would be used by the Commission to evaluate Security-Based Swap Submissions and Advance Notices. The Commission would use the information filed on Form 19b-4 related to Security-Based Swap Submissions to determine whether the security-based swap, or any group, category, type or class of security-based swaps, described in the Security-Based Swap Submission is required to be cleared pursuant to Exchange Act Section 3C(1).

The Commission would use the information on Form 19b-4 related to Advance Notices filed under Section 806(e) to determine the effect on the nature or level of risks that would be presented by a designated clearing agency based on a proposed change to its rules, procedures or operations, and the expected effects on risk to the designated clearing agency, its participants and the market and to determine whether the Commission should make an objection to the proposed change. In addition, the information on the form would be provided to the Board because the Commission is required to provide copies of all Advance Notices and any additional information provided by the designated clearing agency relating to the Advance Notice and to consult with the Board before taking any action on or completing its review of the Advance Notice.¹²¹ In some instances, the Commission also may use the information on the form to determine whether to allow a proposed change to take effect in less than 60 days following the receipt of the

¹²⁰ 15 U.S.C. 78s(b)(1).

¹²¹ 12 U.S.C. 5465(e)(3) and (4).

Advance Notice and to determine whether a change made on an emergency basis is warranted or whether it should be modified or rescinded.

The information proposed to be filed on Form 19b-4 relating to Exchange Act Section 3C and Section 806(e) also would be used by participants of the clearing agency, market participants, other clearing agencies, or the general public to comment on the proposal, as the Commission is proposing to require that a clearing agency post the information on its website. In addition, pursuant to Exchange Act Section 3C, a clearing agency would be required to provide its members with notice of the Security-Based Swap Submission. As with proposed rule changes under Exchange Act Section 19(b), the Commission would solicit comment from interested parties on proposals filed under Exchange Act Section 3C and Section 806(e). Interested parties could use the information to comment on the proposed change and to provide feedback on the development of the clearing agency's service offerings and the rules, procedures and operations of the clearing agency.

The information collected by the Commission with respect to the date on which the SRO posted a proposed rule change on its website (if such posting date is not the same as the filing date) would be used to inform the Commission of the date by which the Commission must send the SRO notice to the Federal Register for publication.

2. Stay of Clearing Requirement

The information provided as required by proposed Rule 3Ca-1 would be used by the Commission to determine whether to grant the stay of the clearing requirement sought by a counterparty and to review whether the clearing requirement would continue to apply to such security-based swap, or any group, category, type, or class of security-based swaps.

C. Respondents

1. Proposed Amendments to Rule 19b-4 and Form 19b-4

There are currently 25 SROs subject to the collection of information under Rule 19b-4 and Form 19b-4, although that number may vary owing to the consolidation of SROs or the introduction of new entities. In fiscal year 2009, these SRO respondents filed 1,405 rule change proposals subject to the current collection of information, of which 1,071 proposed rule changes ultimately became effective.

Although Rule 19b-4 and Form 19b-4 apply to all SROs, the new collection of information requirements in the proposed rules would apply to clearing agencies and, in certain limited circumstances, to other SROs. The proposed amendments relating to Exchange Act Section 3C would apply to clearing agencies that clear security-based swaps. Currently, four clearing agencies are authorized to clear credit default swaps, which include security-based swaps,¹²² pursuant to temporary conditional exemptions under Exchange Act Section 36.¹²³ The obligation to centrally clear security-based swap transactions is a new requirement under Title

¹²² The Commission authorized five entities to clear credit default swaps. See Securities Exchange Act Release Nos. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) and 61973 (April 23, 2010), 75 FR 22656 (April 29, 2010) (CDS clearing by ICE Clear Europe Limited); 60373 (July 23, 2009), 74 FR 37740 (July 29, 2009) and 61975 (April 23, 2010), 75 FR 22641 (April 29, 2010) (CDS clearing by Eurex Clearing AG); 59578 (March 13, 2009), 74 FR 11781 (March 19, 2009), 61164 (December 14, 2009), 74 FR 67258 (December 18, 2009) and 61803 (March 30, 2010), 75 FR 17181 (April 5, 2010) (CDS clearing by Chicago Mercantile Exchange Inc.); 59527 (March 6, 2009), 74 FR 10791 (March 12, 2009), 61119 (December 4, 2009), 74 FR 65554 (December 10, 2009) and 61662 (March 5, 2010), 75 FR 11589 (March 11, 2010) (CDS clearing by ICE Trust US LLC); 59164 (December 24, 2008), 74 FR 139 (January 2, 2009) (temporary CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) (collectively, "CDS Clearing Exemption Orders"). LIFFE A&M and LCH.Clearnet Ltd. allowed their order to lapse without seeking renewal.

¹²³ 15 U.S.C. 78mm. Of the four clearing agencies granted temporary exemptions from registration, only three have cleared products that likely are classified as security-based swaps under Title VII.

VII, and it is anticipated that clearing agencies operating under temporary conditional exemptions will register or will become registered security-based swap clearing agencies.¹²⁴ Based on the fact that there are currently four clearing agencies authorized to clear security-based swaps and that there could conceivably be a few more in the foreseeable future,¹²⁵ the Commission preliminarily estimates that four to six clearing agencies may plan to centrally clear security-based swaps and be subject to the information collection requirements in the proposed rules relating to Exchange Act Section 3C. The Commission is using the higher estimate (six) for the PRA analysis.

The amendments to Rule 19b-4 and Form 19b-4 relating to the Section 806(e) advance notice requirement of changes to rules, procedures or operations would only apply to clearing agencies that are registered with the Commission, designated by the Council as systemically important, and for which the Commission is the Supervisory Agency. There are currently six clearing agencies registered with the Commission; however, only four of these clearing agencies are currently clearing securities transactions. In addition, it is anticipated that several more clearing agencies will be registered with the Commission following the effectiveness of Title VII to clear security-based swaps. For purposes of the PRA analysis, the Commission estimates that the four registered securities clearing agencies that are currently clearing securities and the six estimated clearing agencies that may clear security-based swaps would be subject to the applicable collection of information requirements.

2. Stay of Clearing Requirement

The Commission preliminarily estimates that six security-based swap clearing agencies'

¹²⁴ See Pub. L. No. 111-203, section 763(b).

¹²⁵ The Commission does not expect there to be a large number of clearing agencies that clear security-based swaps, based on the significant level of capital and other financial resources necessary for the formation of a clearing agency.

activities associated with security-based swap clearing requirements would potentially be subject to the collection of information under proposed Rule 3Ca-1 in connection with any counterparty requesting a stay of clearing requirement.

D. Total Annual Reporting and Recordkeeping Burden

1. Background

The proposed amendments to Rule 19b-4 and Form 19b-4 are designed to facilitate the processes for providing the Commission with Security-Based Swap Submissions and Advance Notices and to make these processes efficient by utilizing the existing infrastructure for proposed rule changes, thereby conserving both clearing agency and Commission resources. When amended, Form 19b-4 would enable clearing agencies to submit Security-Based Swap Submissions and Advance Notices electronically with the Commission. The proposed amendments to Rule 19b-4 also would require a clearing agency to post on its website any Security-Based Swap Submissions and any Advance Notices, and any amendments thereto, submitted to the Commission within two business days of submission. A further amendment to Rule 19b-4 would require an SRO that filed a proposed rule change with the Commission to inform the Commission of the date on which it posted such proposal on its website if the posting did not occur on the same day that the SRO filed the proposal with the Commission. Finally, proposed Rule 3Ca-1 would specify the process for a security-based swap counterparty to apply to the Commission for a stay of the clearing requirement.

2. Rule 19b-4 and Form 19b-4

In order to estimate the collection of information, the Commission received informal comments from a few clearing agencies that would be subject to the new requirements in the proposed amendments to Rule 19b-4 and Form 19b-4. Clearing agencies would have to train

personnel and develop policies and procedures to implement the proposed new filing requirements under Rule 19b-4 and Form 19b-4 in connection with Security-Based Swap Submissions and Advance Notices. In addition, clearing agencies indicated they would have to submit additional information to the Commission, either as separate filings or as part of filings also submitted as proposed rule changes under Exchange Act Section 19(b).

The clearing agencies emphasized that the estimated burdens would depend in large part on the rules ultimately adopted by the Commission to define and determine how frequently Security-Based Swap Submissions and Advance Notices would be required to be filed and the nature and extent of information that would be required with each filing. In addition, the clearing agencies stated that the burden per filing could vary widely, depending on the complexity of each individual filing. For example, some clearing agency proposals may require more information or analysis to be submitted as part of the filing. The clearing agencies also stated that the annual burden also could vary widely from year to year depending on the number of new proposals the clearing agency makes in a particular year. As a result, the estimates provided as part of the survey are preliminary and may change after clearing agencies have the opportunity to review and closely evaluate the proposed rules.

The estimates varied among clearing agencies, which may reflect the different internal processes, training programs, and review procedures for new projects currently in place at the different clearing agencies. In addition, some clearing agencies are currently registered with the Commission while others are not. Clearing agencies registered with the Commission already file proposed rule changes under Exchange Act Section 19(b) and have more familiarity with the collection of information requirements related to Rule 19b-4 and Form 19b-4, while clearing agencies that are not registered with the Commission are not as familiar with these requirements

and may incur a greater burden in connection with learning EFTS and training personnel.

The Commission heard from staff of eight clearing agencies. The estimates varied among clearing agencies, and therefore the Commission is using conservative numbers in developing its estimates for the PRA. In addition, in order to provide a conservative estimate, the Commission has calculated the burden for the requirements related to Advance Notices assuming that they would apply to all ten clearing agencies and the burden for the requirements related to Security-Based Swap Submissions assuming they would apply to six clearing agencies.

Finally, the Commission recognizes that there would likely to be some substantive and procedural overlap with respect to the processes for preparing and submitting Security-Based Swap Submissions, Advance Notices and proposed rule changes that relate to the same subject matter. For example, in connection with a decision to clear a new type of security-based swap that was not previously permitted under the clearing agency's rules, a clearing agency could be required to make a filing as a Security-Based Swap Submission, an Advance Notice and a proposed rule change. In this case, because these submissions all relate to the same underlying issue, the amount of time required to prepare a single Form 19b-4 for all three purposes is likely to be less than the aggregate amount of time ordinarily required to prepare and submit an unrelated Security-Based Swap Submission, Advance Notice and proposed rule change. Nevertheless, the Commission is calculating the PRA burden for each process individually without accounting for any reduction due to the anticipated overlap. The Commission has decided to calculate the burdens in this manner in order to provide the most conservative estimates possible. Additionally, the estimates of each of the following burdens are derived from discussions between the Commission's staff and personnel of the clearing agencies, as described above.

a. Internal Policies and Procedures

The Commission preliminarily believes that newly-registered clearing agencies could incur some one-time costs associated with training their personnel about the procedures for submitting Security-Based Swap Submissions and/or Advance Notices in electronic format through EFFS. Based on staff discussions with the clearing agencies, the Commission preliminarily estimates that each newly registered clearing agency will spend approximately 20 hours training all staff members who will use EFFS to submit Security-Based Swap Submissions, Advance Notices and/or proposed rule changes electronically. Accordingly, the Commission estimates that the total one-time burden of training staff members of newly-registered clearing agencies to use EFFS will be 120 hours (six clearing agencies X 20 hours).

Going forward, the Commission preliminarily estimates that each existing SRO (including currently-registered clearing agencies) will spend approximately 10 hours annually training new staff members and updating the training of existing staff members to use EFFS, resulting in a total annual burden of 310 hours ((six newly-registered clearing agencies X 10 hours) + (25 SROs X 10 hours)). The Commission preliminarily believes that only a minimal amount of EFFS training will be submission-specific and that training a person to submit either a proposed rules change, Security-Based Swap Submission or Advance Notice will generally be sufficient to allow such person to make one or more of the other types of submissions.

Based on staff discussions with the clearing agencies, the Commission preliminarily estimates that there would be a one-time paperwork burden of 130 hours for each newly-registered clearing agency to draft and implement internal policies and procedures relating to using EFFS to submit Security-Based Swap Submissions, Advance Notices and proposed rule changes with the Commission, for a total of 780 hours (130 hours X six newly-registered

clearing agencies). In addition, the Commission preliminarily estimates that there will be a one-time paperwork burden of 30 hours for each currently-registered clearing agency to draft and implement modifications to existing internal policies and procedures for using EFFS in order to update them for submitting Security-Based Swap Submissions and/or Advance Notices with the Commission for a total of 120 hours (30 hours X four currently-registered clearing agencies).

b. Proposed Rule Changes

An SRO rule change proposal is generally filed with the Commission after an SRO's staff has obtained approval of its board of directors. The time required to complete a filing varies significantly and is difficult to separate from the time an SRO spends in developing internally the proposed rule change. In a PRA analysis conducted in 2004 in connection with amendments to Rule 19b-4 and Form 19b-4, the Commission estimated that 34 hours is the amount of time that would be required to complete an average proposed rule change filing and 129 hours is the amount of time required to complete a novel or complex proposed rule change filing.¹²⁶ Based on the filings it currently receives from SROs, the Commission preliminarily believes that these estimates remain valid and has relied on these figures to prepare the analysis discussed below.¹²⁷

In fiscal year 2009, 25 SRO respondents filed 1,405 rule change proposals subject to the

¹²⁶ See Exchange Act Release No. 50486, 69 FR 60287, *supra* note 51.

¹²⁷ In 2008, the Commission submitted to OMB a request for approval of an extension of the existing collection of information provided for in Rule 19b-4 and Form 19b-4. 73 FR 5245 (January 29, 2008) (Submission for OMB review; comment request). The PRA analysis conducted in 2008 estimated that the average time to complete a proposed rule change filing was 23.22 hours, without differentiating between average and complex rule filings. In light of the changes made to Exchange Act Section 19(b) pursuant to Section 916 of Dodd-Frank, which provides for new deadlines by which the Commission must publish and act upon proposed rule changes, the Commission has decided to revert to the figures contained in the PRA analysis conducted in 2004. Specifically, the shortened time period by which proposed rule changes will be reviewed by the Commission is likely to cause the SROs to spend additional time preparing and checking the filing, as there will be less time for them to correct a filing after it has been made, justifying the use of the more conservative estimates.

current collection of information. Of this total, the Commission estimates that 60 proposed rule changes could be characterized as novel or complex and 1,345 proposed rule changes could be characterized as average. The Commission preliminarily estimates that the total annual reporting burden for filing proposed rule changes with the Commission under the proposed amendments to Rule 19b-4 and Form 19b-4 will be 66,303 hours $((1,345/25) \times 31^{128}$ average rule change proposals $\times 34$ hours) + $((60/25) \times 31$ complex rule change proposals $\times 129$ hours)). Thus, on average, the reporting burden for filing proposed rule changes is 38.06 hours $(66,303$ hours $/ (1668$ average rule change proposals + 74 complex rule change proposals)).

c. Security-Based Swap Submissions

The time required by clearing agencies to prepare, review and submit Security-Based Swap Submissions to comply with proposed Rule 19b-4(o)(1) likely will vary significantly based on the unique characteristics of each Security-Based Swap Submission and the submitting clearing agency. Based on staff discussions with the clearing agencies, the Commission preliminarily estimates that the amount of time that a clearing agency would require to internally prepare, review and submit a Security-Based Swap Submission is 140 hours. The Commission also estimates that each clearing agency will submit 20 Security-Based Swap Submissions annually. Accordingly, the Commission estimates that the total annual reporting burden for clearing agencies submitting Security-Based Swap Submissions electronically with the Commission under the proposed amendments to Rule 19b-4 and Form 19b-4 will be 16,800 hours $(20$ Security-Based Swap Submissions $\times 140$ hours \times six respondents).

The Commission also preliminarily estimates that a clearing agency would require 60 hours of outside legal work to prepare, review and submit a Security-Based Swap Submission,

¹²⁸ The number of projected SROs is equal to 31 (25 currently registered SROs + six newly-registered clearing agencies).

based on staff discussions with the clearing agencies. Assuming an hourly cost of \$354 for an outside attorney,¹²⁹ the total annual cost in the aggregate for the six respondent clearing agencies to meet these requirements would be \$2,548,800 (60 hours X \$354 per hour for an outside attorney X 20 Security-Based Swap Submissions X six respondent clearing agencies).

d. Advance Notices

With respect to Advance Notices, the Commission preliminarily estimates that the amount of time that designated clearing agency representatives will require to internally prepare, review and electronically file each Advance Notice with the Commission to comply with proposed Rule 19b-4(n)(1) is 90 hours. This figure is based on the staff's discussions with the clearing agencies. The Commission also estimates that two hours should be added to the time required to prepare each Advance Notice to comply with the requirement contained in proposed Rule 19b-4(n)(5) to provide to the Board copies of all materials submitted to the Commission relating to an Advance Notice contemporaneously with such submission to the Commission. The Commission preliminarily estimates that each designated clearing agency will submit 35 Advance Notices to the Commission annually. Accordingly, the Commission estimates that the total annual reporting burden on designated clearing agencies submitting Advance Notices electronically with the Commission under the proposed amendments to Rule 19b-4 and Form 19b-4 will be 32,200 hours (35 Advance Notices X 92 hours X ten respondents).

Based on staff discussions with the clearing agencies, the Commission also preliminarily estimates that a designated clearing agency will require 40 hours of outside legal work to prepare, review and electronically file each Advance Notice with the Commission. Assuming an

¹²⁹ The hourly rate for an attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

hourly cost of \$354 for an outside attorney,¹³⁰ the total annual cost in the aggregate for the ten respondent clearing agencies to meet these requirements would be \$4,956,000 (40 hours X \$354 per hour for an outside attorney X 35 Advance Notices X ten respondents).

e. Summary

The Commission preliminarily estimates that the total annual reporting burden for clearing agencies to internally prepare, file and submit Security-Based Swap Submissions, proposed rule changes and Advance Notices electronically with the Commission under the Rule 19b-4 and Form 19b-4 will be 115,303 hours (16,800 hours for Security-Based Swap Submissions + 32,200 hours for Advance Notices + 66,303 hours for proposed rule changes). The Commission also preliminarily estimates that the total annual cost in the aggregate for the respondent clearing agencies to internally prepare, file and submit Security-Based Swap Submissions, proposed rule changes and Advance Notices electronically with the Commission under the Rule 19b-4 and Form 19b-4 will be \$7,504,800 (\$2,548,800 for Security-Based Swap Submissions + \$4,956,000 for Advance Notices).

3. Posting of Security-Based Swap Submissions, Advance Notices and Proposed Rule Changes on Clearing Agency Websites.

The Commission preliminarily believes that newly-registered clearing agencies could incur some one-time costs associated with posting Security-Based Swap Submissions, Advance Notices and proposed rule changes on their websites. The Commission preliminarily estimates that each newly-registered clearing agency will spend approximately 15 hours creating or updating its existing website in order to provide the capability to post these submissions online resulting in a total one-time burden of 90 hours (six clearing agencies X 15 hours).

With respect to annual burdens, the Commission preliminarily estimates that four hours

¹³⁰ See id.

would be required by a clearing agency to post a Security-Based Swap Submission on its website to comply with proposed Rule 19b-4(o)(5). This figure is based on the staff's discussions with the clearing agencies. The Commission estimates that the total annual reporting burden for clearing agencies to post Security-Based Swap Submissions on their websites will be 480 hours (20 Security-Based Swap Submissions X four hours X six respondents).

The Commission preliminarily estimates that four hours would be required by a designated clearing agency to post an Advance Notice on its website to comply with proposed Rule 19b-4(n)(3). The Commission preliminarily estimates that the total annual reporting burden for designated clearing agencies to post Advance Notices on their websites will be 1,400 hours (35 Advance Notices X four hours X 10 respondents).

To comply with proposed Rule 19b-4(n)(4), the Commission estimates that four hours would be required by a designated clearing agency to post notice on its website of any change to its rules, procedures or operations referred to in an Advance Notice once it has been permitted to take effect. The Commission therefore estimates that the total annual reporting burden for designated clearing agencies to post notice on their websites of any changes to their rules, procedures or operations referred to in Advance Notices would be 1,400 hours (35 Advance Notices X four hours X 10 respondents).

The Commission previously estimated that an SRO would take four hours to post proposed rule change proposals under Exchange Act Section 19(b) and amendments on its website and four hours to update the posted SRO rules on its website once the proposed rules become effective.¹³¹ The Commission preliminarily believes that these estimates remain valid. In addition, of the 1,405 proposed rule changes filed in fiscal year 2009, 1,071 were approved or

¹³¹ See *supra* note 127.

non-abrogated. Accordingly, the total annual reporting burden for SROs to post proposed rule change proposals on their websites and to update their posted rules on their websites once the proposed rules become effective will be 12,280 hours $((1,071/25) \times 31$ SRO respondents) approved or non-abrogated rules \times four hours) + $((1,405/25) \times 31$ SRO respondents) rule change proposals \times four hours)).

In summary, the Commission preliminarily estimates that the total annual reporting burden for all clearing agencies to post submitted Security-Based Swap Submissions, Advance Notices, notices of changes to rules, procedures or operations referred to in Advance Notices once they take effect and proposed rule changes on their websites under Rule 19b-4 and Form 19b-4 will be 15,560 hours (480 hours for Security-Based Swap Submissions + 1,400 hours for Advance Notices + 1,400 hours for posting notices of changes to rules, procedures or operations referred to in Advance Notices + 12,280 hours for proposed rule changes). The Commission requests comment on all of the above estimates.

4. Rule 3Ca-1

Commission staff communicated with certain clearing agencies that likely would be subject to a stay of the clearing requirement and related review under proposed Rule 3Ca-1 in order to estimate the collection of information. The clearing agencies emphasized that the estimated burdens would depend in large part on the number of stays requested annually and the scope of the information requested by the Commission in the course of the related review.

The Commission staff communicated with staff of three entities, representing four clearing agencies total, as two clearing agencies are subsidiaries of the same holding company. As the responses varied among clearing agencies, the Commission has generally used conservative responses in developing its estimates for the PRA.

Based on staff discussions with the clearing agencies, the Commission preliminarily estimates that a clearing agency will spend approximately 18 hours to retrieve, review and submit the information associated with the stay of the clearing requirement. The Commission preliminarily estimates that each clearing agency will be required to provide information requested by the Commission in the course of its reviews of five requests for a stay of the clearing requirement, resulting in a total annual reporting burden of 540 hours (five stay applications X 18 hours to retrieve, review and submit the information X six clearing agencies). The Commission also preliminarily estimates that a clearing agency will require seven hours of outside legal work to retrieve, review and submit the information associated with the stay of the clearing requirement. This figure is based on the staff's discussions with the clearing agencies. Assuming an hourly cost of \$354 for an outside attorney,¹³² the total estimated annual cost in the aggregate for the six respondent clearing agencies to meet these requirements would be \$74,340 (seven hours X \$354 per hour for an outside attorney X five stay of clearing applications X six respondents). The Commission requests comment on these estimates.

Finally, based on its estimates with respect to the preparation Security-Based Swap Submissions, the Commission preliminarily estimates that 100 hours would be required by a counterparty to a security-based swap to prepare and submit an application requesting a stay of the clearing requirement. The Commission preliminarily estimates that counterparties to security-based swaps transactions will submit 30 applications requesting stays of the clearing requirement. Assuming an hourly cost of \$354 for an outside attorney,¹³³ the total annual cost in the aggregate for the respondent counterparties to meet these requirements would be \$1,062,000 (100 hours X \$354 per hour for an outside attorney X 30 stay of clearing applications).

¹³² See supra note 129.

¹³³ See supra note 129.

The Commission requests comment on all of the above estimates.

4. Amendment to Conform to Section 916 of the Dodd-Frank Act

The Commission preliminarily estimates that the requirement that an SRO inform the Commission of the date on which it posted a proposed rule change on its website (if the posting did not occur on the same day that the SRO filed the proposal with the Commission) will impose only a minimal burden, if any, on an SRO. The Commission preliminarily believes that SROs currently post their proposed rule changes on their website on the same day on which they file them with the Commission. Further, it is in the interest of an SRO to continue to do so, since prompt website posting triggers the requirement on the Commission to publish notice of the proposal. The new notice requirement would only be applicable in a situation where the SRO is unable to post its proposed rule change on the same day that it files with the Commission, which the Commission expects would be an unlikely occurrence. However, because the deadline applicable to Commission publication is tied to SRO website posting, and the Commission has no means of ascertaining when website posting was made other than receiving that information from the SRO itself, the Commission is proposing this requirement to capture necessary information to allow it to comply with Exchange Act Section 19, as amended by Section 916 of the Dodd-Frank Act.

Based on its experience receiving and reviewing proposed rule changes filed by SROs, the Commission preliminarily estimates that SROs will fail to post proposed rule changes on their websites on the same day as the filing was made with the Commission in 1% of all cases, or 14 times each year. Further, the Commission preliminarily estimates that each SRO will spend approximately one hour preparing and submitting notice to the Commission of the date on which it posted the proposed rule change on its website, resulting in a total annual burden of 14 hours.

Thus, the Commission preliminarily estimates that the total annual reporting burden under Rule 19b-4 and Form 19b-4 will be 131,987 hours in the initial year and 131,187 hours thereafter.¹³⁴ Additionally, the Commission preliminarily estimates that the total annual reporting burden under proposed Rule 3Ca-1 will be 540 hours. The Commission requests comment on all of the above estimates.

E. Retention Period of Recordkeeping Requirements

Clearing agencies will be required to retain records of the collection of information (the manually signed signature page of the Form 19b-4, a file available to interested persons for public inspection and copying, of all Security-Based Swap Submissions, Advance Notices and

¹³⁴ In the initial year, the paperwork burden is calculated as follows: 120 hours (one-time paperwork burden to train newly-registered clearing agency staff members to use EDFS) + 780 hours (one-time paperwork burden for each newly-registered clearing agency to draft and implement policies and procedures relating to using EDFS to submit proposed rule changes, Security-Based Swap Submissions and Advance Notices) + 120 hours (one-time paperwork burden for each currently-registered clearing agency to draft and implement policies and procedures relating to using EDFS to submit Security-Based Swap Submissions and/or Advance Notices) + 90 hours (one-time paperwork burden for each newly-registered clearing agency to create or update their existing websites in order to provide the capability to post proposed rule changes, Security-Based Swap Submissions and Advance Notices online) + 115,303 hours (the total annual reporting burden for all SROs to prepare, review and submit Security-Based Swap Submissions, proposed rule changes and Advance Notices with the Commission) + 15,560 hours (the total annual burden for all SROs to post Security-Based Swap Submissions, Advance Notices, notices of changes to rules, procedures or operations referred to in Advance Notices and proposed rule changes (including updates to the posted SRO rules) on their websites + 14 hours for SROs to notify the Commission of the date on which it posted a proposed rule change on its website = 131,987 hours. After the initial year, the paperwork burden is calculated as follows: 115,303 hours (the total annual reporting burden for all SROs to prepare, review and submit Security-Based Swap Submissions, proposed rule changes and Advance Notices with the Commission) + 15,560 hours (the total annual burden for all SROs to post Security-Based Swap Submissions, Advance Notices, notices of changes to rules, procedures or operations referred to in Advance Notices and on their websites) + 310 hours (the total annual burden of training new staff members and updating the training of existing staff members to use EDFS) + 14 hours for SROs to notify the Commission of the date on which it posted a proposed rule change on its website = 131,187 hours.

proposed rule changes made pursuant to Rule 19b-4) and all correspondence and other communications reduced to writing (including comment letters) to and from such SROs concerning any Security-Based Swap Submissions, Advance Notices and proposed rule changes, for a period of not less than five years, the first two years in an easily accessible place, according to the current recordkeeping requirements set forth in Exchange Act Rule 17a-1.¹³⁵

The Commission preliminarily believes that maintaining the physical signature page, Security-Based Swap Submissions, Advance Notices, proposed rule changes and all related correspondence and other communications would enable interested parties, including the Commission, to access a record of the authority under which a particular Security-Based Swap Submission, Advance Notice or proposed rule change was made. The Commission notes that the retention of the physical signature page is an existing maintenance requirement for SROs.¹³⁶ The Commission further notes that a similar manual signature retention requirement exists for EDGAR filers.¹³⁷

F. Collection of Information is Mandatory

Any collection of information pursuant to Rule 19b-4 and Form 19b-4 to require electronic submission of security-based swaps, Advance Notices and proposed rule changes with the Commission is a mandatory collection of information. Any collection of information pursuant to Rule 19b-4 to require website posting by clearing agencies of their Security-Based Swap Submissions, Advance Notices and proposed rules changes also is a mandatory collection

¹³⁵ SROs may also destroy or otherwise dispose of such records at the end of five years according to Rule 17a-6 of the Act. 17 CFR 240.17a-6.

¹³⁶ Rule 19b-4(j) currently requires SROs to sign Form 19b-4 electronically in connection with filing a proposed rule change and to retain a copy of the signature page in accordance with Rule 17a-1. Under the proposed rules, Rule 19b-4(j) would be modified such that it would apply also to Security-Based Swap Submissions and Advance Notices.

¹³⁷ 17 CFR 232.302(b).

of information. Any collection of information pursuant to the proposed Rule 3Ca-1 in connection with the application for the stay of the clearing requirement is a mandatory collection of information. Any collection of information pursuant to Rule 19b-4 to require SROs to inform the Commission of the date on which it posted a proposed rule change on its website (if such date is not the same day that it filed the proposal with the Commission) also is a mandatory collection of information.

G. Responses to Collection of Information Will Not Be Kept Confidential

The collection of information pursuant to Rule 19b-4, Form 19b-4 and proposed Rule 3Ca-1 would not be kept confidential.¹³⁸ The posting of Security-Based Swap Submissions, Advance Notices and proposed rule changes would be publicly available on the SRO's website.

H. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

- (1) Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;
- (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
- (3) Enhance the quality, utility and clarity of the information to be collected; and

¹³⁸ While there is a general requirement that information be made publicly available, SROs may request confidential treatment of certain information in accordance with the provisions of the Freedom of Information Act. 5 U.S.C. 552.

(4) Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 3208, New Executive Office Building, Washington, DC 20503; and (2) Elizabeth Murphy, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-44-10. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-44-10, and be submitted to the Securities and Exchange Commission, Records Management, Office of Investor Education and Advocacy, Station Place, 100 F Street, NE, Washington, DC 20549-0213.

V. Consideration of Costs and Benefits

A. Processes for Security-Based Swap Submissions for Review and Staying a Clearing Requirement While the Clearing of the Security-Based Swap is Reviewed

Under Exchange Act Section 3C, Congress mandated that the Commission adopt rules: (i) for a clearing agency's submission for review of any security-based swap, or a group, category, type or class of security-based swaps, that the clearing agency seeks to accept for clearing, and the manner of notice the clearing agency must provide to its members of such

submission; and (ii) for the procedure by which the Commission may stay a clearing requirement while the clearing of a security-based swap is reviewed. The proposed rule relating to Security-Based Swap Submissions specifies the content of Security-Based Swap Submissions, how such Security-Based Swap Submissions shall be submitted, and the manner of notice the clearing agency must provide to its members regarding such submissions. The Commission also is proposing a rule to specify the procedure for staying the clearing requirement applicable to a security-based swap, based either on an application of a counterparty to a security-based swap or on the Commission's own initiative, until the Commission completes a review of the terms of the security-based swap and the clearing arrangement. The Commission is sensitive to the costs and benefits that would result from the proposed rules and has identified certain costs and benefits of the proposal, which are discussed more fully below.

1. Processes for Security-Based Swap Submissions for Review

Pursuant to Exchange Act Section 3C, a clearing agency must submit to the Commission each security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing. The Commission is required to review each Security-Based Swap Submission and determine whether the security-based swap, or any group, category, type or class of security-based swaps, described in the submission is required to be cleared. In reviewing a Security-Based Swap Submission, the Commission is required to review whether the Security-Based Swap Submission is consistent with Exchange Act Section 17A, and must take into account the following factors:

- (i) The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data.
- (ii) The availability of a rule framework, capacity, operational expertise and

resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.

- (iii) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract.
- (iv) The effect on competition, including appropriate fees and charges applied to clearing.
- (v) The existence of reasonable legal certainty in the event of the insolvency of the relevant clearing agency or one or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property.

Additionally, Exchange Act Section 3C requires, in general, that the rules of a clearing agency provide for open access, specifically requiring that the rules:

- (a) prescribe that all security-based swaps submitted to the clearing agency with the same terms and conditions are economically equivalent within the clearing agency and may be offset with each other within the clearing agency; and
- (b) provide for non-discriminatory clearing of a security-based swap executed bilaterally or on or through the rules of an unaffiliated national securities exchange or security-based swap execution facility.

Pursuant to Exchange Act Section 3C, the Commission is required to make available to the public any Security-Based Swap Submission and provide at least a 30-day public comment

period. The Commission is required to make its determination not later than 90 days after receiving the Security-Based Swap Submission, unless the submitting clearing agency agrees to an extension.

The proposed rule would require that the clearing agency include in each Security-Based Swap Submission information that will assist the Commission in reviewing the Security-Based Swap Submission for consistency with Section 17A and meeting the statutory requirements set forth above in items (i) – (v). Additionally, the proposed rule would require that the clearing agency specify how the clearing agency's rules for open access (set forth in items (a) and (b) above) are applicable to the security-based swap described in the Security-Based Swap Submission. The proposed rule would specify that a clearing agency submit security-based swaps to the Commission for review by group, category, type or class to the extent reasonable and practicable to do so.

In addition, the Commission is proposing how Security-Based Swap Submissions shall be submitted by clearing agencies. Because the Commission preliminarily believes that there likely will be significant overlap between filings under Exchange Act Section 19(b) and Rule 19b-4 regarding proposed rule changes and Security-Based Swap Submissions, the Commission is proposing that Security-Based Swap Submissions be filed on Form 19b-4. In many cases, a Security-Based Swap Submission also will be a proposed rule change for purposes of Exchange Act Section 19(b).¹³⁹

¹³⁹ As discussed in section II.A.1 of this release, the Commission anticipates that registered clearing agencies, as SROs, often will be required to file a proposed rule change pursuant to Exchange Act Section 19(b) in connection with clearing a security-based swap, or any group, type, category or class of security-based swaps, and, at the same time, will be required to make a related Security-Based Swap Submission for a determination by the Commission of whether such security-based swap (or group, category, type or class of security-based swaps) is required to be cleared. A proposed rule change constitutes a

The proposed rule provides that a clearing agency must provide notice to its members of a Security-Based Swap Submission and any amendments thereto, by posting the submission on its website within two business days. The proposed rule further requires the clearing agency to maintain this information on its website until the Commission makes a determination regarding the Security-Based Swap Submission, the clearing agency withdraws the submission, or the clearing agency is notified that the submission was not properly filed.

a. Benefits

The proposed rule is designed to implement the submission and notice requirements in Exchange Act Section 3C. The Commission anticipates that the proposed rule would further the purposes of Exchange Act Section 3C by facilitating the filing and regulatory review of Security-Based Swap Submissions and reduce costs to filers by utilizing a format that clearing agencies may be familiar with or, as they become registered clearing agencies, that they will be required to use for all proposed rule changes, Form 19b-4. In addition, the proposed rule would further reduce costs to filers by avoiding a duplication of efforts in providing notice to members of the clearing agency, as well as other interested persons, such as counterparties to security-based swaps, through requiring posting of the Security-Based Swap Submission on the clearing agency's website within two business days of filing with the Commission. The Commission

change in a "stated policy, practice, or interpretation" of an SRO rule. The definition of a "stated policy, practice, or interpretation" in Exchange Act Section 19(b) includes, among other things, "any material aspect of the operation of the facilities of the SRO; or any statement made generally available to the membership of, to all participants in, or to persons having or seeking access . . . to facilities of, the self-regulatory organization ("specified persons"), or to a group or category of specified persons, that establishes or changes any standard, limit, or guideline with respect to (1) the rights, obligations, or privileges of specified persons . . . ; or (2) the meaning, administration, or enforcement of an existing rule." 17 CFR 240.19b-4(b). In cases where accepting a security-based swap (or group, category, type or class of security-based swaps) for clearing constitutes a change in a "stated policy, practice, or interpretation" of the clearing agency, the clearing agency also would be required to file a proposed rule change.

anticipates this prompt notice would provide the clearing agency members and other interested persons with the opportunity to comment on the submission with the potential for providing new information about the suitability of the security-based swap for clearing.

The Commission anticipates the proposed rule requiring the clearing agency to provide information the Commission requires to review Security-Based Swap Submissions would reduce the cost of acquiring necessary information. Requiring the clearing agency to provide necessary information would ensure that the information used by the Commission to evaluate the security-based swap for mandatory clearing is correct and complete, reducing the likelihood that further information requests will be required.

Proposed Rule 19b-4(o)(4) requires a clearing agency to submit security-based swaps to the Commission for review by group, category, type or class of security-based swaps, to the extent reasonable and practicable to do so. The Commission preliminarily believes a broad interpretation of what constitutes a group, category, type or class of security-based swaps is likely to provide benefits to clearing agencies and the Commission. Specifically, it would likely lower the costs associated with the Security-Based Swap Submission process since clearing agencies would be burdened with preparing fewer Security-Based Swap Submissions, and the Commission would be required to process and review fewer submissions.

b. Costs

Form 19b-4 is currently used by registered clearing agencies to file notice of proposed rule changes under Exchange Act Section 19(b) and any clearing agency that becomes registered will be required to use Form 19b-4 for all proposed rule changes. Accordingly, clearing agencies would be familiar with the electronic filing process in place for Form 19b-4 and their staffs would not be required to learn a new filing system. In addition, clearing agencies would be able

to submit a change that is both a proposed rule change under Exchange Act Section 19(b) and a Security-Based Swap Submission in the same filing. Although there are additional information requirements for a Security-Based Swap Submission, clearing agencies would be able to provide the required information as part of the Form 19b-4 submission.

More importantly, the Commission preliminarily believes much of the information the clearing agency provides in a Security-based Swap Submission would be the same as information the clearing agency collected and analyzed in making its business decision to plan to accept the security-based swap, or any group, category, type, or class of security-based swaps, for clearing. The Commission preliminarily believes that the clearing agency may incur costs in presenting this information in a clear and coherent manner in the format as required under the proposed rule.

As previously discussed in the PRA analysis in Section IV, the proposed amendments to Rule 19b-4 and Form 19b-4 will require a clearing agency to submit for a Commission determination, any security-based swap, or any group, category, type or class of security-based swaps that the clearing agency plans to accept for clearing. The Commission preliminarily estimates that the total annual reporting burden for clearing agencies to internally prepare, review and submit Security-Based Swap Submissions electronically with the Commission under the proposed amendments to Rule 19b-4 and Form 19b-4 will be 24,000 hours; this figure includes 7,200 hours of outside legal work. Assuming an hourly cost of \$320 for an in-house compliance attorney,¹⁴⁰ and an hourly cost of \$354 for an outside attorney,¹⁴¹ these requirements would result

¹⁴⁰ The hourly rate for a compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

¹⁴¹ See supra note 129.

in a total annual cost of \$7,924,800 in the aggregate for the six respondent clearing agencies (16,800 hours X \$320 per hour for a compliance attorney) + (7,200 hours X \$354 per hour for an outside attorney).

The Commission preliminarily estimates that there would be a one-time burden of 780 hours for all newly-registered clearing agencies to draft and implement internal policies and procedures related to using EFFS to submit Security-Based Swap Submissions, Advance Notices and proposed rule changes with the Commission. Assuming an hourly cost of \$320 for an in-house compliance attorney,¹⁴² these requirements would result in a total one-time cost of \$249,600 in the aggregate for the six respondent clearing agencies (780 hours X \$320 per hour for an in-house compliance attorney).

The Commission also preliminarily estimates that there would be a one-time burden of 120 hours for all currently-registered clearing agencies to draft and implement modifications to existing internal policies and procedures for using EFFS in order to update them for the submission of Security-Based Swap Submissions and/or Advance Notices with the Commission. Assuming an hourly cost of \$320 for an in-house compliance attorney,¹⁴³ these requirements would result in a one-time cost of \$38,400 in the aggregate for the four respondent clearing agencies (120 hours X \$320 per hour for an in-house compliance attorney).

The Commission preliminarily believes that newly-registered clearing agencies could incur some one-time costs associated with training their personnel about the procedures for submitting Security-Based Swap Submissions and/or Advance Notices in electronic format through EFFS. The Commission preliminarily estimates that six newly-registered clearing agencies would incur a one-time upfront burden of 120 hours to train clearing agency staff

¹⁴² See supra note 140.

¹⁴³ See supra note 140.

members to use EFFS to submit Security-Based Swap Submissions, Advance Notices and/or proposed rule changes electronically. The Commission preliminarily estimates that after the initial year, existing SROs (including currently-registered clearing agencies) would spend approximately 290 hours annually training new staff members and updating the training of existing staff members to use EFFS. Assuming an hourly cost of \$259 for a senior systems analyst,¹⁴⁴ these requirements would result in an overall estimated initial annual cost of \$31,080 in the aggregate for the six newly-registered clearing agencies (120 hours x \$259 per hour for a senior systems analyst) and an annual cost after the initial year of \$75,110 thereafter in the aggregate for all SROs (290 hours x \$259 per hour for a senior systems analyst).

Pursuant to existing Rule 19b-4(l), each SRO is required to post on its website a copy of any proposed rule change the SRO filed with the Commission and any amendments thereto. The proposed rule to implement the submission and notice requirements in Exchange Act Section 3C includes a similar posting requirement for Security-Based Swap Submissions. The Commission preliminarily estimates that the total annual reporting burden for clearing agencies to post Security-Based Swap Submissions on their websites would be 480 hours. Assuming an hourly cost of \$225 for a Webmaster,¹⁴⁵ these requirements would result in a total estimated annual cost of \$108,000 in the aggregate for the six respondent clearing agencies (480 hours x \$225 per hour for a Webmaster).

¹⁴⁴ The hourly rate for a senior systems analyst is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

¹⁴⁵ The hourly rate for a Webmaster is from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

Some Security-Based Swap Submissions would be required to be filed only as Security-Based Swap Submissions under Exchange Act Section 3C and not as proposed rule changes under Exchange Act Section 19(b), for example where a clearing agency's rules already permit it to clear the security-based swap in question. As a result, clearing agencies would incur additional costs by filing a greater number of forms than they do currently under Exchange Act Section 19(b).

2. Staying a Clearing Requirement While the Clearing of the Security-Based Swap is Reviewed

Under Exchange Act Section 3C, after making a determination that a security-based swap (or group, category, type or class of security-based swaps) is required to be cleared, the Commission, on application of a counterparty to a security-based swap or on the Commission's own initiative, may stay the clearing requirement until the Commission completes a review of the terms of the security-based swap and the clearing arrangement.¹⁴⁶ In connection with a stay of the clearing requirement, the Commission is required to adopt rules for reviewing a clearing agency's clearing of a security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency has accepted for clearing.

Under proposed Rule 3Ca-1, a counterparty to a security-based swap subject to the clearing requirement who applies for a stay of the clearing requirement would be required to submit a written statement to the Commission that includes a request for a stay of the clearing requirement; the identity of the counterparties to the security-based swap and a contact at the counterparty requesting the stay; the identity of the clearing agency clearing the security-based swap; the terms of the security-based swap subject to the clearing requirement and a description of the clearing arrangement; and the reasons why a stay should be granted and why the security-

¹⁴⁶

See Pub. L. No. 111-203, section 763(a) (adding Exchange Act Section 3C(c)(1)).

based swap should not be subject to a clearing requirement, specifically addressing the same factors a clearing agency must address in its Security-Based-Swap Submission pursuant to proposed Rule 19b-4(o).¹⁴⁷ The proposed rule also provides that any clearing agency that has accepted for clearing a security-based swap that is subject to the stay shall provide information requested by the Commission necessary to assess any of the factors it determines to be appropriate in the course of its review.

a. Benefits

The Commission preliminarily believes that the proposed rule provides benefits in creating an efficient mechanism for collecting information to be used in the Commission's determination to grant the requested stay and subsequent review of the clearing requirement. Specifically, the counterparty will provide information specifically within its possession – reasons why the stay should be granted and why the security-based swap should not be subject to a clearing requirement. Additionally, any information requested from the clearing agency likely will include information unique to the clearing agency and will facilitate the Commission's review of the clearing requirement subject to the stay.

b. Costs

The proposed rule requires a counterparty requesting a stay provide basic identifying information and information supporting its request for a stay and its position that the security-based swap should not be subject to a clearing requirement. With respect to the proposed rule's requirement that a clearing agency shall provide information requested by the Commission necessary to assess any of the factors it determines to be appropriate in the course of its review, the Commission preliminarily believes this information will likely be information the clearing

¹⁴⁷ Proposed Rule 3Ca-1(b).

agency has in its possession, including updates of information provided in the related Security-Based Swap Submission. The Commission preliminarily estimates that each clearing agency would receive five applications per annum to stay the clearing requirement. The Commission also preliminarily estimates that the total annual reporting burden for the six respondent clearing agencies to compile and provide the information requested by the Commission in connection with the review of the stay of clearing applications would be 750 hours; this figure includes 210 hours of outside legal work. Assuming an hourly cost of \$320 for an in-house compliance attorney,¹⁴⁸ and an hourly cost of \$354 for an outside attorney,¹⁴⁹ these requirements would result in a total estimated annual cost of \$247,140 in the aggregate for the six respondent clearing agencies (540 hours X \$320 per hour for a compliance attorney) + (210 hours X \$354 per hour for an attorney).

Finally, the Commission preliminarily estimates that 100 hours would be required by a counterparty to a security-based swap to prepare and submit an application requesting a stay of the clearing requirement. The Commission also preliminarily estimates that counterparties to security-based swaps transactions would submit 30 applications requesting stays of the clearing requirement. Assuming an hourly cost of \$354 for an outside attorney, the total annual cost in the aggregate for the respondent counterparties to meet these requirements would be \$1,062,000 (100 hours X \$354 per hour for an outside attorney X 30 stay of clearing applications).

The Commission requests that commenters provide views and supporting information regarding the costs and benefits associated with the proposed rules relating to Security-Based Swap submissions and stay of the clearing requirement and related review. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits not already

¹⁴⁸ See supra note 140.

¹⁴⁹ See supra note 129.

identified. The Commission also requests comment on whether other provisions of the Dodd-Frank Act for which Commission rulemaking is required are likely to have an effect on the costs and benefits of the proposed rules.

B. Advance Notices Required Under Section 806(e)

Congress has mandated that the Commission adopt rules to define when proposed changes to a designated clearing agency's rules, procedures or operations could materially affect the nature or level of risks presented by the clearing agency. The proposed rule would determine when notice of such changes must be filed with the Commission and would prescribe how such notices shall be filed. The Commission is sensitive to the costs and benefits that would result from the proposed rule and has identified certain costs and benefits of the proposal, which are discussed more fully below.

1. Benefits

Pursuant to Section 806(e), any registered clearing agency designated as a systemically important financial market utility and for which the Commission is the Supervisory Agency will be required to file with the Commission advance notice of proposed changes to its rules, procedures or operations that could materially affect the nature or level of risks presented by the clearing agency. The proposed rule would reduce regulatory uncertainty pertaining to the filing requirement in Section 806(e) by defining the term "materially affect the nature or level of risks presented" with respect to a change to rules, procedures, or operations. The term would be defined as a matter as to which there is a reasonable possibility that the change could affect the performance of essential clearing and settlement functions or the overall nature or level of risk presented by the designated clearing agency. Such changes would include, but are not limited to, changes that materially affect participant and product eligibility, risk management, daily or

intraday settlement procedures, default procedures, system safeguards, governance or financial resources of the designated financial market utility. However, such changes generally would exclude changes to an existing procedure, control, or service that do not modify the rights or obligations of the designated financial market utility or persons using its payment, clearing, or settlement services and that do not adversely affect the safeguarding of securities, collateral, or funds in the custody or control of the designated financial market utility or for which it is responsible, or changes concerned solely with the administration of the designated financial market utility or related to the routine, daily administration, direction, and control of employees.¹⁵⁰

The Commission also is proposing to facilitate the compliance with the filing requirement in Section 806(e) by prescribing how Advance Notices of proposed changes to rules, procedures or operations shall be filed by designated clearing agencies. Because the requirement to file notice under Section 806(e) is similar to the filing requirement for proposed rule changes under Exchange Act Section 19(b), the Commission is proposing that Advance Notices be filed on Form 19b-4. In many cases, it is likely that a proposed change for purposes of Section 806(c) will also be a proposed rule change for purposes of Exchange Act Section 19(b), reducing costs associated with multiple filings.

The proposed rule is designed to implement the filing requirement in Section 806(e) and to establish criteria for designated clearing agencies regarding when notices shall be filed and the method for filing such notices. The Commission preliminarily believes that the proposed rule would lower the costs of filing and regulatory review of proposed changes that could materially affect the nature or level of risks presented by systemically important clearing institutions. In

¹⁵⁰ Proposed Rule 19b-4(n)(2)(iii).

addition, the proposed rule is intended to provide the public with the opportunity to comment on such proposals by designated clearing agencies. The Commission preliminarily believes the proposed rule would help to assure that the additional information required under Section 806(e) is provided through amendments to the existing Form 19b-4. However, a filing submitted under both Section 806(e) and Exchange Act Section 19(b) would be required to satisfy the standards under both sections in order to become effective.

2. Costs

The Commission preliminarily believes the costs associated with the proposed rule should not be significant for designated clearing agencies. Form 19b-4 is currently used by registered clearing agencies to file notice of proposed rule changes under Exchange Act Section 19(b). Accordingly, designated clearing agencies would be familiar with the filing process in Form 19b-4, and staffs would not be required to learn a new filing system. In addition, clearing agencies would be able to submit a change that is both a proposed rule change under Exchange Act Section 19(b) and a proposed change under Section 806(e) in the same filing. Although there are additional information requirements for a Section 806(e) filing, designated clearing agencies would be able to provide the required information as part of the Form 19b-4 submission.

Some proposed changes may be required to be filed only as Advance Notices under Section 806(e) and not as proposed rule changes under Exchange Act Section 19(b). As a result, the Commission preliminarily believes clearing agencies will incur additional costs by filing a greater number of forms than they do currently under Exchange Act Section 19(b). Based on informal comments from clearing agencies, the Commission preliminarily estimates that each designated clearing agency will file 35 Advance Notices with the Commission annually at a cost

of \$3,200 per submission (10 hours X compliance attorney at \$320 per hour) or \$1,120,000 (\$3200 X 35 Advance Notices X 10 respondent clearing agencies) in the aggregate for the ten respondent clearing agencies.

Proposed Rule 19b-4(n)(3) requires designated clearing agencies to post copies of Advance Notices filed with the Commission on their websites. The Commission estimates that the total annual reporting burden for designated clearing agencies to post Advance Notices on their websites would be 1400 hours. Assuming an hourly cost of \$225 for a Webmaster,¹⁵¹ these requirements would result in an estimated annual cost of \$315,000 in the aggregate for the ten respondent clearing agencies (1400 hours x \$225 per hour for a Webmaster).

Proposed Rule 19b-4(n)(4) requires a designated clearing agency to post notice on its website of any change to its rules, procedures or operations referred to in an Advance Notice once it has been permitted to take effect. The Commission estimates that the total annual reporting burden for designated clearing agencies to post notice on their websites of any change to their rules, procedures or operations referred to in Advance Notices once they take effect would be 1400 hours. Assuming an hourly cost of \$225 for a Webmaster,¹⁵² these requirements would result in an estimated annual cost of \$315,000 in the aggregate for the ten respondent clearing agencies (1400 hours x \$225 per hour for a Webmaster).

C. Amendment to Conform to Section 916 of the Dodd-Frank Act

The Commission preliminarily estimates that the requirement that an SRO inform the Commission of the date on which it posted a proposed rule change on its website (if the posting did not occur on the same day that the SRO filed the proposal with the Commission) will impose only a minimal burden, if any, on an SRO. As discussed in Section IV.B.4., the Commission

¹⁵¹ See supra note 145.

¹⁵² See supra note 145

preliminarily believes that SROs currently post their proposed rule changes on their website on the same day on which they file them with the Commission. It would be an unlikely occurrence for an SRO to fail to post its proposed rule change on the same day that it files with the Commission, since prompt website posting triggers the requirement on the Commission to publish notice of the proposed rule change.

The Commission preliminarily estimates that SROs will fail to post proposed rule changes on their websites on the same day as the filing was made with the Commission in 1% of all cases, or 14 times each year, and that each SRO will spend approximately one hour preparing and submitting notice to the Commission of the date on which it posted the proposed rule change on its website, resulting in a total annual burden of 14 hours. Assuming an hourly cost of \$320 for an in-house compliance attorney,¹⁵³ this requirement would result in a total estimated annual cost of \$4,480 in the aggregate for all SROs (14 hours X \$320 per hour for a compliance attorney) in the aggregate for all SROs.

The Commission requests that commenters provide views and supporting information regarding the costs and benefits associated with the proposals. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits not already identified. The Commission also requests comment on whether other provisions of the Dodd-Frank Act for which Commission rulemaking is required are likely to have an effect on the costs and benefits of the proposed rules.

¹⁵³ See supra note 140.

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

Exchange Act Section 23(a)¹⁵⁴ 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 purposes of the Exchange Act. Section 2(b) of the Securities Act of 1933¹⁵⁵ and Exchange Act Section 3(f)¹⁵⁶ 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 amendments to Rule 19b-4 and Form 19b-4 to reflect the use of these forms for filing Security-Based Swap Submissions and Advance Notices, and proposed Rule 3Ca-1 to facilitate the process for staying the clearing requirement applicable to a security-based swap until the Commission completes a review of the terms of the security-based swap and the clearing arrangement.

A. Proposed Amendments to Rule 19b-4 and Form 19b-4

The proposed amendments to Rule 19b-4 and Form 19b-4 are designed to facilitate the statutorily mandated processes for submitting Security-Based Swap Submissions and Advance Notices to the Commission, and to make each process efficient by utilizing the existing process and EFTS infrastructure for proposed rule changes. Using an existing process to accomplish an additional legislative requirement would conserve both clearing agency and

¹⁵⁴ 15 U.S.C. 78w(a).

¹⁵⁵ 15 U.S.C. 77b(b).

¹⁵⁶ 15 U.S.C. 78c(f).

Commission resources. If amended, Form 19b-4 would enable clearing agencies to submit Security-Based Swap Submissions, and any amendments thereto, and any Advance Notices electronically to the Commission. Submitting Security-Based Swap Submissions and Advance Notices in this manner would impose fewer costs on clearing agencies and the Commission when compared to requiring clearing agencies to use new infrastructure or business processes to make Security-Based Swap Submissions or Advance Notices.

The proposed requirement that the clearing agency aggregate security-based swaps into groups, categories, types or classes to the extent reasonable and practicable to do so, in each Security-Based Swap Submission likely would appropriately streamline the submission process for Commission staff and clearing agencies (i.e., such aggregations would decrease the number of Security-Based Swap Submissions each clearing agency would prepare and submit, and accordingly, the Commission would review). This requirement is intended to make the Security-Based Swap Submission process more efficient.

The proposed amendments to Rule 19b-4 and Form 19b-4 also are intended to improve the transparency of security-based swaps transactions. The proposed amendments to Rule 19b-4 would require a clearing agency to post on its website any Security-Based Swap Submissions and any amendments thereto, if submitted to the Commission within two business days of submission to the Commission, to fulfill the statutory requirement that clearing agencies provide notice to their members of such submissions. The Commission preliminarily believes that public website posting of Security-Based Swap Submissions may promote competition among security-based swap clearing agencies because it will make it easier (and more timely) for clearing agencies to be able to determine the security-based swaps their competitors intend to clear and analyze whether they too wish to clear such

security-based swap.

Similarly, the proposed amendments to Rule 19b-4 would require a designated clearing agency to post on its website proposed changes to its rules, procedures, or operations that trigger the Section 806(e) advance notice requirement and a description of the subjects and issues involved within two business days of the submission of an Advance Notice to the Commission. A designated clearing agency also will be required to post a notice on its website of the effectiveness of any change to its rules, procedures, or operations referred to in an Advance Notice within two business days of the effective date, as monitored by the designated clearing agency and determined in accordance with Section 806(e). The Commission preliminarily believes that public website posting of this information may promote competition and transparency among clearing agencies by giving interested persons an opportunity to submit written data, views, and arguments concerning proposed changes that could materially affect the nature or level of risks presented by a designated clearing agency.

The proposed amendments to Rule 19b-4 and Form 19b-4 with respect to the information that clearing agencies are required to provide are intended to facilitate the Commission's review process for Security-Based Swap Submissions and Advance Notices and to make the process efficient by requiring information the clearing agency is uniquely qualified to provide and likely may already have available.

The Commission preliminarily believes none of the proposed amendments to Rule 19b-4 and Form 19b-4 would have an adverse impact on competition or capital formation, but instead should increase confidence in the robustness of the security-based swap market, encouraging participation and allowing better risk management practices. To the

extent that security-based swaps mitigate the risk associated with capital raising activities, increased investor confidence and use of security-based swaps should foster more efficient capital formation and thereby benefit issuers and investors.

Proposed Rule 3Ca-1 is designed to facilitate the statutorily mandated process for staying the clearing requirement applicable to a security-based swap until the Commission completes a review of the terms of the security-based swap and the clearing arrangement. The proposed rule is designed to create an efficient mechanism for collecting information to be used in the Commission's determination to grant the requested stay and subsequent review of the clearing requirement.

The Commission has not identified any effects on competition or capital formation of the process specified in proposed Rule 3Ca-1. The Commission preliminarily believes proposed Rule 3Ca-1 would not have an adverse impact on competition or capital formation.

The Commission generally requests comment on the competitive or anticompetitive effects of the proposed amendments to Rule 19b-4 and Form 19b-4 on any market participants if adopted as proposed. The Commission also requests comment on what impact the amendments, if adopted, would have on efficiency and capital formation. The Commission requests that commenters provide analysis and empirical data, if available, to support their views regarding any such effects. The Commission notes that such effects may be difficult to quantify. The Commission also requests comment regarding the competitive effects of pursuing alternative regulatory approaches that are consistent with Exchange Act Section 3C, as added by Section 763(a) of the Dodd-Frank Act. In addition, the Commission requests comment on how the other provisions of the Dodd-Frank Act for which Commission rulemaking is required, will interact with and influence the competitive effects of the proposed amendments to Rule 19b-4

and Form 19b-4.

VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),¹⁵⁷ the Commission must advise the OMB as to 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: (i) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (ii) a major increase in costs or prices for consumers or individual industries; or (iii) significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for sixty days pending Congressional review.

The Commission requests comment on the potential impact of the amendments to Rule 19b-4 and Form 19b-4 and new Rules 3Ca-1 and 3Ca-2 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.

VIII. Regulatory Flexibility Certification

The Regulatory Flexibility Act ("RFA")¹⁵⁸ requires the Commission, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)¹⁵⁹ of the Administrative Procedure Act,¹⁶⁰ as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such

¹⁵⁷ 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).

¹⁵⁸ 5 U.S.C. 601 et seq.

¹⁵⁹ 5 U.S.C. 603(a).

¹⁶⁰ 5 U.S.C. 551 et seq.

rulemaking on “small entities.”¹⁶¹ Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule which, if adopted, would not have a significant economic impact on a substantial number of small entities.¹⁶²

A. Clearing Agencies

The amendments to Rule 19b-4 would apply to (i) all clearing agencies that clear security-based swaps and (ii) all designated clearing agencies. Proposed Rules 3Ca-1 and 3Ca-2 would apply to all security-based swap clearing agencies. Four entities are currently exempt from registration as a clearing agency under Exchange Act Section 17A to provide central clearing services for CDS, a class of security-based swaps.¹⁶³ The Commission preliminarily believes, based on its understanding of the market, that likely no more than six security-based swap clearing agencies could be subject to the requirements of the proposed amendments to Rule 19b-4 and proposed Rules 3Ca-1 and 3Ca-2. In addition, the Commission preliminarily believes that approximately ten registered clearing agencies could be designated by the Council as systemically important (and for which the Commission will be the Supervisory Agency), which includes the four existing securities clearing agencies and the six estimated clearing agencies that may clear security-based swaps.

For the purposes of Commission rulemaking in connection with the RFA, a small entity includes, when used with reference to a clearing agency, a clearing agency that: (i) compared, cleared and settled less than \$500 million in securities transactions during the preceding fiscal

¹⁶¹ Section 601(b) of the RFA permits agencies to formulate their own definitions of “small entities.” The Commission has adopted definitions for the term “small entity” for the purposes of rulemaking in accordance with the RFA. These definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10.

¹⁶² See 5 U.S.C. 605(b).

¹⁶³ See CDS Clearing Exemption Orders, *supra* note 122.

year; (ii) had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter); and (iii) is not affiliated with any person (other than a natural person) that is not a small business or small organization.¹⁶⁴ Under the standards adopted by the Small Business Administration, small entities in the finance industry include the following: (i) for entities engaged in investment banking, securities dealing and securities brokerage activities, entities with \$6.5 million or less in annual receipts; (ii) for entities engaged in trust, fiduciary and custody activities, entities with \$6.5 million or less in annual receipts; and (iii) funds, trusts and other financial vehicles with \$6.5 million or less in annual receipts.¹⁶⁵

Based on the Commission's existing information about the entities likely to register to clear security-based swaps, the Commission preliminarily believes that such entities will not be small entities, but rather part of large business entities that exceed the thresholds defining "small entities" set out above. Additionally, while other clearing agencies may become eligible to operate as central counterparties for security-based swaps, the Commission preliminarily does not believe that any such entities would be "small entities" as defined in Exchange Act Rule 0-10.¹⁶⁶ Furthermore, we believe it is unlikely that clearing agencies acting as central counterparties for security-based swaps would have annual receipts of less than \$6.5 million. Accordingly, the Commission believes that any clearing agencies clearing security-based swaps by acting as central counterparties for such transactions will exceed the thresholds for "small entities" set forth in Exchange Act Rule 0-12.

¹⁶⁴ 17 CFR 240.0-10(d).

¹⁶⁵ 13 CFR 121.201, Sector 52.

¹⁶⁶ See 17 CFR 240.0-10(d).

B. Security-Based Swap Counterparties

Proposed Rule 3Ca-1 would apply to any counterparty to a security-based swap subject to the clearing requirement that applies for a stay of the clearing requirement. For the purposes of Commission rulemaking and as applicable to this proposed Rule 3Ca-1, a small entity includes:

(i) when used with reference to a clearing agency, a clearing agency that (a) compared, cleared and settled less than \$500 million in securities transactions during the preceding fiscal year, (b) had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter) and (c) is not affiliated with any person (other than a natural person) that is not a small business or small organization;¹⁶⁷ (ii) when used as reference to an “issuer” or a “person,” other than an investment company, an “issuer” or a “person” that, on the last day of its most recent fiscal year, had total assets of \$5 million or less;¹⁶⁸ or (iii) when used as reference to broker-dealer, a broker-dealer (a) 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, or, if not required to file such statements, a broker-dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last business day of the preceding fiscal year (or in that time that it has been in business, if shorter) and (b) is not affiliated with any person (other than a natural person) that is not a small business or small organization.¹⁶⁹ Under the standards adopted by the Small Business Administration, small entities in the finance industry include the following: (i) for entities engaged in investment banking, securities dealing and securities brokerage activities, entities with \$6.5 million or less in

¹⁶⁷ 17 CFR 240.0-10(d).

¹⁶⁸ 17 CFR 240.0-10(a).

¹⁶⁹ 17 CFR 240.0-10(c).

annual receipts; (ii) for entities engaged in trust, fiduciary and custody activities, entities with \$6.5 million or less in annual receipts; and (iii) funds, trusts and other financial vehicles with \$6.5 million or less in annual receipts.¹⁷⁰

With regard to security-based swap transactions that have counterparties that may meet the definition of a "small entity" under Exchange Act Rule 0-10 and, under proposed Rule 3Ca-1, apply to the Commission for a stay of the clearing requirement, the Commission believes that it is unlikely that the stay application process of proposed Rule 3Ca-1 would have a significant economic impact upon such an entity. Given that the proposed stay application process entails the submission of a written statement to the Commission setting forth information about the security-based swap transaction for which the stay is sought, the Commission believes the impact of the application process on a counterparty would be minimal. Furthermore, even if the stay application process were to have a significant economic impact upon such non-clearing agency counterparty, the Commission believes that the number of entities so impacted would be no more than 30, based on the informal discussions between the staff and the clearing agencies, in terms of number of stay requests and number of small entities making such requests. Accordingly, in respect of non-clearing agency counterparties to security-based swap transactions, the Commission preliminarily believes that proposed Rule 3Ca-1 would not have a significant economic impact on a substantial number of small entities.

C. Certification

For the reasons stated above, the Commission certifies that the proposed amendments to Rule 19b-4 and proposed Rules 3Ca-1 and 3Ca-2 would not have a significant economic impact on a substantial number of small entities for the purposes of the RFA. The Commission

¹⁷⁰

13 CFR 121.201, Sector 52.

encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, including clearing agencies eligible to clear security-based swaps, designated clearing agencies and counterparties to security-based swap transactions, and provide empirical data to support the extent of the impact.

IX. Statutory Authority

Pursuant to the Exchange Act, and particularly Sections 3C, 17A and 19(b) thereof, 15 U.S.C. §§ 78c-3, 78q-1 and 78s(b) and Section 806(e) of the Dodd-Frank Act, 12 U.S.C. § 5465(e), the Commission proposes to amend Rule 19b-4 and Form 19b-4 and add new Rules 3Ca-1 and 3Ca-2, as set forth below.

List of Subjects in 17 CFR Parts 240 and 249

Brokers, Reporting and recordkeeping requirements, Securities.

Text of the Proposed Rule

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 general authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 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.; 18 U.S.C. 1350 and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

Section 240.19b-4 is also issued under 12 U.S.C. 5465(e).

2. §§240.3Ca-1 and 240.3Ca-2 are added following §240.3b-19 to read as follows:

§240.3Ca-1 Stay of clearing requirement and review by the Commission

(a) After making a determination pursuant to a clearing agency's security-based swap submission that a security-based swap, or any group, category, type or class of security-based swaps, is required to be cleared, the Commission, on application of a counterparty to a security-based swap or on the Commission's own initiative, may stay the clearing requirement until the Commission completes a review of the terms of the security-based swap (or group, category, type, or class of security-based swaps) and the clearing of the security-based swap (or group, category, type, or class of security-based swaps) by the clearing agency that has accepted it for clearing.

(b) A counterparty to a security-based swap applying for a stay of the clearing requirement for a security-based swap (or group, category, type, or class of security-based swaps) shall submit a written statement to the Commission that includes:

- (1) A request for a stay of the clearing requirement;
- (2) The identity of the counterparties to the security-based swap and a contact at the counterparty requesting the stay;
- (3) The identity of the clearing agency clearing the security-based swap;
- (4) The terms of the security-based swap subject to the clearing requirement and a description of the clearing arrangement; and
- (5) Reasons why such stay should be granted and why the security-based swap should not be subject to a clearing requirement, specifically addressing the same factors a clearing agency must address in its security-based-swap submission pursuant to §240.19b-4(o)(3) of this chapter.

(c) A stay of the clearing requirement may be granted with respect to a security-based swap, or the group, category, type, or class of security-based swaps, as determined by the

Commission.

(d) The Commission's review shall include, but need not be limited to, a quantitative and qualitative assessment of the factors specified in §240.19b-4(o)(3) of this chapter. Any clearing agency that has accepted for clearing a security-based swap, or any group, category, type or class of security-based swaps, that is subject to the stay of the clearing requirement shall provide information requested by the Commission necessary to assess any of the factors it determines to be appropriate in the course of its review.

(e) Upon completion of its review, the Commission may:

(1) Determine, subject to any terms and conditions that the Commission determines to be appropriate in the public interest, that the security-based swap, or group, category, type, or class of security-based swaps must be cleared; or

(2) Determine that the clearing requirement will not apply to the security-based swap, or group, category, type, or class of security-based swaps, but clearing may continue on a non-mandatory basis.

§240.3Ca-2 Submission of security-based swaps for clearing

Pursuant to section 3C(a)(1) of the Act (15 U.S.C. 78c-3(a)(1)), it shall be unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency that is registered under this Act or a clearing agency that is exempt from registration under the Act if the security-based swap is required to be cleared. The phrase submits such security-based swap for clearing to a clearing agency in the clearing requirement of Section 3C(a)(1) of the Act shall mean that the security-based swap will be submitted for central clearing to a clearing agency that functions as a central counterparty.

* * * * *

3. § 240.19b-4 is amended by:

- a. Removing paragraph (b);
- b. Redesignating paragraph (a) as paragraph (b);
- c. Adding new paragraph (a);
- d. In paragraph (i), by revising the phrase "of all filings made pursuant to this section" to read "of all filings, notices and submissions made pursuant to this section 240.19b-4";
- e. In paragraph (i), adding the words "notice or submission," after the phrase "any such filing,";
- f. In paragraph (i), removing the phrase "the filing of the proposed rule change." and adding in its place "the filing, notice or submission of the proposed rule change, advance notice or security-based swap submission, as applicable.";
- g. In paragraph (j), first sentence; removing the words "with respect to proposed rule changes";
- h. In paragraph (k) adding "240.19b-4" after the words "this section";
- i. Revising paragraph (l), introductory paragraph;
- j. In paragraph (l)(4); replacing the phrase "Web site" to read "website";
- k. In paragraph (m)(1), replacing the phrase "Web site" to read "website";
- l. In paragraph (m)(2), replacing the phrase "Web site" to read "website";
- m. In paragraph (m)(3), replacing the phrase "Web site" to read "website";
- n. Adding paragraph (n); and
- o. Adding paragraph (o).

3. The additions and revisions read as follows:

§ 240.19b-4 Filings with respect to proposed rule changes by self-regulatory organizations.

* * * * *

(a) Definitions. As used in this §240.19b-4:

(1) The term advance notice means a notice required to be made by a designated clearing agency pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act (12 U.S.C. 5465);

(2) The term designated clearing agency means a clearing agency that is registered with the Commission, and for which the Commission is the Supervisory Agency (as determined in accordance with section 803(8) of the Payment, Clearing and Settlement Supervision Act), that has been designated by the Financial Stability Oversight Council pursuant to section 804 of the Payment, Clearing and Settlement Supervision Act (12 U.S.C. 5463) as systemically important or likely to become systemically important;

(3) The term Payment, Clearing and Settlement Supervision Act means Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (124 Stat. 1802, 1803, 1807, 1809, 1811, 1814, 1816, 1818, 1820, 1821; 12 U.S.C. 5461 et seq);

(4) The term proposed rule change has the meaning set forth in Section 19(b)(1) of the Act (15 U.S.C. 78s(b)(1));

(5) The term security-based swap submission means a submission required to be made by a clearing agency pursuant to section 3C(b)(2) of the Act (15 U.S.C. 78c-3(b)(2)) for each security-based swap, or any group, category, type or class of security-based swaps, that such clearing agency plans to accept for clearing;

(6) The term stated policy, practice, or interpretation means:

(i) Any material aspect of the operation of the facilities of the self-regulatory organization; or

(ii) Any statement made generally available to the membership of, to all participants in, or to persons having or seeking access (including, in the case of national securities exchanges or registered securities associations, through a member) to facilities of, the self-regulatory organization ("specified persons"), or to a group or category of specified persons, that establishes or changes any standard, limit, or guideline with respect to:

(A) The rights, obligations, or privileges of specified persons or, in the case of national securities exchanges or registered securities associations, persons associated with specified persons; or

(B) The meaning, administration, or enforcement of an existing rule.

* * * * *

(l) The self-regulatory organization shall post each proposed rule change, and any amendments thereto, on its website within two business days after the filing of the proposed rule change, and any amendments thereto, with the Commission. If a self-regulatory organization does not post a proposed rule change on its website on the same day that it filed the proposal with the Commission, then the self-regulatory organization shall inform the Commission of the date on which it posted such proposal on its website. Such proposed rule change and amendments shall be maintained on the self-regulatory organization's website until:

* * * * *

(n)(1) A designated clearing agency shall provide an advance notice to the Commission of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by such designated clearing agency. Such advance notice shall be submitted to the Commission electronically on Form 19b-4 (referenced in 17 CFR 249.819). The Commission shall, upon the filing of any advance notice, provide for prompt publication thereof.

(2)(i) For purposes of this paragraph (n), the phrase materially affect the nature or level of risks presented, when used to qualify determinations on a change to rules, procedures, or operations at the designated clearing agency, means matters as to which there is a reasonable possibility that the change could affect the performance of essential clearing and settlement functions or the overall nature or level of risk presented by the designated clearing agency.

(ii) Changes to rules, procedures or operations that could materially affect the nature or level or risks presented by a designated clearing agency utility may include, but are not limited to, changes that materially affect participant and product eligibility, risk management, daily or intraday settlement procedures, default procedures, system safeguards, governance or financial resources of the designated clearing agency.

(iii) Changes to rules, procedures or operations that may not materially affect the nature or level or risks presented by a designated clearing agency include, but are not limited to:

(A) Changes to an existing procedure, control, or service that do not modify the rights or obligations of the designated financial market utility or persons using its payment, clearing, or settlement services and that do not adversely affect the safeguarding of securities, collateral, or funds in the custody or control of the designated financial market utility or for which it is responsible; or

(B) Changes concerned solely with the administration of the designated financial market utility or related to the routine, daily administration, direction, and control of employees;

(3) The designated clearing agency shall post the advance notice, and any amendments thereto, on its website within two business days after the filing of the advance notice, and any amendments, thereto the Commission. Such advance notice and amendments shall be maintained on the designated clearing agency's website until the earlier of:

(i) The date the designated clearing agency withdraws the advance notice or is notified that the advance notice is not properly filed; or

(ii) The date the designated clearing agency posts a notice of effectiveness as required by paragraph (n)(4)(ii) of this section.

(4)(i) The designated clearing agency shall post a notice on its website within two business days of the date that any change to its rules, procedures, or operations referred to in an advance notice has been permitted to take effect as such date is determined in accordance with Section 806(e) of the Payment, Clearing and Settlement Supervision Act (12 U.S.C. 5465)

(ii) The designated clearing agency shall post a notice on its website within two business days of the effectiveness of any change to its rules, procedures, or operations referred to in an advance notice.

(5) A designated clearing agency shall provide copies of all materials submitted to the Commission relating to an advance notice with the Board of Governors of the Federal Reserve System contemporaneously with such submission to the Commission.

(o)(1) A clearing agency shall submit to the Commission a security-based swap submission and provide notice to its members of such security-based swap submission.

(2) Every clearing agency that is registered with the Commission that plans to accept a security-based swap, or any group, category, type or class of security-based swaps for clearing shall submit to the Commission electronically on Form 19b-4 (referenced in CFR 249.819) the information required to be submitted for a security-based swap submission, as provided in §240.19b-4 of this chapter and Form 19b-4. Any information submitted to the Commission electronically on Form 19b-4 that is not complete or otherwise in compliance with §240.19b-4 of this chapter and Form 19b-4, shall not be considered a security-based swap submission and the Commission shall so inform the clearing agency within twenty-one business days of the submission on Form 19b-4.

(3) A security-based swap submission submitted by a clearing agency to the Commission shall include a statement that includes, but is not limited to:

(i) How the security-based swap submission is consistent with Section 17A of the Act (15 U.S.C. 78q-1); and

(ii) Information that will assist the Commission in the quantitative and qualitative assessment of the factors specified in Section 3C of the Act (15 U.S.C. 78c-3), including, but not limited to:

(A) The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data;

(B) The availability of a rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded;

(C) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract;

(D) The effect on competition, including appropriate fees and charges applied to clearing;

(E) The existence of reasonable legal certainty in the event of the insolvency of the relevant clearing agency or one or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property;

(F) How the rules of the clearing agency prescribe that all security-based swaps submitted to the clearing agency with the same terms and conditions are economically equivalent within the clearing agency and may be offset with each other within the clearing agency, as applicable to the security-based swaps described in the security-based swap submission.

(G) How the rules of the clearing agency provide for non-discriminatory clearing of a security-based swap executed bilaterally or on or through the rules of an unaffiliated national securities exchange or security-based swap execution facility, as applicable to the security-based swaps described in the security-based swap submission.

(4) A clearing agency shall submit security-based swaps to the Commission for review by group, category, type or class of security-based swaps, to the extent reasonable and practicable to do so.

(5) A clearing agency shall post each security-based swap submission, and any amendments thereto, on its website within two business days after the submission of the security-based swap submission, and any amendments thereto, with the Commission. Such security-based swap submission and amendments shall be maintained on the clearing agency's website until the Commission makes a determination regarding the security-based swap submission or the clearing agency withdraws the security-based swap submission, or is notified that the security-based swap submission is not properly filed.

(6) Upon receipt of a security-based swap submission pursuant to this section, the Commission shall review the security-based swap submission and determine whether the security-based swap, or group, category, type or class of security-based swaps, described in the submission is required to be cleared.

(i) When making a determination, the Commission will take into account the factors addressed in the security-based swap submission and any additional factors the Commission determines to be appropriate. The clearing agency shall provide any additional information requested by the Commission as necessary to assess any of the factors it determines to be appropriate in order to make the determination of whether the clearing requirement applies.

(ii) In making a determination that the clearing requirement shall apply, the Commission may include such terms and conditions to the requirement as the Commission determines to be appropriate in the public interest.

(7) Notices of orders issued pursuant to Section 3C of the Act (15 U.S.C. 78c-3), regarding security-based swap submissions will be given by prompt publication thereof, together with a statement of written reasons therefor.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The general authority citation for part 249 is revised to read as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; 12 U.S.C. 5461 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

Section 249.819 is also issued under 12 U.S.C. 5465(e).

5. The section heading and §249.819 are revised to read as follows:

§249.819 Form 19b-4, for electronic filings with respect to proposed rule changes, advance notices and security-based swap submissions by all self-regulatory organizations.

This form shall be used by all self-regulatory organizations, as defined in Section 3(a)(26) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(26)), to file electronically proposed rule changes with the Commission pursuant to Section 19(b) of the Act and §240.19b-4 of this chapter, advance notices with the Commission pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act (12 U.S.C. 5465) and §240.19b-4 of this chapter and security-based swap submissions with the Commission pursuant to Section 3C(b)(2) of the Act (15 U.S.C. 78c-3(b)(2)) and §240.19b-4 of this chapter.

* * * * *

5. Form 19b-4 (referenced in §249.819) is revised to read as follows:

Note: The text of Form 19b-4 does not and the amendments will not appear in the Code of Federal Regulations.

[FORM 19b-4 TO BE INSERTED HERE]

OMB APPROVAL OMB	
Number:	3235-0045
Expires:	Estimated
average burden hours per response32

Page 1 of <input type="text"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No. SR - <input type="text"/> - <input type="text"/> Amendment No. <input type="text"/>
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Filing by Select SRO
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input type="checkbox"/>	Amendment <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action <input type="checkbox"/>	Date Expires <input type="text"/>	Rule		
			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing and Settlement Act of 2010 Section 806(e)(1)	Section 806(e)(2)	Security-Based Submission pursuant to Securities Exchange Act of 1934 Section 3C(b)(2)
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Exhibit 2 Sent As Paper Document Exhibit 3 Sent As Paper Document

Description
Provide a brief description of the action (limit 250 characters).

Contact Information
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
 Title
 E-mail
 Telephone Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date

By

(Name) (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

For complete Form 19b-4 Instructions please refer to the SRTS Online Filing website.

Form 19b-4 Information

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-(SRO)-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3).

Exhibit 1A - Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-(SRO)-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3).

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit Sent As Paper Document

Exhibit 3 - Form, Report, or Questionnaire

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit Sent As Paper Document

Exhibit 4 - Marked Copies

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item 1 and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

GENERAL INSTRUCTIONS FOR FORM 19b-4

A. Use of the Form

All self-regulatory organization proposed rule changes, except filings with respect to proposed rule changes by self-regulatory organizations submitted pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"), security-based swap submissions, and advance notices shall be filed in an electronic format through the Electronic Form 19b-4 Filing System ("EFFS"), a secure website operated by the Commission. This form shall be used for filings of proposed rule changes by all self-regulatory organizations pursuant to Section 19(b) of the Act, except filings with respect to proposed rule changes by self-regulatory organizations submitted pursuant to Section 19(b)(7) of the Act.¹⁷¹ National securities exchanges, registered securities associations, registered clearing agencies, and the Municipal Securities Rulemaking Board are self-regulatory organizations for purposes of this form. This form shall be used for all security-based swap submissions and advance notices filed by registered clearing agencies. A proposed change that is required to be filed with the Commission under more than one of these three processes (a proposed rule change, security-based swap submission, or advance notice) shall be submitted on the same Form 19b-4.

B. Need for Careful Preparation of the Completed Form, Including Exhibits

This form, including the exhibits, is intended to elicit information necessary for the public to provide meaningful comment on the proposed rule change, security-based swap submission, or advance notice and for the Commission to determine whether the proposed rule change, security-based swap submission, or advance notice is consistent with the requirements of the Act and the rules and regulations thereunder or the Payment, Clearing and Settlement

¹⁷¹ Because Section 19(b)(7)(C) of the Act states that filings abrogated pursuant to this Section should be re-filed pursuant to paragraph (b)(1) of Section 19 of the Act, SROs are required to file electronically such proposed rule changes in accordance with this form.

Supervision Act and the rules and regulations thereunder applicable to the self-regulatory organization. The self-regulatory organization must provide all the information called for by the form, including the exhibits, and must present the information in a clear and-comprehensible manner.

The proposed rule change, security-based swap submission, or advance notice shall be considered filed on the date on which the Commission receives the proposed rule change, security-based swap submission, or advance notice if the filing complies with all requirements of this form. Any filing that does not comply with the requirements of this form may be returned to the self-regulatory organization. Any filing so returned shall for all purposes be deemed not to have been filed with the Commission. See also Rule 0-3 under the Act (17 CFR 240.0-3).

C. Documents Comprising the Completed Form

The completed form filed with the Commission shall consist of the Form 19b-4 Page 1, numbers and captions for all items, responses to all items, and exhibits required in Item 11. In responding to an item, the completed form may omit the text of the item as contained herein if the response is prepared to indicate to the reader the coverage of the item without the reader having to refer to the text of the item or its instructions. Each filing shall be marked on the Form 19b-4 with the initials of the self-regulatory organization, the four-digit year, and the number of the filing for the year (e.g., SRO-YYYY-XX). If the SRO is filing Exhibits 2 or 3 via paper, the exhibits must be filed within 5 calendar days of the electronic submission of all other required documents.

D. Amendments

If information on this form is or becomes inaccurate before the Commission takes action on the proposed rule change or the security-based swap submission, or prior to the expiration of

the statutory review period with respect to advance notices (as determined in accordance with 806(e) of the Payment, Clearing and Settlement Supervision Act, the self-regulatory organization shall correct any such inaccuracy. Amendments shall be filed as specified in Instruction F.

Amendments to a filing shall include the Form 19b-4 Page 1 marked to number consecutively the amendments, numbers and captions for each amended item, amended response to the item, and required exhibits. The amended response to Item 3 shall explain the purpose of the amendment and, if the amendment changes the purpose of or basis for the proposed rule change, security-based swap submission, or advance notice, the amended response shall also provide a revised purpose and basis statement. Exhibit 1 or Exhibit 1A, as applicable, shall be re-filed if there is a material change from the immediately preceding filing in the language of the proposed rule change or in the information provided relating to the proposed rule change, security-based swap submission, or advance notice.

If the amendment alters the text of an existing rule, the amendment shall include the text of the existing rule, marked in the manner described in Item 1(a) using brackets to indicate words to be deleted from the existing rule and underscoring to indicate words to be added. The purpose of this marking requirement is to maintain a current copy of how the text of the existing rule is being changed.

If the amendment alters the text of the proposed rule change as it appeared in the immediately preceding filing (even if the proposed rule change does not alter the text of an existing rule), the amendment shall include, as Exhibit 4, the entire text of the rule as altered. This full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e., partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

If, after the Form 19b-4 is filed but before the Commission takes final action on it, the self-regulatory organization receives or prepares any correspondence or other communications reduced to writing (including comment letters) to and from such self-regulatory organization concerning the proposed rule change, security-based swap submission, or advance notice, the communications shall be filed as Exhibit 2. If information in the communication makes the filing inaccurate, the filing shall be amended to correct the inaccuracy. If such communications cannot be filed electronically in accordance with Instruction F, the communications shall be filed in accordance with Instruction G.

E. Completion of Action by the Self-Regulatory Organization on the Proposed Rule Change

The Commission will not approve a proposed rule change or make a determination regarding a security-based swap submission or raise no objection to an advance notice before the self-regulatory organization has completed all action required to be taken under its constitution, articles of incorporation, bylaws, rules, or instruments corresponding thereto (excluding action specified in any such instrument with respect to (i) compliance with the procedures of the Act or (ii) the formal filing of amendments pursuant to state law).

F. Signature and Filing of the Completed Form

All proposed rule changes, security-based swap submissions, advance notices, amendments, extensions, and withdrawals of proposed rule changes, security-based swap

submissions, and advance notices shall be filed through the EFFS. In order to file Form 19b-4 through EFFS, self-regulatory organizations must request access to the SEC's External Application Server by completing a request for an external account user ID and password. Initial requests will be received by contacting the Trading and Markets Administrator located on our website (<http://www.sec.gov>). An e-mail will be sent to the requestor that will provide a link to a secure website where basic profile information will be requested.

A duly authorized officer of the self-regulatory organization shall electronically sign the completed Form 19b-4 as indicated on Page 1 of the Form. In addition, a duly authorized officer of the self-regulatory organization shall manually sign one copy of the completed Form 19b-4, and the manually signed signature page shall be maintained pursuant to Section 17 of the Act. A registered clearing agency for which the Commission is not the appropriate regulatory agency also shall file with its appropriate regulatory agency three copies of the form, one of which shall be manually signed, including exhibits. A clearing agency that also is a designated clearing agency shall file with the Board of Governors of the Federal Reserve System three copies of the form, one of which shall be manually signed, including exhibits. The Municipal Securities Rulemaking Board also shall file copies of the form, including exhibits, with the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

G. Procedures for Submission of Paper Documents for Exhibits 2 and 3

To the extent that Exhibits 2 and 3 cannot be filed electronically in accordance with Instruction F, four copies of Exhibits 2 and 3 shall be filed with the Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

Page 1 of the electronic Form 19b-4 shall accompany paper submissions of Exhibits 2 and 3. If

the SRO is filing Exhibits 2 and 3 via paper, they must be filed within five calendar days of the electronic filing of all other required documents.

H. Withdrawals of Proposed Rule Changes, Security-based Swap Submissions or Advance Notices

If a self-regulatory organization determines to withdraw a proposed rule change, security-based swap submission, or advance notice, it must complete Page 1 of the Form 19b-4 and indicate by selecting the appropriate check box to withdraw the filing.

I. Procedures for Granting an Extension of Time for Commission Final Action

After the Commission publishes notice of a proposed rule change or security-based swap submission, if a self-regulatory organization wishes to grant the Commission an extension of the time to take final action as specified in Section 19(b)(2) or Section 3C, the self-regulatory organization shall indicate on the Form 19b-4 Page 1 the granting of said extension as well as the date the extension expires.

Information to Be Included in the Completed Form ("Form 19b-4 Information")

1. Text of the Proposed Rule Change

(a) Include the text of the proposed rule change, security-based swap submission, or advance notice. Text of the proposed rule change also should be included either in Exhibit 5 or Exhibit 1 (or Exhibit 1A in the filing of a clearing agency). Changes in, additions to, or deletions from, any existing rule shall be set forth with brackets used to indicate words to be deleted and underscoring used to indicate words to be added.

If any form, report, or questionnaire is

(i) proposed to be used in connection with the implementation or operation of the proposed rule change, security-based swap submission, or advance notice, or

(ii) prescribed or referred to in the proposed rule change, security-based swap submission, or advance notice

then the form, report, or questionnaire must be attached to and shall be considered as part of the proposed rule change, security-based swap submission, or advance notice. If completion of the form, report, or questionnaire is voluntary or is required pursuant to an existing rule of the self-regulatory organization, then the form, report, or questionnaire, together with a statement identifying any existing rule that requires completion of the form, report, or questionnaire, shall be attached as Exhibit 3. If the form, report, or questionnaire cannot be filed electronically in accordance with Instruction F, the documents shall be filed in accordance with Instruction G.

(b) If the self-regulatory organization reasonably expects that the proposed rule change, security-based swap submission, or advance notice will have any direct effect, or significant indirect effect, on the application of any other rule of the self-regulatory organization, set forth the designation or title of any such rule and describe the anticipated effect of the proposed rule change, security-based swap submission, or advance notice on the application of such other rule.

(c) Include the file numbers for prior filings with respect to any existing rule specified in response to Item 1(b).

2. Procedures of the Self-Regulatory Organization

Describe action on the proposed rule change, security-based swap submission, or advance notice taken by the members or board of directors or other governing body of the self-regulatory organization. See Instruction E.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Provide a statement of the purpose of the proposed rule change and its basis under the Act and the rules and regulations thereunder applicable to the self-regulatory organization. With respect to proposed rule changes filed pursuant to Section 19(b)(1) of the Act, except for proposed rule changes that have been abrogated pursuant to Section 19(b)(7)(C) of the Act, the statement should be sufficiently detailed and specific to support a finding that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization. With respect to proposed rule changes filed pursuant to Section 19(b)(1) of the Act that have been abrogated pursuant to Section 19(b)(7)(C) of the Act, the statement should be sufficiently detailed and specific to support a finding under Section 19(b)(7)(D) of the Act that the proposed rule change does not unduly burden competition or efficiency, does not conflict with the securities laws, and is not inconsistent with the public interest or the protection of investors. At a minimum, the statement should:

(a) Describe the reasons for adopting the proposed rule change, any problems the proposed rule change is intended to address, the manner in which the proposed rule change will operate to resolve those problems, the manner in which the proposed rule change will affect various persons (e.g., brokers, dealers, issuers, and investors), and any significant problems known to the self-regulatory organization that persons affected are likely to have in complying with the proposed rule change; and

(b) Explain why the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization. A mere assertion that the proposed rule change is consistent with those requirements is not sufficient. With respect to a proposed rule change filed pursuant to Section 19(b)(1) of the Act

that has been abrogated pursuant to Section 19(b)(7)(C) of the Act, explain why the proposed rule change does not unduly burden competition or efficiency, does not conflict with the securities laws, and is not inconsistent with the public interest and the protection of investors, in accordance with Section 19(b)(7)(D) of the Act. A mere assertion that the proposed rule change satisfies these requirements is not sufficient. In the case of a registered clearing agency, also explain how the proposed rule change will be implemented consistently with the safeguarding of securities and funds in its custody or control or for which it is responsible. Certain limitations that the Act imposes on self-regulatory organizations are summarized in the notes that follow.

Failure to describe and justify the proposed rule change in the manner described above may result in the Commission not having sufficient information to make an affirmative finding that the proposed rule change is consistent with the Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization.

NOTE 1. National Securities Exchanges and Registered Securities Associations.

Under Sections 6 and 15A of the Act, rules of a national securities exchange or registered securities association may not permit unfair discrimination between customers, issuers, brokers, or dealers, and may not regulate, by virtue of any authority conferred by the Act, matters not related to the purposes of the Act or the administration of the self-regulatory organization. Rules of a registered securities association may not fix minimum profits or impose any schedule of or fix rates of commissions, allowances, discounts, or other fees to be charged by its members.

Under Section 11A(c)(5) of the Act, a national securities exchange or registered securities association may not limit or condition the participation of any member in any registered clearing agency.

NOTE 2. Registered Clearing Agencies. Under Section 17A of the Act, rules of a registered clearing agency may not permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency, may not regulate, by virtue of any authority conferred by the Act, matters not related to the purposes of Section 17A of the Act or the administration of the clearing agency, and may not impose any schedule of prices, or fix rates or other fees, for services rendered by its participants.

NOTE 3. Municipal Securities Rulemaking Board. Under Section 15B of the Act, rules of the Municipal Securities Rulemaking Board may not permit unfair discrimination between customers, issuers, municipal securities brokers, or municipal securities dealers, may not fix minimum profits, or impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by municipal securities brokers or municipal securities dealers, and may not regulate, by virtue of any authority conferred by the Act, matters not related to the purposes of the Act with respect to municipal securities or the administration of the Board.

4. Self-Regulatory Organization's Statement on Burden on Competition

State whether the proposed rule change will have an impact on competition and, if so, (i) state whether the proposed rule change will impose any burden on competition or whether it will relieve any burden on, or otherwise promote, competition and (ii) specify the particular categories of persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule change will affect them. If the proposed rule change amends an existing rule, state whether that existing rule, as amended by the proposed rule change, will impose any burden on competition. If any impact on competition is not believed to be a significant burden on competition, explain why. Explain why any burden on competition is necessary or appropriate in furtherance of the purposes of the Act. In providing those

explanations, set forth and respond in detail to written comments as to any significant impact or burden on competition perceived by any person who has made comments on the proposed rule change to the self-regulatory organization. A mere assertion that the proposed rule change satisfies these requirements is not sufficient. The statement concerning burdens on competition should be sufficiently detailed and specific to support a Commission finding that the proposed rule change does not impose any unnecessary or inappropriate burden on competition. Failure to describe and justify the proposed rule change in the manner described above may result in the Commission not having sufficient information to make an affirmative finding that the proposed rule change is consistent with the Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

If written comments were received (whether or not comments were solicited) from members of or participants in the self-regulatory organization or others, summarize the substance of all such comments received and respond in detail to any significant issues that those comments raised about the proposed rule change. If an issue is summarized and responded to in detail under Item 3 or Item 4, that response need not be duplicated if appropriate cross-reference is made to the place where the response can be found. If comments were not or are not to be solicited, so state.

6. Extension of Time Period for Commission Action

State whether the self-regulatory organization consents to an extension of the time period specified in Section 19(b)(2) or Section 19(b)(7)(D) of the Act and the duration of the extension, if any, to which the self-regulatory organization consents.

7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)**

(a) If the proposed rule change is to take, or to be put into, effect, pursuant to Section 19(b)(3), state whether the filing is made pursuant to paragraph (A) or (B) thereof.

(b) In the case of paragraph (A) of Section 19(b)(3), designate that the proposed rule change:

(i) is a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule,

(ii) establishes or changes a due, fee, or other charge,

(iii) is concerned solely with the administration of the self-regulatory organization,

(iv) effects a change in an existing service of a registered clearing agency that

(A) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (B) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service, and set forth the basis on which such designation is made,

(v) effects a change in an existing order-entry or trading system of a self-regulatory organization that (A) does not significantly affect the protection of investors or the public interest; (B) does not impose any significant burden on competition; and (C) does not have the effect of limiting the access to or availability of the system, or

(vi) effects a change that (A) does not significantly affect the protection of investors or the public interest; (B) does not impose any significant burden on competition; and (C) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission written notice

of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. If it is requested that the proposed rule change become operative in less than 30 days, provide a statement explaining why the Commission should shorten this time period.

(c) In the case of paragraph (B) of Section 19(b)(3), set forth the basis upon which the Commission should, in the view of the self-regulatory organization, determine that the protection of investors, the maintenance of fair and orderly markets, or the safeguarding of securities and funds requires that the proposed rule change should be put into effect summarily by the Commission.

NOTE. The Commission has the power under Section 19(b)(3)(C) of the Act to summarily temporarily suspend within sixty days of its filing any proposed rule change which has taken effect upon filing pursuant to Section 19(b)(3)(A) of the Act or was put into effect summarily by the Commission pursuant to Section 19(b)(3)(B) of the Act. In exercising its summary power under Section 19(b)(3)(B), the Commission is required to make one of the findings described above but may not have a full opportunity to make a determination that the proposed rule change otherwise is consistent with the requirements of the Act and the rules and regulations thereunder. The Commission will generally exercise its summary power under Section 19(b)(3)(B) on condition that the proposed rule change to be declared effective summarily shall also be subject to the procedures of Section 19(b)(2) of the Act. Accordingly, in most cases, a summary order under Section 19(b)(3)(B) shall be effective only until such time as the Commission shall enter an order, pursuant to Section 19(b)(2)(A) of the Act, to approve such proposed rule change or, depending on the circumstances, until such time as the Commission

shall institute proceedings to determine whether to disapprove such proposed rule change or, alternatively, such time as the Commission shall, at the conclusion of such proceedings, enter an order, pursuant to Section 19(b)(2)(B), approving or disapproving such proposed rule change.

(d) If accelerated effectiveness pursuant to Section 19(b)(2) or Section 19(b)(7)(D) of the Act is requested, provide a statement explaining why there is good cause for the Commission to accelerate effectiveness.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

State whether the proposed rule change is based on a rule either of another self-regulatory organization or of the Commission, and, if so, identify the rule and explain any differences between the proposed rule change and that rule, as the filing self-regulatory organization understands it. In explaining any such differences, give particular attention to differences between the conduct required to comply with the proposed rule change and that required to comply with the other rule.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

(a) A clearing agency shall submit to the Commission on this Form 19b-4, a security-based swap submission for any security-based swap, or any group, category, type or class of security-based swaps that the clearing agency plans to accept for clearing.

(b) The clearing agency shall include in the security-based swaps submission a statement that includes, but is not limited to:

(i) How the security-based swap submission is consistent with Section 17A of the Act (15 U.S.C. 78q-1);

(ii) Information that will assist the Commission in the quantitative and qualitative assessment of the factors specified in Section 3C of the Act (15 U.S.C. 78c-3), including, but not

limited to:

- (A) The existence of significant outstanding notional exposures, trading liquidity and adequate pricing data;
- (B) The availability of a rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded;
- (C) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the clearing agency available to clear the contract;
- (D) The effect on competition, including appropriate fees and charges applied to clearing;
- (E) The existence of reasonable legal certainty in the event of the insolvency of the relevant clearing agency or one or more of its clearing members with regard to the treatment of customer and security-based swap counterparty positions, funds, and property;
- (F) How the rules of the clearing agency prescribe that all security-based swaps submitted to the clearing agency with the same terms and conditions are economically equivalent within the clearing agency and may be offset with each other within the clearing agency, as applicable to the security-based swaps described in the security-based swap submission.
- (G) How the rules of the clearing agency provide for non-discriminatory clearing of a security-based swap executed bilaterally or on or through the rules of an unaffiliated national securities exchange or security-based swap execution facility, as applicable to the security-based swaps described in the security-based swap submission.

NOTE. In connection with the factor specified in Item 9(b)(ii)(A) above, the clearing agency could address pricing sources, models and procedures demonstrating an ability to obtain

price data to measure credit exposures in a timely and accurate manner, as well as measures of historical market liquidity and trading activity, and expected market liquidity and trading activity if the security-based swap is required to be cleared (including information on the sources of such measures). With respect to the discussion of the factor specified in Item 9(b)(ii)(B) above, the statement describing the availability of a rule framework could include a discussion of the rules, policies or procedures applicable to the clearing of the relevant security-based swap.

Additionally, the discussion of credit support infrastructure specified in Item 9(b)(ii)(B) above could include the methods to address and communicate requests for, and posting of, collateral.

With respect to the factor specified in Item 9(b)(ii)(C) above, the discussion of systemic risk could include a statement on the clearing agency's risk management procedures, including among other things the measurement and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures and default management procedures. With respect to the factor specified in Item 9(b)(ii)(D) above, the discussion of fees and charges could address any volume incentive programs that may apply or impact the fees and charges. With respect to the factor specified in Item 9(b)(ii)(E) above, the discussion could address segregation of accounts and all other customer protection measures under insolvency.

In describing the security-based swap, or any group, category, type or class of security-based swaps, that a clearing agency plans to accept for clearing, the clearing agency could include the relevant product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing and communicating any life cycle events associated with the security-based swap and related adjustments, and the manner in which the information contained in the confirmation of the

security-based swap trade is transmitted. The clearing agency also could discuss its financial and operational capacity to provide clearing services to all customers subject to the clearing requirements as applicable to the particular security-based swap. Finally, the clearing agency could include an analysis of the effect of a clearing requirement on the market for the group, category, type, or class of security-based swaps, both domestically and globally, including the potential effect on market liquidity, trading activity, use of security-based swaps by direct and indirect market participants and any potential market disruption or benefits. This analysis could include whether the members of the clearing agency are operationally and financially capable of absorbing clearing business (including indirect access market participants) that may result from a determination that the security-based swap (or group, category, type or class of security-based swap) is required to be cleared.

(c) A clearing agency shall submit security-based swaps to the Commission for review by group, category, type or class of security-based swaps, to the extent reasonable and practicable to do so.

(d) A clearing agency shall file as an amendment to this Form 19b-4 any additional information necessary to assess any of the factors the Commission determines to be appropriate in order to make a determination regarding the clearing requirement.

(e) A security-based swap submission pursuant to Section 3C that also is required to be filed as a proposed rule change under Section 19(b) or an advance notice under Section 806(e) of the Payment, Clearing and Settlement Supervision Act shall not take effect until determinations are obtained under each of the other applicable statutory provisions.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

(a) A designated clearing agency shall provide notice on this Form 19b-4 sixty (60) days in advance of any proposed change to its rules, procedures, or operations that could, as defined in Rule 19b-4, materially affect the nature or level of risks presented by the designated clearing agency.

(b) A designated clearing agency shall include in the notice a description of:

(i) the nature of the change and expected effects on risks to the designated clearing agency, its participants, or the market; and

(ii) how the designated financial market utility plans to manage any identified risks.

(c) A designated clearing agency shall file as amendment to this Form 19b-4 any additional information that is required to be filed by the Commission as necessary to assess the effect the proposed change would have on the nature or level of risks associated with the designated clearing agency's payment, clearing, or settlement activities and the sufficiency of any proposed risk management techniques.

(d) A designated clearing agency that implements a proposed change on an emergency basis must file notice with the Commission on Form 19b-4 within 24 hours of implementing the change. In addition to the information required for advance notices, the notice of an emergency change shall include a description of the nature of the emergency and the reason the change was necessary for the designated clearing agency to continue to operate in a safe and sound manner. Any change implemented by a designated clearing agency on an emergency basis also must comply with Section 19(b) and Section 3C of the Act to the extent those sections are applicable.

(e) A proposed change filed pursuant to Section 806(e) that is also required to be filed as a proposed rule change under Section 19(b) or a security-based swap submission under Section 3C shall not take effect until determinations are obtained under each of the other applicable statutory provisions.

11. Exhibits

List of exhibits to be filed, as specified in Instructions C and D:

Exhibit 1. Completed Notice of Proposed Rule Change for publication in the Federal Register. Amendments to Exhibit 1 should be filed in accordance with Instructions D and F.

Exhibit 1A. Completed Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice for publication in the Federal Register. Amendments to Exhibit 1A should be filed in accordance with Instructions D and F.

Exhibit 2 (a) Copies of notices issued by the self-regulatory organization soliciting comment on the proposed rule change, security-based swap submission, or advance notice and copies of all written comments on the proposed rule change, security-based swap submission, or advance notice received by the self-regulatory organization (whether or not comments were solicited), presented in alphabetical order, together with an alphabetical listing of such comments. If such notices and comments cannot be filed electronically in accordance with Instruction F, the notices and comments shall be filed in accordance with Instruction G.

(b) Copies of any transcript of comments on the proposed rule change, security-based swap submission, or advance notice made at any public meeting or, if a transcript is not available, a copy of the summary of comments on the proposed rule change made at such meeting. If such transcript of comments or summary of comments cannot be filed electronically

in accordance with Instruction F, the transcript of comments or summary of comments shall be filed in accordance with Instruction G.

(c) If after the proposed rule change, security-based swap submission, or advance notice is filed but before the Commission takes final action on it, the self-regulatory organization prepares or receives any correspondence or other communications reduced to writing (including comment letters) to and from such self-regulatory organization concerning the proposed rule change, the communications shall be filed in accordance with Instruction F. If such communications cannot be filed electronically in accordance with Instruction F, the communications shall be filed in accordance with Instruction G.

Exhibit 3. Copies of any form, report, or questionnaire covered by Item 1(a). If such form, report, or questionnaire cannot be filed electronically in accordance with Instruction F, the form, report, or questionnaire shall be filed in accordance with Instruction G.

Exhibit 4. For amendments to a filing, marked copies, if required by Instruction D, of the text of the proposed rule change as amended.

Exhibit 5. The SRO may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

SPECIFIC INSTRUCTIONS FOR EXHIBIT 1 – NOTICE OF PROPOSED RULE CHANGE
EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34- ; File No. SR]

[Date]

Self-Regulatory Organizations; [Name of Self-Regulatory Organization]; Notice of Filing [and Immediate Effectiveness] of a Proposed Rule Change Relating to [brief description of subject matter of proposed rule change]

General Instructions

A. Format Requirements

The notice must comply with the guidelines for publication in the Federal Register, as well as any requirements for electronic filing as published by the Commission (if applicable). For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-XX-XX). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3). Leave a 1-inch margin at the top, bottom, and right hand side, and a 1 1/2 inch margin at the left hand side. Number all pages consecutively, consistent with Rule 0-3 under the Act (17 CFR 240.0-3). Double space all

primary text and single space lists of items, quoted material when set apart from primary text, footnotes, and notes to tables.

B. Need for Careful Preparation of the Notice

The self-regulatory organization must provide all information required in the notice and present it in a clear and comprehensible manner. It is the responsibility of the self-regulatory organization to prepare Items I, II and III of the notice. The Commission cautions self-regulatory organizations to pay particular attention to assure that the notice accurately reflects the information provided in the Form 19b-4 it accompanies. Any filing that does not comply with the requirements of Form 19b-4, including the requirements applicable to the notice, may be returned to the self-regulatory organization. Any document so returned shall for all purposes be deemed not to have been filed with the Commission. See Instruction B to Form 19b-4.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1), notice is hereby given that on (date)*, the (name of self-regulatory organization) filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

Information to Be Included in the Completed Notice

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

(Supply a brief statement of the terms of substance of the proposed rule change. If the proposed rule change is relatively brief, a separate statement need not be prepared, and the text of the proposed rule change may be inserted in lieu of the statement of the terms of substance. If

* To be completed by the Commission. This date will be the date on which the Commission receives the proposed rule change if the filing complies with all requirements of this form. See Instruction B to Form 19b-4.

the proposed rule change amends an existing rule, indicate changes in the rule by brackets for words to be deleted and underlined for words to be added.)

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

(Reproduce the headings, and summarize briefly the most significant aspects of the responses, to Items 3, 4, and 5 of Form 19b-4, redesignating them as A, B, and C, respectively.)

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

(If the proposed rule change is to be considered by the Commission pursuant to Section 19(b)(2) of the Act, the following paragraph should be used.)

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

(If the proposed rule change is to take, or to be put into, effect pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder, the following paragraph should be used.)

Because the foregoing proposed rule change does not:

(i) significantly affect the protection of investors or the public interest;

(ii) impose any significant burden on competition; and

(iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

(If the proposed rule change is to take, or to be put into, effect pursuant to Section 19(b)(3)(A) of the Act and subparagraphs (1) - (5) of paragraph (f) of Rule 19b-4 thereunder, the following paragraph should be used.)

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and paragraph (f) of Rule 19b-4 thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

(If the proposed rule change is to be considered by the Commission pursuant to Section 19(b)(7)(D) of the Act, the following paragraph should be used.)

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) after consultation with the Commodity Futures Trading Commission, institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number XX on the subject line.

Paper Comments:

- Send paper comments in triplicate to [Name of Secretary], Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number XX. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more

efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for 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. Copies of the filing also will be available for inspection and copying at the principal office of the [self-regulatory organization]. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number XX and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁷²

Secretary

¹⁷²

17 CFR 200.30-3(a)(12).

SPECIFIC INSTRUCTIONS FOR EXHIBIT 1A – NOTICE OF PROPOSED RULE CHANGE,
SECURITY-BASED SWAP SUBMISSION, OR ADVANCE NOTICE FILED BY CLEARING
AGENCIES

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34- ; File No. SR]

[Date]

Self-Regulatory Organizations; [Name of Clearing Agency]; Proposed Rule Change, Security-
Based Swap Submission, or Advance Notice Relating to [brief description of subject matter of
proposed rule change, security-based swap submission, or advance notice]

General Instructions

A. Format Requirements

The notice must comply with the guidelines for publication in the Federal Register, as well as any requirements for electronic filing as published by the Commission (if applicable). For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-XX-XX). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3). Leave a 1-inch margin at the top, bottom, and right hand side, and a 1 1/2 inch margin at the left hand side. Number all pages consecutively, consistent with Rule 0-3 under the Act (17 CFR 240.0-3). Double space all

primary text and single space lists of items, quoted material when set apart from primary text, footnotes, and notes to tables.

B. Need for Careful Preparation of the Notice

The clearing agency must provide all information required in the notice and present it in a clear and comprehensible manner. It is the responsibility of the clearing agency to prepare Items I, II and III of the notice. The Commission cautions clearing agencies to pay particular attention to assure that the notice accurately reflects the information provided in the Form 19b-4 it accompanies. Any filing that does not comply with the requirements of Form 19b-4, including the requirements applicable to the notice, may be returned to the clearing agency. Any document so returned shall for all purposes be deemed not to have been filed with the Commission. See Instruction B to Form 19b-4

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1) and Rule 19b-4, 17 CFR 240.19b-4, notice is hereby given that on (date)*, the (name of clearing agency) filed with the Securities and Exchange Commission the proposed rule change, security-based swap submission, or advance notice as described in Items I, II and III below, which Items have been prepared by the clearing agency. The Commission is publishing this notice to solicit comments on the proposed rule change, security-based swap submission, or advance notice from interested persons.

*To be completed by the Commission. This date will be the date on which the Commission receives the proposed rule change, security-based swap submission, or advance notice filing if the filing complies with all requirements of this form. See Instruction B to Form 19b-4.

Information to Be Included in the Completed Notice

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change, Security-Based Swap Submission, or Advance Notice

(Supply a brief statement of the terms of substance of the proposed rule change, security-based swap submission or advance notice. If the proposed rule change is relatively brief, a separate statement need not be prepared, and the text of the proposed rule change may be inserted in lieu of the statement of the terms of substance. If the proposed rule change amends an existing rule, indicate changes in the rule by brackets for words to be deleted and underlined for words to be added.)

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change, Security-Based Swap Submission, or Advance Notice

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the proposed rule change, security-based swap submission and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. (Reproduce the headings, and summarize briefly the most significant aspects of the responses, to Items 3, 4, and 5 of Form 19b-4, redesignating them as A, B, and C, respectively.)

III. Date of Effectiveness of the Proposed Rule Change, Security-Based Swap Submission, and Advance Notice and Timing for Commission Action

(If the proposed rule change is to be considered by the Commission pursuant to Section 19(b)(2) of the Act, the following paragraph should be used.)

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer

period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

(If the proposed rule change is to take, or to be put into, effect pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(6) of Rule 19b-4 thereunder, the following paragraph should be used.)

Because the foregoing proposed rule change does not:

- (i) significantly affect the protection of investors or the public interest;
- (ii) impose any significant burden on competition; and
- (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

(If the proposed rule change is to take, or to be put into, effect pursuant to Section 19(b)(3)(A) of the Act and subparagraphs (1) - (5) of paragraph (f) of Rule 19b-4 thereunder, the following paragraph should be used.)

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and paragraph (f) of Rule 19b-4 thereunder. At any time within 60 days of the filing of the

proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

(If the proposed rule change is to be considered by the Commission pursuant to Section 19(b)(7)(D) of the Act, the following paragraph should be used.)

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) after consultation with the Commodity Futures Trading Commission institute proceedings to determine whether the proposed rule change should be disapproved.

(If the proposed change is filed as a security-based swap submission pursuant to Section 3C of the Act, the following paragraph should be used.)

Within 90 days after receiving a security-based swap submission, unless the submitting clearing agency agrees to an extension of time limitation, the Commission shall by order make its determination whether the security-based swap, or group, category, type or class of security-based swaps, described in the security-based swap submission is required to be cleared. In making its determination that the clearing requirement shall apply, the Commission may include such terms and conditions to the requirement as the Commission determines to be appropriate in the public interest.

The clearing agency shall post notice on its website of any clearing requirement that is implemented.

(If the proposed change is filed as an advance notice pursuant to the Payment, Clearing and Settlement Supervision Act, the following paragraph should be used.)

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission or the Board of Governors of the Federal Reserve System providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

(If the proposed change is filed following the implementation of a change on an emergency basis pursuant to the Payment, Clearing and Settlement Supervision Act, the following paragraph should be used.)

The clearing agency implemented a proposed change that otherwise would be required to be filed as an advance notice because the clearing agency determined that (i) an emergency existed and (ii) immediate implementation was necessary for the clearing agency to continue to

provide its services in a safe and sound manner. The Commission may require modification or rescission of the proposed change if it finds it is not consistent with the purposes of the Payment, Clearing and Settlement Supervision Act or any applicable rules, orders, or standards prescribed under Section 805(a).

(If the proposal is submitted pursuant to more than one filing requirement, the clearing agency shall add the following language in addition to the language above.)

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, security-based swap submission, or advance notice is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number **XX** on the subject line.

Paper Comments:

- Send paper comments in triplicate to [Name of Secretary], Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

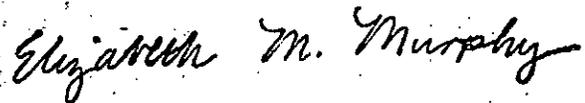
All submissions should refer to File Number **XX**. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more

efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, security-based swap submission, or advance notice that are filed with the Commission, and all written communications relating to the proposed rule change, security-based swap submission, or advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for 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. Copies of the filing also will be available for inspection and copying at the principal office of the [clearing agency]. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number XX and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁷³

Secretary

By the Commission.



Elizabeth M. Murphy
Secretary

Dated: December 15, 2010

¹⁷³

17 CFR 200.30-3(a)(12).



SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

Release No. 34-63556; File No. S7-43-10

RIN 3235-AK88

End-User Exception to Mandatory Clearing of Security-Based Swaps

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: In accordance with Section 763(a) 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 Rule 3Cg-1 under the Securities Exchange Act of 1934 ("Exchange Act") governing the exception to mandatory clearing of security-based swaps available for counterparties meeting certain conditions. The Commission is requesting comments on the proposed rule and related matters.

DATES: Comments must 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 No. S7-43-10 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments:

Paper Comments

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

All submissions should refer to File No. S7-43-10. 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: Peter Curley, Attorney Fellow, at (202) 551-5696, or Andrew Blake, Special Counsel, at (202) 551-5846, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is proposing Rule 3Cg-1 under the Exchange Act to govern the exception to mandatory clearing of security-based swaps available to counterparties to security-based swaps meeting certain conditions. The Commission is soliciting comments on all aspects of the proposed rule and alternative rule language and will carefully consider any comments received.

I. Introduction

On July 21, 2010, the President signed the Dodd-Frank Act into law.¹ 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.² Title VII of the Dodd-Frank Act provides the Commission and the Commodity Futures Trading

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.

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 market.

The Dodd-Frank Act provides that the CFTC will regulate “swaps,” the Commission will regulate “security-based swaps,” and the CFTC and the Commission will jointly regulate “mixed swaps.”³ The Dodd-Frank Act amends the Exchange Act⁴ to require, among other things, the following: (1) transactions in security-based swaps must be cleared through a clearing agency if they are of a type that the Commission determines must be cleared, unless an exemption from mandatory clearing applies;⁵ (2) transactions in security-based swaps must be reported to a registered security-based swap data repository (“SDR”) or the Commission;⁶ and (3) if a security-based swap is subject to a clearing requirement, it must be traded on a registered exchange or a registered or exempt security-based swap execution facility, unless no facility makes such security-based swap available for trading.⁷

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. See Exchange Act Release Nos. 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 of the Dodd-Frank Act) (“Definitions Release”); 63452 (Dec. 7, 2010) (“Definitions Proposing Release”).

⁴ All references to the Exchange Act contained in this release refer to the Securities Exchange Act of 1934, as amended by the Dodd-Frank Act.

⁵ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C).

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).

⁷ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C). See also Pub. L. No. 111-203, § 761 (adding Exchange Act Section 3(a)(77) (defining the term “security-based swap execution facility”).

The Dodd-Frank Act seeks to ensure that, wherever possible and appropriate, derivatives contracts formerly traded exclusively in the OTC market be cleared.⁸ One key way in which the Dodd-Frank Act promotes clearing of such contracts is by setting forth a process by which the Commission would determine whether a security-based swap is required to be cleared; if the Commission makes a determination that a security-based swap is required to be cleared, then parties may not engage in such security-based swap without submitting it for clearing unless an exception applies.

Standards for mandatory clearing of security-based swaps are established by Exchange Act Section 3C(a)(1).⁹ The purpose of mandatory clearing of security-based swap products is to centralize individual counterparty risks through a clearing agency acting as a central counterparty that distributes risk among the clearing agency's participants. Exchange Act Section 3C(g) provides that a security-based swap otherwise subject to mandatory clearing is not required to be cleared if one party to the security-based swap is not a financial entity, is using security-based swaps to hedge or mitigate commercial risk, and notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared security-based swaps (the "end-user clearing exception").¹⁰ Though beneficial for reasons such as those described above, mandatory

⁸ See, e.g., Report of the Senate Committee on Banking, Housing, and Urban Affairs regarding The Restoring American Financial Stability Act of 2010, S. Rep. No. 111-176 at 34 (stating that "[s]ome parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, uncleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible.").

⁹ See Exchange Act Release No. 63557 (Dec. 15, 2010) ("Mandatory Clearing Release").

¹⁰ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)). This clearing exception is elective. When trading with a security-based swap dealer and a major security-based swap participant, counterparties that are not swap dealers, security-based swap dealers, major swap participants or major security-based swap participants have the right to forgo the end-user clearing exception and require clearing

clearing of security-based swaps may also alter the burdens on non-financial end-users of derivatives relative to bilateral transactions, and thereby possibly affect their risk management practices.¹¹ Exchange Act Section 3C(g) is designed to permit non-financial end-users that meet the specified conditions to elect not to centrally clear security-based swaps and retain flexibility to use both cleared and non-cleared security-based swaps in their risk management activities.

The Dodd-Frank Act provides the Commission with authority to adopt rules governing the end-user clearing exception and to prescribe rules, issue interpretations or request information from persons claiming the end-user clearing exception necessary to prevent abuse of the exception.¹² The Commission is also required to consider whether to exempt small banks, savings associations, farm credit system institutions and credit unions from the definition of "financial entity" contained in Exchange Act Section 3C(g)(3)(A). The Commission is proposing Rule 3Cg-1 under the Exchange Act to specify requirements for using the exception to mandatory clearing of security-based swaps established by Exchange

for a security-based swap that is subject to a Commission clearing mandate. These counterparties are granted a similar right when a security-based swap has been listed for clearing, but is not the subject of a Commission clearing mandate. See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(5)). The choice to require or forgo clearing is solely at the non-financial counterparty's discretion. See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(2)).

¹¹ Burdens that may rest upon non-financial end-users arising from central clearing could include clearing fees and the requirement to post initial and variation margin. The net cost of these burdens to non-financial end-users is expected to vary. In particular, the final net cost to non-financial end-users would also need to account for the fees and charges of dealers and other counterparties to security-based swaps with non-financial end-users and for any bilateral margin or other collateral requirements established in connection with such transactions. As a result, it is possible that the costs for an end-user to engage in a centrally cleared transaction may be less than for comparable bilateral transactions in some circumstances. The Commission is requesting comments on the costs experienced by non-financial end-users in connection with both cleared and non-cleared security-based swaps.

¹² See Pub. L. No. 111-203, § 712(f). See also Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(6)).

Act Section 3C(g), together with proposed alternative language to provide an exemption for small banks, savings associations, farm credit system institutions and credit unions.

II. Description of Proposed Rule

A. Notification to the Commission

In order to qualify for the end-user clearing exception, a non-financial entity¹³ that uses security-based swaps to hedge or mitigate commercial risk must notify the Commission how it generally meets its financial obligations associated with non-cleared security-based swaps.¹⁴

The Exchange Act authorizes the Commission to establish rules regarding such notification as well as to prescribe rules as may be necessary to prevent abuse of the end-user clearing exception.¹⁵ The Commission is proposing Rule 3Cg-1 to require non-financial entities to notify the Commission each time the end-user clearing exception is used by delivering certain information to an SDR in the manner required by proposed Exchange Act Regulation SBSR.¹⁶

¹³ Exchange Act Section 3C(g)(1)(A) limits availability of the end-user clearing exception to circumstances when one of the counterparties to the security-based swap is not a financial entity. The term financial entity is defined in Section 3C(g)(3)(A) of the Exchange Act, and includes the following eight entities: (i) a swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap participant; (v) a commodity pool as defined in section 1a(10) of the Commodity Exchange Act; (vi) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80-b-2(a)); (vii) an employee benefit 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); or (viii) a person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956. Four of these terms, "swap dealer", "major swap participant", "security-based swap dealer" and "major security-based swap participant" are themselves the subject of current proposed joint rulemaking by the Commission and the CFTC. Definitions Proposing Release, *supra* note 3.

¹⁴ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(1)(C)).

¹⁵ See Pub. L. No. 111-203, §§ 712(f) and 763(a) (adding Exchange Act Sections 3C(g)(1)(C) and 3C(g)(6)).

¹⁶ See Exchange Act Release No. 63346 (Nov. 18, 2010), 75 FR 75208 (Dec. 2, 2010) ("Regulation SBSR Proposing Release"). Regulation SBSR contemplates that information may be delivered to the Commission directly in limited circumstances when an SDR is not available. When permitted by Regulation SBSR, such delivery would also meet the end-user clearing exception notice requirement. Persons wishing

The Commission believes that receiving a notification for each transaction may provide for a more complete picture regarding how end-users meet their financial obligations based on the transactions in which they engage. The specified additional information would be delivered to the SDR by the reporting party defined in proposed Regulation SBSR (the "Reporting Party")¹⁷ together with other information regarding the security-based swap separately required by proposed Regulation SBSR. Under the applicable requirements of proposed Regulation SBSR, the additional information required by proposed Rule 3Cg-1 would be delivered to the SDR in the same electronic format established by the SDR for purposes of proposed Regulation SBSR,¹⁸ promptly after the security-based swap transaction is executed, which for information of this kind would be no later than:

- 15 minutes after the time of execution for a security-based swap that is executed and confirmed electronically;
- 30 minutes after the time of execution for a security-based swap that is confirmed electronically but not executed electronically; or
- 24 hours after execution for a security-based swap that is not executed or confirmed electronically.¹⁹

The information delivered to the SDR pursuant to Rule 3Cg-1 would need to be accurate as of the date and time the information is delivered to the SDR.²⁰ The Commission believes that

to comment on the requirements of proposed Regulation SBSR should submit comments pursuant to the Regulation SBSR Proposing Release.

¹⁷ Proposed Exchange Act Rule 901(a) under Regulation SBSR defines which of the parties to a security-based swap will be designated the Reporting Party for these purposes. See id.

¹⁸ See id. (proposed Rules 901(h) and 907(a)(2) of proposed Regulation SBSR).

¹⁹ See id. (proposed Rule 901(d)(2) of proposed Regulation SBSR).

²⁰ See id. (for each security-based swap transaction made in reliance on the end-user clearing exception, proposed Rule 901(d)(1)(ix) under Regulation SBSR requires parties to a security-based swap to indicate whether or not the end-user clearing

this requirement should improve transaction efficiency by allowing notification to be made in a manner consistent with other transaction reporting requirements being developed pursuant to the Dodd-Frank Act. The timing requirements should also ensure the Commission has up to date information as of the time of submission.

1. Meeting Financial Obligations

A non-financial entity invoking the end-user clearing exception must notify the Commission of "how it generally meets its financial obligations associated with non-cleared security-based swaps" ("Financial Obligation Notice").²¹ Under existing market practices, counterparties to security-based swaps regularly use forms of collateral support both to create incentives for obligors to meet their financial obligations under the agreements and to provide themselves with access to some asset of value that can be sold or the value of which can be applied in the event of default.²² Though not required by Exchange Act Section 3C(g), such individualized credit arrangements between counterparties in bilateral security-based swap transactions can be important components of risk management consistent with the policy rationale of ensuring that the end-user clearing exception is reasonably available to non-financial entities hedging or mitigating commercial risks.²³

However, a principal feature distinguishing cleared security-based swaps from

exception is being invoked when reporting transaction information to an SDR as required by Exchange Act Section 13(m)(1)(F). The information required under proposed Exchange Act Rule 3Cg-1 is separate from these requirements but would be delivered to the SDR by the Reporting Party in the same manner as required by proposed Regulation SBSR).

²¹ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(1)(C)).

²² See ISDA Collateral Steering Committee, Market Review of OTC Derivative Bilateral Collateralization Practices (2.0), (March 1, 2010) ([available at http://www.isda.org/c_and_a/pdf/Collateral-Market-Review.pdf](http://www.isda.org/c_and_a/pdf/Collateral-Market-Review.pdf)) ("ISDA Collateralization Practices") (explaining credit risk, methods of risk mitigation and the context for collateralization as a risk reduction technique).

²³ See 156 Cong. Rec. S6192 (daily ed. July 22, 2010) (letter from Sen. Dodd and Sen. Lincoln to Rep. Frank and Rep. Peterson (the "Dodd-Lincoln Letter")).

non-cleared security-based swaps is that non-cleared security-based swaps do not provide a uniform method of mitigating such counterparty credit risk.²⁴ Given this lack of uniformity, proposed Rule 3Cg-1(a)(5) would require a counterparty relying on the end-user clearing exception to provide certain information as part of its notification to the Commission regarding the methods used to mitigate credit risk in connection with non-cleared security-based swaps. If more than one method is used then information must be provided regarding each applicable method. Notification of all methods, as proposed in proposed Rule 3Cg-1(a)(5), would provide the Commission with more complete information regarding the risk characteristics of non-cleared security-based swaps used by non-financial entities to hedge or mitigate commercial risk.

Proposed Rule 3Cg-1(a)(5)(i) requires notification to the Commission regarding whether a credit support agreement is being used in connection with the non-cleared security-based swap. For these purposes, the term credit support agreement refers to any agreement, or annex, amendment or supplement to another agreement, which contemplates the periodic transfer of specified collateral to or from another party to support payment obligations associated with the security-based swap. Agreements of this kind are frequently used to mitigate the counterparty credit risk of security-based swaps and other derivatives that are not centrally cleared, but the use of such arrangements may be more or less common among certain types of counterparties and for certain types of security-based swaps.²⁵ The proposed notification would provide the Commission with information regarding the extent to which

²⁴ See ISDA Collateralization Practices, *supra* note 22 (describing methods of risk mitigation used in connection with OTC Derivatives and key legal foundations supporting collateralization).

²⁵ See ISDA Collateralization Practices, *supra* note 22. See also ISDA, ISDA Margin Survey 2010 (available at http://www.isda.org/c_and_a/pdf/ISDA-Margin-Survey-2010.pdf) ("ISDA Margin Survey 2010") (describing collateralization levels for derivatives transactions by counterparty type, product type and types of collateral received).

credit support agreements are used by non-financial entities to support their financial obligations associated with non-cleared security-based swaps.

Proposed Rule 3Cg-1(a)(5)(ii) requires notification to the Commission regarding whether the financial obligations associated with the non-cleared security-based swap are secured by collateral pledged under a written security arrangement not requiring the transfer of possession of collateral to either of the security-based swap counterparties. Examples of this type of arrangement include, but are not limited to, (i) agreements granting security interests over property of the reporting person, whether or not such security interests are perfected by the filing of a mortgage, financing statements or similar documents, and (ii) agreements to transfer assets to collateral agents or escrow agents acting pursuant to instructions agreed by both parties to a security-based swap. While such arrangements may be somewhat less commonly used to mitigate credit risk associated with non-cleared security-based swaps, the Commission preliminarily believes these methods may have particular importance for certain categories of non-financial entities, such as enterprises with high levels of fixed assets relative to cash flows.²⁶ Accordingly, the Commission preliminarily considers it appropriate to separately categorize this information in the data proposed to be collected.

Proposed Rule 3Cg-1(a)(5)(iii) requires notification to the Commission regarding whether the financial obligations associated with the non-cleared security-based swap are guaranteed by a person or entity other than the counterparty invoking the end-user clearing exception. The proposed notification would provide the Commission with information regarding the manner in which financial obligations are met by providing information regarding the use of guarantees by third parties (such as parent companies, affiliated parties or

²⁶ See ISDA Margin Survey 2010, *supra* note 25, at 9 (noting types of non-ISDA collateral agreements used and frequency of use).

others) in meeting financial obligations associated with non-cleared security-based swaps.²⁷

Proposed Rule 3Cg-1(a)(5)(iv) requires notification to the Commission regarding whether the counterparty invoking the end-user clearing exception intends to meet its obligations associated with the security-based swap solely by utilizing available financial resources (*i.e.*, its general creditworthiness).²⁸ Financial resources that might be available to meet obligations associated with non-cleared security-based swaps may include any number of sources, including existing assets, investments and cash balances, cash flow from operations, short-term and long-term lines of credit and capital market sources of funding.

Proposed Rule 3Cg-1(a)(5)(v) requires notification to the Commission regarding whether the counterparty invoking the end-user clearing exception intends to employ means other than those described in proposed Rules 3Cg-1(a)(5)(i), (ii), (iii), or (iv) to meet its financial obligations associated with a security-based swap. This item is intended to separately categorize all other methods that may be used in the markets today or that may develop in the future for meeting obligations associated with non-cleared security-based swaps relying on the end-user clearing exception to provide a clearer picture of the manner in which an end-user is meeting its financial obligations. The Commission anticipates many entities would meet their financial obligations through one of the specific methods listed in Rule

²⁷ See ISDA Collateralization Practices, *supra* note 22, at 20 (identifying master cross-netting and cross-guarantee structures as common credit risk mitigation practices); see also ISDA 2002 Master Agreement, Multicurrency – Cross Border Schedule, Part 4(f) (contemplating bank letters of credit and third party guarantees as credit support documents).

²⁸ For a variety of reasons one or both of the counterparties to some non-cleared security-based swaps may choose not to mitigate credit risk and instead rely on the general creditworthiness of their opposite counterparty, given the circumstances and financial terms of the transaction. See, *e.g.*, Office of the Comptroller of Currency, Risk Management of Financial Derivatives, Comptroller's Handbook, at 50 (Jan. 1997) ([available at http://www.occ.gov/static/publications/handbook/deriv.pdf](http://www.occ.gov/static/publications/handbook/deriv.pdf)) (contemplating that evaluations of individual counterparty credit limits should aggregate limits for derivatives with credit limits established for other activities, including commercial lending).

3Cg-1(a)(5)(i), (ii), (iii), or (iv). The information collected pursuant to proposed Rule 3Cg-1(a)(5)(v), however, may allow the Commission to gain greater insight regarding the potential existence of other means for meeting financial obligations, as well as whether there is a significant number of transactions that would justify more granular rules concerning the manner in which end-users are meeting their financial obligations in the future with respect to whether and how end-users are using other credit risk mitigating methodologies to support meeting their financial obligations associated with non-cleared security-based swaps.

2. Preventing Abuse of the End-User Clearing Exception

The remaining items of information required by proposed Rule 3Cg-1, specifically proposed Rules 3Cg-1(a)(1), (2), (3), (4) and (6), are designed to affirm compliance with particular requirements of Exchange Act Section 3C(g) or otherwise produce information necessary to aid the Commission in its efforts to prevent abuse of the end-user clearing exception as contemplated by Exchange Act Section 3C(g)(6).²⁹

Proposed Rule 3Cg-1(a)(1) requires identifying which of the counterparties to the security-based swap is invoking the end-user clearing exception. At least one counterparty must be identified for each security-based swap that will rely on the end-user clearing exception. When both counterparties to a security-based swap are non-financial entities and meet the other requirements of the end-user clearing exception, both parties may choose to use the exception and provide the required information to the SDR.

Proposed Rule 3Cg-1(a)(2) requires information to be provided regarding the status of the counterparty invoking the end-user clearing exception as a non-financial entity under Section 3C(g)(3) of the Act.³⁰ This information is being solicited because the exception to

²⁹ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(6)). See also Pub. L. No. 111-203, § 764 (adding Exchange Act Section 15F of the Exchange Act creating new business conduct standards applicable to interactions of security-based swap dealers and major security-based swap participants with other counterparties).

³⁰ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(3)).

mandatory clearing of security-based swaps under Exchange Act Section 3C(g) is only available to persons that are not financial entities, or are affiliates of non-financial entities satisfying the requirements of Exchange Act Section 3C(g)(4).

Proposed Rule 3Cg-1(a)(3) requires information to be provided regarding whether the counterparty invoking the end-user clearing exception is an affiliate of another person qualifying for the exception under Exchange Act Section 3C(g), and satisfies the additional requirements of Exchange Act Section 3C(g)(4).³¹ Section 3C(g)(4) of the Exchange Act contains a number of provisions specially designed for finance affiliates of persons qualifying for the end-user clearing exception, and among other things does not permit finance affiliates that are themselves swap dealers, security-based swap dealers, major swap participants, major security-based swap participants or certain other defined categories of entities to use the end-user clearing exception as an agent for another entity in any circumstances.³² Given these additional features, the Commission preliminarily believes it is appropriate to separately

³¹ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(4)).

³² Exchange Act Section 3C(g)(4)(A) provides that affiliates of persons qualifying for the end-user clearing exception will also qualify for the end-user clearing exception if the affiliate (1) acts on behalf of the person and as agent, (2) uses the security-based swap to hedge or mitigate commercial risk of that person or another affiliate of that person that is not a financial entity as defined in Exchange Act Section 3C(g)(3), and (3) is not itself one of seven entities defined in Exchange Act Section 3C(g)(4)(B). See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(4)(A)). The seven entities are: (i) a swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap participant; (v) 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 paragraph (1) or (7) of subsection c of that Act (15 U.S.C. 80a-3(c)); (vi) a commodity pool; or (vii) a bank holding company with over \$50,000,000,000 in consolidated assets. See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(4)(B)). In addition, an affiliate, subsidiary, or wholly owned entity of a person that qualifies for an exception under Exchange Act Section 3C(g)(4)(A) and which is predominantly engaged in providing financing for the purchase or lease of merchandise or manufactured goods of the person shall be exempt from both the margin requirements described in Exchange Act Section 15F(e) and the clearing requirement in Exchange Act Section 3C(a), provided that the security-based swaps in question are entered into to mitigate the risk of the financing activities. See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(4)(C)).

categorize security-based swaps transacted by finance affiliates in particular in order to aid the Commission in its efforts to prevent abuse of the end-user clearing exception by being able to readily identify entities that qualify as financial entities and are participating in the use of the exception.

Proposed Rule 3Cg-1(a)(4) requires information to be provided regarding whether the counterparty invoking the end-user clearing exception uses the security-based swap being reported to hedge or mitigate commercial risk. The exception to mandatory clearing of security-based swaps pursuant to Section 3C(g) of the Exchange Act is only available to persons that use security-based swaps to hedge or mitigate commercial risk. The Commission has proposed to adopt Exchange Act Rule 3a67-4 to define the meaning of hedging or mitigating commercial risk for these purposes.³³

Proposed Rule 3Cg-1(a)(6) requires all counterparties invoking the end-user clearing exception to indicate whether they are an issuer of securities registered under Exchange Act Section 12 or required to file reports pursuant to Exchange Act Section 15(d) ("SEC Filer").³⁴ Under Exchange Act Section 3C(i), the exception to mandatory clearing of security-based swaps pursuant to Exchange Act Section 3C(g) is available to SEC Filers only if an appropriate committee of the issuer's board of directors or governing body has reviewed and approved the issuer's decision to enter into security-based swaps that are subject to the exception.³⁵ When

³³ See *infra* notes 49-51 and accompanying text.

³⁴ For these purposes, a counterparty invoking the end-user clearing exception is considered by the Commission to be an issuer of securities registered under Exchange Act Section 12 or required to file reports pursuant to Exchange Act Section 15(d) if it is controlled by a person that is an issuer of securities registered under Exchange Act Section 12 or required to file reports pursuant to Exchange Act Section 15(d). See Rule 1-02(x) of Regulation S-X, 17 CFR 210.1-02(x) (defining subsidiary for purposes of the financial statements required to be filed as part of registration statements under Section 12, and annual and other reports under Exchange Act Sections 13 and 15(d)).

³⁵ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(i)). For these purposes, the Commission considers a committee to be appropriate if it is specifically

the counterparty invoking the end-user clearing exception is an SEC Filer, two additional items of information must be provided:

- Proposed Rule 3Cg-1(a)(6)(i) requires an SEC Filer invoking the end-user clearing exception to specify its SEC Central Index Key number. Collection of this information will allow the Commission to cross reference materials filed with the relevant SDR with information in periodic reports and other materials filed by the SEC Filer with the Commission.³⁶
- Proposed Rule 3Cg-1(a)(6)(ii) requires confirmation that an appropriately authorized committee of the board of directors or equivalent governing body of the SEC Filer invoking the clearing exception has reviewed and approved the decision to enter the security-based swap subject to the end-user clearing exception.³⁷ The Commission preliminarily believes collection of this information is appropriate to promote compliance with the requirements of the end-user clearing exception.

Request for Comment:

The Commission generally requests comments on all aspects of proposed Rule 3Cg-1.

Additionally, the Commission requests comments on the following specific issues:

authorized to review and approve the issuer's decisions to enter into security-based swaps).

³⁶ Exchange Act Section 3C(i) contemplates board review and approval of the decision to enter into the swap that is subject to the exemption. See Item 305 of Regulation S-K, 17 CFR 229.305.

³⁷ For example, a board resolution or an amendment to a board committee's charter could expressly authorize such committee to review and approve decisions of the reporting person not to clear the security-based swap being reported. In turn, such board committee also could adopt policies and procedures regarding the review and approval required by Exchange Act Section 3C(i), which may include periodic consideration of the relative costs, risk management characteristics and other features of cleared and non-cleared security-based swaps.

- Is it sufficiently clear what information the Commission is requiring to be reported under proposed Rule 3Cg-1? If not, why not? Are there clarifications or instructions the Commission could adopt that would be useful for parties seeking to invoke the end-user clearing exception? If so, what are they and what would be the benefits of adopting them?
- Would it be difficult or prohibitively expensive for counterparties to report the information required under the proposed Rule 3Cg-1? If so, why?
- Should the Commission require more or less frequent notifications to the Commission than are currently contemplated by proposed Rule 3Cg-1? What other types of notifications should the Commission consider and what would be the potential frequency associated with such notifications? Are the requirements that the information provided under the proposal be accurate as of the date and time the information is provided to the SDR appropriate? Should the Commission consider any other time frame for accuracy of information? If so, what time frame should the Commission consider and what would be the advantages or disadvantages of such time frame?
- Should the Commission consider collecting more or less information than it has proposed to collect in connection with the Financial Obligation Notice? Is other information needed to achieve the purposes of the Dodd-Frank Act with respect to how an end-user meets its financial obligations or in order to prevent evasion of the end-user clearing exception? For example, is it necessary or appropriate for the Commission to collect:
 - Additional information from that proposed regarding the credit support agreement and the collateral practices under the agreement, such as the level of margin collateral outstanding (e.g., less than or equal to a specified dollar

amount, or greater than a series of progressively higher dollar amounts) or the frequency of portfolio reconciliation?

- Additional information from that proposed regarding the types of collateral provided (e.g., cash, government securities, other securities, other collateral) by an end-user and the effect of the liquidity of such collateral on the ability of the end-user to meet its financial obligations?
- Additional information from that proposed regarding specific terms of the credit support agreement, such as whether the collateral requirements are unilateral or bilateral provisions and whether there are contractual terms triggered by changes in the credit rating or other financial circumstances of one or both of the counterparties?
- Additional information from that proposed about the guarantor, such as whether or not the guarantor is a parent or affiliate of the person invoking the end-user clearing exception?
- Additional information from that proposed regarding the assets pledged, such as the type of security interest or the type of property being used as collateral?
- Additional information from that proposed regarding the segregation arrangements, such as the identity of the collateral agent or other third party involved in the arrangement, and information regarding whether the arrangement involves a custodial, tri-party or different type of relationship?
- Additional information from that proposed regarding the adequacy of other means being used, or the adequacy of the financial resources available, to meet the financial obligations associated with the non-cleared security-based swap?
- Additional information from that proposed regarding the review and approval by the appropriate committee of the SEC Filer's board or governing body of the

issuer's decision to enter into the security-based swap subject to the end-user clearing exception, such as information provided to the committee and/or a summary of the policies and procedures used by the committee in practice?

- Are each of the terms used in Exchange Act Section 3C(g)(4) sufficiently clear to permit compliance with proposed Rule 3Cg-1 by affiliates invoking the end-user clearing exception? Should the Commission adopt more specific requirements to implement the provisions of Exchange Act 3C(g)(4)? Should the Commission provide further guidance on terms used in Exchange Act Section 3C(g)(4), such as the meaning of the term "predominantly engaged"? If so, what specific rules or guidance should the Commission consider and what would be the benefits of adopting them?
- Are the requirements of Exchange Act Section 3C(i) sufficiently clear to permit compliance with proposed Rule 3Cg-1 by parties invoking the end-user clearing exception? Should the Commission adopt more specific requirements to implement the provisions of Exchange Act 3C(i)? For example, should the Commission adopt provisions to specify the membership or other characteristics of the board committee, such as that a majority of the committee, or the entire committee, consist of independent directors? Should the Commission adopt provisions to clarify the steps that should be taken by board committees reviewing and approving an SEC Filer's decision to enter into security-based swaps subject to the end-user clearing exception? If so, what specific rules should the Commission consider and what would be the benefits or disadvantages of adopting them? Should the review and approval contemplated by Exchange Act Section 3C(i) include a review and approval of the SEC Filer's decisions by a board committee (1) composed of a majority of independent directors, (2) that has adopted procedures pursuant to which security-based swap transactions that are subject to the end-user clearing exception may be entered into by

the company, which are reasonably designed to facilitate a risk management policy that has been approved by the board or an appropriate committee, (3) that makes and approves such changes to the policy as the committee deems necessary, and (4) determines no less frequently than quarterly that all security-based swap transactions entered into during the preceding quarter subject to the end-user clearing exception were effected in compliance with such procedures?³⁸ Are there other Commission rules concerning board approvals that may be useful models for the review and approval contemplated by Exchange Act Section 3C(i)?

- Is the meaning of the term “issuer of securities” as used in Exchange Act Section 3C(i) sufficiently clear? Is there a better alternative that the Commission should consider?
- Should the Commission consider requiring parties invoking the end-user clearing exception to report additional types of information, to limit the possibility for the exception to be abused or for other reasons? If so, what other information should be reported and what would be the benefit of requiring such information to be reported? What categories of information, if any, should not be required to be reported and why?
- Will some types of security-based swaps be more susceptible to abuse than others?

For example:

- Are persons more or less likely to abuse the end-user clearing exception in connection with credit default swaps or equity swaps or when the underlying reference credit or security has certain characteristics?
- Are large or small companies or other identifiable sub-categories of counterparties to security-based swaps more or less likely to abuse the end-user clearing exception than other persons?

³⁸

Cf., 17 CFR 270.17a-7(e) (Rule 17a-7(e) under the Investment Company Act of 1940).

- Are there certain security-based swap products or counterparties that the Commission should monitor for abuse more closely than others?

If so, why?

- Are there different considerations for small companies or other identifiable categories of persons who may wish to invoke the end-user clearing exception? If so, what are they and how should the Commission take these considerations into account?
- Should the Commission consider requiring that a narrative statement be provided when an end-user employs means other than those described in proposed Rules 3Cg-1(a)(5)(i), (ii), (iii), or (iv) to meet its financial obligations?

3. Form of Notice to the Commission

Proposed Rule 3Cg-1(a) provides that a counterparty to a security-based swap that invokes the end-user clearing exception shall satisfy the notice requirements of Exchange Act Section 3C(g)(1)(C) by delivering or causing to be delivered the additional information specified in proposed Rule 3Cg-1(a) to a registered SDR or the Commission in the form and manner required for delivery of the information separately specified under proposed Rule 901(d) of Regulation SBSR.³⁹ Delivery of such information would also allow the information submitted pursuant to proposed Rule 3Cg-1(a) by the counterparty invoking the end-user clearing exception to be made available to the public by the SDR, to the extent required by

³⁹ See Regulation SBSR Proposing Release, *supra* note 16. For each security-based swap transaction made in reliance on the end-user clearing exception, proposed Rule 901(d)(1)(ix) under Regulation SBSR requires parties to a security-based swap to indicate whether or not the end-user clearing exception is being invoked when reporting transaction information to an SDR as required by Exchange Act Section 13(m)(1)(F). Proposed Exchange Act Rule 901(a) under Regulation SBSR defines which of the parties to a security-based swap will be designated the Reporting Party for these purposes. The information required under proposed Exchange Act Rule 3Cg-1 would be in addition to these requirements but would be delivered to the SDR by the Reporting Party in the same manner as required by proposed Regulation SBSR. Regulation SBSR contemplates that information may be delivered to the Commission directly in limited circumstances when an SDR is not available. When permitted by Regulation SBSR, such delivery would also meet the end-user clearing exception notice requirement.

proposed Regulation SBSR.⁴⁰ Under this approach, rather than collecting information through a separate process established by the Commission for these purposes, the information delivered in compliance with the requirements of proposed Rule 3Cg-1(a) and proposed Regulation SBSR would serve as the official notice of a security-based swap transaction made in reliance on the end-user clearing exception.

The Dodd-Frank Act requires all transactions in security-based swaps (whether cleared or non-cleared) to be reported to a registered SDR or the Commission.⁴¹ As centralized recordkeeping facilities of OTC derivatives transactions, SDRs are intended to play a critical role in enhancing transparency in the security-based swap markets. SDRs will enhance transparency by having complete records of security-based swap 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.⁴² The Commission recently

⁴⁰ See Regulation SBSR Proposing Release, at Section V., supra note 16, discussing public dissemination of security-based swap transaction information generally, including Exchange Act Section 13(m)(1)(B) (authorizing the Commission to make security-based swap transaction data available to the public to enhance price discovery) and Exchange Act Section 13(m)(1)(E)(iv) (requiring the Commission to consider whether public disclosure of security-based swap transaction data will materially reduce market liquidity). The Commission preliminarily believes information collected pursuant to proposed Rule 3Cg-1 would not be required to be publicly disseminated, but is requesting comments on this point. See infra note 47 and accompanying text.

⁴¹ See Pub. L. No. 111-203, §§ 763(i) and 766(a) (adding Exchange Act Sections 13(m)(1)(G) and 13A(A)(1), respectively).

⁴² In the case of non-cleared security-based swaps, each SDR is required to confirm with both parties to the security-based swap the accuracy of the data submitted to the SDR pursuant to Exchange Act Section 13(n)(5)(B), and both the parties to the security-based swap and the SDR have duties to correct errors in the data that may be identified under proposed Rules 905(a) (parties to the security-based swap) and 905(b) (SDRs) of Regulation SBSR. See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(5)(B); Regulation SBSR Proposing Release, supra note 16. SDRs are required by Exchange Act Section 13(n)(5) (15 U.S.C. 78m(n)(5)) to have policies and procedures reasonably designed to protect the privacy of all transaction information received by the SDR, and the Commission recently proposed Rule 13n-9 to implement this requirement. See Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306

proposed a series of new rules relating to the SDR registration process, duties, and core principles to ensure that SDRs operate in the manner contemplated by the Dodd-Frank Act.⁴³ The Commission also recently proposed Regulation SBSR to establish the standards that would apply when information is submitted to an SDR.⁴⁴

The Commission preliminarily believes collecting notice information for the end-user clearing exception through SDRs will support the development of straight through trade processing, help to reduce the administrative burdens of the notice requirement and assure the accuracy of the information collected.⁴⁵ Using the centralized facilities of SDRs should also make it easier for the Commission to analyze how the end-user clearing exception is being used, monitor for potentially abusive practices, and take timely action to address abusive practices if they were to develop.⁴⁶

(Dec. 10, 2010) (“Regulation SDR Release”). Exchange Act Section 13A(c) requires each party to a non-cleared security-based swap to maintain records of the security-based swaps held by such party in the form required by the Commission, and Exchange Act Section 13A(d) mandates that these records must be in a form not less comprehensive than required to be collected by SDRs. See Pub. L. No. 111-203, § 766(a) (adding Exchange Act Sections 13A(c)-(d)). These records are available for inspection by the Commission and other specified authorities pursuant to Exchange Act Section 13A(c)(2) (Pub. L. No. 111-203, § 766(a) (adding Exchange Act Section 13A(c)(2))).

⁴³ See Regulation SDR Release, supra note 42.

⁴⁴ See id.

⁴⁵ See id. Exchange Act Sections 13(n) and 13A require parties to report transaction information to SDRs, confirm its accuracy and correct inaccuracies. See Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)); Pub. L. No. 111-203, § 766(a) (adding Exchange Act Section 13A). The Commission preliminarily believes these requirements create sufficient assurance to consider the transaction records collected by SDRs reliable for use in connection with regulatory decisions, and therefore the Commission preliminarily believes the records should also be considered reliable for purposes of the notice requirement under Exchange Act Section 3C(g). Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)).

⁴⁶ The proposed notification method is supported by the recordkeeping requirements under Exchange Act Section 13A, which will permit the Commission to review transaction information and take such action as may be necessary to prevent abuses of the end-user clearing exception. See Pub. L. No. 111-203, § 766(a) (adding Exchange

Under proposed Regulation SBSR, and in particular proposed Rule 901(d), the information required to be reported to an SDR includes, if the security-based swap is not cleared, “whether the exception in Section 3C(g) of the Exchange Act was invoked.” This information would then be included in the transaction report disseminated to the public under proposed Rule 902. Pursuant to proposed Rule 3Cg-1(a), however, the information required to be reported to an SDR would include more detailed information than simply whether Section 3C(g) was invoked – for example, under Rule 3Cg-1(a) the reportable information would include the identity of the counterparty relying on the clearing exception, and information regarding how that counterparty expects to meet its financial obligations. The Commission preliminarily believes that this additional information would either fall under the exception to public dissemination contained in proposed Rule 902(c)(2),⁴⁷ or otherwise should be excluded from the publicly-disseminated transaction report. Thus, the only information collected pursuant to Rule 3Cg-1 that would be disseminated publicly is “whether the exception to Section 3C(g) of the Exchange Act was invoked.”

Request for Comment:

The Commission generally requests comments on all aspects of proposed Rule 3Cg-1. Additionally, the Commission requests comments on the following specific issues:

- Is it appropriate for the Commission to require notification regarding use of the end-user clearing exception to be made through SDRs? Should notifying the Commission necessarily involve direct conveyance of the information to the

Act Section 13A). Such Commission action would be taken in a manner consistent with our review practices for other transaction information submitted to SDRs, rather than through a separate process developed for these purposes, thereby helping to maintain consistency of regulatory action in comparable areas.

⁴⁷ Proposed Rule 902(c)(2) of Regulation SBSR would prohibit disclosure of any information disclosing the business transactions and market positions of any person with respect to a security-based swap that is not cleared. See *supra* note 16 (citing Regulation SBSR Proposing Release).

Commission rather than delivery through an SDR? What are the advantages or disadvantages of the Commission's proposal?

- Does collecting Financial Obligation Notice information through SDRs interfere with the ability of non-financial entities to use the end-user clearing exception in any way? Are SDRs reliable enough to be used for these purposes? Are the services provided by SDRs reasonably available to non-financial entities?
- Is Financial Obligation Notice information different from other information proposed to be collected by SDRs in some respect that makes use of SDRs for these purposes inappropriate? If so, how is the notice information different and why is it inappropriate to use SDRs to collect the information?
- Would it be preferable to require notice of use of the end-user clearing exception to be given through the Commission's EDGAR system on a newly developed EDGAR form?⁴⁸ What would be the advantages or disadvantages of using the EDGAR system? For example:
 - Do parties intending to invoke the end-user clearing exception anticipate any benefits or burdens of filing an EDGAR form electronically that should be considered?
 - Is the EDGAR system likely to be familiar to all entities invoking the end-user clearing exception? Will small companies or other identifiable categories of persons face different burdens or advantages than others when using the EDGAR system?

⁴⁸ See EDGAR Filer Manual, Volume I: "General Information" Version 8 (Sept. 2009), incorporated by reference into the Code of Federal Regulations (Release Nos. 33-9058, 34-60390, 39-2466, IC-28838, July 28, 2009); EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 15 (Aug. 2010), incorporated by reference into the Code of Federal Regulations (Release Nos. 33-9140; 34-62873; 39-2471; IC-29413, Sept. 9, 2010).

- Should the Commission require persons invoking the end-user clearing exception to submit notice to the Commission on an EDGAR form in addition to the information collected through SDRs? Would collecting information in both ways significantly aid the Commission's efforts to prevent abuse of the end-user clearing exception or have other benefits that should be considered by the Commission? Would doing so create significant additional burdens for persons invoking the end-user clearing exception?
- Other than the alternative of using the Commission's EDGAR system, are there other methods that the Commission should consider for receiving notification regarding the use of the end-user clearing exception? For example, could the information submitted to an SDR also be dually submitted to Commission in some form? If so, what are the possible alternatives and what advantages or disadvantages would they have?
- Do the Exchange Act and the associated rules and proposed rules regulating SDRs and parties to security-based swaps create sufficient assurance that notice information collected through SDRs will be accurate? Are there additional protections the Commission should establish to create greater assurance that the notice information collected will be accurate? If so, what are they and how will they improve the information collection process?
- Would the person reporting information to the SDR be in a position to know, in all cases, the information the Commission is requiring to be reported under proposed Rule 3Cg-1(a)? If not, why not? Are representations and warranties and similar established market practices associated with documenting security-based swap transactions adequate to ensure the person reporting information to the SDR can obtain the information required to be reported under proposed Rule 3Cg-1?

- Should the Commission consider more or less frequent reporting of the information required by Rule 3Cg-1(a)? How frequently will the information required to be reported be expected to change? Would alternatives to proposed Rule 3Cg-1 such as the collection of periodic reports or updates of general notifications to the Commission be sufficient to achieve the purposes of Exchange Act Section 3C(g)? If so, what are the possible alternatives and what advantages or disadvantages would they have?
- How long would it be expected to take for the person reporting information to the SDR to gather the information required under proposed Rule 3Cg-1(a)? Will the time needed to gather the required information disrupt the transaction process for security-based swaps to any material extent?
- Should the Commission require persons invoking the end-user clearing exception to follow additional compliance practices in some circumstances? For example:
 - Should the Commission require persons invoking the end-user clearing exception swap to create additional records of the means being used to mitigate the credit risk of the security-based swap as contemplated by proposed Rule 3Cg-1(a)(5) and maintain such record in the manner required by Exchange Act Section 13A(d)?
 - Should the Commission require persons invoking the end-user clearing exception to file materials referred to in proposed Rule 3Cg-1(a)(5) with the Commission? Why or why not?
 - Should the Commission require persons invoking the end-user clearing exception to establish any other additional compliance practices? If not, why not? If so, what should those practices be and what would be the advantages and disadvantages of adopting such a requirement?

- Will collecting notice information together with other transaction information have the advantages expected by the Commission? For example, will analyzing information regarding use of the end-user clearing exception by product type and other transaction characteristics help to promote market efficiency or inform future Commission rulemaking? Are there other advantages or disadvantages related to collecting notice information through SDRs that the Commission should consider? If so, what are they?
- Does collecting notice information regarding use of the end-user clearing exception through SDRs create significantly greater burdens or advantages for some parties to security-based swaps compared to others? For example, will parties who frequently transact security-based swaps face higher or lower burdens or advantages compared to parties that enter into security-based swap transactions less frequently? Will parties who enter into both cleared and non-cleared security-based swaps face different burdens or advantages in comparison to parties who enter into only cleared security-based swaps or only non-cleared security-based swaps? Will small companies face different burdens than large companies? If so, what steps should the Commission consider taking to account for these differences? Given that certain efficiencies may arise from conducting frequent transactions in security-based swaps, are the additional burdens that may be faced by small companies or non-financial entities that enter into security-based swaps infrequently unique to the proposed rule or do they principally reflect the nature of the security-based swaps market and the nature of the transacting party? Are there benefits from collecting notice information that should also be considered?
- Should any or all of the information required to be reported to an SDR pursuant to proposed Rule 3Cg-1(a) be publicly disseminated? Should public dissemination be limited only to the fact that Exchange Act Section 3C(g) was invoked? Are there any

changes to the proposed rules the Commission should consider regarding public dissemination? If publicly disclosed, how would market participants, academics and other members of the public expect to use such information and what are the potential benefits or costs of such uses? Would additional information be useful? What information, if any, included in proposed Rule 3Cg-1(a) would raise concerns for end-users if made public after the end-user elected to use the exception? How would the public interest be better served by keeping information relating to the end-user clearing exception in or out of the public domain?

- If restrictions on public dissemination of the information are in place, should the Commission consider permitting such dissemination after the lapse of a certain period of time? If so, should all or only a subset of the information be disseminated? What would be an appropriate time period for a delay in dissemination? How would the analysis of whether the public interest would be better served by keeping information relating to the end-user clearing exception in or out of the public domain change based on whether there is a delay in such dissemination?
- Should information regarding whether the end-user clearing exception was invoked that is collected pursuant to proposed Rule 3Cg-1(a) be made available to the public through the SDR or through new processes established by the Commission? What would be the advantages and disadvantages of either approach?

B. Hedging or Mitigating Commercial Risk

To apply the end-user clearing exception, Exchange Act Section 3C(g)(1)(B) requires a non-financial entity to determine whether it uses security-based swaps to hedge or mitigate commercial risk.⁴⁹ The phrase “hedging or mitigating commercial risk” is itself the subject of current joint rulemaking by the Commission and the CFTC. The Commission and the CFTC

⁴⁹ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(1)(B)).

recently proposed a definition of "hedging or mitigating commercial risk" under proposed Exchange Act Rule 3a67-4 that the Commission preliminarily believes should also govern the meaning of "hedging or mitigating commercial risk" for purposes of Exchange Act Section 3C(g)(1)(B).⁵⁰ The Commission preliminarily believes this approach should ensure consistency of interpretation across the Exchange Act provisions for which this concept is

⁵⁰ See Definitions Proposing Release, supra note 3. Persons wishing to comment on the definition of "hedging or mitigating commercial risk" should submit comments pursuant to the Definitions Proposing Release. For reference, proposed Exchange Act Rule 3a67-4(a) reads as follows:

"Hedging or mitigating commercial risk"

For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67) and §240.3a67-1 of this chapter, a security-based swap position shall be deemed to be held for the purpose of hedging or mitigating commercial risk when:

- (a) Such position is economically appropriate to the reduction of risks that are associated with the present conduct and management of a commercial enterprise, or are reasonably expected to arise in the future conduct and management of the commercial enterprise, where such risks arise from:
 - (1) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;
 - (2) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise; or
 - (3) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;
- (b) Such position is:
 - (1) Not held for a purpose that is in the nature of speculation or trading;
 - (2) Not held to hedge or mitigate the risk of another security-based swap position or swap position, unless that other position itself is held for the purpose of hedging or mitigating commercial risk as defined by this section or 17 CFR § 1.3(ttt); and
- (c) The person holding the position satisfies the following additional conditions:
 - (1) The person identifies and documents the risks that are being reduced by the security-based swap position;
 - (2) The person establishes and documents a method of assessing the effectiveness of the security-based swap as a hedge; and
 - (3) The person regularly assesses the effectiveness of the security-based swap as a hedge."

relevant and provide assurance of fair and equivalent treatment for similarly situated parties in a wide variety of circumstances.⁵¹

Request for Comment:

The Commission generally requests comments on all aspects of proposed Rule 3Cg-1. Additionally, the Commission requests comments on the following specific issues:

- Are there reasons to believe that the proposed joint rulemaking by the Commission and the CFTC to define the meaning of certain terms used in the Exchange Act may affect the availability of the end-user clearing exception? If so, what specifically are the affects expected and what concerns do they raise?
- Are there further distinctions or clarifications that should be made by the Commission for purposes of the end-user clearing exception that are different from those being made in connection with the proposed joint rulemaking by the Commission and the CFTC? If so, what are they and what would be the benefits of adopting them?
- Are there technical requirements or details associated with terms used in the definition of “financial entity” in Exchange Act Section 3C(g)(3) that may have unexpected consequences when used in connection with the end-user clearing exception? Are there aspects of the CEA, the Investment Advisers Act of 1940 (15

⁵¹ The Commission notes that certain portions of proposed Rule 3a67-4 would be either inapplicable to, or would need to be interpreted in light of, the circumstances surrounding the end-user clearing exception. For example, subparagraph 3a67-4(c)(3) of the proposed Rule requires that a person regularly assess the effectiveness of the security-based swap as a hedge. Given that persons must determine whether the end-user clearing exception is available at the time the security-based swap is first confirmed, this portion of proposed Rule 3a67-4 is inapplicable for purposes of Exchange Act Section 3C(g)(1)(B). In addition, proposed Rule 3a67-4 does not contemplate applying the definition of hedging or mitigating commercial risk to affiliates. Exchange Act Section 3C(g)(4) creates certain additional requirements for affiliates of non-financial entities seeking to invoke the end-user clearing exception, and these requirements must also be satisfied for the end-user clearing exception to be available.

U.S.C. 80), the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002), or the Bank Holding Company Act of 1956 (12 U.S.C. 184) that are incorporated in the definition that may need to be taken into consideration by the Commission to ensure the end-user clearing exception is available in appropriate circumstances? If so, what specific changes should the Commission consider and what would be the benefits of adopting them?

- Should the Commission consider adopting a separate definition of “hedging or mitigating commercial risk” specifically designed to address the circumstances of the end-user clearing exception? If so, what are the specific considerations associated with the end-user clearing exception that make a separate rule desirable? What features would such a rule need in order to be effective and what would be the benefits of adopting them?
- Should the Commission consider limiting or broadening the definition of “hedging or mitigating commercial risk” as it applies to the end-user clearing exception? For example, should security-based swaps subject to the end-user clearing exception be required to hedge or mitigate commercial risk on a single risk or an aggregate risk basis, and/or on a single entity or a consolidated basis? Are more specific industry-specific rules on hedging or rules that apply only to certain categories of asset classes appropriate at this time? Should security-based swaps facilitating asset optimization or dynamic hedging be included? Why or why not?

Commenters are requested to discuss both the policy and legal bases underlying such comments.

- If an entity is designated as a swap dealer, security-based swap dealer, major swap participant or major security-based swap participant only for some of its swaps or security-based swaps, should it be treated as a financial entity under Exchange Act

Section 3C(g)(3) and thereby be disqualified from invoking the end-user clearing exception for all of its security-based swaps? If so, why? If not, should the Commission require security-based swap dealers and major security-based swap participants in that position to separate or otherwise keep distinct those security-based swap activities for which they are designated as a security-based swap dealer or major security-based swap participant from their other security-based swap activities? If so, how? If not, why not?

III. Required Consideration of a Clearing Exemption for Small Banks, Savings Associations, Farm Credit System Institutions and Credit Unions

Mandatory clearing of security-based swaps is a central part of the reforms enacted by the Dodd-Frank Act and generally applies to financial entities without regard to size. However, Section 3C(g)(3)(B) of the Exchange Act requires the Commission to consider whether to exempt small banks, savings associations, farm credit systems institutions and credit unions from the Act's definition of "financial entity", including specifically those with total assets of \$10,000,000,000 or less ("Identified Financial Institutions").⁵² The advantages and disadvantages associated with mandatory clearing may be different with respect to certain types of financial entities and the Commission is required to consider whether such differences warrant granting an exemption for Identified Financial Institutions.⁵³

The Identified Financial Institutions may use security-based swaps, and other derivatives to hedge or mitigate their business risks in ways that may be directly related to the business of banking. Under the definition of "financial entity" in the Dodd-Frank Act, however, these institutions would not qualify to use the end-user clearing exception unless further action is taken by the Commission. Depending on the extent to which an Identified Financial Institution relies on security-based swaps to manage its risk, the lack of an end-user

⁵² See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(3)(B)).

⁵³ See Dodd-Lincoln Letter, supra note 23.

exception could limit the availability, or raise associated initial costs, of security-based swaps for that institution.

Alternatively, providing a blanket carve-out from the clearing requirement, albeit in connection with hedging transactions, for a class of financial entities could undercut the statutory goal of greater centralized clearing and the related benefits of efficiency and transparency. The Commission preliminarily does not believe that Identified Financial Institutions transact in securities-based swaps for hedging purposes in significant volume, but is requesting comments on this point. The Commission would also be interested in commenters' views on the practical impact of either permitting or prohibiting Identified Financial Institutions from using the end-user exception to effect securities-based swaps transactions, and how narrowly or broadly any exemption should be structured.⁵⁴

In accordance with Section 3C(g)(3)(B) of the Exchange Act and taking the above considerations into account, the Commission is proposing alternative additional rule text under consideration in proposed Rules 3Cg-1(b) and (c) to exclude from the definition of "financial entity" those banks, savings associations, farm credit systems institutions and credit unions with total assets of \$10 billion or less falling within the definition of "financial entity" solely because of Section 3C(g)(3)(A)(viii) of the Exchange Act. The Commission preliminarily believes it would be appropriate to consider an alternative that contains an exemption for such

⁵⁴ See S. Rep. No. 111-176, at 34 (2010) (Report of the Senate Committee on Banking, Housing, and Urban Affairs regarding The Restoring American Financial Stability Act of 2010 discussing the end-user clearing exception and exceptions from bilateral reporting, capital and margin requirements, and stating that "Some parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, uncleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible. Also, OTC (contracts not cleared centrally) should still be subject to reporting, capital, and margin requirements so that regulators have the tools to monitor and discourage potentially risky activities, except in very narrow circumstances. These exceptions should be crafted very narrowly with an understanding that every company, regardless of the type of business they are engaged in, has a strong commercial incentive to evade regulatory requirements.")

entities at the \$10 billion total assets threshold because it would be consistent with the consideration contemplated in Section 3C(g)(3)(B) of the Exchange Act and because it may include financial institutions in the relevant categories that may face difficulties in meeting the burdens associated with a mandatory clearing requirement due to their limited operations or infrequent use of security-based swaps.

Specifically, the alternative language would apply to a bank, as defined in Section 3(a)(6) of the Act, the deposits of which are insured by the Federal Deposit Insurance Commission; a savings association, as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1831), the deposits of which are insured by the Federal Deposit Insurance Commission; a farm credit system institution chartered under the Farm Credit Act of 1971 (12 U.S.C. 2001); or an insured Federal credit union, State credit union or State-chartered credit union under the Federal Credit Union Act (12 U.S.C. 1752) falling within the definition of “financial entity” solely because of Section 3C(g)(3)(A)(viii) of the Exchange Act. The exemption would not be available to any institution that falls into any of the other seven categories specified in Exchange Act Section 3C(g)(3) for any reason. The \$10 billion total asset threshold for these entities would be measured by reference to the total assets of the institution on the last day of the most recent fiscal year. The Commission believes it would be appropriate to consider such time frame for measurement of the \$10 billion threshold in order to balance the need to maintain an updated assessment of the total asset threshold and the need to avoid frequently monitoring the ability to make use of the exemption.

Request for Comment:

The Commission generally requests comments on all aspects of proposed Rule 3Cg-1. In addition, to inform our consideration of whether it would be appropriate for the Commission to provide an exemption for Identified Financial Institutions, the Commission requests comments on the following specific issues:

- Should the Commission grant an exemption from mandatory clearing requirements for Identified Financial Institutions? Would it be better for the Commission to simply require Identified Financial Institutions to follow the same clearing requirements as other financial entities? Why or why not?
- Is the proposed alternative language in proposed Rules 3Cg-1(b) and (c) sufficiently clear to allow Identified Financial Institutions to assess whether or not they would qualify to use the alternative proposed end-user clearing exception? Why or why not? If not, what steps could the Commission take to make the standards more clear and what would be the advantages or disadvantages of the alternative approach?
- How significant are the aggregated activities of Identified Financial Institutions to the security-based swap market currently? Do the activities of such institutions have a material effect on the pricing of swaps, or contribute to an understanding of the security-based swap market? What is the aggregate gross exposure of security-based swaps held by Identified Financial Institutions? How would these activities and exposures change if such institutions were excluded from the mandatory clearing requirement? Is it possible that the activities of such institutions could change in a way such that they could have an effect on the pricing of security-based swaps if they are excluded from the mandatory clearing requirement? If so, what would be the effect on pricing of security-based swaps?
- What types of security-based swap transactions do Identified Financial Institutions enter into and why? Are any risks presented by these types of transactions adequately addressed through the regulatory controls and business practices of Identified Financial Institutions? Should the Commission consider treating different types of security-based swaps differently when considering whether the

end-user clearing exception is available for Identified Financial Institutions? If so, what specific distinctions should be considered by the Commission and what would be the advantages and disadvantages of adopting them?

- Would there be any benefit for Identified Financial Institutions in receiving an exemption taking into account their anticipated activity in the security-based swap market? What would be the potential effects of granting an exemption for Identified Financial Institutions? What would be the effect on the security-based swap market? What would be the effect on the goals of promoting central clearing and reducing systemic risk?
- If an exemption permitting Identified Financial Institutions to use the end-user clearing exception were to be adopted, should the Commission consider limiting the availability of the end-user clearing exception to only some of the financial institutions identified in Exchange Act Section 3C(g)(3)(B)? Are there differences in the supervisory regimes applicable to banks, savings associations, farm credit institutions and credit unions that create material substantive differences between such institutions that are relevant for these purposes? If so, what specific distinctions should be considered by the Commission and what would be the benefits of adopting them?
- Do Identified Financial Institutions commonly enter into security-based swaps? Would such institutions' behavior in respect of security-based swaps change if the end-user exception was extended or not extended to include them?
- What would be the possible consequences of not proposing an exemption on the banking activities and operational practices of Identified Financial Institutions? Would the absence of an exemption prevent Identified Financial Institutions from providing or increase the costs of providing certain types of financial services to

their customers or require them to make additional investments? If so, how?

What types of services and what types of customers might be impacted? What types of investments might be required? Would the expected impact be justified by the systemic or other benefits of requiring mandatory clearing?

- Is the \$10,000,000,000 total asset threshold an appropriate point for the Commission to use when defining the availability of a clearing exception for Identified Financial Institutions? Should the threshold be lower? Should the threshold be higher? Is there a measure other than total assets, or a more precise definition of total assets, that should be used for these purposes, and if so, what would be the benefit of adopting the alternative measure?
- What would be an appropriate frequency for measuring compliance with the \$10,000,000,000 total asset threshold for entities? Is the proposed time frame too long or too short? If so, why? Are there any difficulties in measuring or monitoring such threshold? Would Identified Financial Institutions generally measure and monitor such thresholds as part of their normal business practices?

IV. General Request for Comments

The Commission is requesting comments from all members of the public. The Commission will carefully consider the comments that it receives. The Commission seeks comment generally on all aspects of the proposed rule. 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 rule sufficiently clear? Is additional guidance from the Commission necessary?

3. What are the technological or administrative burdens of complying with the rule proposed by the Commission? Does the method of collecting information contained in the proposed rule offer any technological or administrative advantages in comparison to other possible methods?
4. Should the Commission implement substantive requirements in addition to, or in place of, the requirements in the proposed rule?

In addition, the Commission seeks commenters' views regarding any potential impact of the proposal on non-financial entities expecting to invoke the end-user clearing exception, SDRs, other market participants, and the public generally. The Commission seeks comments on the proposal as a whole, including its interaction with the other provisions of the Dodd-Frank Act. The Commission seeks comments on whether the proposals would help achieve the broader goals of increasing transparency and accountability in the OTC derivatives market.

The Commission requests comment generally on whether its proposed actions today to govern the exception to mandatory clearing of security-based swaps available under Exchange Act Section 3C(g) are necessary or appropriate for those purposes. If commenters do not believe the provisions of the proposed rule are necessary and appropriate, why not? What would be the preferred action?

Title VII requires that the SEC 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 proposing rules related to an exception to mandatory clearing of swaps as required under Section 723(a) 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, we request comments on the impact of any differences between the Commission and CFTC approaches to the regulation of swap data repositories and SDRs, respectively. Specifically, do the regulatory approaches under the Commission's proposed rulemaking pursuant to Section 763(a) of the Dodd-Frank Act and the CFTC's proposed rulemaking pursuant to Section 723(a) 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 the approaches proposed by the Commission and the CFTC to govern the end-user clearing exception to mandatory clearing of security-based swaps and swaps are comparable? If not, why? Do commenters believe there are approaches that would make the end-user clearing exceptions for security-based swaps and swaps more comparable? If so, what are they and what would be the benefits of adopting such approaches? 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(a) of the Dodd-Frank Act governing the exception to mandatory clearing of security-based swaps.

V. Paperwork Reduction Act Analysis

Proposed Rule 3Cg-1

Proposed Rule 3Cg-1 Notice to the Commission [and Financial Entity Exemption] contains "collection of information" requirements within the meaning of the Paperwork

reduction Act of 1995 (44 U.S.C. §3501 et seq.). The Commission has submitted it to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title of the new collection of information under proposed Rule 3Cg-1 under the Exchange Act is "Rule 3Cg-1 Notice to the Commission [and Financial Entity Exemption]." OMB has not yet assigned a control number for the new collection of information contained in proposed Rule 3Cg-1 under the Exchange Act. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

A. Summary of Collection of Information

Proposed Rule 3Cg-1(a) under the Exchange Act would require a counterparty to a security-based swap transaction to meet the requirements of Exchange Act Section 3C(g)(1)(C) by delivering certain specified items of information to an SDR in the manner required by proposed Regulation SBSR.⁵⁵ Whenever the end-user clearing exception is invoked, ten additional items of information would be required to be produced. If the counterparty invoking the end-user clearing exception is also an issuer of securities under Exchange Act Section 12 or required to file periodic reports with the Commission pursuant to Exchange Act Section 15(d) then two additional items of information would also be required for a total of twelve items of information required to be produced. In either case, this additional information collected in the form and manner required by Regulation SBSR would

⁵⁵ See *supra*, notes 21-37 and accompanying text. Proposed Regulation SBSR would specify who reports security-based swap transactions, where such transactions are to be reported, what information is to be reported, and in what format. The information required under proposed Exchange Act Rule 3Cg-1 would be in addition to these requirements but would be delivered to the SDR by the Reporting Party in the same manner as required by proposed Regulation SBSR. Regulation SBSR contemplates that information may be delivered to the Commission directly in limited circumstances when an SDR is not available. When permitted by Regulation SBSR, such delivery would also meet the end-user clearing exception notice requirement.

serve as the official notice to the Commission of a security-based swap transaction that is made in reliance on the end-user clearing exception.⁵⁶

B. Proposed Use of Information

The collection of information in proposed Rule 3Cg-1(a) serves two purposes contemplated by the Dodd-Frank Act. First, the proposed Rule identifies what a party to a security-based swap transaction must do to satisfy the statutory requirement in Exchange Act 3C(g)(1)(C) to provide notice to the Commission if it invokes the end-user clearing exception.⁵⁷ Second, the Commission expects the empirical data collected under Rule 3Cg-1(a) will aid efforts to prevent abuse of the end-user clearing exception by allowing it to evaluate how the end-user clearing exception is being used, identify areas of potential concern and take prompt action to limit abuses in appropriate circumstances.⁵⁸

C. Respondents

The proposed collection of information in proposed Rule 3Cg-1(a) would apply to transactions that qualify for the end-user clearing exception under Exchange Act Section 3C(g)(1) where at least one of the parties to the security-based swap is not included in the definition of financial entity and is using the security-based swap to hedge or mitigate commercial risk. For an entity to determine whether it is not a financial entity and whether it is using the security-based swap transaction to hedge or mitigate commercial risk, the party must first make an assessment under the applicable definition of financial entity in Exchange Act Section 3C(g)(3)⁵⁹ and then consider whether the definition of hedging or mitigating

⁵⁶ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(1)(C)).

⁵⁷ Id.

⁵⁸ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(6)).

⁵⁹ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(3)(A)(i)-(viii)).

commercial risk in proposed Rule 3a67-4 applies to the security-based swap in question.⁶⁰ In addition, those entities that may be considered Identified Financial Institutions and therefore fall within the exemption under the proposed alternative language in Rule 3Cg-1(b) and (c) would be required to conduct an assessment under the proposed alternative language to determine whether they are entitled to elect to use the end-user clearing exception.

Based on the information currently available to the Commission, the Commission preliminarily estimates there are roughly 5,000 entities in the credit default swaps marketplace.⁶¹ The Commission preliminarily estimates that 1,000 of these entities regularly participate in the market for credit default swaps and other security-based swaps to an extent that may lead them to be reporting persons for purposes of proposed Regulation SBSR. In addition, the Commission estimates that there may be up to another 4,000 security-based swap counterparties⁶² that transact security-based swaps much less frequently.⁶³ The Commission preliminarily believes the 1,000 regular participants in the security-based swaps market are likely to be entities that are financial entities for purposes of the Dodd-Frank Act and would therefore not qualify for the end-user clearing exception, while the 4,000 less frequent counterparties to security-based swaps could, for purposes of the end-user clearing exception, be non-financial entities using security-based swaps to hedge or mitigate commercial risk. These 4,000 counterparties are also preliminarily believed by the Commission to include Identified Financial Institutions using security-based swaps.⁶⁴ Accordingly, with respect to

⁶⁰ See Definitions Proposing Release, supra note 3.

⁶¹ See Regulation SBSR Proposing Release, supra note 16.

⁶² Id.

⁶³ This figure is based on the 5,000 total participants in the security-based swap market minus the 1,000 of those participants that qualify as financial entities.

⁶⁴ For purposes of the discussion that follows, the term “non-financial entities” includes Identified Financial Institutions that would be excluded from the definition of

burdens applicable to all security-based swap counterparties that qualify for the end-user clearing exception, the Commission preliminarily believes that it is reasonable to use the figure of 4,000 respondents for purposes of estimating collection of information burdens under the PRA.

D. Total Initial and Annual Reporting and Recordkeeping Burdens

The Commission preliminarily believes the notification required by proposed Rule 3Cg-1⁶⁵ imposes a limited reporting or record keeping burden, because it references commonly used market practices when defining whether a security-based swap hedges or mitigates commercial risk⁶⁶ and utilizes the proposed reporting and recordkeeping mechanism under Rule 901 of Regulation SBSR to meet the notice requirement contemplated by Exchange Act Section 3C(g)(1)(C).⁶⁷ Under proposed Rule 3Cg-1 the additional reporting burden on the party invoking the end-user clearing exception would be to identify and document the commercial risk being hedged and the effectiveness of the proposed security-based swap as a hedge, and then complete ten or, at the most, twelve additional data points in a larger set of transaction information that would be required to be submitted to an SDR or the Commission under proposed Regulation SBSR. In addition, those entities that may be considered Identified Financial Institutions and therefore fall within the exemption under the proposed alternative language in Rule 3Cg-1(b) and (c) would be required to conduct an assessment under the proposed alternative language to determine whether they are entitled to elect to use the end-user clearing exception. The recordkeeping burden on the SDR would also be limited

“financial entity” in Exchange Act Section 3C(g)(3) in the event the proposed alternative language in Rules 3Cg-1(b) and (c) is adopted by the Commission.

⁶⁵ For purposes of the discussion that follows, references to proposed Rule 3Cg-1 are to proposed Rule 3Cg-1 including the alternative proposed rule text, unless otherwise noted.

⁶⁶ See Definitions Proposing Release, supra note 3.

⁶⁷ See Regulation SBSR Proposing Release, supra note 16.

to storing the additional ten or twelve data points in the larger set of transaction information separately required to be delivered pursuant to proposed Regulation SBSR.

1. Estimated Number of Security-Based Swap Transactions

According to publicly available data from the Depository Trust Clearing Corporation (“DTCC”) recently, there have been an average of approximately 20,000 new transactions in single-name credit default swap (“CDS”) transactions per day,⁶⁸ corresponding to a total number of CDS transactions of approximately 5,200,000 per year.⁶⁹ The Commission preliminarily believes that CDS represent 85% of all security-based swap transactions.⁷⁰ Accordingly, and to the extent that historical market activity is a reasonable predictor of future activity,⁷¹ the Commission preliminarily estimates that the total number of security-based swap transactions that would be subject to proposed Rule 3Cg-1 on an annual basis would be approximately 6,200,000.⁷²

⁶⁸ See, e.g., “Table 17: Summary of Weekly Transaction Activity,” http://www.dtcc.com/products/derivserv/data_table_iii.php (weekly data as updated by DTCC).

⁶⁹ Cf., Regulation SBSR Proposing Release, *supra* note 16, which used an estimate of 36,000 transactions in single name CDS transactions per day, referencing the same DTCC data. The difference is accounted for by differences in the scope of proposed Rule 3Cg-1 compared to proposed Regulation SBSR. Proposed Regulation SBSR encompasses both new transactions in security-based swaps and certain transactions occurring during the lifecycle of security-based swaps and therefore both of these elements are taken into account for purposes of its discussion of estimated burdens to be experienced by respondents as a result of the proposed regulation. Proposed Rule 3Cg-1 would only affect new transactions and therefore the estimated number of transactions used for purposes of the burden calculations is limited to new transactions.

⁷⁰ The Commission’s estimate is based on internal analysis of available security-based swap market data. The Commission is seeking comment about the overall size of the security-based swap market.

⁷¹ The Commission notes that regulation of the security-based swap markets, including by means of proposed Regulation SBSR and proposed Rule 3Cg-1, could impact market participant behavior.

⁷² This figure is based on the following: $(5,200,000 / 0.85) = 6,117,647$.

Based on publicly available information and consultation with industry sources, the Commission preliminarily believes that even the most active non-financial entity participants in the security-based swap market enter a relatively small number of new security-based swaps during any given period.⁷³ There are approximately 4,000 participants in the security-based swap marketplace that the Commission preliminarily believes could qualify for the end-user clearing exception and they represent approximately 80% of the total number of participants in the security-based swap market.⁷⁴ However, based on all information reviewed the Commission preliminarily estimates that non-financial entities account for 1% of all security-based swap transactions.⁷⁵

2. Reporting and Recordkeeping Burdens

To qualify for the end-user clearing exception proposed Rule 3Cg-1(a)(4) would require a non-financial entity to determine whether the terms of the proposed security-based swap and the manner in which it will be used satisfy the definition of hedging or mitigating commercial risk established by proposed Exchange Act Rule 3a67-4. To meet the

⁷³ Information from ISDA surveys relating to collateralized swap transactions indicate that the average number of outstanding OTC derivative trades for non-bank firms generally average just 1% of all transactions in the marketplace, and this figure includes transactions associated with certain parties not entitled to invoke the end-user clearing exception, such as certain major swap participants, commodity pools as defined in section 1a(10) of the Commodity Exchange Act and private funds as defined in section 202(a) of the Investment Advisers Act of 1940. See ISDA Collateral Committee, ISDA Feasibility Study: Extending Collateralized Portfolio Reconciliations (Dec. 18, 2009) ([available at www.isda.org/c_and_a/pdf/ISDA-Portfolio-Reconciliation-Feasibility-Study.pdf](http://www.isda.org/c_and_a/pdf/ISDA-Portfolio-Reconciliation-Feasibility-Study.pdf)). The Commission is seeking comment about the overall size of the security-based swap market.

⁷⁴ This 80% figure is based on the quotient of dividing the 4,000 participants that could qualify for the end-user clearing exception by the estimated 5,000 participants in the security-based swaps marketplace.

⁷⁵ See *supra* note 73. An estimate that non-financial entities account for 1% of security-based swap transactions will be used for purposes of the calculations that follow below.

requirements of the definition, subsection 3a67-4(a)(3) of proposed Rule 3a67-4 specifies that the counterparty to the security-based swap must identify and document one or more risks associated with the present or future conduct and management of the enterprise that are being reduced by the security-based swap and establish and document a method of assessing the effectiveness of the security-based swap as a hedge for such identified risks. In complying with proposed Rule 3a67-4, non-financial entities seeking to invoke the end-user clearing exception would need to establish and maintain an appropriate compliance mechanism including the necessary professional, legal, technical and administrative support to make and document the required assessment of hedging effectiveness.⁷⁶

The Commission preliminarily believes that counterparties transacting in security-based swaps to hedge commercial risks ordinarily will have established risk management or financial control systems in place for other reasons which will likely be adjusted to accommodate the requirements of proposed Rule 3a67-4(a)(3).⁷⁷ Accordingly, the Commission preliminarily estimates that designing and implementing an appropriate compliance and support program to estimate the hedging effectiveness of security-based swaps would impose an initial one time aggregate burden of approximately 44,000 hours,

⁷⁶ See Definitions Proposing Release, supra note 3.

⁷⁷ The Commission preliminarily believes some entities establish and follow these types of procedures so that their hedging transactions will qualify for hedge accounting treatment under generally accepted accounting principles, which require procedures similar to those contained in this proposed rule, or to meet other statutory requirements. While hedging relationships involving security-based swaps that qualify for the hedging or mitigating commercial risk exception within the proposed rule are not limited to those recognized as hedges for accounting purposes, we believe that entities that are not seeking hedge accounting treatment for their hedging transactions commonly identify and document their risk management activities as well as assess the effectiveness of those activities as a matter of good business practice. See also Item 305 of Regulation S-K, 17 CFR 229.305 (requiring SEC Filers to provide identified risk based disclosures relating to their activities in financial derivatives); Internal revenue Code Section 1259 (26 U.S.C. 1259) (recognizing hedging transactions as "constructive sales" of certain appreciated financial positions in specified circumstances).

corresponding to 11 burden hours for each reporting party, to adjust these established risk management or financial control systems to accommodate the requirements of proposed Rule 3a67-4.⁷⁸

The Commission preliminarily estimates that to gather the information required to notify the Commission that a security-based swap is being used to hedge or mitigate commercial risk purposes of proposed Rule 3Cg-1(a)(4) would impose an ongoing aggregate annual burden of approximately 62,000 burden hours for all respondents, which corresponds to an ongoing annual aggregate burden of approximately 16 burden hours for each respondent.⁷⁹ The Commission further preliminarily estimates that for a party to make an assessment required under proposed Rules 3Cg-1(b) and (c) of the proposed alternative rule text, if applicable, gather the remaining information required by proposed Rule 3Cg-1(a) and include the information in the security-based swap information delivered to an SDR as contemplated by proposed Regulation SBSR would impose an ongoing aggregate annual burden of approximately 31,000 burden hours for all respondents, which corresponds to an ongoing aggregate annual burden of approximately eight (8) burden hours for each respondent,⁸⁰ as

⁷⁸ This figure is based on the following: (Senior Business Analyst at 4 hours) + (Compliance Manager at 4 hours) + (Director of Compliance at 2 hours) + (Compliance Attorney at 1 hour) x (4000 respondents) = 44,000 burden hours; (44,000 burden hours per year) / (4000 respondents) = 11 burden hours per year per respondent.

⁷⁹ These figures are based on the following: (((Senior Business Analyst at 30 minutes) + (Compliance Manager at 30 minutes)) x (6,200,000 security-based swap transactions) x (1% transactions by parties eligible to invoke end-user clearing exception))) / 60 minutes = 62,000 burden hours per year; (62,000 burden hours per year) / 4,000 respondents = 15.5 burden hours per year per respondent.

⁸⁰ These figures are based on the following: ((Compliance Manager at 30 minutes) x (6,200,000 security-based swap transactions) x (1% transactions by parties eligible to invoke end-user clearing exception)) / 60 minutes = 31,000 burden hours per year; (31,000 burden hours per year) / 4,000 respondents = 7.75 burden hours per year per respondent.

each item of additional information is factual information known to the party invoking the end-user clearing exception and unlikely to vary from transaction to transaction.⁸¹

The Commission preliminarily believes that proposed Rule 3Cg-1 would impose minimal additional burdens on either Reporting Parties not using the end-user clearing exception themselves or on SDRs. Reporting Parties would be required by proposed Regulation SBSR to report transaction information relating to security-based swaps in a specified manner, and the Commission therefore preliminarily believes reporting a limited number of additional data elements to the SDR in an equivalent manner will have a de minimis effect on the burdens they experience. Similarly, the Commission preliminarily believes that for an SDR to receive and retain these additional data fields would effectively impose minimal additional burdens, as the information would be transmitted and received electronically and would then be stored as part of the existing transaction data already required under proposed Regulation SBSR.

For the reasons described above, the Commission preliminarily estimates that the initial one-time aggregate burden associated with proposed Rule 3Cg-1 would be 44,000 hours,

⁸¹ For example, the Commission preliminarily expects that a counterparty's status as a non-financial entity, a finance affiliate or an SEC Filer would change infrequently. The Commission understands the time required to collect this information is likely to vary depending on whether the particular security-based swap is documented using electronic or manual processes. Electronic processes allow for fields of required information to be populated automatically, substantially reducing the time required for transaction processing and compliance confirmation. A high percentage of electronically eligible security-based swaps are currently transacted using electronic processes. See ISDA, 2010 ISDA Operations Benchmarking Survey (available at http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf) (showing that for credit derivatives 99% of transactions are eligible to be confirmed electronically and 98% of eligible transactions are confirmed electronically, while for equity derivatives 36% of transactions are eligible to be confirmed electronically and 81% of eligible transactions are confirmed electronically). The Commission preliminarily believes CDS transactions represent 85% of all security-based swap transactions. See supra note 69. The 30 minutes of time estimated to be required to produce the information to comply with proposed Rule 3Cg-1 (other than the hedging or mitigating commercial risk requirement) is intended to account for both manually and electronically processed transactions.

corresponding to 11 burden hours for each respondent,⁸² and the recurring aggregate annualized burden associated with proposed Rule 3Cg-1 would be 93,000 burden hours, which corresponds to 23 annual burden hours per respondent.⁸³

E. Collection of Information Is Mandatory

The collection of information under proposed Rule 3Cg-1 would be mandatory when a security-based swap counterparty chooses to invoke the end-user clearing exception.

F. Record Retention Period

Information collected pursuant to proposed Rule 3Cg-1 would be required to be retained for not less than five years. The Commission recently proposed to adopt rules to regulate the operation of SDRs, which include recordkeeping requirements for security-based swap transaction data reported to a registered SDR pursuant to proposed Regulation SBSR. Specifically, proposed Rule 13n-5(b)(5) would require registered SDRs to maintain the transaction data for not less than five years after the applicable security-based swap expires and historical positions and historical market values for not less than five years.⁸⁴ Exchange Act Section 13A(c)⁸⁵ requires each party to a non-cleared security-based swap to maintain records of the security-based swaps held by such party in the form required by the Commission, and Exchange Act Section 13A(d)⁸⁶ mandates that these records must be in a form not less comprehensive than required to be collected by SDRs. These records are available for inspection by the Commission and other specified authorities pursuant to Exchange Act

⁸² See supra note 78 and accompanying text.

⁸³ This figure is the sum of the calculations presented in notes 79 and 80 above. Summation differences between the final figures in the body of the text are due to the effects of rounding.

⁸⁴ See Regulation SDR Release, supra note 42. See also Pub. L. No. 111-203, § 763(i) (adding Exchange Act Section 13(n)(5)).

⁸⁵ See Pub. L. No. 111-203, § 766(a) (adding Exchange Act Section 13A(c)).

⁸⁶ See Pub. L. No. 111-203, § 766(a) (adding Exchange Act Section 13A(d)).

Section 13A(c)(2).⁸⁷ Accordingly, security-based swap transaction reports received by a registered SDR pursuant to proposed Rule 3Cg-1 and proposed Rule 901 of Regulation SBSR would be required to be retained for not less than five years.

G. Responses to Collection of Information Will Be Kept Confidential

A registered SDR would be under a general obligation to maintain the confidentiality of all information collected pursuant to proposed Rule 3Cg-1 and proposed Rule 901 of Regulation SBSR, subject to limited exceptions under proposed Regulation SDR.⁸⁸ The Commission also preliminarily believes that the additional information collected pursuant to proposed Rule 3Cg-1 would either fall under the exception to public dissemination contained in proposed Rule 902(c)(2), or otherwise should be excluded from the publicly-disseminated transaction report.⁸⁹ Accordingly, the Commission preliminarily believes the collection of information pursuant to proposed Rule 3Cg-1 would be confidential and would not be publicly available.

To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential, subject to the provisions of the Freedom of Information Act ("FOIA"). Exemption 4 of FOIA provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential."⁹⁰ The information required to be submitted to the Commission under proposed Rule 3Cg-1 may contain proprietary financial information regarding security-based swap transactions and therefore be subject to protection from disclosure under Exemption 4 of the FOIA.

⁸⁷ See Pub. L. No. 111-203, § 766(a) (adding Exchange Act Section 13A(c)(2)).

⁸⁸ See Regulation SDR Release, supra note 42.

⁸⁹ See supra note 47 and accompanying text.

⁹⁰ 5 U.S.C. 552(b)(4).

H. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;
2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
3. Enhance the quality, utility and clarity of the information to be collected;
and
4. Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, OMB, Room 3208, New Executive Office Building, Washington, DC 20503; and (2) Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-43-10. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-43-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213.

VI. Analysis of Costs and Benefits of the Proposed Rule

Proposed Rule 3Cg-1 implements the requirements of Exchange Act Section 3C(g) which provides an exception to the general requirement that a security-based swap must be cleared provided that one party to the security-based swap (1) is not a financial entity, (2) is using security-based swaps 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 security-based swaps. The application of the end-user clearing exception is solely at the discretion of the counterparty to the security-based swap that meets the conditions of Exchange Act Section 3C(g)(1). Section 3C(g) specifically preserves the ability of counterparties qualifying for the end-user clearing exception to elect to clear a security-based swap when a clearing agency is available and to select the clearing agency at which the security-based swap will be cleared.

The purpose of mandatory clearing of security-based swap products is to centralize individual counterparty risks through a clearing agency acting as a central counterparty that distributes risk among the clearing agency's participants. When effective, centralization of counterparty risks through clearing reduces the likelihood that defaults propagate between counterparties by establishing and enforcing margin requirements based on risk-based models and parameters designed to limit the possibility that participants will be exposed to losses they cannot anticipate or control. Effective central clearing can also lessen the risk of capital flight from a dealer that becomes economically distressed. In particular, without central clearing, a solvency concern at a major dealer could be made worse by its counterparties quickly moving to other dealers.⁹¹

⁹¹ Darrell Duffie and Haoxiang Zhu, "Does a Central Clearing Counterparty Reduce Counterparty Risk?," (Stanford University, Working Paper, 2010) (available at <http://www.stanford.edu/~duffie/DuffieZhu.pdf>).

However, mandatory clearing of security-based swap products may also alter the burdens on non-financial end-users of derivatives relative to bilateral transactions, including direct costs associated with clearing fees and additional margin requirements and indirect costs associated with using derivatives less tailored to their individual business needs and thereby possibly affect their risk management practices.⁹² Exchange Act Section 3C(g) is designed to permit non-financial end-users that meet the specified conditions to elect not to centrally clear security-based swaps and retain flexibility to use both cleared and non-cleared security-based swaps in their risk management activities.

A. Notification to the Commission

Exchange Act Section 3C(g)(1)(C) requires a non-financial entity that uses security-based swaps to hedge or mitigate commercial risk to notify the Commission how it generally meets its financial obligations associated with non-cleared security-based swaps in order for the end-user clearing exception to be available.⁹³ Section 3C(g)(1)(C) contemplates that the Commission may establish the manner of notification and Exchange Act Section 3C(g)(6) provides that the Commission may prescribe such rules as may be necessary to prevent abuse of the end-user clearing exception. In accordance with Exchange Act Sections 3C(g)(1)(C) and 3C(g)(6), proposed Rule 3Cg-1(a) requires that notification be given to the Commission by delivering specified information to a registered SDR or the Commission with each security-based swap transaction that invokes the end-user clearing exception in the manner required by proposed new Regulation SBSR under the Exchange Act.⁹⁴

⁹² See supra note 11 and accompanying text.

⁹³ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(1)(c)).

⁹⁴ See Regulation SBSR Proposing Release, supra note 16.

1. Meeting Financial Obligations

Proposed Rule 3Cg-1(a)(5) requires the reporting of five specified items of information to satisfy the requirement under the Exchange Act Section 3C(g)(1)(C) for a non-financial entity invoking the end-user clearing exception to notify the Commission of “how it generally meets its financial obligations associated with non-cleared security-based swaps.” Because non-cleared security-based swaps are not subject to uniform margin and collateral requirements such as those established by clearing agencies, providing this information will be useful in monitoring the extent to which non-financial entities that invoke the end-user exception are taking steps to mitigate credit risks associated with security-based swaps.

In order to understand these potential risks, proposed Rule 3Cg-1(a)(5) requires a counterparty invoking the end-user clearing exception to provide notification regarding how they expect to meet their financial obligations associated with the security-based swap by reporting specified information to a registered security-based swap depository. In particular, an entity invoking the end-user clearing exception must indicate in the materials provided to the SDR whether it provides security for the performance of its financial obligations by (i) transferring assets directly to the security-based swap counterparty pursuant to a written credit support agreement; (ii) pledging collateral pursuant to a security arrangement not requiring the transfer of collateral to the security-based swap counterparty; (iii) receiving credit support from a third-party pursuant to a written guarantee; (iv) solely relying on its available financial resources; or (v) using other means.

a. Benefits

Requiring end-users to provide the Commission with general information regarding their arrangements to meet financial obligations associated with non-cleared security-based swaps may confer benefits by reducing concerns about the potential risks that these market

participants introduce into the financial markets in the absence of central clearing. The notification will also allow the Commission to understand how margining and other credit support practices may affect the prices and liquidity of security-based swaps, including by comparing and contrasting the trading costs of non-cleared security-based swaps with different credit support characteristics to each other and to security-based swaps that are cleared. Proposed Rule 3Cg-1(a)(5) also establishes a reporting option for "other means" that may be used to meet financial obligations associated with non-cleared security-based swaps providing the Commission with insight on the possible emergence of new and currently less common methods of mitigating financial risks associated with non-cleared security-based swaps that may arise as the market develops.

b. Costs

The Commission preliminarily estimates the costs associated with the notification required by Rule 3Cg-1(a)(5) will be limited, as the methods used to meet financial obligations associated with non-cleared security-based swaps are expected to be readily known to counterparties invoking the end-user clearing exception and unlikely to vary from transaction to transaction. The Commission preliminarily estimates there are 6,200,000 transactions in security-based swaps annually,⁹⁵ and that parties eligible to invoke the end-user clearing exception are counterparties in approximately 1% of all security-based swap transactions.⁹⁶ The Commission preliminarily estimates that to gather the information required for purposes of complying with proposed Rule 3Cg-1(a)(5) would impose an ongoing aggregate annual burden of approximately 15,500 burden hours for all respondents, which corresponds to a burden of

⁹⁵ See supra note 72 and accompanying text.

⁹⁶ Based on the information presented in note 73 above and the accompanying text, the Commission preliminarily estimates entities qualifying for the end-user exception are involved in roughly 1% of the estimated 6,200,000 annual security-based swap transactions, or 62,000 such transactions ((6,200,000 x 1%) = 62,000).

four (4) burden hours for each respondent.⁹⁷ Accordingly, applying an estimated hourly cost of \$316 for a compliance attorney to gather information about how the counterparty is meeting its Financial Notice Obligation,⁹⁸ the Commission preliminarily estimates proposed Rule 3Cg-1(a)(5) would result in an ongoing aggregate annual cost of \$4,900,000 to the entire end-user community, which corresponds to an average ongoing aggregate annual cost of \$1,225 per end-user.⁹⁹

2. Preventing Abuse of the End-User Clearing Exception

To aid the Commission's efforts to prevent abuse of the end-user clearing exception, proposed Rule 3Cg-1(a) requires notification of which of the counterparties to the security-based swap is invoking the end-user clearing exception, whether the counterparty invoking the exception is or is not a financial entity, whether the counterparty invoking the exception is a finance affiliate meeting the requirements of Exchange Act 3C(g)(4), whether the counterparty invoking the exception uses the security-based swap to hedge or mitigate commercial risk, and whether the counterparty invoking the exception is an SEC Filer. SEC Filers invoking the end-user clearing exception must provide their SEC Central Index Key number and confirm that an appropriate committee of the SEC Filer's board of directors or

⁹⁷ See supra note 80 and accompanying text. The estimates that follow are based on an assumption that the burden of complying with proposed Rule 3Cg-1(a)(5) is equivalent to the burden of complying with the other requirements of proposed Rule 3Cg-1, not including proposed Rule 3Cg-1(a)(4).

⁹⁸ The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2009, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. The remaining hourly rates for professionals used in this cost benefit analysis section are also derived from this source and modified in the same manner.

⁹⁹ These monetized costs are calculated as follows: (15 minutes/60 minutes per hour) x (\$316 dollars per hour) x (62,000 security-based swap transactions annually) = \$4,898,000 annually; (\$4,898,000 annually) / 4,000 respondents = \$1,225 average annually per respondent.

equivalent body has reviewed and approved the decision to enter into the security-based swap that is subject to the end-user clearing exception.

a. Benefits

Requiring notification of the above-listed information would provide regulators with information about the end-user that could help verify that the end-user clearing exception is being invoked by market participants appropriately. The requirement to identify which counterparty is invoking the end-user clearing exception is critical in making this determination. Similarly, since Exchange Act Section 3C(g) limits the availability of the end-user clearing exception to non-financial entities and counterparties hedging or the mitigating commercial risk, an affirmative notification to the Commission that these two factors are satisfied will help verify eligibility of the counterparty to invoke the exception. Given the nature of the specific provisions in the Exchange Act governing use of the end-user clearing exception by finance affiliates,¹⁰⁰ separately identifying transactions involving finance affiliates will also help to ensure these requirements are complied with over time.

The Commission preliminarily expects counterparties to security-based swaps invoking the end-user clearing exception would frequently be entities that have raised capital in public financial markets and are therefore regulated by the Commission.¹⁰¹ Entities registered under the Exchange Act Section 12 or required to file reports pursuant to the Exchange Act Section 15(d) are generally required to include a discussion of qualitative and quantitative elements of market risk in annual reports filed with the Commission, including a discussion of

¹⁰⁰ See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C(g)(4)).

¹⁰¹ See Coalition for Derivatives End-Users comment (September 20, 2010), pursuant to Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Rel. No. 34-62,717, 75 Fed. Reg. 51,429 (Aug. 20, 2010).

how derivatives are used to manage risk.¹⁰² Notification by an end-user that it is subject to this requirement would allow regulators to review how frequently SEC Filers use the end-user clearing exception and better understand how security-based swaps are used by SEC Filers to hedge or mitigate commercial risk. The proposed requirement that SEC Filers invoking the end-user clearing exception provide the relevant Commission file number will allow the Commission to cross reference information received in connection with the end-user clearing exception with other Commission documents more easily. The additional proposed requirement that SEC Filers indicate whether a committee of the board of directors (or equivalent body) reviewed and approved the decision to enter into the security-based swap that is the subject of the end-user clearing exception would serve as confirmation that the requirements of Exchange Act Section 3C(i) applicable to SEC Filers were completed.

b. Costs

To qualify for the end-user clearing exception a non-financial entity would be required to determine whether the terms of the proposed security-based swap and the manner in which it will be used satisfy the definition of hedging or mitigating commercial risk established by proposed Exchange Act Rule 3a67-4. To meet the requirements of the definition, subsection 3a67-4(a)(3) of proposed Rule 3a67-4 specifies that the counterparty to the security-based swap must identify and document one or more risks associated with the present or future conduct and management of the enterprise and establish and document a method of assessing the effectiveness of the security-based swap as a hedge for such identified risks.

¹⁰² See Item 305 of Regulation S-K, 17 CFR 229.305. The Commission does not require companies with a public common equity float of less than \$75 million, or, if a company is unable to calculate public equity float, less than \$50 million in revenue in the last fiscal year to provide quantitative and qualitative disclosure about market risk as required of larger companies under Regulation S-K. See Smaller Reporting Company Regulatory Relief and Simplification, Securities Act Release No. 8876, Exchange Act Release No. 56994, Trust Indenture Act No. 2451 (Dec. 19, 2007), 73 FR 934 (Jan. 4, 2008).

The Commission preliminarily believes that non-financial entities seeking to invoke the end-user clearing exception would need to establish and maintain an appropriate compliance mechanism to meet the hedge or mitigate standard in proposed Rule 3a67-4 including the necessary professional, legal, technical and administrative support to make and document the required assessment of hedging effectiveness.¹⁰³ The Commission also preliminarily believes that counterparties transacting in security-based swaps to hedge commercial risks ordinarily will have established risk management systems in place for other reasons that can be adjusted to accommodate the requirements of proposed Rule 3Cg-1(a)(4) and proposed Rule 3a67-4.¹⁰⁴ Accordingly, the Commission preliminarily estimates that designing and implementing an appropriate compliance and support program to identify the risks being reduced and document the hedging effectiveness of security-based swaps would impose an initial one time initial aggregate cost of \$13,200,000 to all end-users, which corresponds to an average initial cost of \$3300 per end-user.¹⁰⁵

The Commission expects there would also be ongoing costs associated with determining whether the hedging or mitigating commercial risk standard is met for each security-based swap transaction for which the end-user clearing exception is invoked. The Commission preliminarily estimates that to gather the information required for purposes of complying with proposed Rule 3a67-4 and proposed Rule 3Cg-1(a)(4) would impose an ongoing aggregate annual burden of approximately 62,000 burden hours for all respondents,

¹⁰³ See supra note 76 and accompanying text.

¹⁰⁴ See supra note 77 and accompanying text.

¹⁰⁵ This figure is based on the following: (Senior Business Analyst at 4 hours x \$234 per hour) + (Compliance Manager at 4 hours x \$294 per hour) + (Director of Compliance at 2 hours x \$426 per hour) + (Compliance Attorney at 1 hour x \$316 per hour) x (4000 respondents) = \$13,120,000; (\$13,120,000 initial aggregate cost) / (4000 respondents) = \$3,280 initial aggregate cost per respondent. See also supra note 78.

which corresponds to a burden of 16 burden hours for each respondent.¹⁰⁶ Assuming an hourly cost of \$234 per hour for a senior business analyst and \$294 per hour for a compliance manager to meet this requirement, proposed Rule 3Cg-1 would impose an annual cost of \$16,400,000 to all end-users and an average annual cost of \$4,100 dollars per end-user.¹⁰⁷

It was estimated that to make an assessment required under proposed Rules 3Cg-1(b) and (c) of the alternative proposed rule text, if applicable, gather the information required by Rule 3Cg-1(a) besides the information with respect to hedging or mitigating commercial risk, would require the additional work of a compliance manager.¹⁰⁸ That information is factual information a party is likely to have as a result of its existing compliance process and the information is unlikely to vary between transactions.¹⁰⁹ Costs associated with collecting requisite Financial Obligation Notice information required by proposed Rule 3Cg-1(a)(5) have already been discussed.¹¹⁰ Therefore, the information collection and reporting costs that remain to be accounted for are those not associated with either proposed Rules 3Cg-1(a)(4) or

¹⁰⁶ See supra note 79 and accompanying text. The estimates that follow are based on an assumption that the burden of complying with proposed Rule 3Cg-1(a)(5) is equivalent to the burden of complying with the requirements of proposed Rule 3Cg-1, not including proposed Rules 3Cg-1(a)(4), given the comparable nature of the information required.

¹⁰⁷ This figure is based on the following: ((Senior Business Analyst at 30 minutes x \$234 per hour) + (Compliance Manager at 30 minutes x \$294 per hour)) x ((6,200,000 security-based swap transactions) x (1% transactions by parties eligible to invoke end-user clearing exception)) = \$16,368,000 aggregate ongoing costs per year; (\$16,368,000 aggregate ongoing costs per year) / (4,000 respondents) = \$4,092 in aggregate ongoing costs per year per respondent. These figures do not include the costs associated with complying with proposed Rule 3Cg-1(a)(5), which are separately accounted for in note 99 above and the accompanying text, or costs associated with proposed Rule 3Cg-1 other than proposed Rules 3Cg-1(a)(4) and (5), which are separately accounted for in note 112 below and the accompanying text. See also supra note 79.

¹⁰⁸ See supra note 80 and accompanying text.

¹⁰⁹ See supra note 81.

¹¹⁰ See supra note 99 and accompanying text.

(5). The Commission preliminarily estimates that to gather the information required for purposes of complying with proposed Rule 3Cg-1 other than proposed Rules 3Cg-1(a)(4) and (5) would impose an ongoing aggregate annual burden of approximately 15,500 burden hours for all respondents, which corresponds to a burden of four (4) burden hours for each respondent.¹¹¹ These remaining costs are estimated to impose an annual cost of approximately \$4,600,000 on all respondents and an average annual cost of approximately \$1,200 per respondent.¹¹²

3. Form of Notice to the Commission

Exchange Act Section 3C(g)(1)(C) requires that a non-financial entity invoking the end-user clearing exception notify the Commission how it generally meets its financial obligations and gives the Commission discretion to establish how to collect this information. To satisfy this requirement, proposed Rule 3Cg-1(a) requires entities invoking the end-user clearing exception to deliver specified information to a registered SDR in the form and manner required for delivery of information specified under proposed Rule 901(d) of Regulation SBSR.¹¹³ Under this approach, rather than collecting information through a separate process established by the Commission for these purposes, the information delivered in compliance

¹¹¹ See supra note 80 and accompanying text. The estimates that follow are based on an assumption that the burden of complying with proposed Rule 3Cg-1(a)(5) is equivalent to the burden of complying with the requirements of proposed Rule 3Cg-1, not including proposed Rule 3Cg-1(a)(4), given the comparable nature of the information required.

¹¹² These monetized costs are calculated as follows: (15 minutes/60 minutes per hour) x (Compliance Manager at \$294 dollars per hour) x (62,000 security-based swap transactions annually) = \$4,557,000 annually; (\$4,557,000 dollars annually) / (4,000 respondents) = \$1,139 average annually per respondent. These figures do not include the costs associated with complying with proposed Rule 3Cg-1(a)(5), which are separately accounted for in note 99 above and the accompanying text, and the costs associated with complying with proposed Rule 3Cg-1(a)(4), which are separately accounted for in note 107 above and the accompanying text.

¹¹³ See supra notes 16-20 and accompanying text.

with the requirements of proposed Rule 3Cg-1(a) and proposed Regulation SBSR would serve as the notice to the Commission necessary to invoke the end-user clearing exception.

a. Benefits

Since all market participants must already report security-based swap transactions to a registered SDR, the Commission preliminarily believes that requiring participants invoking the end-user clearing exception to report the information required by proposed Rule 3Cg-1(a) as part of the transaction record should be a reliable and cost-effective method of collecting the information. Standardized reporting through a registered SDR also should increase transparency of the market to regulators by providing a full account of all transactions, which benefits market participants through increased confidence in the reliability and integrity of market transactions and activity. Furthermore, standardized reports should allow periodic auditing, which should be less costly to regulators than examining on a case-by-case basis possibly unstructured financial data submitted by entities invoking the exception to perform their regulatory duties.

b. Costs

Because the form of notice required by proposed Rule 3Cg-1(a) would use the existing reporting and recordkeeping mechanism for security-based swap transactions that is required by proposed Rule 901 of Regulation SBSR, the Commission preliminarily believes the form of notice required by proposed Rule 3Cg-1(a) would impose no additional burden on persons invoking the end-user clearing exception or SDRs other than those described above. The information required to be provided to the Commission pursuant to proposed Rule 3Cg-1(a) would be transmitted and received electronically and would be stored as part of the existing transaction materials that would be required to be prepared by proposed Regulation SBSR. The Commission preliminarily believes that information collected under proposed Rule 3Cg-1 will not be required to be publicly disseminated by the SDR, therefore the Commission

preliminarily believes there will be no costs associated with organizing and posting such information under the requirements for public dissemination of information proposed to be met by SDRs.¹¹⁴

4. Total Costs

In total, the Commission preliminarily estimates that proposed Rule 3Cg-1 would result in a one-time initial aggregate annualized cost of \$13,200,000, or \$3400 per covered entity¹¹⁵ and an ongoing aggregate annualized cost of \$25,900,000 for all covered entities, or approximately \$6,500 per covered entity.¹¹⁶

B. Request for Comments

The Commission requests comment on the costs and benefits of proposed Rule 3Cg-1 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 and benefits. In addition, the Commission requests comment on the following:

- What other factors, if any, should the Commission consider to estimate the costs and benefits of proposed Rule 3Cg-1?
- Is there additional data the Commission should use to estimate the costs and benefits of proposed Rule 3Cg-1?
- Would proposed Rule 3Cg-1 create additional costs and benefits not discussed here?

¹¹⁴ See Regulation SBSR Proposing Release, supra note 16, proposed Rule 902; Regulation SDR Release, supra note 42, proposed Rule 13n-4(b)(6).

¹¹⁵ See supra note 105 and accompanying text.

¹¹⁶ These figures are based on the following: (\$4,900,000 associated with proposed Rule 3Cg-1(a)(5)) + (\$16,400,000 to comply with proposed Rule 3Cg-1(a)(4)) + (\$4,600,000 to comply with other notification requirements established by Rule 3Cg-1) = \$25,900,000; (\$25,900,000 aggregate annual ongoing costs) / (4000 covered entities) = \$6,475 per covered entity.

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

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. In addition to the protection of investors, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact of such rules on competition.¹¹⁷ 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.

The Commission preliminarily believes that the Rule 3Cg-1 would impose limited competitive burdens on counterparties to security-based swaps qualifying for the end-user clearing exception and the financial markets generally because the overall costs associated with invoking the end-user clearing exception are limited. Using the proposed reporting structure of Regulation SBSR to satisfy the notice requirement necessary to invoke the end-user clearing exception would promote efficiency by allowing participants in the security-based swap market to use an existing process to accomplish an additional legislative requirement. Satisfaction of the notice requirement in this way is preliminarily believed by the Commission to promote efficiency by allowing participants to fully utilize the capabilities of SDRs being established to serve the security-based swaps market specifically rather than requiring them to use a separate filing process and data repository created for other purposes, such as the Commission's EDGAR system, or to establish new infrastructure or business processes to meet the statutory notice obligation.

¹¹⁷ See 15 U.S.C. 78w(a)(2).

The end-user clearing exception would be available to non-financial entities¹¹⁸ that use security-based swaps to hedge or mitigate commercial risk, but do not necessarily compete with each other. Such counterparties by definition would not transact in security-based swaps as their primary business, but rather as part of a risk management program related to their other commercial operations. Therefore, the Commission preliminarily expects the end-user clearing exception to have a neutral effect on competition. In addition, proposed Rule 3Cg-1 contains elements noted above intended to limit the potential for the end-user clearing exception to be abused, as contemplated by Exchange Act Section 3C(g)(6). Features of this kind are preliminarily expected by the Commission to limit the potential for counterparties that make use of the exception to avoid the mandatory clearing requirements to gain an unfair competitive advantage over their competitors.

Proposed Rule 3Cg-1 allows certain non-financial entities who use security-based swaps to hedge or mitigate commercial risk to bypass mandatory clearing, and instead engage in non-cleared security-based swap transactions even when equivalent products are available for clearing by a central counterparty. To the extent that proposed Rule 3Cg-1 is successful in separating appropriate uses of the end-user clearing exception from abusive ones, the proposed rule should help economic efficiency and capital formation by not imposing additional costs on end-users using security-based swaps to hedge or mitigate commercial risk and therefore not contributing to systemic risk in the financial system.

The Commission requests comment on the possible effects of proposed Rule 3Cg-1 on efficiency, competition, and capital formation. The Commission requests that commenters provide views and supporting information regarding any such effects. The Commission notes that such effects are difficult to quantify. The Commission seeks comment on possible

¹¹⁸ For purposes of the discussion that follows, the term "non-financial entities" includes Identified Financial Institutions that would be excluded from the definition of "financial entity" in Exchange Act Section 3C(g)(3) in the event the proposed alternative language in Rules 3Cg-1(b) and (c) is adopted by the Commission.

anti-competitive effects of the proposed Rule not already identified. The Commission also requests comment regarding the competitive effects of pursuing alternative regulatory approaches such as requiring notice to be provided through the Commission's EDGAR system. In addition, the Commission requests comment on how the other provisions of the Dodd-Frank Act, for which Commission rulemaking is required, will interact with and influence the competitive effects of the proposed Rule.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA") the Commission must advise the OMB whether the proposed regulation constitutes a "major" rule.¹¹⁹ 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.

The Commission requests comment on the potential impact of proposed Rule 3Cg-1, on the economy on an annual basis, on the costs or prices for consumers or individual industries, and on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. Initial Regulatory Flexibility Act Certification

Section 603(a) of the Regulatory Flexibility Act¹²⁰ ("RFA") requires federal agencies, in promulgating rules, to make available for public comment an initial regulatory flexibility

¹¹⁹ See Pub. L. No. 104-121 (March 29, 1996), as amended by Pub. L. No. 110-28 (May 25, 2007).

¹²⁰ See Pub. L. No. 96-354, 94 Stat. 1164 (1980), as amended by SBREFA.

analysis that describes the impact of the proposed rule on small entities. Alternatively, section 605(b) of the RFA provides that this analysis shall not apply to any proposed rule or proposed rule amendment, if the head of the agency certifies that the rule if promulgated will 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 business includes an issuer or person, other than an investment company, that on the last day of its most recent fiscal year had total assets of \$5 million or less.¹²¹ Based on input from security-based swap market participants and its own information, the Commission preliminarily believes that currently there is very little use of security-based swaps by non-financial entities that would be eligible to use the end-user clearing exception¹²², and that the non-financial entities eligible to invoke the end-user clearing exception and transacting in security-based swaps would be corporations, partnerships and trusts with assets in excess of \$10 million.¹²³ On this basis, the Commission preliminarily believes that the number of security-based swap 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 Rule 3Cg-1 would be likely to alter the type of counterparties presently engaging in security-based transactions.

¹²¹ 17 CFR 230.157. See also 17 CFR 240.0-10(a).

¹²² See supra note 73 and accompanying text.

¹²³ The Commodity Futures Modernization Act of 2000 introduced the concept of “eligible contract participant” that the Commission preliminarily believes is a standard frequently referenced by market participants and which may act to limit the ability of non-financial entities with assets less than \$10 million to transact in security-based swaps. See Pub. L. No. 106-554, 114 Stat. 2763 (Dec. 21, 2000). See also Section 1(a)(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 (defining “eligible contract participant”). The Dodd-Frank Act added a definition of eligible contract participant to the Exchange Act which references the equivalent definition in the CEA, and created new standards to limit the ability of persons who are not eligible contract participants to transact in security-based swaps. See Pub. L. No. 111-203, § 761(a) (adding Exchange Act Section 3(a)(65)). See also Pub. L. No. 111-203, § 761(e) (adding Exchange Act Section 6(l)) (making it unlawful for any person to effect a transaction in a security-based swap for a person that is not an eligible contract participant, unless such transaction is conducted on a registered national securities exchange).

Therefore, the Commission preliminarily believes that proposed Rule 3Cg-1 would have a de minimis impact on small entities.

For the foregoing reasons, the Commission certifies that Rule 3Cg-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 Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

X. Statutory Basis and Text of Proposed Rule

Pursuant to the Exchange Act and particularly Section 3C thereof, the Commission proposes new Rule 3Cg-1, as set forth below, governing the exception to mandatory clearing of security-based swaps established by Exchange Act Section 3C(g).

List of Subjects in 17 CFR Part 240

Reporting and Recordkeeping Requirements, Securities.

Text of the Proposed Rule

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, 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.; 18 U.S.C. 1350; and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

Section 240.3Cg-1 is also issued under Pub. L. 111-203, §763, 124 Stat. 1841 (2010).

* * * * *

2. Add §240.3Cg-1 to read as follows:

§ 240.3Cg-1 Notice to the Commission [and Financial Entity Exemption].

(a) A counterparty to a security-based swap that invokes the clearing exception under Section 3C(g)(1) of the Act (15 U.S.C. 78c-3(g)(1)) shall satisfy the requirements of Section 3C(g)(1)(C) of the Act (15 U.S.C. 78c-3(g)(1)(C)) by delivering or causing to be delivered the following additional information to a registered security-based swap data repository (or, if none is available, to the Commission) in the form and manner required for delivery of the information separately specified under §242.901(d) of Regulation SBSR of this chapter:

- (1) The identity of the counterparty relying on the clearing exception;
- (2) Whether the counterparty invoking the clearing exception is a “financial entity” as defined in Section 3C(g)(3) of the Act (15 U.S.C. 78c-3(g)(3));
- (3) Whether the counterparty invoking the clearing exception is a finance affiliate meeting the requirements described in Section 3C(g)(4) of the Act (15 U.S.C. 78c-3(g)(4));
- (4) Whether the security-based swap is used by the counterparty invoking the clearing exception to hedge or mitigate commercial risk as defined in §240.3a67-4 of this chapter;
- (5) Whether the counterparty invoking the clearing exception generally expects to meet its financial obligations associated with the security-based swap by using any of the following:
 - (i) A written credit support agreement;
 - (ii) A written agreement to pledge or segregate assets;
 - (iii) A written third-party guarantee;

(iv) Solely the counterparty's available financial resources; or

(v) Means other than those described in paragraphs (a)(5)(i), (ii), (iii) and (iv) of this section;

(6) Whether the counterparty invoking the clearing exception is an issuer of securities registered under Section 12 (15 U.S.C. 78l) or subject to reporting requirements pursuant to Section 15(d) (15 U.S.C. 78o(d)) of the Act, and if so:

(i) The relevant Commission Central Index Key number for the counterparty invoking the clearing exception; and

(ii) Whether an appropriate committee of the board of directors (or equivalent body) of the counterparty invoking the clearing exception has reviewed and approved the decision to enter into a security-based swap subject to the clearing exception.

Additional Rule Text under Consideration by the Commission

(b) For purposes of Section 3C(g)(1)(A) of the Act (15 U.S.C. 78c-3(g)(1)(A)), any person specified in paragraph (c) of this section that would be a financial entity within the meaning of the term in Section 3C(g)(3)(A) of the Act (15 U.S.C. 78c-3(g)(3)(A)) solely because of Section 3C(g)(3)(A)(viii) of the Act (15 U.S.C. 78c-3(g)(3)(A)(viii)) shall be exempt from the definition of financial entity.

(c) A person shall be eligible for the exemption in paragraph (b) of this section if such person:

(1) Is organized as a bank, as defined in Section 3(a)(6) of the Act (15 U.S.C. 78c), the deposits of which are insured by the Federal Deposit Insurance Commission, a savings association, as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1831), the deposits of which are insured by the Federal Deposit Insurance Commission, a farm credit system institution chartered under the Farm Credit Act of 1971 (12 U.S.C. 2001), or an insured

Federal credit union or State-chartered credit union under the Federal Credit Union Act (12 U.S.C. 1752); and

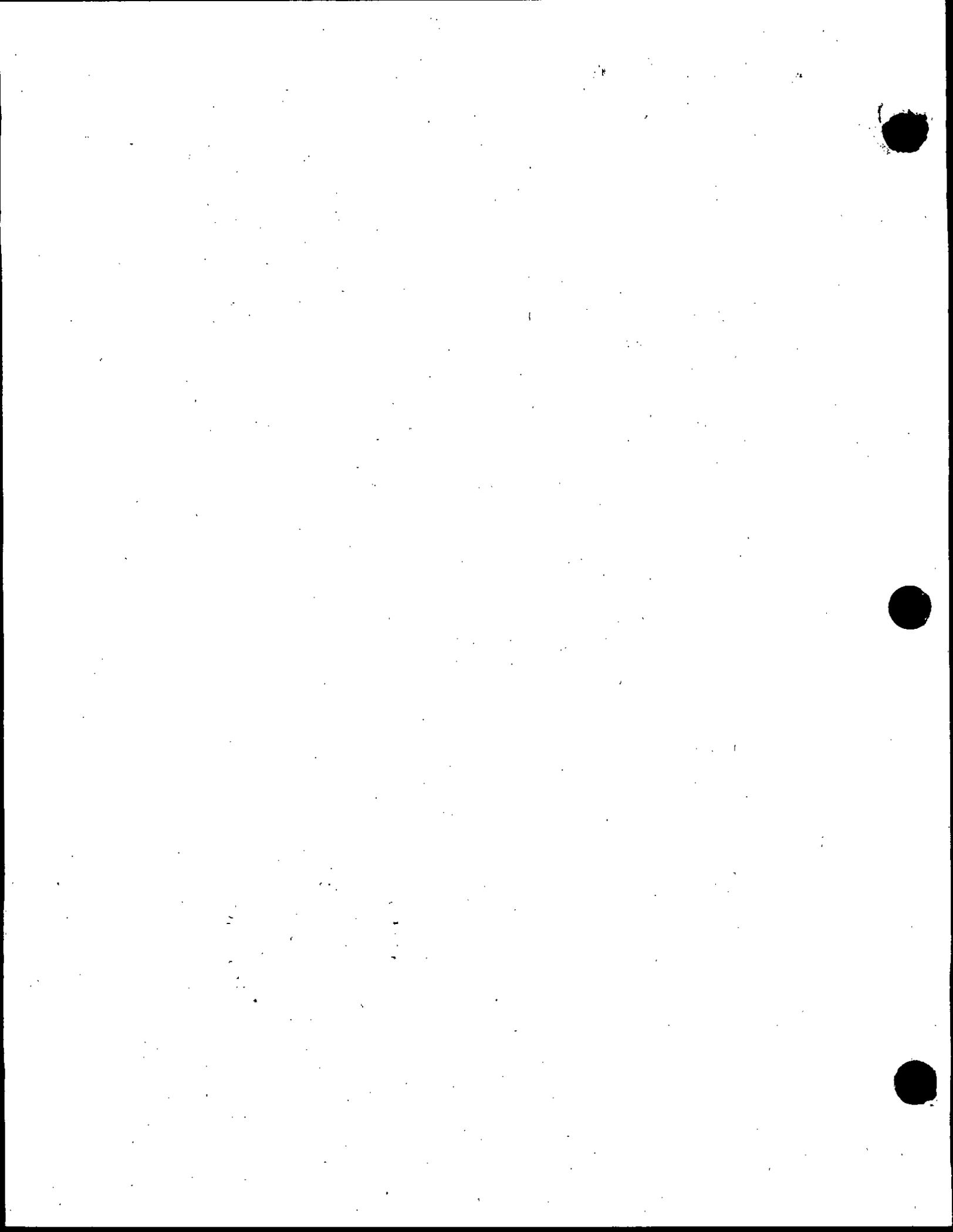
(2) Has total assets of \$10,000,000,000 or less on the last day of the most recent fiscal year.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: December 15, 2010



SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 229 and 249

[Release No. 34-63547; File No. S7-40-10]

RIN 3235-AK84

CONFLICT MINERALS

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing changes to the annual reporting requirements of issuers that file reports pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934 to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules would require any issuer for which conflict minerals are necessary to the functionality or production of a product manufactured, or contracted to be manufactured, by that issuer to disclose in the body of its annual report whether its conflict minerals originated in the Democratic Republic of the Congo or an adjoining country. If so, that issuer would be required to furnish a separate report as an exhibit to its annual report that includes, among other matters, a description of the measures taken by the issuer to exercise due diligence on the source and chain of custody of its conflict minerals. These due diligence measures would include, but would not be limited to, an independent private sector audit of the issuer's report conducted in accordance with standards established by the Comptroller General of the United States. Further, any issuer furnishing such a report would be required, in that report, to certify that it obtained an independent private sector audit of its report, provide the audit report, and make its reports available to the public on its Internet website.

DATES: Comments should be received on or before January 31, 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/proposed.shtml>);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-40-10 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 S7-40-10. 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 copying in the Commission's Public Reference Room 100 F Street, NE, Washington, DC 20549-1090, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: John Fieldsend, Special Counsel in

the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: The Commission is proposing to add a new Item 104 to Regulation S-K,¹ revise Item 601 of Regulation S-K,² and amend Form 20-F,³ Form 40-F,⁴ and Form 10-K⁵ under the Securities Exchange Act of 1934 (the “Exchange Act”).⁶

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¹ 17 CFR 229.10 et seq.

² 17 CFR 229.601.

³ 17 CFR 249.220f.

⁴ 17 CFR 249.240f.

⁵ 17 CFR 249.310.

⁶ 15 U.S.C. 78a et seq.

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I. BACKGROUND AND SUMMARY

A. Statutory Requirements

Section 1502 (the "Conflict Minerals Provision") of the Dodd-Frank Wall Street

Reform and Consumer Protection Act (the "Act")⁷ amends the Exchange Act by adding new Section 13(p).⁸ The Commission is required pursuant to new Section 13(p) to issue final rules implementing Section 13(p) no later than 270 days after the date of enactment, or April 15, 2011.⁹ Section 13(p) requires the Commission to promulgate disclosure and reporting regulations regarding the use of conflict minerals from the Democratic Republic of the Congo (the "DRC") and adjoining countries (together the "DRC countries").¹⁰ Section 1502(a) of the Conflict Minerals Provision, which is titled "Sense of the Congress on Exploitation and Trade of Conflict Minerals Originating in the Democratic Republic of the Congo," sets forth the background for this provision. In Section 1502(a), Congress provides that: "It is the sense of the Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein, warranting the provisions of section 13(p) of the Securities Exchange Act of 1934, as added by subsection (b)."¹¹

Section 13(p) mandates that the Commission promulgate regulations requiring

⁷ Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010).

⁸ 15 U.S.C. 78m(p).

⁹ See Exchange Act Section 13(p)(1)(A).

¹⁰ The term "adjoining country" is defined in Section 1502(e)(1) of the Act as a country that shares an internationally recognized border with the DRC.

¹¹ Section 1502(a) of the Act.

that a “person described”¹² disclose annually whether any “conflict minerals”¹³ that are “necessary to the functionality or production of a product manufactured by such person”¹⁴ originated in the DRC countries,¹⁵ and make that disclosure publicly available on the issuer’s Internet website.¹⁶ If a person’s conflict minerals originated in the DRC countries, that person must submit a report (the “Conflict Minerals Report”) to the Commission that includes a description of the measures taken by the person to exercise due diligence on the minerals’ source and chain of custody.¹⁷ In general, undertaking due diligence involves performing the investigative measures that a reasonably prudent person would perform in the management of his or her own property. Under Section 13(p), the measures that must be taken to exercise due diligence “shall include an independent private sector audit” of the Conflict Minerals Report that is conducted according to standards established by the Comptroller General of the United States, in accordance with the Commission’s promulgated rules, in consultation with the Secretary

¹² The term “person described” is defined in Exchange Act Section 13(p)(2) as one (1) who is required to file reports under Sections 13(p)(1)(A), and (2) the conflict minerals are necessary to the functionality or production of a product manufactured by such person. Section 13(p)(1)(A) does not provide a definition but refers back to Section 13(p)(2).

¹³ The term “conflict mineral” is defined in Section 1502(e)(4) of the Act as (A) columbite-tantalite, also known as coltan (the metal ore from which tantalum is extracted); cassiterite (the metal ore from which tin is extracted); gold; wolframite (the metal ore from which tungsten is extracted); or their derivatives; or (B) any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the DRC countries.

¹⁴ Exchange Act Section 13(p)(2)(B).

¹⁵ Exchange Act Section 13(p)(1)(A).

¹⁶ See Exchange Act Section 13(p)(1)(E) (stating that each issuer “shall make available to the public on the Internet website of such [issuer] the information disclosed under” Exchange Act Section 13(p)(1)(A)).

¹⁷ See Exchange Act Section 13(p)(1)(A)(i).

of State.¹⁸ The person submitting the Conflict Minerals Report must also identify the independent private sector auditor¹⁹ and certify the independent private sector audit.²⁰

Further, the Conflict Minerals Report must include a description of the products manufactured or contracted to be manufactured that are not “DRC conflict free,” the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and “the efforts to determine the mine or location of origin with the greatest possible specificity.”²¹ The term “DRC Conflict Free” is defined in Exchange Act Section 13(p)(1)(A)(ii) and Exchange Act Section 13(p)(1)(D) as products that do not contain conflict minerals that “directly or indirectly finance or benefit armed groups” in the DRC countries.²² Each person must make their Conflict Minerals Report available to the public on that person’s Internet website.²³

B. Overview of Proposed Rules

Our proposed rules would apply to issuers who file reports with the Commission

¹⁸ See *id.* (requiring in the Conflict Minerals Report “a description of the measures taken by the person to exercise due diligence on the source and chain of custody of such [conflict] minerals, which measures shall include an independent private sector audit of such report”). The Conflict Minerals Provision assigns certain responsibilities to other federal agencies. In developing our proposed rules, our staff has consulted with the staff of these other agencies, including the Government Accountability Office (the “GAO”), which is headed by the Comptroller General, and the State Department.

¹⁹ See Exchange Act Section 13(p)(1)(A)(ii) (stating that the issuer must provide a description of the “entity that conducted the independent private sector audit in accordance with” Exchange Act Section 13(p)(1)(A)(i)).

²⁰ As noted in Exchange Act Section 13(p)(1)(B), if an issuer is required to provide a Conflict Minerals Report that includes an independent private sector audit, that issuer “shall certify the audit” and that certified audit “shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals.”

²¹ See Exchange Act Section 13(p)(1)(A)(ii).

²² *Id.*; Exchange Act Section 13(p)(1)(D).

²³ Exchange Act Section 13(p)(1)(E).

under Exchange Act Sections 13(a)²⁴ or 15(d)²⁵ and for which conflict minerals are “necessary to the functionality or production of a product manufactured” or contracted to be manufactured by such issuer.²⁶ These issuers would be required to disclose, based on their reasonable country of origin inquiry, in the body of their annual reports whether their conflict minerals originated in the DRC countries. If an issuer concludes that its conflict minerals did not originate in the DRC countries, the issuer would disclose this determination and the reasonable country of origin inquiry process it used in reaching this determination in the body of its annual report. Also, the issuer would be required to provide on its Internet website its determination that its conflict minerals did not originate in the DRC countries, disclose that this information is available on its website and the Internet address of that site in the body of its annual report, and maintain records demonstrating that its conflict minerals did not originate in the DRC countries. If the issuer concludes that its conflict minerals did originate in the DRC countries, or is unable to conclude that its conflict minerals did not originate in the DRC countries, the issuer would similarly disclose this conclusion, note that the Conflict Minerals Report is furnished as an exhibit to the annual report, furnish the Conflict Minerals Report, make available the Conflict Minerals Report on its Internet website, disclose that the Conflict Minerals Report is posted on its Internet website, and provide the Internet address of that site.

As required by Section 13(p), our proposed rules would require that an issuer

²⁴ 15 U.S.C. 78m(a).

²⁵ 15 U.S.C. 78o(d).

²⁶ Exchange Act Section 13(p)(2)(B).

provide, in its Conflict Minerals Report, a description of the measures it had taken to exercise due diligence on the source and chain of custody of its conflict minerals, which would have to include a certified independent private sector audit of the Conflict Minerals Report that identifies the auditor and is furnished as part of the Conflict Minerals Report. Further, the issuer would be required to include in the Conflict Minerals Report a description of its products manufactured or contracted to be manufactured containing conflict minerals that are not “DRC conflict free,”²⁷ the facilities used to process those conflict minerals, those conflict minerals’ country of origin, and the efforts to determine the mine or location of origin with the greatest possible specificity. The issuer would be required to exercise due diligence in making these determinations in the Conflict Minerals Report.

II. DISCUSSION

The Conflict Minerals Provision establishes, and we are likewise proposing, a disclosure requirement for conflict minerals that is divided into three steps. The first step required by Section 1502 is for the issuer to determine whether it is subject to the Conflict Minerals Provision. An issuer is only subject to the Conflict Minerals Provision if it is a “person described,” which the Conflict Minerals Provision defines as one for whom “conflict minerals are necessary to the functionality or production of a product manufactured by such person.”²⁸ If an issuer does not meet this definition, the issuer would not be required to take any action, make any disclosures, or submit any reports. If,

²⁷ The definition of the term “DRC conflict free” in our proposed rules would be identical to the definition in Exchange Act Sections 13(p)(1)(A)(ii) and 13(p)(1)(D).

²⁸ Exchange Act Section 13(p)(2).

however, an issuer meets this definition, that issuer would move to the second step.

The second step would require the issuer to determine after a reasonable country of origin inquiry whether its conflict minerals originated in the DRC countries. If the issuer determines that its conflict minerals did not originate in the DRC countries, the issuer would disclose this determination and the reasonable country of origin inquiry it used in reaching this determination in the body of its annual report.²⁹ If, however, the issuer determines that its conflict minerals did originate in the DRC countries, or if it is unable to conclude that its conflict minerals did not originate in the DRC countries, the issuer would disclose this conclusion in its annual report and move to the third step.³⁰

Finally, the third step under the Conflict Minerals Provision would require an issuer with conflict minerals that originated in the DRC countries, or an issuer that is unable to conclude that its conflict minerals did not originate in the DRC countries, to furnish a Conflict Minerals Report as described in greater detail below. As required by Section 13(p)(1)(A)(ii), in the Conflict Minerals Report, the issuer would be required to provide, among other information, a description of any of its products that contain conflict minerals that it is unable to determine did not “directly or indirectly finance or benefit armed groups” in the DRC countries.³¹ The issuer would identify such products by describing them as not “DRC conflict free.” If any of its products contain conflict

²⁹ The issuer also would be required to make available this disclosure on its Internet website, disclose in its annual report that the disclosure is posted on its Internet website, and disclose the Internet address on which this disclosure is posted. Such an issuer, however, would not have any further disclosure or reporting obligations with regard to its conflict minerals.

³⁰ The issuer also would be required make its Conflict Minerals Report available to the public on its Internet website, disclose in its annual report that the Conflict Minerals Report is posted on its Internet website, and disclose the Internet address on which the Conflict Minerals Report is posted.

³¹ See Exchange Act Section 13(p)(1)(A)(ii).

minerals that do not “directly or indirectly finance or benefit” these armed groups, the issuer may describe such products as “DRC conflict free,” whether or not the minerals originated in the DRC countries.

A. Conflict Minerals

The Conflict Minerals Provision defines the term “conflict mineral” as cassiterite, columbite-tantalite, gold, wolframite, or their derivatives, or any other minerals or their derivatives determined by the Secretary of State to be financing conflict in the DRC countries.³² Cassiterite is the metal ore that is most commonly used to produce tin, which is used in alloys, tin plating, and solders for joining pipes and electronic circuits.³³ Columbite-tantalite is the metal ore from which tantalum is extracted. Tantalum is used in electronic components, including mobile telephones, computers, videogame consoles, and digital cameras, and as an alloy for making carbide tools and jet engine components.³⁴ Gold is used for making jewelry and, due to its superior electric conductivity and corrosion resistance, is also used in electronic, communications, and aerospace equipment.³⁵ Finally, wolframite is the metal ore that is used to produce tungsten, which is used for metal wires, electrodes, and contacts in lighting, electronic,

³² Section 1502(e)(4) of the Act. Presently, the Secretary of State has not designated any other mineral as a conflict mineral. Therefore, the conflict minerals include only cassiterite, columbite-tantalite, gold, wolframite, or their derivatives.

³³ Tin Statistics and Information, U.S. GEOLOGICAL SURVEY, available at, <http://minerals.usgs.gov/minerals/pubs/commodity/tin/>.

³⁴ Niobium (Columbium) and Tantalum Statistics and Information, U.S. GEOLOGICAL SURVEY, available at, <http://minerals.usgs.gov/minerals/pubs/commodity/niobium>.

³⁵ Gold Statistics and Information, U.S. GEOLOGICAL SURVEY, available at, <http://minerals.usgs.gov/minerals/pubs/commodity/gold>.

electrical, heating, and welding applications.³⁶ Based on the many uses of these minerals, we expect the Conflict Minerals Provision to apply to many companies and industries.

B. Step One – Determining Issuers Covered by the Conflict Mineral Provision

1. Issuers That File Reports Under the Exchange Act

Our proposed rules would apply to any issuer that files reports with the Commission under the Exchange Act, provided that the issuer is a “person described” under the Conflict Minerals Provision. The Conflict Minerals Provision defines a “person described” as one for whom conflict minerals are “necessary to the functionality or production of a product manufactured by such person.”³⁷ We note that the provision could be read to apply to any company, including companies that are not subject to Commission reporting requirements, or individuals, so long as conflict minerals are necessary to the functionality or production of a product manufactured by that entity or individual. Such a broad reading of the provision, however, does not appear warranted given the provision’s background and its location in the section of the Exchange Act dealing with reporting issuers.³⁸ Conversely, the Conflict Minerals Provision does not

³⁶ Tungsten Statistics and Information, U.S. GEOLOGICAL SURVEY, available at, <http://minerals.usgs.gov/minerals/pubs/commodity/tungsten>.

³⁷ See *supra* note 12.

³⁸ H.R. REP. NO. 111-517, Joint Explanatory Statement of the Committee of Conference, Title XV, “Conflict Minerals,” at 879 (Conf. Rep.) (June 29, 2010) (“The conference report requires disclosure to the SEC by all persons otherwise required to file with the SEC for whom minerals originating in the Democratic Republic of Congo and adjoining countries are necessary to the functionality or production of a product manufactured by such person.”); 156 CONG. REC. S3978 (daily ed. May 19, 2010) (statement of Sen. Feingold) (stating that the “Brownback amendment was narrowly crafted” and, in discussing the provision, referring only to “companies on the U.S. stock exchanges”); 156 CONG. REC. S3865-66 (daily ed. May 18, 2010) (stating that the Conflict Minerals Provision “is a narrow SEC reporting requirement” and referring only to “SEC reporting requirements” in discussing the provision); and 156 CONG. REC. S3816-17 (daily ed. May 17, 2010) (statement of Sen. Durbin) (stating that the provision “would require companies listed on the New York Stock Exchange to disclose in their SEC filings”).

limit its disclosure or reporting obligations to issuers of any particular size. Again, the only limiting factor appears to be whether conflict minerals are “necessary to the functionality or production” of an issuer’s products.³⁹ Based on these considerations, we are not proposing to include an exemption for smaller reporting companies, although we request comment below on whether that would be appropriate.

We have received letters and other communications with a variety of recommendations regarding the Conflict Minerals Provision and our rulemaking,⁴⁰ including those that discussed what the provision’s definition of a “person described” should be construed to mean. Specifically, one industry group representative stated that the term was intended to apply solely to persons who file periodic reports under Section 13(a)(2) of the Exchange Act, although that representative indicates that the provision is unclear as written.⁴¹ A separate individual who submitted a letter to us stated that the provision’s definition of the term is broad and appears to cover more than only reporting issuers.⁴² Finally, another issuer that submitted a letter to us indicated our rules should define a “person described” in the broadest possible sense so that it includes non-reporting companies.⁴³ This issuer stated that, because the provision’s intent is to limit the exploitation and trade of conflict minerals so as to prevent human rights abuses, and

³⁹ Exchange Act Section 13(p)(2)(B).

⁴⁰ To facilitate public input on the Act, the Commission has provided a series of e-mail links, organized by topic, on its website at <http://www.sec.gov/spotlight/regreformcomments.shtml>. The public comments we have received on the topic of the Conflict Minerals Provision are available on our website at <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-8.pdf>.

⁴¹ See letter from Jewelers Vigilance Committee.

⁴² See letter from Stuart P. Seidel, Esq. (stating that a person described is “not the usual SEC ‘issuer’ requirement and appears much broader”).

⁴³ See letter from Tiffany & Co.

the provision is not necessarily intended to protect investors, the scope of the provision should include more than just reporting issuers. Further, the issuer stated that applying our proposed rules only to reporting issuers would unfairly burden reporting issuers and damage their competitive position.

We recognize there is some ambiguity as to whom the Conflict Minerals Provision applies given that the Conflict Minerals Provision states that the Commission shall promulgate regulations for any “person described,”⁴⁴ and the provision states that a “person is described” if “conflict minerals are necessary to the functionality or production of a product manufactured by such person.”⁴⁵ Therefore, the Conflict Minerals Provision could be interpreted to apply to a wide range of private companies not previously subject to our disclosure and reporting rules. However, given the provision’s legislative background, its statutory location, and the absence of Congressional direction to apply these provisions to companies not previously subject to those rules,⁴⁶ we do not propose to extend the rules beyond reporting companies. Also, even if we were to interpret the provision in this manner, it is uncertain how the Commission could administer such a program. Therefore, our proposed rules would apply only to issuers that file reports with the Commission under Section 13(a) or Section 15(d) of the Exchange Act, although we

⁴⁴ See Exchange Act Section 13(p)(1)(A).

⁴⁵ See *supra* note 12.

⁴⁶ See H.R. REP. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title XV, “Conflict Minerals,” at 879 (Conf. Rep.) (June 29, 2010) (“The conference report requires disclosure to the SEC by all persons otherwise required to file with the SEC for whom minerals originating in the Democratic Republic of Congo and adjoining countries are necessary to the functionality or production of a product manufactured by such person.”)

request comment on this question below.⁴⁷ Consistent with the statutory language, our rules would apply to domestic companies, foreign private issuers, and smaller reporting companies. The statutory language does not suggest an exemption for foreign private issuers or smaller reporting companies and our proposal, therefore, would cover those issuers, although we request comment on this question below.

Request for Comment

1. Should our reporting standards, as proposed, apply to all conflict minerals equally?⁴⁸
2. Should our rules, as proposed, apply to all issuers that file reports under Sections 13(a) and 15(d) of the Exchange Act? If not, to what issuers or other persons should our rules apply? Should we require an issuer that has a class of securities exempt from Exchange Act registration pursuant to Exchange Act Rule 12g3-2(b)⁴⁹ to provide the disclosure and reporting requirements in its home country annual report or in a report on EDGAR? Would such an approach be consistent with the Act?⁵⁰

⁴⁷ Section 13(a) requires issuers with classes of securities registered under Section 12 of the Exchange Act to file periodic and other reports. 15 U.S.C. 78l. Section 15(d) requires issuers with effective registration statements under the Securities Act of 1933 (the "Securities Act") to file reports similar to Section 13(a) for the fiscal year within which such registration statement became effective. 15 U.S.C. 77a *et seq.* Therefore, if our proposed rules did not include issuers required to file reports under Section 15(d), some issuers who file annual reports may not otherwise be required to comply with our proposed conflict minerals rules.

⁴⁸ See the petition attached to the memorandum of the November 18, 2010 meeting with Chairman Mary L. Schapiro and with John Prendergast and Darren Fenwick of The Enough Project, Sasha Lezhnev of Grassroots Reconciliation Group, and Deborah R. Meshulam of DLA Piper (calling on the Commission to promulgate rules that would require equal reporting standards for all the conflict minerals), available at, <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-80.pdf>.

⁴⁹ 17 CFR 240.12g3-2(b). A foreign private issuer may claim that exemption as long as it meets a foreign listing requirement, publishes its material home country documents in English on its Internet website or through another electronic information delivery system that is generally available to the public in its primary trading market, and otherwise is not required to file Exchange Act reports. A foreign private issuer typically relies on the Rule 12g3-2(b) exemption in order to establish an unlisted American Depositary Receipt ("ADR") facility for the issuance and trading of ADRs through the over-the-counter market.

⁵⁰ The Commission has not considered Rule 12g3-2(b)-exempt companies to be subject to Exchange Act reporting and filing requirements. Prior to the amendment to Rule 12g3-2(b) in 2008, we required issuers

3. Should we have an alternative interpretation of a "person described?"
4. Should our rules apply to foreign private issuers, as proposed? Should we exempt such issuers and, if so, why and on what basis? Should the rules otherwise be adjusted in some fashion for foreign private issuers?
5. Would our proposed rules present undue costs to smaller reporting companies? If so, how could we mitigate those costs? Also, if our proposed rules present undue costs to smaller reporting companies, do the benefits of making their conflict minerals information publicly available justify these costs? Should our rules provide an exemption for smaller reporting companies? Alternatively, should our rules provide more limited disclosure and reporting obligations for smaller reporting companies? If so, what should these limited requirements entail? For example, should our rules require smaller reporting companies to disclose, if true, that conflict minerals are necessary to the functionality or production of their products but not require those issuers to disclose whether those conflict minerals originated in the DRC countries or to furnish a Conflict Minerals Report? Should our rules provide for a delayed implementation date for smaller reporting companies in order to provide them additional time to prepare for the requirement and the benefit of observing how larger companies comply?
6. Should we require that all individuals and entities, regardless of whether they are reporting issuers, private companies, or individuals who manufacture products for which conflict minerals are necessary to the functionality or production of the

claiming the Rule 12g3-2(b) exemption to furnish paper copies of their material home country documents to the Commission. The documents were deemed furnished and not filed under the Exchange Act because they were subject to their home country, and not Exchange Act, disclosure rules.

products, provide the conflict minerals disclosure and, if necessary, a Conflict Minerals Report? If so, how would we oversee such a broad reporting system?

7. Would requiring compliance with our proposed rules only by issuers filing reports under the Exchange Act unfairly burden those issuers and place them at a significant competitive disadvantage compared to companies that do not file reports with us? If so, how can we lessen that impact?
8. General Instruction I to Form 10-K contains special provisions for the omission of certain information by wholly-owned subsidiaries. General Instruction J to Form 10-K contains special provisions for the omission of certain information by asset-backed issuers. Should either or both of these types of registrants be permitted to omit the proposed conflict minerals disclosure in the annual reports on Form 10-K?

2. “Manufacture” and “Contract to Manufacture” Products

The Conflict Minerals Provision applies to any person for whom conflict minerals are necessary to the functionality or production of a product manufactured by that person.⁵¹ It appears, therefore, that the Conflict Minerals Provision was not intended to apply to all issuers, but was intended to apply only to issuers that manufacture products. In this regard, our proposed rules would likewise apply to reporting issuers that manufacture products.

We do not propose to define the term “manufacture” in our rules, since we believe it is generally understood.⁵² We note that some of those submitting letters in advance of

⁵¹ See Exchange Act Section 13(p)(2)(B).

⁵² For example, the Second Edition of the Random House Webster’s Dictionary defines the term to include the “making goods or wares by hand or machinery, esp. on a large scale.” RANDOM HOUSE WEBSTER’S DICTIONARY 403(2d ed. 1996).

this rulemaking have suggested our proposed rules should define the term “manufacturing” with greater specificity and have provided their views on this matter. One non-governmental organization (“NGO”) stated that the term “manufactured” should be defined as the “production, preparation, assembling, combination, compounding, or processing of ingredients, materials, and/or processes such that the final product has a name, character, and use, distinct from the original ingredients, materials, and/or processes.”⁵³ An industry group indicated that the term manufacture should exempt issuers involved in the “mining, processing, refining, alloying, fabricating, importing, exporting or sale” of gold and those engaged in “jewelry repairs or refurbishment, . . . setting or re-setting diamonds or gemstones into mountings or . . . [the] manufactur[ing of] individual custom jewelry pieces.”⁵⁴ We are not proposing to define the term, but we request comment on that point below.

One section of the Conflict Minerals Provision defines a “person described” as one for which conflict minerals are “necessary to the functionality or production of a product manufactured by such a person,”⁵⁵ while another section of the provision requires issuers to describe “the products manufactured or contracted to be manufactured that are not DRC conflict free” [emphasis added] in their Conflict Mineral Reports.⁵⁶ The absence of the phrase “contract to manufacture” from the “person described” definition raises some question as to whether the requirements apply equally to those who

⁵³ See letter from The Enough Project.

⁵⁴ See letter from Jewelers Vigilance Committee.

⁵⁵ Exchange Act Section 13(p)(2)(B).

⁵⁶ Exchange Act Section 13(p)(1)(A)(ii).

manufacture products themselves and those who contract to have their products manufactured by others. Based on the totality of the provision, however, it appears that the legislative intent was for the provision to apply both to issuers that directly manufacture products and to issuers that contract the manufacturing of their products for which conflict minerals are necessary to the functionality or production of those products. Our proposed rules, therefore, would apply equally to issuers that manufacture products and to issuers that “contract to manufacture” their products. We believe that this approach would allow the “contracted to be manufactured” language to have effect in the Conflict Minerals Report.

With regard to what it means to “contract to manufacture a product,” an industry group expressed concern that our rules could include retailing issuers’ private label goods.⁵⁷ Two of the Congressmen who sponsored Section 1502 have stated in a letter submitted to us that rules implementing the provision should “exempt pure retailers” from any reporting requirements.⁵⁸ In this regard, they suggested that the rules should clarify that retailers who sell “pure ‘white label’ products,” products over which retailers have no influence regarding their manufacture, would not be required to provide information regarding any conflict minerals in those products. Also, they indicated that the rules should include products that a retailer “contracts to be manufactured or for which the retailer issues unique product requirements.”⁵⁹

We intend that our proposed rules would apply to issuers that contract for the

⁵⁷ See letter from National Retail Federation.

⁵⁸ Letter from Senator Richard J. Durbin and Representative Jim McDermott, United States Congress.

⁵⁹ Id.

manufacturing of products over which they have any influence regarding the manufacturing of those products. They also would apply to issuers selling generic products under their own brand name or a separate brand name that they have established, regardless of whether those issuers have any influence over the manufacturing specifications of those products, as long as an issuer has contracted with another party to have the product manufactured specifically for that issuer. We do not, however, propose that our rules would apply to retail issuers that sell only the products of third parties if those retailers have no contract or other involvement regarding the manufacturing of those products, or if those retailers do not sell those products under their brand name or a separate brand they have established and do not have those products manufactured specifically for them.

Request for Comment

9. Should we define the term “manufacture?” If so, how should we define the term?
10. Should our rules, as proposed, apply both to issuers that manufacture and issuers that contract to manufacture products in which conflict minerals are necessary to the functionality or production of those products?
11. Should we require a minimum level of influence, involvement, or control over the manufacturing process before an issuer must comply with our proposed rules? If so, how should we articulate the minimum amount? Should we require issuers to have nominal, minimal, substantial, total, or another level of control over the manufacturing process before those issuers become subject to our rules? How would those amounts be measured? Should we require that issuers must, at minimum, mandate that the product be manufactured according to particular specifications?

12. Is it appropriate to consider issuers who sell generic products under their own labels or labels that they establish to be contracting the manufacture of those products as long as those issuers have contracted with other parties to have the products manufactured specifically for them? If not, what would be a more appropriate approach?

3. Mining Issuers as “Manufacturing” Issuers

As a separate but related issue, our proposed rules would consider issuers that mine conflict minerals, including issuers that mine gold, to be manufacturing those minerals, and issuers contracting for the mining of conflict minerals to be contracting the manufacturing of those minerals. In this regard, we have received input that our proposed rules should not consider a gold mining issuer as manufacturing or contracting to manufacture gold.⁶⁰ Conversely, another view expressed to us by an NGO was that our proposed rules should consider mining commensurate with manufacturing or contracting to manufacture.⁶¹ This NGO cited to and quoted from the United States Controlled Substances Act,⁶² which includes mining under the definition of manufacturing. We are proposing in an instruction to our proposed rules⁶³ that mining issuers should be considered to be manufacturing conflict minerals when they extract

⁶⁰ See letter from Jewelers Vigilance Committee (stating that our proposed “rules should make clear that the mining, processing, refining, alloying, fabricating, importing, exporting or sale of gold does not constitute ‘manufacture’”).

⁶¹ See letter from The Enough Project.

⁶² 21 U.S.C.A. 802(15), the United States Controlled Substances Act, which defines the term “manufacture” as the production, preparation, propagation, compounding, or processing of a drug or other substance, either directly or indirectly or by extraction from substances of natural origin”).

⁶³ New Item 4(a) of Form 10-K (through new Instruction 1 to Item 104 of Regulation S-K), new Instruction 2 to Item 16 of Form 20-F, and new Instruction 2 to General Instruction B(16) of Form 40-F.

those minerals.⁶⁴ We do, however, request comment on this point below.

Request for Comment

13. Is it appropriate for our rules, as proposed, to consider reporting issuers that are mining companies as “persons described” under Section 1502? Does the extraction of conflict minerals from a mine constitute “manufacturing” or “contracting to manufacture” a “product” such that mining issuers should be subject to our rules?
14. Alternatively, should a mining issuer not be viewed as manufacturing a product under our rules unless it engages in additional processes to refine and concentrate the extracted minerals into salable commodities or otherwise changes the basic composition of the extracted minerals?
15. If so, what transformative processes, if any, should mining issuers be permitted to perform on conflict minerals before our proposed rules should consider them to be manufacturing products to which conflict minerals are necessary?

4. When Conflict Minerals Are “Necessary” to a Product

The Conflict Minerals Provision requires the Commission to promulgate regulations requiring that any “person described” disclose annually whether conflict minerals that are “necessary” originated in the DRC countries and, if so, submit to the Commission a Conflict Minerals Report.⁶⁵ The provision further states that a “person is described” if “conflict minerals are necessary to the functionality or production of a

⁶⁴ See Industry Guide 7 [17 CFR 229.802(g)] (implying that companies may “produce” minerals from a mining reserve).

⁶⁵ Exchange Act Section 13(p)(1)(A).

product manufactured by such person.”⁶⁶ The provision, however, provides no additional explanation or guidance as to the meaning of this phrase. Likewise, we do not propose to define when a conflict mineral is necessary to the functionality or production of a product. We are, however, requesting comment on whether our rules should define this phrase and, if so, how.

We have received differing input as to when a conflict mineral should be considered necessary to the functionality or production of a product for purposes of the Conflict Minerals Provision. One NGO stated that the term “necessary” should be interpreted broadly and, at a minimum, include conflict minerals that are “intentionally added,” “closely related,” or “directly essential” to the production of a product.⁶⁷ That NGO indicated also that a conflict mineral is necessary when it is “required for the financial success or marketability of the product.”⁶⁸ Further, the NGO affirmed that it believes that our proposed rules should exempt any product that contains naturally occurring trace amount of conflict minerals.⁶⁹ Two of the Congressional sponsors of Section 1502 indicated that “it is the policy of Section 1502 to require transparency of all sourcing of conflict minerals” from the DRC countries, so they believe the provision was intended “to include all uses of conflict minerals coming from DRC – except those that are ‘naturally occurring’ or ‘unintentionally included’ in the product.”⁷⁰

⁶⁶ Exchange Act Section 13(p)(2)(B).

⁶⁷ Letter from The Enough Project.

⁶⁸ Id.

⁶⁹ Id.

⁷⁰ Letter from Senator Richard J. Durbin and Representative Jim McDermott, United States Congress.

While we are not proposing to define “necessary to the functionality or production,” we note that if a mineral is necessary, the product is covered without regard to the amount of the mineral involved.⁷¹ Further, we intend our proposed rules to include products if the conflict mineral is intentionally included in a product’s production process and is necessary to that process, even if that conflict mineral is not ultimately included anywhere in the final product.⁷² On the other hand, conflict minerals necessary to the functionality or production of a physical tool or machine used to produce a product would not be considered necessary to the production of the product even if that tool or machine is necessary to producing the product. For example, if an automobile containing no conflict minerals is produced using a wrench that contains conflict minerals necessary to the functionality or production of that wrench, we would not consider the conflict minerals in that wrench necessary to the production of the automobile.

Request for Comment

16. Should our rules define the phrase “necessary to the functionality or production of a product,” or is that phrase sufficiently clear without a definition? If our rules should define the phrase, how should it be defined?
17. If we were to define this phrase, should we delineate it to mean that a conflict mineral would be necessary to a product’s functionality only if the conflict mineral is necessary to the product’s basic function? If so, should we define the term “basic function” and, if so, how should we define that term? Should we define the term to

⁷¹ See discussion infra Part II.F.1.

⁷² See letter from Senator Richard J. Durbin and Representative Jim McDermott, United States Congress (“All users of conflict minerals that originate from the Democratic Republic of the Congo and adjoining countries that are not naturally occurring...or are a purely unintentional byproduct...need to be subject to reporting and transparency.”).

include components of a product if those components are necessary to the product's basic function such that a conflict mineral would be considered necessary to the functionality of a product if the conflict mineral is necessary to the functionality of any of the product's components that are required for that product's basic function? For example, if the only conflict minerals in an automobile are contained in the automobile's radio, should our proposed rules consider those conflict minerals necessary to the automobile's functionality even if the automobile's basic function is for transportation? If that radio is marketed and sold with the automobile, should our proposed rules consider the conflict minerals that are isolated in the radio necessary to the functionality of the automobile? Alternatively, should such a definition consider only conflict minerals isolated in an automobile component required specifically for the automobile's basic function as necessary for the functionality of the automobile?

18. If we were to define the phrase "necessary to the functionality," should we delineate it to mean that a conflict mineral would be necessary to a product's functionality if the conflict mineral is included in a product for any reason because that conflict mineral would be contributing to the product's economic utility? Does the fact that, if a conflict mineral is not "necessary" it, axiomatically, could be excluded from the product or the manufacturing process support such a broad reading?
19. Should we define the phrase to indicate that, as one letter suggested, a conflict mineral should be considered necessary when "[t]he conflict mineral is intentionally added to the product; or [t]he conflict mineral is used by the [issuer] for the production of a product and such mineral is purchased in mineral form by the [issuer]"

and used by the [issuer] in the production of the final product but does not appear in the final product; and [t]he conflict mineral is essential to the product's use or purpose; or [t]he conflict mineral is required for the marketability of the product?"⁷³

20. Should we delineate the phrase "necessary to the production" to mean that a conflict mineral would be necessary to a product's production only if the conflict mineral is intentionally included in a product's production process even if that conflict mineral is not ultimately included in the final product because it was removed or washed away prior to the completion of the production process? Should we consider conflict minerals necessary to the production of a product if they are not contained in the product but they are necessary to the functionality or production of a physical tool or machine used to produce a product? Should we consider such conflict minerals necessary to the production of a product if the tool or machine used to produce the product was manufactured for the purpose of producing the product? Would such an approach cover too broad a group of tools or machines? Should we limit such an approach to certain kinds of tools or machines, and if so, which ones? Should we be more specific and provide, as a letter recommended, that a conflict mineral is necessary to a product's production only if it is "used by [an issuer] for the production of a product and such mineral is purchased in mineral form by the [issuer] and used by the [issuer] in the production of the final product but does not appear in the final product?"⁷⁴

⁷³ See letter submitted by Patricia Jurewicz on November 18, 2010 (the "Multi-Stakeholder Group Letter") (representing a consortium of NGOs, large issuers, and socially responsible institutional investors).

⁷⁴ See *id.*

21. Should we delineate the phrase “necessary to the production” so that our rules would not consider conflict minerals occurring naturally in a product or conflict minerals that are purely an unintentional byproduct of the product as necessary to the production of that product?

C. Step Two – Determining Whether Conflict Minerals Originated in the DRC Countries and the Resulting Disclosure

If conflict minerals are necessary to the functionality or production of a product manufactured by that issuer, the Conflict Minerals Provision requires an issuer to disclose whether those conflict minerals originated in the DRC countries.⁷⁵ If they did not originate in the DRC countries, the statute requires the issuer to make available that disclosure on its Internet website, but does not require the issuer to submit anything further to the Commission. If, however, any of the issuer’s conflict minerals originated in the DRC countries, the provision requires the issuer to submit to the Commission a Conflict Minerals Report for the portion of its conflict minerals that originated in the DRC countries, and make that report available on its Internet website.

The rules we are proposing would require an issuer to disclose whether its conflict minerals originated in the DRC countries. Under our proposed rules, an issuer would be required to make a reasonable country of origin inquiry as to whether its conflict minerals originated in the DRC countries, but our proposed rules would not set forth what constitutes a reasonable country of origin inquiry. If, after a reasonable country of origin inquiry, an issuer concludes that any of its conflict minerals did not originate in the DRC countries, the issuer would be required to disclose this in the body of the annual report

⁷⁵ Exchange Act Section 13(p)(1)(A).

and on its Internet website.⁷⁶ Also, the issuer would be required to disclose in the body of the annual report the Internet address on which the disclosure is posted and retain the information on the website at least until the issuer's subsequent annual report is filed with the Commission. Further, the issuer would be required to disclose in the body of its annual report the reasonable country of origin inquiry it undertook to determine that its conflict minerals did not originate in the DRC countries and maintain reviewable business records to support its determination.⁷⁷ The issuer, however, would not be required to make any other disclosures with regard to its conflict minerals that did not originate in the DRC countries.

Under our proposed rules, if an issuer determines through its reasonable country of origin inquiry that any of its conflict minerals originated in the DRC countries, or if the issuer is unable to determine after a reasonable country of origin inquiry that any such conflict minerals did not originate in the DRC countries, our proposed rules would require the issuer to disclose this in the body of the annual report and disclose that the Conflict Minerals Report is furnished as an exhibit to the annual report. Additionally, the issuer would be required to make available its Conflict Minerals Report on its Internet website, disclose in the body of its annual report that the Conflict Minerals Report is posted online, and disclose in the body of its annual report the Internet address on which the Conflict Minerals Report is located.⁷⁸ We note, however, that under our proposal

⁷⁶ See Exchange Act Section 13(p)(1)(E). The issuer would be required to keep this information on its Internet website until it filed its subsequent annual report.

⁷⁷ See Multi-Stakeholder Group Letter (suggesting that entities subject to the Conflict Minerals Provision be required to maintain reviewable business records to support a negative determination).

⁷⁸ See Exchange Act Section 13(p)(1)(E).

such an issuer would only have to post the Conflict Minerals Report on its Internet website and would not have to post any of the disclosures it provides in the body of its annual report.⁷⁹

1. Location of Disclosure

Our proposed rules would require disclosure about conflict minerals in an issuer's annual report on Form 10-K for a domestic issuer, Form 20-F for a foreign private issuer, and Form 40-F for an eligible Canadian issuer. Section 1502 requires issuers to disclose information about their conflict minerals annually, but does not otherwise specify where this disclosure must be located, either in terms of which form or in terms of where within a particular form. Our proposed rules would require this disclosure in the existing Form 10-K, Form 20-F, or Form 40-F annual report because issuers are already required to file these reports so this approach should be less burdensome than requiring a separate annual report to be filed. Further, to facilitate locating the conflict minerals disclosure within the annual report without over-burdening investors with extensive information about conflict minerals in the body of the report, our proposed rules would require issuers to include brief conflict minerals disclosure under a separate heading entitled, "Conflict Minerals Disclosure," and the more extensive, information in a separate exhibit to the annual report, if required.

To implement Section 1502 of the Act, we are proposing to add new Item 4(a) of

⁷⁹ We recognize that there may be instances in which an issuer determines that its products contain a mixed assortment of conflict minerals, such that some did not originate in the DRC countries, some originated in the DRC countries, some have minerals that the issuer cannot determine did not originate in the DRC countries, or any combination thereof. If an issuer can determine which conflict minerals did not originate in the DRC countries, it would not have to provide a Conflict Minerals Report regarding those minerals. However, the issuer would still be required to file a Conflict Minerals Report for the minerals that originated in the DRC countries or that the issuer was unable to determine did not originate in the DRC countries.

Form 10-K (which references new Item 104(a) of Regulation S-K), new Item 16(a) of Form 20-F, and a new General Instruction B(16)(a) of Form 40-F. These rules would require that an issuer disclose in its annual report under a separate heading, entitled "Conflict Minerals Disclosure," its determination as to whether any of its conflict minerals originated in the DRC countries, based on its reasonable country of origin inquiry, and, for its conflict minerals that do not originate in the DRC countries, a brief description of the reasonable country of origin inquiry it conducted in making such a determination. Our proposed rules would not require an issuer who determines that its conflict minerals did not originate in the DRC countries, based on its reasonable country of origin inquiry, to provide any further disclosures.

We are also proposing that an issuer include brief additional disclosure in the body of the annual report if the issuer's conflict minerals originated in the DRC countries or if the issuer cannot determine that its conflict minerals did not originate in the DRC countries, based on its reasonable country of origin inquiry. We propose to add new Item 4(a) of Form 10-K, new Item 104(b)(2) of Regulation S-K, new Item 16(b)(2) of Form 20-F, and new General Instruction B(16)(b)(2) and Form 40-F to implement this additional disclosure. These proposed requirements would require an issuer to disclose that its conflict minerals originated in the DRC countries, or that it is unable to conclude that its conflict minerals did not originate in the DRC countries, that its Conflict Minerals Report has been furnished as an exhibit to the annual report, that the Conflict Minerals Report, including the certified independent private sector audit, is publicly available on the issuer's Internet website, and the issuer's Internet address on which the Conflict Minerals Report and audit report are located. As noted above, we are proposing this

approach to facilitate access to the conflict minerals information by placing it outside the body of the annual report.

The Conflict Minerals Provision requires that each issuer make its Conflict Minerals Report available to the public on the issuer's Internet website.⁸⁰ Consistent with the statute, we are proposing that new Item 104(b)(3) of Regulation S-K, new Item 16(b)(3) of Form 20-F, and new General Instruction B(16)(b)(3) of Form 40-F require an issuer to make such a report, including the certified audit report, available to the public by posting the text of the report on its Internet website. Our proposed rules would require that the text of the Conflict Minerals Report remain on the issuer's website at least until it files its subsequent annual report. Although we would require an issuer that furnishes a Conflict Minerals Report to provide some disclosures in the body of its annual report regarding that report, we would not require that issuer to post this disclosure on its website. We believe this is appropriate because any information disclosed in the body of the annual report would also be included in or the Conflict Minerals Report, which would be required to be posted on the issuer's Internet website.

Request for Comment

22. Should we require issuers to provide the conflict minerals disclosure and reporting requirements mandated under Section 13(p) in its Exchange Act annual report, as proposed? Should we require, or permit, the conflict minerals disclosure to be included in a new, separate form furnished annually on EDGAR, rather than adding it to Form 10-K, Form 20-F, and Form 40-F? Would requiring issuers to disclose the

⁸⁰ See Exchange Act Section 13(p)(1)(E), which is entitled "Information Available to the Public" and states that "[e]ach person described under paragraph (2) shall make available to the public on the Internet website of such person the information disclosed by such person under subparagraph (A)."

information in a separate annual report be consistent with Section 13(p)? Should we develop a separate annual report to be filed on EDGAR that includes all of the specialized disclosures mandated by the Dodd-Frank Act?⁸¹ What would be the benefits or burdens of such a form for investors or issuers with necessary conflict minerals?

23. Should we require some brief disclosure in the body of the annual report, as proposed?
24. Should our rules provide that, rather than be included in the body of the annual report, all required information would be set forth in the Conflict Minerals Report that would be furnished as an exhibit to the annual report?
25. Instead, should all required information, including the Conflict Minerals Report, be included in the body of the annual report?
26. Should issuers with necessary conflict minerals that did not originate in the DRC countries be required to disclose any information other than as proposed? For example, should we require such an issuer to disclose the countries from which its conflict minerals originated?
27. Should we, as proposed, require issuers to describe the reasonable country of origin inquiry they used in making their determination that their conflict minerals did not originate in the DRC countries? Is a separately captioned section in the body of the annual report the appropriate place for this disclosure?
28. Should we require, as proposed, that an issuer maintain reviewable business records if it determines that its conflict minerals did not originate in the DRC countries? Are

⁸¹ Sections 1502, 1503, and 1504 of the Act.

there other means of verifying an issuer's determination that its minerals did not originate in the DRC countries? Should we specify for how long issuers would be required to maintain these records? For example, should we require issuers to maintain records for one year, five years, 10 years, or another period of time?

29. Should we require the disclosure in an issuer's annual report to be provided in an interactive data format? Why or why not? Would investors find interactive data to be a useful tool to easily find the information provided? If so, what format would be most appropriate for providing standardized data disclosure? For example, should the format be eXtensible Business Reporting Language (XBRL), as one letter recommended,⁸² or should the format be eXtensible Markup Language (XML)?
30. Should we require issuers to briefly disclose in the body of their annual reports the contents of the Conflict Minerals Report? If so, how much of the information in the Conflict Minerals Report should we require issuers to disclose?
31. Should we require an issuer to post its audit report on its Internet website, as proposed?
32. Should we require, as proposed, that an issuer post its Conflict Minerals Report and its audit report on its Internet website at least until it files its subsequent annual report? If not, how long should an issuer keep this information posted on its Internet website?

2. Standard for Disclosure

We are proposing rules that would require issuers to disclose, based on their reasonable country of origin inquiry, whether their necessary conflict minerals originated

⁸² See letter from the Social Investment Forum.

in the DRC countries or that they are unable to determine, after such a reasonable country of origin inquiry, that their conflict minerals did not originate in the DRC countries. Our proposed rules would not specify what constitutes a reasonable country of origin inquiry. Instead, the proposed rules would require an issuer that determined its conflict minerals did not originate in the DRC countries to disclose its reasonable country of origin inquiry in making its determination.

Under our proposal, the reliability of any inquiry would be based solely on whether the information used provides a reasonable basis for an issuer to be able to trace the origin of any particular conflict mineral it uses.⁸³ For example, it would not satisfy our proposed rules for an issuer to conclude that it is unreasonable for it to attempt to determine the origin of its conflict minerals solely because of the large amount of conflict minerals it uses in its products or the large number of its products that include conflict minerals. Instead, that issuer would be required to make a reasonable country of origin inquiry as to the origin of all of its conflict minerals that are necessary to the functionality or production of its products that it manufactures or contracts to be manufactured to determine whether those conflict minerals originated in the DRC countries.

A multi-stakeholder group suggested a similar approach. This group recommended that our proposed rules require an issuer to make a reasonable inquiry into whether its conflict minerals originated in the DRC countries, provide a stated basis for any determination that the source and origin of the conflict minerals was not in the DRC

⁸³ This determination would not be based on whether an issuer considers it reasonable to undertake to determine the origin of all its conflict minerals as a whole.

countries, and maintain auditable business records to support a negative determination.⁸⁴ Similarly, in a separate submission, an NGO stated that our proposed rules should require issuers to conduct “a sufficient inquiry to enable them to have a reasonable basis to state whether necessary conflict minerals do or do not originate in the DRC or an adjoining country.”⁸⁵ In this regard, that NGO also indicated that our proposed rules should require that the issuer “disclose the basis for any determination that necessary conflict minerals did not originate in the DRC or an adjoining country.”⁸⁶

Others who submitted letters, however, have suggested different standards for determining whether an issuer’s conflict minerals originated in the DRC countries. A different NGO stated that our proposed rules should require issuers to “conduct sufficient due diligence to enable them to determine accurately whether conflict minerals do or do not originate from the DRC or an adjoining country.”⁸⁷ An industry group indicated that our proposed rules should require issuers to use due diligence in determining whether their conflict minerals originated in the DRC countries.⁸⁸ The letter from that industry group stated, however, that it is not possible for issuers in every instance to determine definitively the origins of certain conflict minerals,⁸⁹ so it suggested that our proposed rules “should thus create a mechanism by which entities can make a disclosure stating ‘no

⁸⁴ See Multi-Stakeholder Group Letter.

⁸⁵ See letter from The Enough Project.

⁸⁶ Id.

⁸⁷ Letter from Global Witness.

⁸⁸ Letter from Jewelers Vigilance Committee.

⁸⁹ We note that the comments submitted by the Jewelers Vigilance Committee refer only to gold.

evidence of DRC or adjoining country origin.”⁹⁰

We recognize the possibility that issuers who have conducted a reasonable country of origin inquiry may nonetheless not be able to determine with absolute accuracy the origins of their conflict minerals. We do not believe, however, that it is appropriate for our rules to permit issuers to satisfy their country of origin disclosure requirement by concluding that there is “no evidence” that their conflict minerals originated in the DRC countries and, thereby, not be required to provide any further information regarding their conflict minerals. Such an allowance might encourage issuers to conduct poorly planned or executed inquiries. Therefore, under our proposed rules such an issuer would still be required to file a Conflict Minerals Report and, therefore, would be required to exercise a greater level of investigation into the source and chain of custody of its conflict minerals. As discussed in greater detail below, we would permit issuers who cannot determine the origins of their conflict minerals, based on their reasonable country of origin inquiry, to disclose that they are unable to determine that their conflict minerals did not originate in the DRC countries. This approach is similar to one recommended by a multi-stakeholder group, which indicated that, if an issuer “is unable to determine the origin of the minerals specified in the statute after making a reasonable country of origin inquiry, the [issuer] should be required to submit” a Conflict Minerals Report.⁹¹

We believe that conducting a reasonable country of origin inquiry before disclosing whether an issuer’s conflict minerals originated in the DRC countries is

⁹⁰ Letter from Jewelers Vigilance Committee.

⁹¹ See Multi-Stakeholder Group Letter.

appropriate. However, our proposed rules would not state what that reasonable country of origin inquiry would entail because we believe that necessarily would depend on the issuer's particular facts and circumstances. In this regard, we note that the reasonable country of origin inquiry requirement is not meant to suggest that issuers would have to determine with absolute certainty whether their conflict minerals originated in the DRC countries, as the Commission has often stated that a reasonableness standard is not the same as an absolute standard.⁹²

We note that conducting the reasonable country of origin inquiry could be less exhaustive than the due diligence discussed below. We believe that this disparity in how the standards are characterized reflects the language in the Conflict Minerals Provision. Initially, the provision requires issuers to determine whether their conflict minerals originated in the DRC countries. After making this determination, only issuers with conflict minerals that originated in the DRC countries or issuers that cannot determine their minerals did not originate in the DRC countries must submit to the Commission the Conflict Minerals Report, which describes, among other matters, the issuer's due diligence exercised on the source and chain of custody of its conflict minerals. It appears, therefore, that the provision was not intended to require the same investigation

⁹² See Management's Report on Internal Control Over Financial Reporting, Release No. 33-8762 (Dec. 20, 2006) [71 FR 77635] (stating that the "Commission has long held that 'reasonableness' is not an 'absolute standard of exactitude for corporate records'" (citing to Foreign Corrupt Practices Act of 1977, Release No. 34-17500 (Jan. 20, 1981) [46 FR 11544]) and that "the terms 'reasonable,' 'reasonably' and 'reasonableness' in the context of Section 404 [of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7262] implementation do not imply a single conclusion or methodology, but encompass the full range of appropriate potential conduct, conclusions or methodologies upon which an issuer may reasonably base its decisions"). This release also cites to the Foreign Corrupt Practices Act (the "FCPA"), 15 U.S.C. 78m(b)(7) and Exchange Act Section 13(b)(7), which states that "the terms 'reasonable assurances' and 'reasonable detail' mean such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." The release further cites to the conference committee report on amendments to the FCPA, CONG. REC. H2116 (daily ed. Apr. 20, 1988), which states the reasonableness "standard 'does not connote an unrealistic degree of exactitude or precision,'" but instead "contemplates the weighing of a number of relevant factors, including the cost of compliance."

for determining whether conflict minerals originated in the DRC countries and for determining the source and chain of custody of those conflict minerals that originate in the DRC countries.

We believe that the steps necessary to constitute a reasonable country of origin inquiry will depend on the available infrastructure at a given point in time. Presently, we do not believe there is any single or exclusive manner for issuers to conduct this inquiry. However, one way we would view an issuer as satisfying the reasonable country of origin inquiry standard is if it received reasonably reliable representations from the facility at which its conflict minerals were processed that those conflict minerals did or did not originate in the DRC countries. These representations could come either directly from that facility or indirectly through the issuer's suppliers, but the issuer would have to reasonably believe these representations to be true based upon the facts and circumstances. For example, one way that an issuer could reasonably rely on a facility's representations regarding the source of its conflict minerals is if the smelter was identified as one that processes only "DRC conflict free" minerals under recognized national or international standards after receiving an independent third party audit of the source and chain of custody of the conflict minerals it processes. It is important to note, however, that although reliance on smelter certifications and supplier declarations may be sufficient now due to our understanding of the current information systems in place to discover conflict minerals' countries of origin, as these systems improve, the facts and circumstances surrounding what would be considered a reasonable country of origin inquiry may change. In other words, as systems improve, smelter certifications and supplier declarations may not satisfy a reasonable country of inquiry standard.

In this regard, we note a letter submitted to us by a multi-stakeholder group that discussed a similar approach, which referred to a “compliant smelter.”⁹³ The multi-stakeholder group stated that it would prefer a “supplier declaration approach” to sourcing conflict minerals, which would “consist of having direct and component suppliers and others in the supply chain take reasonable means to assure that all the tin, tantalum, tungsten, and/or gold in their materials/products are sourced from a compliant smelter.” The group stated further that a smelter would be “compliant” if it meets the requirements of an individual or industry wide audit process that stipulates the collection, disclosure, and efforts made to obtain certain information.⁹⁴

Request for Comment

33. Is a reasonable country of origin inquiry standard an appropriate standard for determining whether an issuer’s conflict minerals originated in the DRC countries for purposes of our rules implementing the Conflict Minerals Provision? If not, what other standard would be appropriate? Rather than requiring a reasonable country of origin inquiry as proposed, should our rules mandate that the standard for making the supply chain determinations, as set forth in Exchange Act Sections 13(p)(1)(A)(i) and (ii) (and described below), also applies to the determination as to whether an issuer’s conflict minerals originated in the DRC countries? Should we provide additional guidance about what would constitute a reasonable country of origin inquiry in determining whether conflict minerals originated in the DRC countries?

34. Should we not require any type of inquiry? For example, would it be appropriate and

⁹³ See Multi-Stakeholder Group Letter.

⁹⁴ Id.

consistent with the Conflict Minerals Provision to permit an issuer to make no inquiry, so long as it disclosed that fact?

35. Should issuers be able to rely on reasonably reliable representations from their processing facilities, either directly or indirectly through their suppliers, to satisfy the reasonable country of origin inquiry standard? If so, should we provide additional guidance regarding what would constitute reasonably reliable representations and what type of guidance should we provide? If not, what would be a more appropriate requirement?
36. Should any qualifying or explanatory language be allowed in addition to or instead of the reasonable country of origin inquiry standard, as proposed, regarding whether issuers' conflict minerals originated in the DRC countries? For example, should issuers be able to state that none of their conflict minerals originated in the DRC countries "to the best of their knowledge" or that "they are not aware" that any conflict minerals originated in the DRC countries?

D. Step Three – Conflict Minerals Report's Content and Supply Chain Due Diligence

The Conflict Minerals Provision requires any issuer determining that its necessary conflict minerals originated in the DRC countries to submit to the Commission a Conflict Minerals Report that includes, among other matters, a description of the measures taken by the issuer to exercise due diligence on the source and chain of custody of its conflict minerals, which measures "shall include an independent private sector audit" of the Conflict Minerals Report.⁹⁵ In this regard, the Conflict Minerals Provision states that the

⁹⁵ Exchange Act Section 13(p)(1)(A)(i).

issuer submitting the Conflict Minerals Report “shall certify the audit...that is included in such report” and such a certified audit “shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals.”⁹⁶

In order to implement these requirements, our proposed rules would require issuers that determined that their necessary conflict minerals originated in the DRC countries and those that are unable to determine that their conflict minerals did not originate in the DRC countries to exercise due diligence on the source and chain of custody of their conflict minerals and describe the due diligence they exercised. After exercising due diligence to make their Conflict Minerals Report determinations, issuers would be required describe their products that are not “DRC conflict free,” the country of origin of those conflict minerals, the facilities used to process those conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.⁹⁷ Additionally, our proposed rules would require all issuers furnishing a Conflict Minerals Report to certify that they obtained an independent private sector audit of the report and furnish as part of the Conflict Minerals Report the audit report of the independent private sector auditor.

1. Content of Conflict Minerals Report

⁹⁶ Exchange Act Section 13(p)(1)(B).

⁹⁷ In this release, we refer to the issuer determinations required by Exchange Act Sections 13(p)(1)(A)(i) and (ii) regarding the source and chain of custody of the issuer’s conflict minerals, its products manufactured or contracted to be manufactured that are not DRC conflict free, its conflict minerals’ country of origin, the facilities used to process its conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity as the issuer’s “supply chain determinations.” We recognize, of course, that issuers that are unable to determine that their conflict minerals did not originate in the DRC countries would not know their minerals’ country of origin and may not know their minerals processing facility.

As required by the Conflict Minerals Provision,⁹⁸ our proposed rules would require issuers to exercise due diligence on the source and chain of custody of their conflict minerals and to describe those due diligence measures in their Conflict Minerals Reports.⁹⁹ Moreover, consistent with the Conflict Minerals Provision,¹⁰⁰ we are proposing to require that the description of the measures taken by issuers to exercise due diligence on the source and chain of custody of their conflict minerals include a certified independent private sector audit conducted in accordance with the standards established by the Comptroller General of the United States.¹⁰¹ The proposed rules also state that the audit would constitute a critical component of due diligence.¹⁰² To implement the Conflict Minerals Provision's requirement that issuers "certify the audit,"¹⁰³ we are

⁹⁸ See Exchange Act Section 13(p)(1)(A)(i).

⁹⁹ These rules would be included in proposed Item 104(b)(1)(i) of Regulation S-K, proposed Item 16(b)(1)(i) of Form 20-F, and proposed General Instruction B(16)(b)(1)(i) of Form 40-F.

¹⁰⁰ See Exchange Act Sections 13(p)(1)(A)(i) and 13(p)(1)(B).

¹⁰¹ See Exchange Act Section 13(p)(1)(A). We note that, under the Conflict Minerals Provision, the Comptroller General establishes the appropriate standards for the independent private sector audit. Staff of the GAO has informed our staff that they preliminarily believe no new standards need to be promulgated, but rather auditing standards that are part of the Government Auditing Standards, such as the standards for Attestation Engagements or the standards for Performance Audits will be applicable. See GAO-07-731G. The GAO staff has not indicated whether and, if so, what evaluation criteria are required for an Attestation Engagement.

¹⁰² See new Item 4(a) of Form 10-K (referring to new Item 104(b)(1)(i) of Regulation S-K), new Item 16(b)(1)(i) of Form 20-F, and new General Instruction B(16)(b)(1)(i) of Form 40-F. Exchange Act Section 13(p)(1)(A)(i) states that a Conflict Minerals Report must include "a description of the measures taken by the person to exercise due diligence on the source and chain of custody of such minerals, which measures shall include an independent private sector audit of such report submitted through the Commission that is conducted in accordance with standards established by the Comptroller General of the United States, in accordance with the rules promulgated by the Commission, in consultation with the Secretary of State." Exchange Act Section 13(p)(1)(B) defines the term "Certification" as follows: "The person submitting a report under subparagraph (A) shall certify the audit described in clause (i) of such subparagraph that is included in such report. Such a certified audit shall constitute a critical component of due diligence in establishing the source and chain of custody of such minerals."

¹⁰³ Exchange Act Section 13(p)(1)(B).

proposing that issuers be required to certify that they obtained an independent private sector audit of their Conflict Minerals Report,¹⁰⁴ and we are proposing that issuers provide this certification in that report.¹⁰⁵ Further, as required by the Conflict Minerals Provision,¹⁰⁶ we are proposing that our rules require descriptions, in the Conflict Minerals Report, of issuers' products that are not "DRC conflict free," the facilities used to process those conflict minerals, the country of origin of those conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.¹⁰⁷

An issuer that is required to furnish a Conflict Minerals Report because it is unable to determine that its conflict minerals did not originate in the DRC countries must also provide this information. We recognize that such an issuer may not be able to determine with certainty whether any of its products are or are not "DRC conflict free," insofar as their initial efforts to determine the origin of the conflict minerals in those products under the reasonable country of origin inquiry was inconclusive and their subsequent due diligence on the source and chain of custody of such minerals was also inconclusive. Consistent with Section 13(p)(1)(A)(ii), we would require such an issuer to

¹⁰⁴ Alternatively, one could interpret this language to mean that an issuer must ensure that the audit it obtained is accurate, but such an interpretation would appear to mean that an issuer must review the audit of its Conflict Minerals Report, which the issuer created originally. We are not proposing this approach since it appears redundant.

¹⁰⁵ These rules would be included under proposed Item 104(b)(1)(ii) of Regulation S-K, proposed Item 16(b)(1)(ii) of Form 20-F, and proposed General Instruction B(16)(b)(1)(ii) of Form 40-F.

¹⁰⁶ See Exchange Act Section 13(p)(1)(A)(ii), which states that a Conflict Minerals Report must include, among other matters, "a description of the products manufactured or contracted to be manufactured that are not DRC conflict free..., the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity."

¹⁰⁷ These rules would be included under proposed Item 104(b)(1)(iii) of Regulation S-K, proposed Item 16(b)(1)(iii) of Form 20-F, and proposed General Instruction B(16)(b)(1)(iii) of Form 40-F.

describe all of its products that contain such conflict minerals and to identify these products as not “DRC conflict free”¹⁰⁸ since the issuer would not be able to establish that the minerals did not directly or indirectly finance or benefit armed groups in the DRC countries. Also, such issuers would be required to describe, to the extent known after conducting due diligence, the facilities used to process those conflict minerals and the efforts to determine the mine or location of origin with the greatest possible specificity.¹⁰⁹ An issuer may provide additional disclosure explaining, for example, that although these products are labeled as not “DRC conflict free” in compliance with our rules implementing the Conflict Minerals Provision, the issuer has been unable to determine the source of the conflict minerals, including whether the conflict minerals in these products benefited or financed armed groups in the DRC countries.

An issuer’s description of any of its products that are not “DRC conflict free” should be based on its individual facts and circumstances so that the description sufficiently identifies the products or categories of products. For example, an issuer may disclose each model of a product containing conflict minerals that are not “DRC conflict free,” each category of a product containing conflict minerals that are not “DRC conflict free,” the specific products containing conflict minerals that are not “DRC conflict free” that were produced during a specific time period, that all its products contain conflict

¹⁰⁸ If any products contain conflict minerals that did not originate in the DRC countries and conflict minerals that the issuer is unable to determine did not originate in the DRC countries, the issuer would be required to classify those products as not “DRC conflict free.” Similarly, if any of an issuer’s products contain conflict minerals that did not originate in the DRC countries, that the issuer is unable to determine did not originate in the DRC countries, or that originated in the DRC countries but did not directly or indirectly finance or benefit armed groups in the DRC countries, and also contain conflict minerals that originated in the DRC countries and that directly or indirectly financed or benefited armed groups in the DRC countries, the issuer must classify those products as not “DRC conflict free.”

¹⁰⁹ We recognize that such issuers would not be able to provide the country of origin of those minerals.

minerals that are not “DRC conflict free,” or another such description depending on the issuer’s facts and circumstances.

The Conflict Minerals Provision uses the phrase “facilities used to process the conflict minerals,” which would appear to refer to the smelter or refinery through which the issuer’s minerals passed. We note also that the Conflict Minerals Provision states that products are “DRC conflict free” when those products do not contain conflict minerals that directly or indirectly finance or benefit armed groups.¹¹⁰ Section 1502(e)(3) of the Act defines the term “armed group” as “an armed group that is identified as perpetrators of serious human rights abuses in the annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961,”¹¹¹ as it relates to the DRC countries.¹¹² Our proposed rule includes a cross reference to that definition to provide guidance to issuers.

Our proposed rules would require issuers to furnish, as part of their Conflict Minerals Report, the audit report prepared by the independent private sector auditor and to specifically identify that auditor.¹¹³ While one might read the statutory language to suggest that only the issuer’s certification of the audit, and not the audit report itself, is required to be submitted, we preliminarily believe that approach is not the better reading

¹¹⁰ See Exchange Act Sections 13(p)(1)(A)(ii) and 13(p)(1)(D).

¹¹¹ 22 U.S.C. 2151n(d) and 2304(b).

¹¹² Section 1502(e)(3) of the Act.

¹¹³ These rules would be included in proposed Item 4(a) of Form 10-K (through Item 104(b)(1)(iv) of Regulation S-K), proposed Item 16(b)(1)(iv) of Form 20-F, and proposed General Instruction B(16)(b)(1)(iv) of Form 40-F. Having our proposed rules require the issuer to identify the certified independent private sector auditor would satisfy Exchange Act Section 13(p)(1)(A)(ii), which states that the issuer must provide a description of “the entity that conducted the independent private sector audit in accordance with clause (i).”

of the Conflict Minerals Provision. As noted above, the Conflict Minerals Provision emphasizes that the independent audit is a “critical component of due diligence.” In light of the importance of this audit report to our new reporting requirements and the statutory language, we are proposing to require that the audit report be furnished with the Conflict Minerals Report.

Although we are proposing that the audit report be furnished with the Conflict Minerals Report, new Item 4(a) of Form 10-K (referring to new Instruction 2 to Item 104 of Regulation S-K), new Instruction 3 to Item 16 of Form 20-F, and new Instruction 3 to General Instruction B(16) of Form 40-F would state that the Conflict Minerals Report, which would include the audit report, would not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the issuer specifically incorporates it by reference. For example, if an issuer incorporates by reference its annual report into a Securities Act registration statement, that issuer would not be automatically incorporating the Conflict Minerals Report into the Securities Act document. Therefore, in such a situation, the independent private sector auditor would not assume expert liability and the issuer would not,¹¹⁴ therefore, have to file a consent from that auditor unless the issuer specifically incorporates by reference the Conflict Minerals Report into the Securities Act registration statement.

Request for Comment

37. Should our rules, as proposed, require issuers that are unable to determine the origin of their conflict minerals to label their products that contain such minerals as not “DRC conflict free”? Is this approach consistent with the Conflict Minerals

¹¹⁴ See Rule 436 of Regulation C [17 CFR 230.436].

Provision”? Would it be more appropriate to allow such issuers to label such products differently, such as “May Not Be DRC Conflict Free”? Would having a separate category for products that contain such unknown origin minerals be consistent with the Conflict Minerals Provision? Would the proposed approach be confusing for readers, or can issuers sufficiently address any confusion by including supplemental disclosure for those products that contain minerals of unknown origin?

38. Should our rules, as proposed, permit issuers to describe their products that contain conflict minerals that do not qualify as being DRC conflict free or that may not qualify as being DRC conflict free based on their individual facts and circumstances? If not, how should we require issuers to describe their products that contain conflict minerals that do not qualify as being DRC conflict free? If an issuer had hundreds or thousands of products that were not DRC conflict free, would the report provide overwhelming information? Would it be unduly expensive to produce?
39. Should our rules, as proposed, require issuers to disclose the facilities, countries of origin, and efforts to find the mine or location of origin only for its conflict minerals that do not qualify as DRC conflict free, and not for all of its conflict minerals? Alternatively, should we require issuers to disclose the facilities, countries of origin, and efforts to find the mine or location of origin for all of its conflict minerals regardless of whether those conflict minerals do not qualify as DRC conflict free?
40. Should our rules require issuers to disclose the mine or location of origin of their conflict minerals with the greatest possible specificity in addition to requiring issuers, as proposed, to describe the efforts to determine the mine or location of origin with the greatest possible specificity? If so, how should we prescribe how the location is

described?

41. As suggested in a submission,¹¹⁵ should our rules require issuers to include information on the capacity of each mine they source from along with the weights and dates of individual mineral shipments?
42. We are proposing that an issuer “certify the audit” by certifying that it obtained such an audit. Should we further specify the nature of the certification? We are not proposing that anyone sign this certification. Should our rules require issuers to have the audit’s certification signed? If so, who should be required to sign the certification? Also, if we revise our proposal to require an individual to sign, should the individual who signs the certification sign it in his or her capacity within the company or on behalf of the company? What liability should our rules assign to the individual who signs the certification?
43. Should our rules, as proposed, require an issuer to furnish its independent private sector audit report as part of its Conflict Minerals Report? Are there other ways to give effect to the Conflict Minerals Provision’s requirement of Section 13(p)(1)(B) that the issuer “certify the audit...that is included in” [emphasis added] the Conflict Minerals Report? Would investors find the audit report useful? How would the potential liability for a furnished audit report affect the cost and availability of such audit services?
44. Should our rules provide that, as proposed, the independent private sector audit report furnished as an exhibit to an issuer’s annual report not be deemed to be incorporated

¹¹⁵ See the petition attached to the memorandum of the November 18, 2010 meeting with Chairman Mary L. Schapiro and with John Prendergast and Darren Fenwick of The Enough Project, Sasha Lezhnev of Grassroots Reconciliation Group, and Deborah R. Meshulam of DLA Piper, available at <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-80.pdf>.

by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the issuer specifically incorporates it by reference? Is this audit report qualitatively different from other expert's reports for which consent is required under our rules?

45. Are there other ways we should treat the audit report under our rules to balance the interests of receiving a high quality audit and not unnecessarily increasing potential liability and costs?

2. Location and Furnishing of Conflict Minerals Report

As noted above, we are proposing rules that require a Conflict Minerals Report to be furnished as an exhibit to an issuer's annual report on Form 10-K, Form 20-F, or Form 40-F, as applicable.¹¹⁶ By requiring issuers to furnish their Conflict Minerals Report as an exhibit to the annual report, our proposed rules would enable anyone accessing the Commission's Electronic Data Gathering, Analysis, and Retrieval system (the "EDGAR" system)¹¹⁷ to determine quickly whether an issuer furnished a Conflict Minerals Report with its annual report. Specifically, proposed Item 4(a) of Form 10-K (through Item 104 to Regulation S-K), Item 16 to Form 20-F, and General Instruction B(16) to Form 40-F would require an issuer to furnish its Conflict Minerals Report as an exhibit to its annual report. Also, our proposed rules would further revise Regulation S-K and Form 20-F to include a new Paragraph (96) of Item 601(b) and a new Paragraph 16 to the "Instructions as to Exhibits" section of Form 20-F to provide additional instructions specifically for

¹¹⁶ Our proposed rules would require that issuers furnish their Conflict Minerals Report as Exhibit 96 to their annual reports.

¹¹⁷ See the Securities and Exchange Commission's Internet website, "Researching Public Companies Through EDGAR: A Guide for Investors," available at: <http://www.sec.gov/investor/pubs/edgarguide.htm>.

their exhibits under Item 601 and Paragraph 16, respectively. The text of Item 601(b)(96) and Paragraph 16 would be substantially similar and only would reference Item 104 and Item 16, respectively.¹¹⁸

Under our proposed rules, an issuer's Conflict Minerals Report, which would include the independent private sector audit report, would not be "filed" for purposes of Section 18 of the Exchange Act and would, thus, not be subject to the liability of that section of the Exchange Act unless the issuer states explicitly that the Conflict Minerals Report and the independent private sector audit report are filed under the Exchange Act. Instead, these documents would only be furnished to the Commission. These documents, therefore, would be treated in the same manner as other furnished disclosures, such as the certifications required to be submitted as exhibit 32¹¹⁹ to Exchange Act documents under Rule 13a-14(b)¹²⁰ or Rule 15d-14(b)¹²¹ and Section 1350 of Chapter 63 of Title 18 of the United States Code,¹²² the Audit Committee Report required by Item 407(d) of Regulation S-K,¹²³ and the Compensation Committee Report required by Item 407(e)(5) of Regulation S-K.¹²⁴ Similarly, our proposed rules would not consider the Conflict

¹¹⁸ Item 601(96) of Regulation S-K would state, "The report required by Item 104(b) of Regulation S-K, if applicable." Also, Paragraph 16 in the "Instructions as to Exhibits" section to Form 20-F would state, "The Conflict Minerals Report required by Item 16 of this Form, if applicable." Further, our proposed rules would revise the Exhibit Table in Item 601 of Regulation S-K.

¹¹⁹ Item 601(32)(ii) of Regulation S-K [17 CFR 229.601(b)(32)].

¹²⁰ 17 CFR 240.13a-14(b).

¹²¹ 17 CFR 240.15d-14(b).

¹²² 18 U.S.C. 1350.

¹²³ 17 CFR 229.407(d).

¹²⁴ 17 CFR 229.407(e)(5).

Minerals Report and the independent private sector audit report incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the issuer specifically incorporates them by reference into the documents.

We believe this approach is not inconsistent with the Conflict Minerals Provision, which provides that an issuer must “submit” the Conflict Minerals Report, and does not otherwise mandate that the information be filed with the Commission.¹²⁵ Further, we preliminarily believe this approach is appropriate in light of the nature and purpose of this disclosure as set forth in Section 1502(a) of the Act.¹²⁶ It appears that the nature and purpose of the Conflict Minerals Provision is for the disclosure of certain information to help end the emergency humanitarian situation in the eastern DRC that is financed by the exploitation and trade of conflict minerals originating in the DRC countries,¹²⁷ which is qualitatively different from the nature and purpose of the disclosure of information that has been required under the periodic reporting provisions of the Exchange Act.¹²⁸ Finally, we note that we have received input indicating that our proposed rules should allow issuers to furnish their conflict minerals disclosures and Conflict Minerals Reports, as applicable.¹²⁹

¹²⁵ See Exchange Act Section 13(p)(1)(A).

¹²⁶ See *supra* note 11. A co-sponsor of the Conflict Minerals Provision stated that the disclosure of an issuer’s conflict minerals information would help investors make a more informed decision. See 156 CONG. REC. S3865-66 (statement of Sen. Feingold) (daily ed. May 18, 2010) (stating that “[c]reating these mechanisms to enhance transparency will help the United States and our allies more effectively deal with these complex problems, at the same time that they will also help American consumers and investors make more informed decisions.”)

¹²⁷ *Id.*

¹²⁸ 15 U.S.C. 78b.

¹²⁹ See letter from the American Bar Association.

Although the Conflict Minerals Report would not be subject to Section 18 liability,¹³⁰ we note that under Exchange Act Section 13(p)(1)(C), failure to comply with the Conflict Minerals Provision would deem the issuer's due diligence process "unreliable" and, therefore, the Conflict Minerals Report "shall not satisfy" our proposed rules.¹³¹ In this regard, issuers that fail to comply with our proposed rules would be subject to liability for violations of Exchange Act Sections 13(a) or 15(d), as applicable.¹³²

Request for Comment

46. Should we, as proposed, require the Conflict Minerals Report to be furnished as an exhibit to the issuer's annual report? If not, how should it be provided?
47. Should we require the Conflict Minerals Report to be filed as an exhibit, rather than furnished, which would affect issuers' liability under the Exchange Act or under the Securities Act (if any such issuer incorporates by reference its annual report into a Securities Act registration statement)?
48. Under Exchange Act Section 18, "Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the Exchange Act] or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15, 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

¹³⁰ 15 U.S.C. 78r.

¹³¹ See Exchange Act Section 13(p)(1)(C).

¹³² 15 U.S.C. 78m(a) and 15 U.S.C. 78o(d).

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.”¹³³ Is it appropriate not to have the Conflict Minerals Report subject to the Section 18 liability even if the elements of Section 18 liability can be established? Should we require the Conflict Minerals Report to be filed for purposes of Exchange Act Section 18, but permit an issuer to elect not to incorporate it into Securities Act filings?

49. Should the Conflict Minerals Report be furnished annually on Form 8-K.¹³⁴ Would that approach be consistent with Exchange Act Section 13(p)(1)(A)? If so, should foreign private issuers, which do not file Forms 8-K, be permitted to submit the Conflict Minerals Report either in their Form 20-F or 40-F as applicable, or annually on Form 6-K, at their election?

3. Due Diligence Standard in the Conflict Minerals Report

Our proposed rules would require issuers to use due diligence regarding the supply chain determinations in their Conflict Minerals Report.¹³⁵ Our proposed rules would not, however, dictate the standard for, or otherwise provide guidance concerning, due diligence that issuers must use in making their supply chain determinations. Instead,

¹³³ Exchange Act Section 18(a).

¹³⁴ See, e.g., letter from American Bar Association.

¹³⁵ See new Item 4(a) of Form 10-K (as through new Item 104(b)(1) of Regulation S-K), new Item 16(b)(1) of Form 20-F, and a new General Instruction B(16)(b)(1) of Form 40-F.

our proposed rules would require issuers to disclose the due diligence they used in making their determinations, such as whether they used any nationally or internationally recognized standards or guidance of supply chain due diligence.

The Conflict Minerals Provision requires issuers to conduct due diligence based on the provision's requirement that issuers describe their due diligence on the source and chain of custody of their conflict minerals.¹³⁶ Also, the provision states that issuers shall include an independent private sector audit of the Conflict Minerals Report as a critical component of due diligence.¹³⁷ Further, under Exchange Act Section 13(p)(1)(C), the Commission may determine an issuer's independent private sector audit or other due diligence processes to be unreliable and, under the terms of the Conflict Minerals Provision, any Conflict Minerals Report that relies on such an unreliable due diligence process would not satisfy our proposed rules.¹³⁸ In light of these statutory provisions, our proposed rules provide that an issuer's Conflict Minerals Report must include reliable due diligence processes, and that due diligence is required in making the supply chain determinations in the Conflict Minerals Report.

We note that we have received suggestions that due diligence is required in making the supply chain determinations. One letter received stated that a due diligence obligation "needs to be extended to the supply chain."¹³⁹ Two of the Congressional sponsors of Section 1502 of the Act have indicated their belief that the due diligence

¹³⁶ Exchange Act Section 13(p)(1)(A)(i).

¹³⁷ Exchange Act Section 13(p)(1)(B).

¹³⁸ Exchange Act Section 13(p)(1)(C).

¹³⁹ Letter from Howland Greene Consultants LLC.

requirement should not be limited to determining whether the smelter uses due diligence.¹⁴⁰ An NGO submitted to us a description of its model supply chain due diligence processes, which would require issuers to perform due diligence on all aspects of their supply chain, including the supply chain determinations in their Conflict Minerals Reports.¹⁴¹ In addition, an industry group from the precious metals industry indicated that it would not be opposed to conducting due diligence of its supply chains and, in fact, that due diligence is already part of its current business practice.¹⁴² We note, however, that another industry group submitted a letter to us expressing concern about the feasibility of implementing a due diligence requirement, particularly with regard to gold.¹⁴³ This industry group pointed out that applying due diligence requirements to the gold supply chain would be especially challenging because the supply chain often begins with a bullion produced by a refiner that incorporates both newly mined and recycled gold.¹⁴⁴

We believe that the statutory provision contemplates that issuers must use due diligence in their supply chain determinations. We do not believe, however, that it would be appropriate to prescribe any particular guidance for conducting due diligence because

¹⁴⁰ See letter from Senator Richard Durbin and Representative Jim McDermott.

¹⁴¹ See attached materials to the memorandum of the September 15, 2010 meeting of the staff of Division of Corporation Finance met with Corinna Gilfillan, Jonathan Grant, and Annie Dunnebacke of Global Witness, available at, <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-18.pdf>.

¹⁴² See letter from International Precious Metals Institute.

¹⁴³ See letter from Tiffany & Co.

¹⁴⁴ Letter from Jewelers Vigilance Committee.

the conduct undertaken by a reasonably prudent person may vary and evolve over time.¹⁴⁵ Although we are not proposing to establish any particular conduct requirements, we believe that due diligence must be performed and information about what conduct an issuer performed in its due diligence regarding its supply chain determinations is relevant. Our proposed rules, therefore, would require issuers to describe the due diligence used in making these determinations. In particular, we expect that an issuer whose conduct conformed to a nationally or internationally recognized set of standards of, or guidance for, due diligence regarding conflict minerals supply chains¹⁴⁶ would provide evidence that the issuer used due diligence in making its supply chain determinations.

If an issuer is unable to determine, after a reasonable country of origin inquiry, that its conflict minerals did not originate in the DRC countries, that issuer still would be required to submit a Conflict Minerals Report and obtain an independent private sector audit of that Conflict Minerals Report. We note that in such instances an issuer may not be able to provide all the information required by the Conflict Minerals Report, such as its conflict minerals' country of origin. We would, however, expect such an issuer to provide as much of the required information as possible, such as a description of the

¹⁴⁵ For instance, the Organisation for Economic Cooperation and Development (the "OECD") is developing due diligence guidance for conflict mineral supply chains. See Organisation for Economic Cooperation and Development (the "OECD"), Draft Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (2010), available at <http://www.oecd.org/dataoecd/13/18/46068574.pdf>. Also, on November 30, 2009, the United Nations Security Council adopted Resolution 1896 that, among other matters, extended and expanded the mandate of the United Nations Group of Experts for the Democratic Republic of the Congo to create recommendations on due diligence guidelines for minerals originating in the DRC. See United Nations Security Council Resolution 1896 (2009) [S/RES/1896 (2009)].

¹⁴⁶ See, e.g., OECD, Draft Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas (2010), available at <http://www.oecd.org/dataoecd/13/18/46068574.pdf>.

measures it took to exercise due diligence on the source and chain of custody of its conflict minerals.

In this regard, if an issuer is unable to determine after a reasonable country of origin inquiry that its conflict minerals did not originate in the DRC countries, the issuer would be required to exercise due diligence in making its supply chain determinations. Therefore, such an issuer would be required to describe its due diligence efforts regarding the facilities used to process the conflict minerals, the conflict minerals' country of origin, if it can be determined, and the efforts to determine the mine or location of origin with the greatest possible specificity.

Request for Comment

50. Should our rules, as proposed, require an issuer to use due diligence in its supply chain determinations and the other information required in a Conflict Minerals Report? If so, should those rules prescribe the type of due diligence required and, if so, what due diligence measures should our rules prescribe? Alternatively, should we require only that persons describe whatever due diligence they used, if any, in making their supply chain determinations and their other conclusions in their Conflict Minerals Report?

51. Should different due diligence measures be prescribed for gold because of any unique characteristics of the gold supply chain? If so, what should those measures entail?

52. Should our rules state that an issuer is permitted to rely on the reasonable representations of its smelters or any other actor in the supply chain,¹⁴⁷ provided there

¹⁴⁷ In the industry, tantalite-columbite, cassiterite, and wolframite are "smelted" into their component metals whereas gold is "refined." Even so, both processes are substantially similar. When we refer to "smelting" those references are intended to include the "refining" of gold as well.

- is a reasonable basis to believe the representations of the smelters or other parties?
53. Is our approach to issuers that are unable to determine that their products did not originate in the DRC countries appropriate?
54. Should our rules prescribe any particular due diligence standards or guidance?
55. Should our rules require that an issuer use specific national or international due diligence standards or guidance, such as standards developed by the OECD, the United Nations Group of Experts for the DRC, or another such organization? If so, should our rules require the issuer to disclose which due diligence standard or guidance it used? Should we list acceptable national or international organizations that have developed due diligence standards or guidance on which an issuer may rely? Should our rules permit issuers to rely on standards from federal agencies if any such agencies develop applicable rules?

E. Time Periods

1. Furnishing of the Initial Disclosure and Conflict Minerals Report

The Conflict Minerals Provision requires issuers to provide their initial conflict minerals disclosure and, if necessary, their initial Conflict Minerals Report after their first full fiscal year following the promulgation of our final rules.¹⁴⁸ Assuming we adopt rules in April 2011, as required by the statutory provision, a December 31 fiscal year-end issuer would first have to provide conflict minerals disclosure or a Conflict Minerals Report after the end of its December 31, 2012 fiscal year. An issuer with a May 31 fiscal

¹⁴⁸ See Exchange Act Section 13(p)(1)(A) (stating that an issuer must “disclose annually, beginning with the [issuer’s] first full fiscal year that begins after the date of promulgation of [our] regulations”).

year-end, however, would have to provide the conflict minerals disclosure or a Conflict Minerals Report in its annual report for the fiscal year that encompasses the period from June 1, 2011 through May 31, 2012.

Request for Comment

56. Should our rules, as proposed, require that a complete fiscal year begin and end before issuers are required to provide their initial disclosure or Conflict Minerals Report regarding their conflict minerals?
57. If we require issuers to provide their disclosure or reporting requirements in their Exchange Act annual reports, should we permit them to file an amendment to the annual report within a specified period of time subsequent to the due date of the annual report, similar to Article 12 schedules or financial statements provided in accordance with Regulation S-X Rule 3-09,¹⁴⁹ to provide the conflict minerals information?¹⁵⁰ If so, why and for which issuers should our rules permit such a delay? For example, should we allow this delay only for smaller reporting companies?
58. Should we phase in our rules and permit certain issuers, such as smaller reporting companies, to delay compliance with the Conflict Minerals Provision's disclosure and reporting obligations until a period after that which is provided in the Exchange Act Section 13(p)(1)(A)?

2. Time Period in which Conflict Minerals Must be Disclosed or Reported

¹⁴⁹ 17 CFR 210.3-09.

¹⁵⁰ See letter from the American Bar Association.

The Conflict Minerals Provision requires issuers to disclose whether their necessary conflict minerals originated in the DRC countries “in the year for which such reporting is required.”¹⁵¹ We believe the date that the issuer takes possession of a conflict mineral would determine which reporting year an issuer would have to provide the required disclosure or Conflict Minerals Report for its conflict minerals. For example, if a December 31 fiscal year-end issuer takes possession of the conflict minerals, or product containing the conflict minerals, on December 31, the issuer would have to provide the required disclosure or a Conflict Minerals Report for the current year. However, if that same issuer did not take possession of the minerals until January 1, the issuer would not have to provide the disclosure or a report until the end of the year beginning that day and ending on the subsequent December 31.

In an instance in which an issuer contracts the manufacturing of a product in which a conflict mineral is necessary to the production of that product, but the conflict mineral is not included in the product, the issuer may use the date it takes possession of the product to determine which reporting year the issuer would have to provide the required disclosure or Conflict Minerals Report for the conflict mineral used to produce the product. For example, if a December 31 fiscal year-end issuer takes possession on December 31 of the product for which a conflict mineral was necessary to produce but that did not end up in the product, the issuer would have to provide the required disclosure or a Conflict Minerals Report for the year ended on that December 31. However, if that same issuer did not take possession of the product until the subsequent day, January 1, the issuer would not have to provide the disclosure or a report until the

¹⁵¹ Exchange Act Section 13(p)(1)(A).

end of the year beginning that January 1 and ending on the subsequent December 31.

Request for Comment

59. Is “possession” the proper determining factor as to when issuers should provide the required disclosure or a Conflict Minerals Report regarding a necessary conflict mineral? If not, what would be a more appropriate test and why?
60. Should our rules allow individual issuers to establish their own criteria for determining which reporting period to include any required conflict minerals disclosure or Conflict Minerals Report, provided that the issuers are consistent and clear with their criteria from year-to-year?
61. We note it is possible issuers may have stockpiles of existing conflict minerals that they previously obtained. Do we adequately address issuers’ disclosure and reporting obligations regarding their existing stockpiles of conflict minerals? If not, how can we address existing stockpiles of conflict minerals? Should our rules permit a transition period so that issuers would not have to provide any conflict minerals disclosure or report regarding any conflict mineral extracted before the date on which our rules are adopted? Alternatively, would the reasonable country of origin inquiry standard for determining the origin of the conflict minerals and the due diligence standard or guidance for determining the source and chain of custody of the conflict minerals that originated in the DRC countries accomplish the same goal? For example, should issuers be required to inquire about the origin of their conflict minerals extracted before the date on which our rules are adopted? As another example, should issuers file a Conflict Minerals Report regarding conflict minerals that originated in the DRC countries before the date on which our rules are adopted?

F. Thresholds, Alternatives, Termination, Revisions, and Waivers

1. Materiality Threshold

As discussed above, the Conflict Minerals Provision's only limiting factor is that the conflict minerals must be "necessary to the functionality or production" of an issuer's products.¹⁵² The provision has no materiality thresholds for disclosure based on the amount of conflict minerals an issuer uses in its production processes. Therefore, we are not proposing to include a materiality threshold for the disclosure or reporting requirements in our proposed rules.

Request for Comment

62. Should there be a de minimis threshold in our rules based on the amount of conflict minerals used by issuers in a particular product or in their overall enterprise? If so, what would be a proper threshold amount? Would this be consistent with the Conflict Minerals Provision?¹⁵³

2. Recycled and Scrap Minerals

Our proposed rules would allow for different treatment of conflict minerals from recycled and scrap sources than from mined sources due to the difficulty of looking through the recycling or scrap process to determine the origin of the minerals. As suggested in a letter, we would consider conflict minerals "recycled" that are reclaimed end-user or post-consumer products, but we would not consider those minerals "recycled" if they are partially processed, unprocessed, or a byproduct from another

¹⁵² Exchange Act Section 13(p)(2)(B).

¹⁵³ See letter from Senator Richard J. Durbin and Representative Jim McDermott, United States Congress (stating that a de minimis rule would create an overly generous loop-hole because the weight of essential conflict minerals in many products is very small).

ore.¹⁵⁴ Given the difficulty of looking through the recycling or scrap process, we expect that issuers generally will not know the origins of their recycled or scrap conflict minerals, so we believe it would be appropriate for our proposed rules to require that issuers using recycled or scrap conflict minerals furnish a Conflict Minerals Report subject to special rules. Under our proposed rules,¹⁵⁵ if issuers obtain conflict minerals from a recycled or scrap source, they may consider those conflict minerals to be DRC conflict free.¹⁵⁶ We believe that including this alternative approach in our proposed rules is consistent with the Conflict Minerals Provision because issuers purchasing conflict minerals from recycled or scrap sources would not implicate the concerns of the provision.¹⁵⁷

Issuers whose conflict minerals originated from recycled or scrap sources would be required to disclose in their annual report, under the “Conflict Minerals Disclosure” heading, that their conflict minerals were obtained from recycled or scrap sources and

¹⁵⁴ See Multi-Stakeholder Group Letter.

¹⁵⁵ See new Items 104(b)(2) and (c)(4) of Regulation S-K, new Items 16(b)(2) and (c)(4) of Form 20-F, and new General Instructions B(16)(b)(2) and (c)(4) of Form 40-F.

¹⁵⁶ Because our proposed rules would automatically classify recycled or scrap conflict minerals DRC conflict free, issuers with products containing such minerals would not need to provide in the Conflict Minerals Report a description of the recycled or scrap conflict minerals’ processing facilities or country of origin, nor would they be required to describe their efforts to determine the mine or location of origin with the greatest possible specificity.

¹⁵⁷ See Section 1502(a) of the Act. See also, 156 Cong. Rec. S3816-17 (daily ed. May 17, 2010) (statement of Sen. Durbin) (“We can’t begin to solve the problems of eastern Congo without addressing where the armed groups are receiving their funding, mainly from the mining of a number of key conflict minerals. We, as a nation of consumers as well as industry, have a responsibility to ensure that our economic activity does not support such violence. That is why I join with Senators Brownback and Feingold to support the Congo conflict minerals amendment, which is now pending on this bill.”). One of the provision’s sponsors, however, indicated that the Conflict Minerals Provision was intended, in part, to allow investors to make informed decisions. See 156 CONG. REC. S3865-66 (statement of Sen. Feingold) (daily ed. May 18, 2010) (stating that the provision would “enhance transparency [and] will help the United States and our allies more effectively deal with these complex problems, at the same time that they will also help American consumers and investors make more informed decisions” [emphasis added]).

that they furnished a Conflict Minerals Report regarding those recycled or scrap minerals. Under our proposed rules, issuers would state in their Conflict Minerals Report that their recycled or scrap minerals are considered DRC conflict free. In addition, such issuers would describe the measures taken to exercise due diligence in determining that their conflict minerals were recycled or scrap. Again, however, our proposed rules would not specify the due diligence required of such issuers. Further, our proposed rules would not define when a conflict mineral is recycled or scrap. Instead, any issuer seeking to use this alternative approach would provide its reasons for believing that the conflict mineral is from recycled or scrap sources in its Conflict Minerals Report, which would include due diligence on the source of the mineral.

A number of those that have submitted letters indicated that our rules should allow conflict minerals from recycled or scrap sources to be considered as not originating in the DRC countries or as DRC conflict free.¹⁵⁸ A number of these letters primarily discussed recycled gold.¹⁵⁹ Other letters, however, stated that our proposed rules should exempt all recycled or reclaimed conflict metals.¹⁶⁰ Additionally, most of the letters that expressed a view on a recycled and scrap alternative approach indicated that the approach

¹⁵⁸ See, e.g. letters from Jewelers Vigilance Committee, Howland Greene Consultants LLC, International Precious Metals Institute, and the National Association of Manufacturers.

¹⁵⁹ See letters from Jewelers Vigilance Committee (stating that recycled gold would be impossible to trace, making an exemption appropriate) and International Precious Metals Institute (stating that “[w]e also believe that recycled gold waste and scrap should be deemed to be a conflict-free source”).

¹⁶⁰ See letters from Howland Greene Consultants LLC (stating that “[r]ecycling should be encouraged and recognized as a legitimate way to classify a listed metal as DRC Conflict Free”) and the National Association of Manufacturers (stating that our proposed rules should exempt recycled or scrap minerals because it “is impossible to track” the source of these minerals “due to the various forms of recycling and thousands of consolidators, reclaimers, and scrap dealers both domestic and foreign” and because exempting recycled or scrap minerals “does not contradict the congressional intent” of the Conflict Minerals Provision).

should include a certain level of due diligence in determining that the conflict minerals were derived from recycled or scrap sources.¹⁶¹

Our proposed rules regarding recycled and scrap conflict minerals would apply to all conflict minerals. If recycled or scrap minerals are mixed with new minerals, the recycled and scrap alternative approach would apply only to the portion of the minerals that are recycled or scrap and the issuer would be required to furnish a Conflict Minerals Report regarding at least the recycled or scrap minerals. If the issuer's new conflict minerals did not originate in the DRC countries, that Conflict Minerals Report would contain only information regarding the recycled or scrap minerals. If, however, the new conflict minerals originated in the DRC countries, or the issuer was unable to determine that its new conflict minerals did not originate in the DRC countries, the Conflict Minerals Report would include information regarding both the new conflict minerals and the recycled or scrap conflict minerals.

Request for Comment

63. Should our rules, as proposed, include an alternative approach for conflict minerals from recycled or scrap sources as proposed? If so, should that approach permit issuers with necessary conflict minerals to classify those minerals as DRC conflict free, as proposed? Should we require, as proposed, issuers using conflict minerals from recycled or scrap sources to furnish a Conflict Minerals Report, including a certified independent private sector audit, disclosing that their conflict minerals are

¹⁶¹ See letters from Howland Greene Consultants LLC (stating that recycled minerals should be classified as DRC Conflict Free only "if specific criteria are met") and International Precious Metals Institute (stating that recycled gold waste and scrap should be deemed to be a conflict-free source only "in the absence of particular geographical risk or other red flags").

from these sources? If not, why not?

64. Instead, should our rules require issuers with recycled or scrapped conflict minerals to undertake reasonable inquiry to determine they are recycled or scrapped and to disclose the basis for their belief that their minerals are, in fact, from these sources?
65. Should our rules, as proposed, require that issuers use due diligence in determining whether their conflict minerals are from recycled or scrap sources as proposed and file a Conflict Minerals Report including an independent private sector audit of that report? If so, should our rules prescribe the due diligence required? If our rules should not require due diligence, should our rules require any alternative standard or guidance? If so, what standard or guidance? Should our rules define what constitutes recycled or scrap conflict minerals? If so, what would be an appropriate definition?
66. Should this treatment be limited to gold, or should it apply to all conflict minerals, as proposed?
67. Is our alternative approach to recycled and scrap minerals appropriate? Is there a significant risk that conflict minerals that are not "DRC conflict free" may be inappropriately processed and "recycled" so as to take advantage of this alternate approach?
68. Should we allow exemptions to the information required by smaller reporting companies regarding their use of recycled or scrap minerals? For example, should we not require smaller reporting to furnish a Conflict Minerals Report regarding their recycled or scrap minerals? As another example, if we require smaller reporting companies to furnish a Conflict Minerals Report with respect to recycled or scrap minerals, should we not require those issuers to have such Conflict Minerals Reports

audited?

3. Termination, Revisions, and Waivers

The Conflict Minerals Provision states that the Commission shall revise or temporarily waive its conflict minerals rules if the President transmits to the Commission a determination that a revision or waiver is in the national security interest of the United States and the President provides reasons for this determination.¹⁶² However, any exemption to the Conflict Minerals Provision may last no longer than two years from the date of the exemption's initial publication.¹⁶³ Also, the Conflict Minerals Provision's disclosure and reporting requirements shall terminate when the President determines and certifies to the appropriate congressional committees that "no armed groups continue to be directly involved and benefitting from commercial activity involving conflict minerals."¹⁶⁴ The Conflict Minerals Provision may not, however, terminate earlier than five years after the Act was enacted.¹⁶⁵ We plan to act in accordance with these provisions should any of the situations they describe occur. Our proposed rules, however, would not include these sections of the Conflict Minerals Provision because we do not believe that a rule to implement this section is necessary at this time.

Request for Comment

69. Should our rules address specifically the Conflict Minerals Provision's revision,

¹⁶² See Exchange Act Section 13(p)(3).

¹⁶³ Id.

¹⁶⁴ Section 1502(e)(4) of the Act defines the term "appropriate congressional committees" as the Committee on Appropriations, the Committee on Foreign Affairs, the Committee on Ways and Means, and the Committee on Financial Services of the House of Representatives and the Committee on Appropriations, the Committee on Foreign Relations, the Committee on Finance, and the Committee on Banking, Housing, and Urban Affairs of the Senate.

¹⁶⁵ See Exchange Act Section 13(p)(4).

waiver, or termination requirements? If so, how should our rules address this?

G. General Request for Comment

We request and encourage any interested person to submit comments on any aspect of our proposals, other matters that might have an impact on the amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

III. PAPERWORK REDUCTION ACT

A. Background

The proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (the "PRA").¹⁶⁶ We are submitting the proposed amendments to the Office of Management and Budget (the "OMB") for review in accordance with the PRA.¹⁶⁷ The title for the collection of information is:

- (1) "Regulation S-K" (OMB Control No. 3235-0071);¹⁶⁸
- (2) "Form 10-K" (OMB Control No. 3235-0063);
- (3) "Form 20-F" (OMB Control No. 3235-0288); and
- (4) "Form 40-F" (OMB Control No. 3235-0381).

¹⁶⁶ 44 U.S.C. 3501 *et seq.*

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

¹⁶⁸ The paperwork burden from Regulation S-K is imposed through the forms that are subject to the disclosures in Regulation S-K and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burdens imposed by Regulation S-K to be a total of one hour.

The regulation and forms were adopted under the Securities Act and the Exchange Act. The regulation and forms set forth the disclosure requirements for periodic reports and registration statements filed by companies to help shareholders make informed investment and voting decisions. The hours and costs associated with preparing and filing the form constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

The proposed rules and form amendments would implement Section 13(p) of the Exchange Act, which was added by Section 1502 of the Act. As discussed in detail above, the proposed rules and form amendments would require an issuer to provide statutorily-mandated information regarding conflict minerals that are necessary to the functionality or production of a product manufactured or contracted to be manufactured by such an issuer. In this regard, we are proposing to add new disclosure and reporting requirements to the above forms, which would be substantially the same in each form.¹⁶⁹ The same conflict minerals disclosure requirements would apply to U.S. and foreign issuers.

The proposed rules would require any issuer filing reports under the Exchange Act to disclose in its annual reports whether conflict minerals that are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the issuer originated in the DRC countries. If so, the issuer would be required to furnish as an exhibit to its annual report a Conflict Minerals Report that includes a

¹⁶⁹ New Item 4(a) in the Form 10-K would require issuers to furnish in the Form 10-K the information located in new Item 104 of Regulation S-K, which would set forth the new disclosure and reporting requirements to be included in the Form 10-K. For Forms 20-F and 40-F, the new disclosure and reporting requirements are contained within the form itself.

description of the measures taken by the issuer to exercise due diligence on the source and chain of custody of those minerals, which measures shall include an independent private sector audit of the Conflict Minerals Report that is certified by the issuer. Also, the Conflict Minerals Report would include a description of the issuer's products manufactured or contracted to be manufactured that are not DRC conflict free, the identity of the independent private sector auditor, the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.

These proposed rules would increase the amount of information that certain issuers must compile and disclose in their forms and would increase the disclosure burden in annual reports for certain issuers. Issuers filing reports under the Exchange Act that do not have conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by those issuers would have no disclosure or reporting requirements under the rules, but they would have the burden of determining whether conflict minerals are necessary to the functionality or production of products they manufacture or contract to manufacture. Under our proposed rules implementing the Conflict Minerals Provision, issuers that have conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by those issuers must determine whether those conflict minerals originated in the DRC countries. Our proposed rules would require issuers to conduct a reasonable country of origin inquiry in determining whether their conflict minerals originated in the DRC countries. This reasonable country of origin inquiry could vary among issuers, but we believe that issuers would generally have to conduct a relatively thorough

investigation to meet this standard. Therefore, we believe that the burden on issuers to determine the origin of their conflict minerals could be significant. If an issuer determines, however, that its conflict minerals did not originate in the DRC countries, its subsequent disclosure burden would be relatively insignificant. Such an issuer would be required to disclose in its annual report and on its website only that its conflict minerals did not originate in the DRC countries and disclose in its annual report the reasonable country of origin inquiry it used to make this determination.

Issuers with conflict minerals that originated in the DRC countries, or issuers that were unable to determine that their conflict minerals did not originate in the DRC countries, would be required to furnish a Conflict Minerals Report and would be required to use due diligence in determining the information required in that Conflict Minerals Report. Our proposed rules would require issuers to disclose, in their Conflict Minerals Report, the measures they took to exercise due diligence on the source and chain of custody of their conflict minerals. Additionally, issuers would have to disclose, based on their due diligence, whether any of the products they manufactured or contracted to be manufactured are not DRC conflict free. Also, issuers would be required to disclose the facilities used to process their conflict minerals, the country from which their conflict minerals originated, and the efforts to determine the mine or location of origin with the greatest possible specificity. Further, issuers would have to obtain an independent private sector audit of their Conflict Minerals Report and include in the Conflict Minerals Report a certification that they obtained such an audit, the identity of the auditor, and the audit report. Finally, the issuer would be required to post the Conflict Minerals Report, including the audit report, on its Internet website.

The type of reasonable country of origin inquiry and the due diligence standard for determining this information could vary among issuers. Regardless, we expect that all issuers with conflict minerals that originated in the DRC countries, or issuers that were unable to determine that their conflict minerals did not originate in the DRC countries, would have to conduct a thorough investigation to meet the reasonable country of origin inquiry and due diligence standards, which could be another significant burden on these issuers. The burden would be greater on issuers whose products contained conflict minerals that were not "DRC conflict free" because these issuers would have to determine which of their products contain conflict minerals that are not "DRC conflict free," whereas issuers with only "DRC conflict free" minerals would not have to make such a determination. Compliance with the proposed amendments by affected issuers would be mandatory. The disclosure and reports submitted by issuers would not be kept confidential and there would be no mandatory retention period for the information disclosed.

B. Burden and Cost Estimates Related to the Proposed Amendments

The proposed rules and form amendments would require, if adopted, additional disclosure for an annual report filed on Form 10-K, Form 20-F, or Form 40-F by an issuer with necessary conflict minerals, which would increase the burden hour and cost estimates for each of those forms. For purposes of the PRA, we estimate the total annual increase in the paperwork burden for all affected companies to comply with our proposed collection of information requirements to be approximately 153,864 of company personnel time and to be approximately \$71,243,000 for the services of outside professionals. These estimates include the time and cost of collecting the information,

preparing and reviewing disclosure, filing documents, and retaining records.

In deriving our estimates, we recognize that the burdens will likely vary among individual companies based on a number of factors, including the size and complexity of their operations and the number of products they manufacture or contract to manufacture and the number of those products that contain conflict minerals. We believe that some issuers will experience costs in excess of this average in the first year of compliance with the proposals and some issuers may experience less than these average costs.¹⁷⁰

We have based our estimates of the effect that the adopted rules and form amendments, if adopted, would have on those collections of information as a result of the required due diligence process and independent private sector audit of the Conflict Minerals Report primarily on information that we have obtained from various stakeholder groups.

We do not expect all issuers' conflict minerals to have originated in the DRC countries. The DRC accounts for approximately 15% to 20% of the world's tantalum, and for considerably smaller percentage of the other three conflict minerals.¹⁷¹

Therefore, for the purposes of the PRA, we assume that only 20% of the 5,994 affected issuers¹⁷² will have to furnish an audited Conflict Minerals Report, which would be 1,199

¹⁷⁰ See letter from the National Association of Manufacturers (suggesting that any change to an issuer's supply chain computer systems "is likely to range from \$1 million to \$25 million" per issuer "depending on the size and complexity of the supply chain"). We expect that the internal collection burden will vary from company to company depending on each company's needs and circumstances.

¹⁷¹ See Jessica Hölzer, *Retailers Fight to Escape 'Conflict Minerals' Law*, THE WALL STREET JOURNAL, Dec. 2, 2010, at B1. The DRC also accounts for approximately 4% of the world's tin, see *id.*, and approximately 0.3% of global gold mine production, see letter from Jewelers Vigilance Committee (citing to GFMS Gold Survey 2010).

¹⁷² We estimate that approximately 5,551 Forms 10-K, 377 Forms 20-F, and 66 Forms 40-F will be affected by the proposed amendments.

issuers.

Although no entity has yet conducted due diligence for its conflict minerals supply chain or obtained an audit of this due diligence, we obtained estimates from one entity that works with NGOs and one industry group of possible costs associated with conducting the due diligence and the audit based on the preliminary information they currently have. The entity that works with NGOs has estimated that the annual cost of conducting the due diligence for the four conflict minerals ranges between \$20 million and \$25 million. An industry group provided a much lower range of between \$8 million and \$10 million to set up a mineral source validation scheme. Although our rules do not require issuers to use an industry-wide due diligence process to comply with their due diligence obligations, we expect that most affected issuers will contribute to and rely on an industry wide due diligence process as part of their overall compliance.¹⁷³ Therefore, for purposes of the PRA, we have averaged the highest and the lowest estimates we received of the due diligence costs to obtain an aggregate estimate of \$16.5 million¹⁷⁴ for the 1,199 issuers estimated to be required to file Conflict Minerals Reports.

Issuers that are required to file Conflict Minerals Reports must also obtain and certify an audit of the Conflict Minerals Report. One industry group indicated that it preliminarily estimates that each independent private sector audit of the Conflict Minerals Report will cost approximately \$25,000 on average. We estimate that the 1,199 affected issuers' \$25,000 cost would result in to an industry wide audit of approximately

¹⁷³ See Multi-Stakeholder Group Letter (stating that, although individual issuers are responsible for their own due diligence, an issuer "may rely on an industry wide process where applicable and appropriate").

¹⁷⁴ $(\$25 \text{ million} + \$8 \text{ million})/2 = \$16.5 \text{ million}$.

\$29,975,000. Therefore, based on these figures, we estimate the PRA burden for the audit and due diligence requirements to the industry would be approximately \$46,475,000.¹⁷⁵ We expect that the rules' effect will be higher during the first year of their effectiveness, due to the initial costs of creating minerals tracking systems, and diminish in subsequent years.

We have derived the burden hour and cost estimates for preparing the required disclosure in the annual reports and for determining when a registrant has conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by the registrant by estimating the total amount of time it will take the company to prepare the disclosure and make the determination. We estimate that the disclosure preparation for all affected registrants will take 36 hours per Form 10-K (27 hours in-house personnel time and a cost of approximately \$3,600 for professional services). We estimate that for Forms 20-F and 40-F, the disclosure preparation will also take 36 hours (9 hours in-house personnel time and a cost of approximately \$10,800 for professional services).

We derived the above estimates by estimating the average number of hours it would take an issuer to prepare and review the proposed disclosure requirements. These estimates represent the average burden for all companies, both large and small.

When determining these estimates, we have assumed that:

- for Form 10-K, 75% of the burden of preparation is carried by the company internally and that 25% of the burden of the preparation is carried by outside

¹⁷⁵ \$16,500,000 + \$29,975,000 = \$46,475,000.

- professionals retained by the company at an average cost of \$400 per hour; and
- for Forms 20-F and 40-F, 25% of the burden of preparation is carried by the company internally and that 75% of the burden of preparation is carried by outside professionals retained by the company at an average cost of \$400 per hour.

The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours.

1. Form 10-K

For purposes of the PRA, we estimate that, of the 13,545 Form 10-Ks filed annually, approximately 5,551 are filed by companies that would be affected by the proposed rules and form amendments.¹⁷⁶ We further estimate that the annual incremental paperwork burden for the Forms 10-K as a result of the proposed rule and form amendments would be 27 burden hours per affected form associated with the company's preparation of the disclosure, and \$19,983,600¹⁷⁷ associated with the cost of hiring professionals to help prepare the disclosure. In addition, we estimate for these purposes that those issuers required to submit a Conflict Minerals Report would also expend a total of \$43,040,161¹⁷⁸ associated with the cost of hiring professionals to conduct the due diligence and the independent private sector audit of the Conflict Minerals Report.

2. Regulation S-K

¹⁷⁶ We arrived at this number by estimating the number of issuers that fall under all the SIC codes that our staff believes most likely to manufacture or contract to manufacture products with conflict minerals necessary to the functionality or production of products manufactured or contracted to be manufactured by those issuers, and subtracted from that figure the number of issuers that file reports on Form 20-F and Form 40-F.

¹⁷⁷ $\$3,600 \times 5,551 = \$19,983,600$.

¹⁷⁸ $\$46,475,000 \times (5551/5994) = \$43,040,161$

While the proposed rule and form amendments would make revisions to Regulation S-K, the collection of information requirements for that regulation are reflected in the burden hours estimated for Form 10-K. The rules in Regulation S-K do not impose any separate burden. Consistent with historical practice, we are proposing to retain an estimate of one burden hour to Regulation S-K for administrative convenience.

3. Form 20-F

For purposes of the PRA, we estimate that, of the 942 Form 20-F annual reports, approximately 377 are filed each year by companies that would be affected by the proposed rule and form amendments.¹⁷⁹ We estimate that the annual incremental paperwork burden for the Forms 20-F as a result of the proposed rule and form amendments would be nine burden hours per affected form associated with the company's preparation of the disclosure, and \$4,071,600¹⁸⁰ associated with the cost of hiring professionals to help prepare the disclosure. In addition, we estimate for these purposes that those issuers required to prepare a Conflict Minerals Reports would also expend a total of \$2,923,102¹⁸¹ associated with the cost of hiring professionals to conduct the due diligence and the independent private sector audit.

4. Form 40-F

For purposes of the PRA, we estimate that, of the 205 Form 40-F annual reports filed each year, approximately 66 are filed by companies that would be affected by the

¹⁷⁹ We arrived at this estimate by determining the number of issuers that fall under all the SIC codes that our staff believes are most likely to manufacture or contract to manufacture products with conflict minerals necessary to the functionality or production of products manufactured or contracted to be manufactured by those issuers that file reports on Form 20-F.

¹⁸⁰ $\$10,800 \times 377 = \$4,071,600$.

¹⁸¹ $\$46,475,000 \times (377/5994) = \$2,923,102$.

proposed rule and form amendments.¹⁸² We estimate that the annual incremental paperwork burden for the Forms 40-F as a result of the proposed rule and form amendments would be nine burden hours per affected form associated with the company's preparation of the disclosure, and \$712,800¹⁸³ associated with the cost of hiring professionals to help prepare the disclosure. In addition, we estimate for these purposes that those issuers required to prepare a Conflict Minerals Report would also expend a total of \$511,737¹⁸⁴ associated with the cost of hiring professionals to conduct the due diligence and the independent private sector audit.

C. Summary of Proposed Changes to Annual Compliance Burden in Collection of Information

The following table illustrates the estimated changes in annual compliance burden in the collection of information in hours and costs for Exchange Act annual reports as a result of the proposed rule and form amendments.

Table 1

Form	Number of Responses ¹⁸⁵	Incremental Company	Incremental Professional Cost
10-K	5,551	149,877	\$63,023,761
20-F	377	3,393	\$6,994,702
40-F	66	594	\$1,224,537

Table 2

¹⁸² We arrived at this estimate by determining the number of issuers that fall under all the SIC codes that our staff believes are most likely to manufacture or contract to manufacture products with conflict minerals necessary to the functionality or production of products manufactured or contracted to be manufactured by those issuers that file reports on Form 40-F.

¹⁸³ $\$10,800 \times 66 = \$712,800$.

¹⁸⁴ $\$46,475,000 \times (66/5994) = \$511,737$.

¹⁸⁵ This number corresponds to the estimated number of forms expected to be affected by the proposed rules and form amendments.

Form	Current Annual Response ¹⁸⁶	Current Burden Hours (A)	Increase in Burden Hours (B)	Proposed Burden Hours (C)=(A)+(B)	Current Professional Costs (D)	Increase in Professional Costs (E)	Proposed Professional Costs (F)=(D)+(E)
10-K	13,545	21,363,548	149,877	21,513,425	\$2,848,473,000	\$63,023,761	\$2,911,496,761
20-F	942	622,907	3,393	626,300	\$743,089,980	\$6,994,702	\$750,084,682
40-F	205	21,884	594	22,478	\$26,260,500	\$1,224,537	\$27,485,037

D. Request for Comment

We request comment on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of 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; (iv) 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; and (v) evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

In particular, we request comment and supporting empirical data for purposes of the PRA on whether the proposed rule and form amendments:

- will affect the burden hours and costs required to produce the annual reports on Forms 10-K, 20-F, and 40-F; and

¹⁸⁶ The proposed rules and form amendments would not change the number of annual responses.

- if so, whether the resulting change in the burden hours and costs required to produce those Exchange Act annual reports is the same as or different than the estimated incremental burden hours and costs proposed by the Commission.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090, with reference to File No. S7-40-10. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-40-10, 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 collection 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 of publication.

IV. COST-BENEFIT ANALYSIS

Section 1502 of the Act amends the Exchange Act by adding new Section 13(p),¹⁸⁷ which requires the Commission to promulgate disclosure and reporting

¹⁸⁷ See Exchange Act Section 13(p).

regulations regarding the use of conflict minerals from the DRC countries. In response to the requirements of Exchange Act Section 13(p) as set forth in Section 1502 of the Act, the Commission is proposing new rules and form amendments that would provide for the disclosure and reporting of the use of conflict minerals from the DRC countries. The proposed rules and form amendments implement the requirements in Section 1502 of the Act and, as necessary or appropriate, require additional disclosure in a manner that we believe is consistent with Congress's intent.

First, Section 13(p)(1)(A) indicates that the Conflict Minerals Provision applies to a "person described," who is defined in Section 13(p)(2)(B) as one for whom conflict minerals are necessary to the functionality or production of a product manufactured by that person.¹⁸⁸ This provision could be read quite broadly to apply to any business, including individuals and companies that are not subject to SEC reporting, so long as conflict minerals are necessary to the functionality or production of a product manufactured by that entity or individual. We believe that such a broad reading of the provision is not warranted, however, given the provision's background and its location in the section of the Exchange Act that pertains to reporting issuers.¹⁸⁹ As a result, our proposed rules would apply only to issuers that file reports with the Commission under the Exchange Act, provided that conflict minerals are necessary to the functionality or production of a product manufactured by any such an issuer.

While our proposed amendments would not define specifically when a conflict mineral is "necessary to the functionality or production of a product," we intend our

¹⁸⁸ See *supra* note 12.

¹⁸⁹ See *supra* note 38.

proposed rules to provide that a conflict mineral is “necessary to the production of a product” if a conflict mineral is intentionally included in a product’s production process and the conflict mineral is necessary to that process, even if that conflict mineral is not ultimately included anywhere in the final product. Our proposed amendments would specify that, although a conflict mineral is necessary to the functionality or production of a product manufactured or contracted to be manufactured by the issuer, if that conflict mineral was obtained from recycled or scrap minerals, that mineral would be considered DRC conflict free. This approach for recycled or scrap minerals is not included in the Conflict Minerals Provision, but we believe it is appropriate because such conflict minerals would not be implicating the concerns that prompted the enactment of this statutory provision.¹⁹⁰

Third, Section 13(p)(1)(A) indicates that issuers must disclose whether their necessary conflict minerals originated in the DRC countries.¹⁹¹ The Conflict Minerals Provision, however, is silent as to how issuers would determine whether their conflict minerals originated in the DRC countries. Our proposed amendments would indicate that an issuer’s determination of whether or not any of its necessary conflict minerals originated in the DRC countries would be required to be based on a reasonable country of origin inquiry into the minerals’ origins and, if the issuer determines its necessary conflict minerals did not originate in the DRC countries, that the issuer would have to disclose in the body of its annual report the reasonable country of origin inquiry it undertook to make its determination and would have to maintain reviewable business records to

¹⁹⁰ See supra note 157.

¹⁹¹ See Exchange Act Section 13(p)(1)(A).

support this determination.

Fourth, our proposed amendments would specify where the Conflict Minerals report required by Section 13(p)(1)(A) of the Exchange Act should be provided.¹⁹² The statutory provision does not indicate how issuers should submit their Conflict Minerals Reports to the Commission. Our proposed amendments would require issuers with necessary conflict minerals that originated in the DRC countries to furnish their Conflict Minerals Reports as an exhibit to their annual report on Form 10-K, Form 20-F, or Form 40-F, as applicable. In addition, although the Conflict Minerals Provision indicates that the Conflict Minerals Report must include an independent private sector audit of such report submitted through the Commission, it is unclear what record of that independent private sector audit an issuer must submit to the Commission and how it must do so, if at all. Our proposed amendments would require issuers to furnish an audit report of the independent private sector audit as part of and in the same exhibit to the annual report as the issuer's Conflict Minerals Report. Our proposed amendments also specify the required certification of the independent private sector audit. Our proposed amendments would require an issuer that furnishes a Conflict Minerals Report to include a statement in the body of its annual report that the Conflict Minerals Report is furnished as an exhibit to the annual report, that the Conflict Minerals Report and the certified audit report are available on its Internet website, and the Internet address of the website where the Conflict Minerals Report and audit report are located. Our proposed amendments would also require that the disclosure be posted on the issuer's Internet website at least until the issuer files its subsequent annual report.

¹⁹² Id.

Finally, our proposed amendments would require that the Conflict Minerals Report be furnished with the Commission, rather than filed. The Conflict Minerals Provision indicates that the report should be “submitted” to us,¹⁹³ but it does not indicate whether the report should be filed or furnished. Information that is furnished, rather than filed, with us is not subject to liability under Section 18 of the Exchange Act. By requiring the Conflict Minerals Report to be furnished with us, we are subjecting such reports to less liability than would exist if the reports were filed with us. However, under Exchange Act Section 13(p)(1)(C), failure to comply with the Conflict Minerals Provision would deem the issuer’s due diligence process “unreliable” and, therefore, the Conflict Minerals Report “shall not satisfy” our proposed rules.¹⁹⁴ Also, issuers that fail to comply with our proposed rules would be subject to liability for violations of Exchange Act Sections 13(a) or 15(d), as applicable.¹⁹⁵

The Commission is sensitive to the costs and benefits imposed by the proposed rules and form amendments. The discussion below focuses on the costs and benefits of the proposals made by the Commission to implement the Act within its permitted discretion, rather than the costs and benefits of the Act itself.

A. Benefits

Overall, we expect that our proposed rules will have the benefit of furthering Congress’s goal of deterring the financing of armed groups in the DRC countries through commercial activity in conflict minerals. The proposed rules, if adopted, would specify

¹⁹³ See Exchange Act Section 13(p)(1)(A).

¹⁹⁴ See Exchange Act Section 13(p)(1)(C).

¹⁹⁵ 15 U.S.C. 78m(a) and 15 U.S.C. 78o(d).

which companies are covered by the disclosure and reporting requirements in Section 1502 of the Act and the alternative approach to disclosure for recycled or scrap minerals. The proposed rules would also specify the information that reporting companies with necessary conflict minerals would be required to disclose. This specification would benefit reporting companies by reducing uncertainty about their compliance with Commission rules.

Our proposal specifies the location of the initial disclosure of conflict minerals' origin and the location of the Conflict Minerals Report and should make it easier for interested parties to locate this information. In addition, our proposal to require reporting companies to furnish the independent private sector audit report would make the report easily accessible to interested parties. Thus, market participants and observers may benefit from the increased disclosure and improved reporting to the extent that they find information about conflict mineral use relevant to their decision making.

Additionally, our decision to require issuers to furnish with the Commission the independent private sector audit report instead of filing it would free the independent private sector auditors preparing these reports from assuming expert liability. Relative to the filing option that we could have proposed, this should decrease the cost to independent private sector auditors of providing such audits to conflict minerals-reporting companies. Depending on the state of competition in the market for independent private sector audits, the lower costs due to auditors not being required to assume expert liability could result in lower audit fees, which in turn should decrease conflict minerals-reporting companies' cost of compliance with the statute.

We are proposing that reporting companies covered by Section 1502 of the Act

use a reasonable country of origin inquiry in determining whether their conflict minerals originated in the DRC countries and use due diligence in making their supply chain determinations. We have chosen not to provide guidance on what would constitute a "reasonable country of origin inquiry." Similarly, we have chosen not to propose a specific standard for due diligence. We believe that these decisions should benefit reporting issuers by allowing them the flexibility to use the reasonable country of origin inquiry and due diligence standards that are best suited to their circumstances. We believe that disclosure of the inquiry performed and the due diligence undertaken may benefit market participants if they are interested in learning such information.

In addition, our proposed rules and form amendments would provide that conflict minerals obtained from recycled or scrap sources would be considered DRC conflict free. This should benefit issuers by providing an alternative approach for recycled or scrap minerals and reduce their compliance costs with the disclosure requirements in Section 1502 of the Act, particularly for recycled or scrap minerals, the origins of which are difficult to trace.

B. Costs

We anticipate that reporting companies would incur costs in meeting the additional disclosure required for their Exchange Act annual reports under Section 13(p) and the proposed rules and form amendments. The Commission's proposal to require an exhibit for the Conflict Minerals Report and that reporting companies furnish with the Commission the independent private sector audit report as an exhibit to their annual reports will result in costs related to the preparation of such exhibits. In addition, including manufacturing companies, companies contracting to manufacture products,

companies contracting for the manufacture of products to sell under their own brand name or a separately established brand name, and mining companies as "persons described" would result in a larger number of companies incurring the disclosure compliance costs, compared to an interpretation that excluded some of these companies. Not requiring auditors to assume expert liability could increase the costs to market participants and other observers because auditors may not have as strong incentives to ensure their determinations are correct. Also, the Commission's proposal would require issuers that determine following a reasonable country of origin inquiry that their conflict minerals did not originate in the DRC countries must keep reviewable records, which will result in costs related to obtaining and maintaining these records. Further, such issuers would also incur costs in disclosing the reasonable country of origin inquiry in their annual reports. However, as described above, we believe these approaches are consistent with the Conflict Minerals Provision.

If a reporting company chose to incorporate by reference its independent private sector audit report into a Securities Act document, the independent private sector auditor would assume expert liability, if the auditor consented to the inclusion of its report. This would not be required under our proposals but, if an issuer chose to do so, this might increase the cost to independent private sector auditors of providing such audits to issuers furnishing Conflict Minerals Reports. Depending on the state of competition in the market for independent private sector audits, the additional cost stemming from the assumption of expert liability could be passed on to issuers furnishing Conflict Minerals Reporting in the form of higher audit fees, which in turn would increase these companies' cost of compliance with the statute, although, as noted, issuers could avoid such costs by

not incorporating the audit report into their Securities Act filings. In any event, since this audit market is still in its nascence, and issuers presumably would not choose to incorporate the report by reference, the above effects are difficult to assess but are likely insignificant.

C. Request for Comment

We request comment on the disclosures and accuracy of our estimates in this section.

V. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine if an action is necessary or appropriate in the public interest, also to consider whether the action will promote efficiency, competition, and capital formation.¹⁹⁶ Section 23(a)(2) of the Exchange Act also requires the Commission, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition.¹⁹⁷ In addition, Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.¹⁹⁸

The Commission is proposing the new rules and form amendments discussed in this release to implement the requirements of Exchange Act Section 13(p) as set forth in

¹⁹⁶ 15 U.S.C. 78c(f).

¹⁹⁷ 15 U.S.C. 78w(a)(2).

¹⁹⁸ Id.

Section 1502 of the Act. We believe that our proposed rulemaking would have a different impact on competition in different industries. In industries where most or all companies are subject to disclosure or reporting requirements under the statute, we believe anti-competitive effects to be unlikely. In industries where not all or only a few companies are subject to the disclosure or reporting requirements, issuers that must provide disclosure or furnish Conflict Mineral Reports would incur competitive costs because of our disclosure and reporting requirements and clarifications.

Although the costs to perform the investigative work required and, if necessary, the independent private sector audit fees could increase the disclosure and reporting compliance costs for issuers that provide disclosure or furnish Conflict Minerals Reports versus companies who do not provide disclosure or furnish such reports, the net effect on competition would depend on how these costs compare to the benefits that companies obtain by using conflict minerals from the DRC countries, such as lower input costs.

Anti-competitive effects might be of larger magnitude in industries where the proportion of companies not covered by the Exchange Act Section 13(p) is larger. For instance, mining issuers might suffer a competitive disadvantage with respect to mining companies that are not required to provide disclosure or Conflict Minerals Reports but use DRC minerals, such as U.S. private mining companies or foreign mining companies, because the issuers would be required to incur investigative, disclosure, and reporting costs as a result of the statute and our rules.

We are proposing to require issuers to furnish the Conflict Minerals Report with the Commission instead of filing it and have it included in Exchange Act reports and Securities Act registration statements. This requirement may limit the costs to, and the

potential negative impact on, capital formation. We are not currently aware of any effects on efficiency or capital formation, but we seek comment on whether there are any such effects.

Request for Comment

70. We request comment on whether the proposed rules, if adopted, would promote efficiency, competition, and capital formation or have an impact or burden on competition. Commentators are requested to provide empirical data and other factual support for their view, if possible.

VI. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Initial Regulatory Flexibility Act Analysis¹⁹⁹ relates to proposed rules and form amendments to implement Section 13(p) of the Exchange Act, which concerns certain disclosure and reporting obligations of issuers with conflict minerals necessary to the functionality or production of any product manufactured or contracted to be manufactured by those issuers. As set forth by Section 13(p), an issuer with such necessary conflict minerals must disclose whether those minerals originated in the DRC countries and, if so, must submit to the Commission a Conflict Minerals Report.

A. Reasons for, and Objectives of, the Proposed Action

The proposed rule and form amendments are designed to implement the requirements of Section 1502 of the Act. Specifically, the proposed rules and form amendments would require all issuers with necessary conflict minerals to disclose in their annual reports whether those conflict minerals originated in the DRC countries. Issuers with necessary conflict minerals that originate in the DRC countries, or that are unable to

¹⁹⁹ This analysis has been prepared in accordance with 5 U.S.C. 603.

determine that their necessary conflict minerals did not originate in the DRC countries, must provide the conflict minerals disclosure specified by our rules in their Exchange Act annual reports.

Any issuer with necessary conflict minerals that did originate in the DRC countries, or that is unable to determine that its necessary conflict minerals did not originate in DRC countries, also must furnish as an exhibit to its Exchange Act annual reports a Conflict Minerals Report, which requires the issuer to describe the measures it has taken to exercise due diligence on the source and chain of custody of such minerals, which measures shall include an certified independent private sector audit that shall constitute a critical component of due diligence. The Conflict Minerals Report must include a description of the products manufactured or contracted to be manufacture that are not DRC conflict free, the identification of the independent private sector auditor, and the disclosure of the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity. Also, issuers shall make available to the public on their Internet websites their Conflict Minerals Reports.

B. Legal Basis

We are proposing the rule and form amendments contained in this document under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act, and Sections 12, 13, 15, and 23(a) of the Exchange Act.

C. Small Entities Subject to the Proposed Amendments

The proposals would affect small entities that file annual reports with the Commission under the Exchange Act, and that have conflict minerals necessary to the

functionality or production of products they manufacture or contract to manufacture. Exchange Act Rule 0-10(a)²⁰⁰ defines an issuer to be a “small business” or “small organization” for purposes of the Regulatory Flexibility Act if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We believe that the proposals would affect small entities with necessary conflict minerals as defined under Section 13(p). We estimate that there are approximately 793 companies to which conflict minerals are necessary and that may be considered small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed rule and form amendments would add to the annual disclosure requirements of companies with necessary conflict minerals, including small entities, by requiring them to comply with the disclosure and reporting obligations under Section 13(p) and provide certain additional disclosure in their Exchange Act annual reports.

Among other matters, that information must include, as applicable:

- disclosure as to whether conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufacture by an issuer did originate in the DRC countries; and, if so,
- a Conflict Minerals Report furnished as an exhibit to the annual report, which includes a certified independent private sector audit report.
- reviewable business records regarding any determination that an issuer’s conflict minerals did not originate in the DRC countries.

The same disclosure and reporting requirements would apply to U.S. and foreign issuers. We are proposing to amend Form 10-K and Regulation S-K to require domestic

²⁰⁰ 17 CFR 240.0-10(a).

issuers to provide the conflict minerals information. Because Regulation S-K does not directly apply to Forms 20-F and 40-F,²⁰¹ we propose to amend those forms to include the same disclosure requirements for issuers that are foreign private issuers.²⁰²

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe there are no federal rules that duplicate, overlap or conflict with the proposed rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposals, we considered the following alternatives:

- (1) Establishing different compliance or reporting requirements which take into account the resources available to smaller entities;
- (2) Exempting smaller entities from coverage of the disclosure requirements, or any part thereof;
- (3) The clarification, consolidation, or simplification of disclosure for small entities; and
- (4) Use of performance standards rather than design standards.

We believe that separate disclosure requirements for small entities that would differ from the proposed reporting requirements, or exempting them from those

²⁰¹ While Form 20-F may be used by any foreign private issuer, Form 40-F is only available to a Canadian issuer that is eligible to participate in the U.S.-Canadian Multijurisdictional Disclosure System ("MJDS").

²⁰² Proposed Item 16 under Part II of Form 20-F and proposed General Instruction B(16) of Form 40-F.

requirements, would not achieve the disclosure objectives of Section 13(p). The proposed rules are designed to implement the conflict minerals disclosure and reporting requirements of Section 13(p). That statutory section applies to all issuers with necessary conflict minerals, regardless of size. However, the reasonable country of origin inquiry standard for determining whether conflict minerals originated in the DRC countries and the due diligence standard necessary for making the supply chain determinations in the Conflict Minerals Report are performance standards and would vary based on the facts and circumstances of each individual issuer. We have requested comment as to whether we should provide an exemption for smaller reporting companies and whether doing so would be consistent with the statute.

The proposed rules would require clear disclosure about the source and chain of custody of an issuer's necessary conflict minerals, which may result in increased transparency about the origin of those minerals. The proposed requirement to disclose the information in the body of and as an exhibit to an issuer's Exchange Act annual report may simplify the process of submitting the proposed conflict minerals disclosure and Conflict Minerals Reports. In addition, furnishing the Conflict Minerals Reports and the audit reports as exhibits would simplify the search and retrieval of this information regarding issuers, including small entities, for investors and other interested persons.

We have otherwise used design rather than performance standards in connection with the proposed amendments because, based on our past experience, we believe the proposed amendments would be more useful if there were specific disclosure requirements. In addition, the specific disclosure requirements in the proposed amendments would promote consistent and comparable disclosure among all issuers with

necessary conflict minerals.

G. Solicitation of Comment

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- how the proposed amendments can achieve their objective while lowering the burden on small entities;
- the number of small entity companies that may be affected by the proposed amendments;
- whether small entity companies should be exempt from the rule;
- the existence or nature of the potential impact of the proposed amendments on small entity companies discussed in the analysis; and
- how to quantify the impact of the proposed amendments.

Respondents are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),²⁰³ a rule is "major" if it has resulted, or is likely to result in:

- an annual effect on the economy of \$100 million or more;

²⁰³ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

Request for Comment

71. We request comment on whether our proposals would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries;
- and
- any potential effect on competition, investment or innovation.

VIII. STATUTORY AUTHORITY AND TEXT OF THE PROPOSED AMENDMENTS

The amendments described in this release are being proposed under the authority set forth in Sections 6, 7-10, 19(a), and 28 of the Securities Act, as amended, and Sections 12, 13, 15(d), 23(a), and 36 of the Exchange Act, as amended.

List of Subjects

17 CFR Parts 229 and 249

Reporting and recordkeeping requirements, Securities.

TEXT OF THE PROPOSED AMENDMENTS

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II, of the Code of Federal Regulations as follows:

PART 229 - STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 - REGULATION S-K

1. The authority citation for part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Add §229.104 to read as follows:

§229.104 (Item 104) Conflict minerals disclosure.

(a) If any conflict minerals, as defined by paragraph (c)(3) of this section, are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the registrant in the year covered by the annual report, the registrant must disclose in its annual report under a separate heading entitled "Conflict Minerals Disclosure" whether any of these conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, as defined by paragraph (c)(1) of this section or that the registrant is not able to determine that its conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country. The registrant's determination of whether or not any of these conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, or its inability to determine that these conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country, must be based on its reasonable country of origin inquiry. If the registrant determines that its conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by it did not

originate in the Democratic Republic of the Congo or an adjoining country, the registrant must make that disclosure available on its Internet website and must also disclose this determination in its annual report under the separate "Conflict Minerals Disclosure" heading along with the reasonable country of origin inquiry it undertook to make its determination, that its disclosure is located on its Internet website, and the address of that Internet website. The disclosure must remain on the registrant's Internet website at least until the registrant files its subsequent annual report. Also, the registrant must maintain reviewable business records to support any such negative determination.

(b) If any conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by the registrant originated in the Democratic Republic of the Congo or an adjoining country, if the registrant is unable to determine that such conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country, or if such conflict minerals came from recycled or scrap sources, the registrant must:

(1) Furnish a Conflict Minerals Report as an exhibit to its annual report with the following information:

(i) A description of the measures taken by the registrant to exercise due diligence on the source and chain of custody of the conflict minerals or to exercise due diligence in determining that the conflict minerals came from recycled or scrap sources, which shall include but not be limited to a certified independent private sector audit of the Conflict Minerals Report, conducted in accordance with standards established by the Comptroller General of the United States, that shall constitute a critical component of the registrant's due diligence in establishing the source and chain of custody of the conflict

minerals or that the conflict minerals came from recycled or scrap sources;

(ii) A certification by the registrant that it obtained such an independent private sector audit;

(iii) A description of any of the registrant's products manufactured or contracted to be manufactured containing conflict minerals that are not "DRC conflict free," as defined in paragraph (c)(4) of this section, the facilities used to process those conflict minerals, the country of origin of those conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity, and

(iv) The audit report prepared by the independent private sector auditor, which identifies the entity that conducted the audit.

(2) In addition to the disclosures required by paragraph (a) of this section, disclose under the separate "Conflict Minerals Disclosure" heading in the annual report that the registrant has furnished a Conflict Minerals Report as an exhibit to the annual report; that the Conflict Minerals Report and the certified independent private sector audit report are available on its Internet website; and the Internet address of its Internet website where the Conflict Minerals Report and audit report are located.

(3) Make the Conflict Minerals Report, including the certified audit report, available to the public by posting the text of the report on its Internet website. The text of the Conflict Minerals Report must remain on the registrant's Internet website at least until the registrant files its subsequent annual report.

(c) For the purposes of this section, the following definitions apply:

(1) Adjoining country. The term adjoining country means a country that shares an internationally recognized border with the Democratic Republic of the Congo.

(2) Armed group. The term armed group means an armed group that is identified as a perpetrator of serious human rights abuses in the most recently issued annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961 (22 U.S.C. 2151n(d) and 2304(b)) relating to the Democratic Republic of the Congo or an adjoining country for the year the annual report is due.

(3) Conflict mineral. The term conflict mineral means:

(i) Columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives; or

(ii) Any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

(4) DRC conflict free. The term DRC conflict free means that a product does not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Conflict minerals that a registrant is unable to determine did not originate in the Democratic Republic of the Congo or an adjoining country are not "DRC conflict free." Conflict minerals that a registrant obtains from recycled or scrap sources are considered DRC conflict free.

Instructions to Item 104

(1) A registrant that files reports with the Commission under Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78o(d)) of the Exchange Act, for whom conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that registrant, shall provide the information required by this item. A registrant that mines conflict minerals would be considered to be

manufacturing those minerals for the purpose of this item.

(2) The information required by this Item shall not be deemed to be "filed" with the Commission or subject to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically incorporates the information by reference into a document filed under the Securities Act or the Exchange Act. The disclosure required by this Item need not be provided in any filings other than an annual report on Form 10-K (§249.310 of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

3. Amend §229.601 in the exhibit table to add entry (96) and add paragraph (b)(96) to read as follows:

§ 229.601 (Item 601) Exhibits.

(a) * * *

Exhibit Table * * *

EXHIBIT TABLE													
	Securities Act Forms							Exchange Act Forms					
	S-1	S-3	S-4 ¹	S-8	S-11	F-1	F-3	F-4 ³	10	8-K ²	10-D	10-Q	10-K
* * * * *													
(36) through (95) [Reserved]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
(96) Conflict Minerals Report	—	—	—	—	—	—	—	—	—	—	—	—	X
(97) [Reserved]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

(98) [Reserved]	N/A													
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(b) ***

(96) Report on conflict minerals from the Democratic Republic of the Congo or an Adjoining Country. The report required by Item 104(b)(1) of Regulation S-K, if applicable.

PART 249 -- FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

5. Amend Form 20-F (referenced in §249.220f) by adding Item 16 and by adding paragraph 16 to the Instructions as to Exhibits.

The addition reads as follows:

Note: The text of Form 20-F 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 20-F

PART II

* * * * *

Item 16. Conflict Minerals Disclosure

(a) If any conflict minerals, as defined by paragraph (c)(3) of this Item, are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the registrant in the year covered by the annual report, the registrant must disclose in its annual report under a separate heading entitled "Conflict Minerals Disclosure" whether any of these conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, as defined by paragraph (c)(1) of this Item, or that the registrant is not able to determine that its conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country. The registrant's determination of whether or not any of these conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, or its inability to determine that these conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country, must be based on its reasonable country of origin inquiry. If the registrant determines that its conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by it did not originate in the Democratic Republic of the Congo or an adjoining country, the registrant must make that disclosure available on its Internet website and must also disclose this determination in its annual report under the separate "Conflict Minerals Disclosure" heading along with the reasonable country of origin inquiry it undertook to make its determination, that its disclosure is located on its Internet website, and the address of that Internet website. The disclosure must remain on the registrant's Internet website at least

until the registrant files its subsequent annual report. Also, the registrant must maintain reviewable business records to support any such negative determination.

(b) If any conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by the registrant originated in the Democratic Republic of the Congo or an adjoining country, if the registrant is unable to determine that such conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country, or if such conflict minerals came from recycled or scrap sources, the registrant must:

(1) Furnish a Conflict Minerals Report as an exhibit to its annual report with the following information:

(i) a description of the measures taken by the registrant to exercise due diligence on the source and chain of custody of the conflict minerals or to exercise due diligence in determining that the conflict minerals came from recycled or scrap sources, which shall include but not be limited to a certified independent private sector audit of the Conflict Minerals Report, conducted in accordance with standards established by the Comptroller General of the United States, that shall constitute a critical component of the registrant's due diligence in establishing the source and chain of custody of the conflict minerals or that the conflict minerals came from recycled or scrap sources;

(ii) a certification by the registrant that it obtained such an independent private sector audit;

(iii) a description of any of the registrant's products manufactured or contracted to be manufactured containing conflict minerals that are not "DRC conflict free," as defined in paragraph (c)(4) of this Item, the facilities used to process those

conflict minerals, the country of origin of those conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity; and

(iv) the audit report prepared by the independent private sector auditor, which identifies the entity that conducted the audit.

(2) In addition to the disclosures required by paragraph (a) of this Item, disclose under the separate "Conflict Minerals Disclosure" heading in the annual report that the registrant has furnished a Conflict Minerals Report as an exhibit to the annual report; that the Conflict Minerals Report and the certified independent private sector audit report are available on its Internet website; and the Internet address of its Internet website where the Conflict Minerals Report and audit report are located.

(3) Make the Conflict Minerals Report, including the certified audit report, available to the public by posting the text of the report on its Internet website. The text of the Conflict Minerals Report must remain on the registrant's Internet website at least until the registrant files its subsequent annual report.

(c) For the purposes of this Item, the following definitions apply:

(1) Adjoining country. The term adjoining country means a country that shares an internationally recognized border with the Democratic Republic of the Congo.

(2) Armed group. The term armed group means an armed group that is identified as a perpetrator of serious human rights abuses in the most recently issued annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of the Foreign Assistance Act of 1961 (22 U.S.C. 2151n(d) and 2304(b)) relating to the Democratic Republic of the Congo or an adjoining country for the year the annual report is due.

(3) Conflict mineral. The term conflict mineral means:

- (i) columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives; or
- (ii) any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

(4) DRC conflict free. The term DRC conflict free means that a product does not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Conflict minerals that a registrant is unable to determine did not originate in the Democratic Republic of the Congo or an adjoining country are not "DRC conflict free." Conflict minerals that a registrant obtains from recycled or scrap sources are considered DRC conflict free.

Instructions to Item 16

(1) Item 16 applies only to annual reports, and does not apply to registration statements on Form 20-F. A registrant must provide the information required in Item 16 beginning with the annual report that it files for its first full fiscal year beginning after [April 15, 2011].

(2) A registrant that files reports with the Commission under Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78o(d)) of the Exchange Act, for whom conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that registrant, shall provide the information required by this item. A registrant that mines conflict minerals would be considered to be manufacturing those minerals for the purpose of this item.

(3) The information required by this Item shall not be deemed to be "filed"

with the Commission or subject to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically incorporates the information by reference into a document filed under the Securities Act or the Exchange Act. The disclosure required by this Item need not be provided in any filings other than an annual report on Form 20-F (§249.220f of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

* * * * *

INSTRUCTIONS AS TO EXHIBITS

* * * * *

16. The Conflict Minerals Report required by Item 16 of this Form, if applicable.

* * * * *

6. Amend Form 40-F (referenced in §249.240f) by adding paragraph (16) to General Instruction B as follows:

Note: The text of Form 40-F 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 40-F

GENERAL INSTRUCTIONS

B. Information to be Filed on this Form

(16) Conflict Minerals Disclosure

(a) If any conflict minerals, as defined by paragraph (c)(3) of this Instruction, are necessary to the functionality or production of a product manufactured or contracted to be manufactured by the registrant in the year covered by the annual report, the registrant must disclose in its annual report under a separate heading entitled "Conflict Minerals Disclosure" whether any of these conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, as defined by paragraph (c)(1) of this Instruction, or that the registrant is not able to determine that its conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country. The registrant's determination of whether or not any of these conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, or its inability to determine that these conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country, must be based on its reasonable country of origin inquiry. If the registrant determines that its conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by it did not originate in the Democratic Republic of the Congo or an adjoining country, the registrant must make that disclosure available on its Internet website and must also disclose this determination in its annual report under the separate "Conflict Minerals Disclosure"

heading along with the reasonable country of origin inquiry it undertook to make its determination, that its disclosure is located on its Internet website, and the address of that Internet website. The disclosure must remain on the registrant's Internet website at least until the registrant files its subsequent annual report. Also, the registrant must maintain reviewable business records to support any such negative determination.

(b) If any conflict minerals necessary to the functionality or production of a product manufactured or contracted to be manufactured by the registrant originated in the Democratic Republic of the Congo or an adjoining country, if the registrant is unable to determine that such conflict minerals did not originate in the Democratic Republic of the Congo or an adjoining country, or if such conflict minerals came from recycled or scrap sources, the registrant must:

(1) Furnish a Conflict Minerals Report as an exhibit to its annual report with the following information:

(i) a description of the measures taken by the registrant to exercise due diligence on the source and chain of custody of the conflict minerals or to exercise due diligence in determining that the conflict minerals came from recycled or scrap sources, which shall include but not be limited to a certified independent private sector audit of the Conflict Minerals Report, conducted in accordance with standards established by the Comptroller General of the United States, that shall constitute a critical component of the registrant's due diligence in establishing the source and chain of custody of the conflict minerals or that the conflict minerals came from recycled or scrap sources;

(ii) a certification by the registrant that it obtained such an independent private sector audit;

(iii) a description of any of the registrant's products manufactured or contracted to be manufactured containing conflict minerals that are not "DRC conflict free," as defined in paragraph (c)(4) of this Instruction, the facilities used to process those conflict minerals, the country of origin of those conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity; and

(iv) the audit report prepared by the independent private sector auditor, which identifies the entity that conducted the audit.

(2) In addition to the disclosures required by paragraph (a) of this Instruction, disclose under the separate "Conflict Minerals Disclosure" heading in the annual report that the registrant has furnished a Conflict Minerals Report as an exhibit to the annual report; that the Conflict Minerals Report and the certified independent private sector audit report are available on its Internet website; and the Internet address of its Internet website where the Conflict Minerals Report and audit report are located.

(3) Make the Conflict Minerals Report, including the certified audit report, available to the public by posting the text of the report on its Internet website. The text of the Conflict Minerals Report must remain on the registrant's Internet website at least until the registrant files its subsequent annual report.

(c) For the purposes of this Instruction, the following definitions apply:

(1) Adjoining country. The term adjoining country means a country that shares an internationally recognized border with the Democratic Republic of the Congo.

(2) Armed group. The term armed group means an armed group that is identified as a perpetrator of serious human rights abuses in the most recently issued annual Country Reports on Human Rights Practices under sections 116(d) and 502B(b) of

the Foreign Assistance Act of 1961 (22 U.S.C. 2151n(d) and 2304(b)) relating to the Democratic Republic of the Congo or an adjoining country for the year the annual report is due.

(3) Conflict mineral. The term conflict mineral means:

(i) columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives; or

(ii) any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country.

(4) DRC conflict free. The term DRC conflict free means that a product does not contain conflict minerals that directly or indirectly finance or benefit armed groups in the Democratic Republic of the Congo or an adjoining country. Conflict minerals that a registrant is unable to determine did not originate in the Democratic Republic of the Congo or an adjoining country are not "DRC conflict free." Conflict minerals that a registrant obtains from recycled or scrap sources are considered DRC conflict free.

Notes to Paragraph (16) of General Instruction B

(1) Paragraph (16) of General Instruction B applies only to annual reports, and does not apply to registration statements on Form 40-F. A registrant must provide the information required in paragraph (16) beginning with the annual report that it files for its first full fiscal year beginning after [April 15, 2011].

(2) A registrant that files reports with the Commission under Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78o(d)) of the Exchange Act, for whom conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that registrant, shall provide the information required

by this Instruction. A registrant that mines conflict minerals would be considered to be manufacturing those minerals for the purpose of this Instruction.

(3) The information required by this Instruction shall not be deemed to be "filed" with the Commission or subject to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically incorporates the information by reference into a document filed under the Securities Act or the Exchange Act. The disclosure required by this Instruction need not be provided in any filings other than an annual report on Form 40-F (§249.240f of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

* * * * *

7. Amend Form 10-K (referenced in §249.310) by adding Item 4(a) as follows:

Note: The text of Form 10-K 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 10-K

* * * * *

PART I

Item 4. Specialized Disclosures

(a) Furnish the information required by Item 104 of Regulation S-K (§ 229.104 of this chapter).

Instruction

A registrant must provide the information required in Item 4 beginning with the annual report that it files for its first full fiscal year beginning after [April 15, 2011].

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy

Secretary

Dated: December 15, 2010

*Chairman Schapiro and
Commissioner Paredes
not participating*

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229 and 249

[RELEASE NO. 34-63549; FILE NO. S7-42-10]

RIN 3235-AK85

DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to our rules pursuant to Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to disclosure of payments by resource extraction issuers. Section 1504 added Section 13(q) to the Securities Exchange Act of 1934, which requires the Commission to issue rules requiring resource extraction issuers to include in an annual report information relating to any payment made by the issuer, or by a subsidiary or another entity controlled by the issuer, to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. Section 13(q) requires a resource extraction issuer to provide information about the type and total amount of payments made for each project related to the commercial development of oil, natural gas, or minerals, and the type and total amount of payments made to each government. In addition, Section 13(q) requires a resource extraction issuer to provide certain information regarding those payments in an interactive data format, as specified by the Commission.

DATES: Comments should be received on or before January 31, 2011.

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-42-10 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, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.
- All submissions should refer to File Number S7-42-10. 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 also are available for Web site viewing and copying 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 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: Tamara Brightwell, Senior Special Counsel, Division of Corporation Finance, or Elliot Staffin, Special Counsel in the Office of International Corporate Finance, Division of Corporation Finance, at (202) 551-3290, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-4553.

SUPPLEMENTARY INFORMATION: We are proposing new Item 105¹ of Regulation S-K,² an amendment to Item 601 of Regulation S-K,³ and amendments to Forms 10-K,⁴ 20-F,⁵ and 40-F⁶ under the Securities Exchange Act of 1934 (“Exchange Act”).⁷

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¹ Proposed 17 CFR 229.105.

² 17 CFR 229.10 et al.

³ 17 CFR 229.601.

⁴ 17 CFR 249.310.

⁵ 17 CFR 249.220f.

⁶ 17 CFR 249.240f.

⁷ 15 U.S.C. 78a et seq.

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I. BACKGROUND

This release is one of several we are required to issue to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act").⁸

⁸ Pub. L. No. 111-203 (July 21, 2010). To facilitate public input on the Act, the Commission has provided a series of e-mail links, organized by topic, on its website at <http://www.sec.gov/spotlight/regreformcomments.shtml>. The public comments we received are available on our website at <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specialized-disclosures.shtml>.

This release proposes a new rule⁹ and certain rule¹⁰ and form amendments¹¹ to implement Section 13(q) of the Exchange Act, which was added by Section 1504 of the Act. New Section 13(q) requires the Commission to “issue final rules that require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including – (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals, and (ii) the type and total amount of such payments made to each government.”¹²

Section 13(q) provides the following definitions and descriptions of several key terms:

- “resource extraction issuer” means an issuer that is required to file an annual report with the Commission and engages in the commercial development of oil, natural gas, or minerals;¹³
- “commercial development of oil, natural gas, or minerals” includes exploration, extraction, processing, export, and other significant actions

⁹ See proposed Regulation S-K Item 105 [17 CFR 229.105].

¹⁰ See proposed Regulation S-K Item 601(b)(97) and (98) [17 CFR 229.601(b)(97) and (98)].

¹¹ See proposed Item 16I under Part II of Form 20-F, and proposed paragraph (17) to General Instruction B of Form 40-F.

¹² 15 U.S.C. 78m(q)(2)(A).

¹³ 15 U.S.C. 78m(q)(1)(D).

relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity, as determined by the Commission;¹⁴

- “foreign government” means a foreign government, a department, agency or instrumentality of a foreign government, or a company owned by a foreign government, as determined by the Commission;¹⁵ and
- “payment” means a payment that:
 - is made to further the commercial development of oil, natural gas, or minerals;
 - is not de minimis; and
 - includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with the guidelines of the Extractive Industries Transparency Initiative (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.¹⁶

Section 13(q) specifies that “[t]o the extent practicable, the rules issued under [the section] shall support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.”¹⁷ As noted above, the statute explicitly refers to one international

¹⁴ 15 U.S.C. 78m(q)(1)(A).

¹⁵ 15 U.S.C. 78m(q)(1)(B).

¹⁶ 15 U.S.C. 78m(q)(1)(C).

¹⁷ 15 U.S.C. 78m(q)(2)(E).

initiative, the Extractive Industries Transparency Initiative ("EITI"),¹⁸ in the definition of "payment." Although the provision regarding international transparency efforts does not explicitly mention the EITI, the legislative history indicates that the EITI was considered in connection with the new statutory provision.¹⁹ The United States is one of several

¹⁸ The EITI was announced by former UK Prime Minister Tony Blair at the World Summit on Sustainable Development in Johannesburg in September 2002. See <http://www.citi.org/eiti/history>. The World Bank Group officially endorsed the EITI in 2003. See Implementing the Extractive Industries Transparency Initiative (2008) ("Implementing the EITI") (available at <http://eiti.org/document/implementingtheeiti>): The EITI is a voluntary coalition of oil, natural gas, and mining companies, foreign governments, investor groups, and other international organizations dedicated to fostering and improving transparency and accountability in countries rich in oil, natural gas, and minerals through the publication and verification of company payments and government revenues from oil, natural gas, and mining. See Implementing the EITI. According to the EITI, "[b]y encouraging greater transparency and accountability in countries dependent on the revenues from oil, gas and mining, the potential negative impacts of mismanaged revenues can be mitigated, and these revenues can instead become an important engine for long-term economic growth that contributes to sustainable development and poverty reduction." EITI Source Book (2005) at p. 4 (available at <http://eiti.org/files/document/sourcebookmarch05.pdf>).

Currently five countries – Liberia, Azerbaijan, Timor Leste, Ghana, and Mongolia – have achieved "EITI compliant" status by completing a validation process in which company payments are matched with government revenues by an independent auditor (available at <http://eiti.org/countries/compliant>). Some 27 other countries are EITI candidates in good standing and are in the process of complying with EITI standards (available at <http://eiti.org/candidatecountries>). Several other countries have indicated their intent to implement the EITI (available at <http://eiti.org/othercountries>): Implementation of the EITI varies across countries – the EITI provides criteria and a framework for implementation, but allows countries to make key decisions on the scope of its program (e.g. degree of aggregation of data, inclusion of subnational or social or community payments). See Source Book, pp. 23-24.

¹⁹ See, e.g., statement by Senator Lugar, one of the authors of Section 1504 ("This domestic action will complement multilateral transparency efforts such as the Extractive Industries Transparency Initiative – the EITI – under which some countries are beginning to require all extractive companies operating in their territories to publicly report their payments."), 111 Cong. Rec. S3816 (daily ed. May 17, 2010). Other examples of international transparency efforts include the recent amendments of the Hong Kong Stock Exchange listing rules for mineral companies and the London Stock Exchange AIM rules for extractive companies. See Amendments to the GEM Listing Rules of the Hong Kong Stock Exchange, Chapter 18A.05(6)(c) (effective June 3, 2010) (available at http://www.hkex.com.hk/cng/rulesreg/listrules/gemrulesup/Documents/gem34_miner.pdf) (requiring a mineral company to include in its listing document, if relevant and material to the company's business operations, information regarding its compliance with host country laws, regulations and permits, and payments made to host country governments in respect of tax, royalties and other significant payments on a country by country basis) and Note for Mining and Oil & Gas Companies – June 2009 (available at <http://www.londonstockexchange.com/companies-and-advisors/aim/advisers/rules/guidance-note.pdf>) (requiring disclosure in the initial listing of "any payments aggregating over £10,000

countries that support the EITI.²⁰

The Commission's rules under Section 13(q) must require a resource extraction issuer to submit the payment information included in an annual report in an interactive data format²¹ using an interactive data standard established by the Commission.²²

Section 13(q) defines "interactive data format" to mean an electronic data format in which pieces of information are identified using an interactive data standard.²³ The section also defines "interactive data standard" as a standardized list of electronic tags that mark information included in the annual report of a resource extraction issuer.²⁴ The rules issued pursuant to Section 13(q)²⁵ must include electronic tags that identify:

- the total amount of payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments;
- the government that received the payments and the country in which the government is located; and

made to any government or regulatory authority or similar body made by the applicant or on behalf of it, in regards to the acquisition of, or maintenance of its assets.").

²⁰ See the list of EITI supporting countries at <http://eiti.org/supporters/countries>.

²¹ 15 U.S.C. 78m(q)(2)(C).

²² 15 U.S.C. 78m(q)(2)(D).

²³ 15 U.S.C. 78m(q)(1)(E).

²⁴ 15 U.S.C. 78m(q)(1)(F).

²⁵ 15 U.S.C. 78m(q)(2)(D)(i).

- the project of the resource extraction issuer to which the payments relate.²⁶

Section 13(q) further authorizes the Commission to require electronic tags for other information that it determines is necessary or appropriate in the public interest or for the protection of investors.²⁷

Section 13(q) provides that the final rules “shall take effect on the date on which the resource extraction issuer is required to submit an annual report relating to the fiscal year...that ends not earlier than 1 year after the date on which the Commission issues final rules[.]”²⁸

Finally, Section 13(q) requires the Commission to make publicly available online, to the extent practicable, a compilation of the information required to be submitted by resource extraction issuers under the new rules.²⁹ The statute does not dictate a particular form or content for that compilation.

II. PROPOSED RULES UNDER SECTION 13(q)

A. Summary

As discussed in detail below, we are proposing amendments to Form 10-K, Form 20-F, and Form 40-F to require the disclosures mandated by Section 13(q). The disclosure requirements for Form 10-K would be set forth in new Item 105 of Regulation S-K,³⁰ which would require a resource extraction issuer to provide information relating to any payment made by it, a subsidiary, or an entity under its control to a foreign

²⁶ 15 U.S.C. 78m(q)(2)(D)(ii).

²⁷ 15 U.S.C. 78m(q)(2)(D)(ii).

²⁸ 15 U.S.C. 78m(q)(2)(F).

²⁹ 15 U.S.C. 78m(q)(3).

³⁰ See proposed Item 105 of Regulation S-K.

government or the U.S. Federal Government during the fiscal year covered by the annual report for the purpose of the commercial development of oil, natural gas, or minerals.

The item would specify that this information would be set forth in two exhibits to the filing – one exhibit filed in HyperText Markup Language (“HTML”) or American Standard Code for Information Interchange (“ASCII”) format and another exhibit filed in eXtensible Business Reporting Language (“XBRL”) format. We are proposing to amend Item 601 of Regulation S-K to add these new exhibits to Form 10-K for the disclosure.³¹

We also propose to add new Item 4(c) to Form 10-K to require a resource extraction issuer to provide disclosure in Part I of Form 10-K noting that the information required by Section 13(q) and new Item 105 of Regulation S-K is included in exhibits to the filing.³² An issuer would be required to include in the proposed exhibits the type and total amount of payments made for each project, as well as the type and total amount of payments made to each government, relating to the commercial development of oil, natural gas, or minerals.³³ The proposed rules also would require a resource extraction issuer to include certain detailed information about the payments made.

Section 13(q) applies to any issuer that is required to file an annual report with the Commission and that engages in the commercial development of oil, natural gas, or minerals, which includes foreign private issuers that file annual reports on Forms 20-F and 40-F.³⁴ Because Regulation S-K does not apply to those forms, we propose to amend

³¹ See proposed Items 601(b)(97) and (98) of Regulation S-K.

³² See proposed Item 4(c) under Part I of Form 10-K.

³³ See proposed Item 105(a) and Items 601(b)(97) and (b)(98) of Regulation S-K.

³⁴ While Form 20-F may be used by any foreign private issuer, Form 40-F is only available to a Canadian issuer that is eligible to participate in the U.S.-Canadian Multijurisdictional Disclosure System (“MJDS”).

Forms 20-F and 40-F to include the same disclosure requirements as those proposed for resource extraction issuers that are not foreign private issuers.³⁵

As noted above, Section 13(q) requires the Commission to issue rules requiring the payment information to be submitted in an interactive data format. We propose to require a resource extraction issuer to submit the information in an exhibit using the interactive data standard known as XBRL.

B. Definition of “Resource Extraction Issuer”

Under the proposed rule and form amendments, “resource extraction issuer” would be defined as it is under Section 13(q). Specifically, a resource extraction issuer would be defined as an issuer that:

- is required to file an annual report with the Commission; and
- engages in the commercial development of oil, natural gas, or minerals.³⁶

Section 13(q) specifically applies to issuers that are required to file an annual report with the Commission and that engage in the commercial development of oil, natural gas, or minerals. The provision does not indicate that the Commission, in adopting implementing rules, should provide different standards for different issuers or should exempt any issuers from the new requirements.³⁷ Thus, under the proposal, all U.S. companies and foreign companies that are engaged in the commercial development

³⁵ See proposed Item 16I under Part II of Form 20-F and proposed paragraph (17) to General Instruction B of Form 40-F.

³⁶ See proposed Item 105(b)(4) of Regulation S-K, proposed Item 16I.B.(4) under Part II of Form 20-F, and proposed paragraph B.(17)(b)(4) under the General Instructions of Form 40-F.

³⁷ A commentator requested that the Commission consider an exemption to allow foreign private issuers to follow their home country rules and disclose in their Form 20-F the required home country disclosure. The commentator expressed concern that foreign private issuers will be required to provide multiple payment disclosures in their Form 20-F to satisfy U.S., UK, and EU requirements. See letter from Royal Dutch Shell plc (“RDS”) (October 25, 2010).

of oil, natural gas, or minerals, and that are required to file annual reports with the Commission, regardless of size or the extent of business operations constituting commercial development of oil, natural gas, or minerals, would be subject to Section 13(q). Likewise, the proposed rules would apply equally to companies that fall within this definition whether or not they are owned or controlled by governments.

Request for comment

1. Should the Commission exempt certain categories of issuers, such as smaller reporting companies or foreign private issuers,³⁸ from the proposed rules? If so, which ones and why? If not, why not? Would providing an exemption for certain issuers be consistent with the statute?³⁹ If we do not provide such an exemption when adopting final rules, would foreign private issuers or any other issuers deregister to avoid the disclosure requirement?
2. Would our proposed rules present undue costs to smaller reporting companies? If so, how could we mitigate those costs? Also, if our proposed rules present undue costs to smaller reporting companies, do the benefits of making their resource

³⁸ See the definition of "smaller reporting company" in Exchange Act Rule 12b-2 [17 CFR 240.12b-2] and the definition of "foreign private issuer" in Exchange Act Rule 3b-4 [17 CFR 240.3b-4].

³⁹ Cf. Statement of Senator Cardin in support of Amendment No. 3732 to Restoring American Financial Stability Act (S. 3217) (indicating the legislation was intended to cover foreign private issuers by stating that "The provisions of this amendment would apply to all oil, gas, and mining companies required to file periodic reports with the SEC, namely, 90 percent of the major internationally operating oil companies and 8 out of the 10 largest mining companies in the world – only 2 of which are U.S. companies. We are talking about foreign-owned companies, not U.S. companies, by and large. Of the top 50 oil and gas companies by proven oil reserves, 20 are national oil companies that do not usually operate internationally. These companies are not registered with the SEC and ... do not compete with internationally operating companies. Of the remaining 30 companies that do operate internationally, 27 would be covered by this legislation – 27 of the 30. These include Canadian, European, Russian, Chinese, Brazilian, and other international companies."), 111 Cong. Rec. S3316 (daily ed. May 6, 2010). See also letter from Senator Cardin (December 1, 2010) ("Senator Cardin") (stating that, with respect to the meaning of resource extraction issuer, "the intent was to include all issuers, including foreign issuers, which have a reporting requirement to the SEC.").

extraction payment information publicly available justify these costs? Should our rules provide more limited disclosure and reporting obligations for smaller reporting companies? If so, what should these limited requirements entail?

Should our rules provide for a delayed implementation date for smaller reporting companies in order to provide them additional time to prepare for the requirement and the benefit of observing how larger companies comply?

3. Should the Commission provide an exemption to allow foreign private issuers to follow their home country rules and disclose in their Form 20-F the required home country disclosure?
4. Should the rules apply to issuers that are owned or controlled by governments, as proposed? If so, why? If not, why not? Should the disclosure requirements be varied for such entities?
5. General Instructions I and J to Form 10-K contain special provisions for the omission of certain information by wholly-owned subsidiaries and asset-backed issuers. Should either or both of these types of registrants be permitted to omit the proposed resource extraction payment disclosure in the annual reports on Form 10-K?

C. Definition of “Commercial Development of Oil, Natural Gas, or Minerals”

As noted above, Section 13(q) defines “commercial development of oil, natural gas, or minerals” for purposes of the section.⁴⁰ Consistent with Section 13(q), we propose to define “commercial development of oil, natural gas, or minerals” to include the activities of exploration, extraction, processing, export and other significant actions

⁴⁰ See Section I. above and 15 U.S.C. 78m(q)(1)(A).

relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity.⁴¹ While Section 13(q) provides the Commission with flexibility to define commercial development, we believe it is appropriate to use the statutory direction in the proposed rules and to seek comment on the scope of activities included in the proposed definition.

We understand that the EITI criteria primarily focus on exploration and production activities.⁴² Thus, the statutory language appears to include activities beyond what is currently contemplated by the EITI.⁴³ However, because the statute sets forth a clear list of activities, we preliminarily believe that our rules should be consistent with that list.

The proposed definition is intended to capture only activities that are directly related to the commercial development of oil, natural gas, or minerals. It is not intended to capture activities that are ancillary or preparatory to such commercial development. Accordingly, we would not consider a manufacturer of a product used in the commercial development of oil, natural gas, or minerals to be engaged in the commercial development of the resource.⁴⁴ For example, a manufacturer of drill bits or other

⁴¹ See proposed Item 105(b)(1) of Regulation S-K, proposed Item 161.B.(1) under Part II of Form 20-F, and proposed paragraph B.(17)(b)(1) under the General Instructions of Form 40-F.

⁴² See, e.g., Implementing the EITI at p. 24. Exploration and production activities often are referred to as "upstream activities." Id. We note, however, that at least one EITI program has included the disclosure of payments made in connection with or following processing activities, such as excise and export taxes, in addition to those relating to exploration and production activities. See Liberian Extractive Industries Transparency Initiative Secretariat, Final Report of the Administrators of the Second LEITI Reconciliation, Annex 2 (February 2010) ("Liberian Final Report") (available at <http://leiti.org.lr/doc/LEITI2ndReconciliationFinalReport.pdf>).

⁴³ See also letter from Senator Cardin, stating that "... EITI is a minimum reporting standard, and the intent of Sec. 1504 was to go beyond these requirements.").

⁴⁴ In this regard, we have received a letter suggesting that we clarify whether selling equipment to a resource extraction company, which is then used to explore for oil, natural gas, or minerals, is a

machinery used in the extraction of oil would not fall within the definition of commercial development. Similarly, transportation activities generally would not be included within the proposed definition. On the other hand, an issuer engaged in the removal of impurities, such as sulfur, carbon dioxide, and water, from natural gas after extraction but prior to its transport through the pipeline would be included in the definition of commercial development because such removal is generally considered to be a necessary part of the processing of natural gas in order to prevent corrosion of the pipeline.

Request for Comment

6. Should we, as proposed, define “commercial development of oil, natural gas, or minerals” as the term is described in the statute? Should it be defined differently (e.g. more broadly or more narrowly)? If we should define the term, what definition would be appropriate?
7. Should the definition of “commercial development of oil, natural gas, or minerals” include the activities of exploration, extraction, processing, and export, as proposed?⁴⁵ Should we exclude any of these activities? If so, which activities and why? If not, why not? Would excluding certain activities be consistent with the statute?
 - In this regard, we note that, as discussed above, disclosing payments beyond those related to exploration and production is not required by the EITI criteria,

significant action relating to oil, natural gas, or minerals. See letter from Mike Koehler, Assistant Professor of Business Law, Butler University (September 3, 2010).

⁴⁵ In this regard, we have received a letter suggesting that we interpret the statutory definition of commercial development to include “upstream” activities involved in the exploration and production of resources, “midstream” activities involved in the trading and transport of resources, and “downstream” activities involved in the refining, ore processing and marketing of resources. See the letter from Calvert Investments and Social Investment Forum (“Calvert and SIF”) (November 15, 2010).

and other countries have focused on identifying, reporting and verifying revenue streams related to those activities only.⁴⁶ Should the definition only include the activities of exploration and extraction, consistent with the EITI, and not include processing, export, and other significant actions?⁴⁷ Should the definition include the activities of exploration, extraction, and only some processing activities, such as those related to the upgrading of bitumen and heavy oil?⁴⁸ Should the definition explicitly include production, consistent with the use of that term by the EITI?⁴⁹ Does "production" in the oil, natural gas, and mining industries include activities that are different than those covered by "extraction" so that if we do not include production in the definition of commercial development, some payments may go unreported?

8. Are there other significant activities that we should include in the definition?⁵⁰
Should we provide further guidance regarding activities that may not be covered

⁴⁶ See Implementing the EITI at p. 35.

⁴⁷ Some commentators support limiting the definition of commercial development to "upstream" activities only. See letters from American Petroleum Institute ("API") (October 12, 2010); National Mining Association ("NMA") (November 16, 2010) (submitted as a "White Paper"); and RDS. In contrast, other commentators support a definition of commercial development that covers "upstream," "midstream," and "downstream" activities. See letters from Calvert and SIF and Publish What You Pay United States ("PWYP") (November 22, 2010).

⁴⁸ See letter from API, which suggests this approach.

⁴⁹ We believe the term "extraction" would include the production of oil and natural gas as well as the extraction of minerals. The EITI appears to use the terms "extraction" and "production" interchangeably. For example, the EITI recognizes that "the benefits of resource extraction occur as revenue streams over many years..." EITI Source Book at p. 8. However, when discussing various aspects of benefit streams, such as their materiality, the EITI refers to a company's or host government's estimated total production value. See EITI Source Book, p. 27.

⁵⁰ We have received a request to specify that other significant actions "includes the transport of oil, natural gas or ores, such as in pipelines or other mechanisms" and "may include, but not be limited to, contracting for services such as security operations that may be necessary to the operation of a particular element of the resource extraction life cycle." Letter from PWYP.

by the list of activities, but could constitute a "significant action?" If so, what activities should be covered?

9. As noted, we do not believe the proposed definition of "commercial development of oil natural gas, or minerals" would include transportation to the extent that the oil, natural gas, or minerals are transported for purposes other than export, and we note that payments related to transportation activities generally are not included in EITI programs.⁵¹ Should the definition include transportation of oil, natural gas, or minerals?⁵² Should compression of natural gas be treated as processing, and therefore subject to the proposed rules, or transportation, and therefore not subject to the proposed rules?
10. Should the definition of "commercial development of oil, natural gas, or minerals" explicitly exclude any other oil, natural gas, or mining activities? If so, please tell us what types of activities should be excluded and why.
11. Should we provide any additional guidance regarding the types of activities that may be within or outside of the scope of the definition?

D. Definition of "Payment"

Section 13(q) defines "payment" to mean a payment that:

- is made to further the commercial development of oil, natural gas, or minerals;

⁵¹ Implementing the EITI at p. 35. While transporting, processing, and refining are activities that are outside the scope of most EITI programs, the EITI has stated that "a country may find it useful to cover these 'downstream' oil, gas, and mining transactions in order to gain a better understanding of overall sector financial flows, and possibly to obtain a better understanding of the link between the value of downstream transactions and original, upstream transactions (exploration and production-related)." Implementing the EITI at pp. 35-36.

⁵² PWYP advocated including transportation under the definition of commercial development "[g]iven the potential size of the payments involved, and the capacity of vertically integrated companies to substitute payments to governments at different levels...." Letter from PWYP.

- is not de minimis; and
- includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, consistent with EITI's guidelines (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.⁵³

We propose to define the term "payment" in the proposed rule and form amendments using the definition provided in the statute.⁵⁴

1. Types of Payments

We interpret Section 13(q) to provide that the types of payments that are included in the statutory language should be subject to disclosure under our rules to the extent that the Commission determines that the types of payments and any "other material benefits" are part of the "commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals." Consistent with Section 13(q), we propose to require resource extraction issuers to disclose payments of the type identified in the statute because, as discussed below, we preliminarily believe that they are part of the "commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals." Therefore, we are proposing to include the statutory list as the list of payments covered by the rules. We note that the types of payments listed in the statute generally are consistent with the types of payments the EITI suggests should be disclosed, which we believe is evidence that the payment types are part of the commonly

⁵³ 15 U.S.C. 78m(q)(1)(C).

⁵⁴ See proposed Item 105(b)(3) of Regulation S-K, proposed Item 16I.B.(3) under Part II of Form 20-F, and proposed paragraph B.(17)(b)(3) under the General Instructions of Form 40-F.

recognized revenue stream for this purpose. As noted above, the statute provides that our determination should be consistent with the EITI's guidelines, to the extent practicable. Guidance for implementing the EITI suggests that a country's disclosure requirements might include the following benefit streams:⁵⁵

Benefit Stream ⁵⁶	Further description
Host government's production entitlement	This is the host government's share of the total production. This production entitlement can either be transferred directly to the host government or to the national state-owned company. Also, this stream can either be in kind and/or in cash.
National state-owned company production entitlement	This is the national state-owned company's share of the total production. This production entitlement is derived from the national state-owned company's equity interest. This stream can either be in kind and/or in cash.
Profits taxes	Taxes levied on the profits of a company's upstream activities.
Royalties	<p>Royalty arrangements will differ between host government regimes.</p> <p>Royalty arrangements can include a company's obligation to dispose of all production and pay over a proportion of the sales proceeds.</p> <p>On other occasions, the host government has a more direct interest in the underlying production and makes sales arrangements independently of the concession holder. These "royalties" are more akin to a host government's production entitlement.</p>

⁵⁵ EITI Source Book, pp. 27-28.

⁵⁶ Under the EITI, benefit streams are defined as being any potential source of economic benefit which a host government receives from an extractive industry. See EITI Source Book, p. 26.

Dividends ⁵⁷	Dividends paid to the host government as shareholder of the national state-owned company in respect of shares and any profit distributions in respect of any form of capital other than debt or loan capital.
Bonuses (such as signature, discovery, production)	Payments related to bonuses for and in consideration of: <ul style="list-style-type: none"> • Awards, grants and transfers of extraction rights; • Achievement of certain production levels or certain targets; and • Discovery of additional mineral reserves/deposits.
Licence fees, rental fees, entry fees and other considerations for licences and/or concessions	Payments to the host government and/or national state-owned company for: <ul style="list-style-type: none"> • Receiving and/or commencing exploration and/or for the retention of a licence or concession (licence/concession fee)[.] • Performing exploration work and/or collecting data (entry fees). These are likely to be made in the pre-production phase. • Leasing or renting the concession or licence area.
Other significant benefits to host governments ⁵⁸	These benefit streams include tax that is levied on the income, production or profits of companies. These exclude tax that is levied on consumption, such as value-added taxes, personal income taxes or sales taxes.

We preliminarily believe that a definition that is generally consistent with EITI guidance furthers the intent of the statute to support international transparency efforts.

⁵⁷ Dividends are not included in the list of payments identified in Section 13(q) and the proposed rules do not include dividends in the list of payments required to be disclosed.

⁵⁸ Under our proposed rules, taxes include both profit taxes and taxes that the EITI suggests are significant benefits to host governments. We have not identified any other material benefits at this time.

At this time we are not proposing to determine "other material benefits" that should be classified as payments subject to disclosure. We recognize that there may be other payments that should be included in, or excluded from, the list. In addition, it is possible that the nature of payments that are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals may change over time, including in response to final rules promulgated under Section 13(q). We also recognize that it may be appropriate to provide more specific guidance about the particular payments that should be disclosed. Our requests for comment are intended to elicit detailed information about what types of payments should be included in, or excluded from, the rules; what additional guidance may be helpful or necessary; and whether there are "other material benefits" that should be specified in the list of payments subject to disclosure because they are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals.

Request for comment

12. Should the definition of "payment" include the list of the types of payments from Section 13(q), as proposed? Are there additional types of payments that we should include in the definition of "payment?" Should the definition exclude certain types of payments? Are there certain payments, for example, specific types of taxes, fees, or benefits that we should include in, or exclude from, the list? Alternatively, should we provide guidance in our rules in the form of examples of payments that we believe resource extraction issuers would be required to disclose?

13. As noted above, the definition of payment includes "taxes," which is consistent with Section 13(q) and the EITI.⁵⁹ In order to clarify the meaning of this term in a manner consistent with the EITI, we have included an instruction in our proposal noting that resource extraction issuers would be required to disclose taxes on corporate profits, corporate income, and production and would not be required to disclose taxes levied on consumption, such as value added taxes, personal income taxes, or sales taxes.⁶⁰ Consistent with the EITI, we are not proposing to require disclosure of consumption taxes because we do not believe such taxes are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, and minerals. Is our proposal regarding disclosure of taxes appropriate? Should the types of taxes listed as requiring disclosure, or not requiring disclosure, be revised? If so, how should they be revised? Are there other taxes that we should include in or exclude from the disclosure requirements?
14. While the definition of "payment" in Section 13(q) does not address the means by which a payment may be made, we believe it would cover payments made in cash or in kind. Should a resource extraction issuer be required to disclose payments regardless of how the payment is made (e.g. in cash or in kind)?⁶¹ Should the rule

⁵⁹ As noted above, the EITI includes in its suggested list of payments to be disclosed profits taxes and "other significant benefits," which include taxes levied on the "income, production or profits of companies." EITI Source Book at pp. 27-28.

⁶⁰ See proposed Instruction to paragraph (b)(3)(iii)(A) of Regulation S-K Item 105, proposed Instruction 3 to Item 16I of Form 20-F, and proposed Note 3 to Instruction B.(17) of Form 40-F.

⁶¹ For example, the EITI permits the use of an "in kind" measure, such as the number of barrels or volume conveyed to the host government, instead of a cash value, for production entitlements and royalty arrangements that are similar to production entitlements. See EITI Source Book, p. 27.

be revised to make clear that "payment" would include payments made in cash or in kind?

15. The definition includes "fees (including license fees)," which is consistent with Section 13(q) and the EITI. As noted above, the EITI gives examples of the fees that should be disclosed, including concession fees, entry fees, and leasing and rental fees, which would likewise be covered under our proposal. In addition to license fees, should the rules specifically list other types of fees that would be subject to disclosure?
16. Are there other fees that we should identify in the rules or in guidance? For example, should we specify that disclosure would be required for fees paid for environmental permits, water and surface use permits, and other land use permits; fees for construction and infrastructure planning permits, air quality and fire permits, additional environmental permits, customs duties, and trade levies? Would these types of fees be considered to fall within the categories of fees that we have identified as being subject to disclosure?
17. Are there some types of fees that we should explicitly exclude from the definition?
18. The definition includes "bonuses," which is consistent with Section 13(q) and the EITI. "Bonuses" would include the examples of bonuses identified by the EITI as noted in the table above. Should we provide further guidance about the meaning of the term "bonus" for purposes of this disclosure?
19. Are there types of bonuses that we should exclude from the definition of "payment?"

20. Are there "other material benefits" that we should specify as being included within the definition of "payment?" In that regard, how should we determine what benefits "are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals?" Should we include a broad, non-exclusive definition of "other material benefits," such as benefits that are material to and directly result from or directly relate to the exploration, extraction, processing, or export of oil, natural gas, or minerals?⁶² Or would including a broad definition be inconsistent with the statutory language directing us to identify other material benefits that "are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals?"
21. As noted, dividends are not included in the list of payments required to be disclosed under the proposed rules. Should we determine that dividends are "other material benefits" and require disclosure of dividends? Are dividends part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals?
22. We do not believe the proposed definition of payment should include payments resource extraction issuers make for infrastructure improvements, even if they are a direct cost of engaging in the commercial development of oil, natural gas, or minerals because it is not clear that such payments would be covered by the specific list of items in the statute or otherwise would be a part of the commonly

⁶² One commentator requested that we define broadly other material benefits as governmental payments "relating to the execution of any aspect of covered operations in the relevant jurisdiction that a reasonable person would find material to the project's net worth," including but not limited to activities involved in the exploration and production of resources, the trading and transport of resources, and the refining and marketing of resources. Letter from PWYP.

- recognized revenue stream for the commercial development of oil, natural gas, or minerals.⁶³ Should our definition cover such payments? Would such payments be considered part of the commonly recognized revenue stream? Would these types of payments distort the disclosure of payments for extractive activities?
23. "Social or community" payments generally include payments that relate to improvements of a host country's schools or hospitals, or to contributions to a host country's universities or funds to further resource research and development. As proposed, our rules would not expressly include social or community payments within the definition of "payment." Some EITI programs include social or community payments while others do not.⁶⁴ Are such payments part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals? Should we require disclosure of only certain "social or community" payments under the "other material benefits" provision, such as if those payments directly fulfill a condition to engaging in resource extraction activities in the host country?⁶⁵ Would such payments be considered part of the commonly recognized revenue stream?

⁶³ Mining companies often make such payments either because, due to the poor level of development in a host country, infrastructure improvements are necessary to gain access to the host country's minerals, or because the companies are contractually obligated to improve the host country's roads as a condition of engaging in exploration or extraction activities. The EITI has acknowledged that the scope of an EITI program might have to be expanded to include such infrastructure payments. See Implementing the EITI, p. 25.

⁶⁴ See Implementing the EITI, p. 24. See also letter from Senator Cardin (noting that many EITI implementing countries are considering reporting on social payments). One commentator has requested that we exclude payments relating to community development, including those pertaining to local purchasing or employment, from the disclosure requirements. See letter from NMA.

⁶⁵ See letter from PWYP (supporting the inclusion of "social" payments under the definition of payment, which it defines as payments "made by extractive industry participants in order to reduce operational risk by improving the welfare of local communities, individual citizens and

24. Are there other types of payments that we should include as “other material benefits?” For example, should we, as requested by one commentator, require disclosure of “ancillary payments made pursuant to the investment contract (including personnel training programs, local content, technology transfer and local supply requirements)” and payments “related to any liabilities incurred (including penalties for violations of law or regulation, environmental and remediation liabilities, and bond guarantees entered into with the central banks or similar national or multi-national entities, as well as costs arising in connection with any such bond guarantees)?”⁶⁶
25. Should we provide additional guidance regarding the types of payments that resource extraction issuers should disclose? If additional guidance is appropriate, should we provide clarification in the rules or as interpretive guidance?

2. The “Not De Minimis” Requirement

Section 13(q) defines “payment,” in part, to be a payment that is “not de minimis,” without defining what would be considered “not de minimis.” If a payment is de minimis, it would not be subject to disclosure; if it is not de minimis, it could be subject to disclosure if the other standards for disclosure are present.

Under the EITI, countries are free to establish a materiality level for disclosure. For example, countries may establish a materiality level based on the size of payments or

organizations in the villages, cities or countries where these companies work, or in order to obtain a ‘social license to operate’.” Cf. letter from NMA (opposing disclosure of payments “that provide only ‘indirect economic benefits’ such as construction of local infrastructure (like schools, roads, hospitals, and the like) that are not primarily used for extractive activities.”).

⁶⁶ Letter from PWYP.

the size of companies subject to disclosure.⁶⁷ As noted, Section 13(q) established the threshold for payment disclosure as “not de minimis” rather than requiring disclosure of “material” payments.⁶⁸ Given the use of the phrase “not de minimis,” we preliminarily do not believe that “not de minimis” equates to a materiality standard. The term “de minimis” is defined generally as something that is “lacking significance or importance” or “so minor as to merit disregard.”⁶⁹ We preliminarily believe the phrase “not de minimis” is sufficiently clear that further explication is unnecessary, and we do not propose to prescribe a standard for what amounts would be considered de minimis or not de minimis for purposes of the new disclosure requirement.

We preliminarily believe it is more appropriate to define the term “payment” consistent with the definition in Section 13(q) without specifically defining “not de minimis” for purposes of the requirement. However, we seek comment, as described below, on whether to define “not de minimis.” We also are soliciting comment on several possible standards to include in our final rule, as necessary or appropriate, to provide additional certainty concerning what payments are required to be disclosed under these new rules. As described in more detail below, the possible standards could include an absolute dollar amount, a relative measure (e.g. a percentage of expenses, revenues or

⁶⁷ Implementing the EITI, p. 30. The EITI Source Book notes that a benefit stream is material “if its omission or misstatement could distort the final EITI report” for the country. EITI Source Book at p. 26.

⁶⁸ In contrast, the definition of payment also includes the phrase “other material benefits.”

⁶⁹ Merriam-Webster Dictionary (available at <http://www.merriam-webster.com/dictionary/deminimis>).

some other amount incurred per project or in total for the year covered by the annual report), or a combination of the two approaches.⁷⁰

Request for comment

26. Section 13(q) establishes the threshold for payment disclosure as “not de minimis,” which we preliminarily believe is a standard different from a materiality standard.⁷¹ Is our interpretation that “not de minimis” is not the same as “material” correct?
27. Should we define “not de minimis” for purposes of the proposed rules? Why or why not?⁷² What would be the advantages or disadvantages of not defining that term? If the final rules do not provide a definition, should an issuer be required to disclose the basis and methodology it used in assessing whether a payment amount was “not de minimis?”
28. If we should define “not de minimis,” what should that definition be?⁷³ Provide data to support your definition if you are able to do so.

⁷⁰ For example, we could define “not de minimis” to be an amount that meets or exceeds the lesser of a dollar amount, such as \$100,000, or a percentage, such as 1%, of an issuer’s expenses, revenues or some other amount for the year.

⁷¹ One commentator stated that “reporting only on material payments is contrary to Congress’s distinction between a de minimis standard applied to individual payments and a materiality standard applied to benefit streams.” See letter from Revenue Watch Institute (December 6, 2010) (“RWI”).

⁷² Some commentators have requested that we provide a definition of “not de minimis.” See letter from Calvert and SIF (stating such a definition is necessary “due to the lack of applicable precedent regarding the de minimis concept featured in Section 1504. . .”); NMA; and PWYP.

⁷³ Calvert and SIF have suggested that we set the “de minimis threshold” at \$15,000, which is similar to the level used by the London Stock Exchange’s Alternative Investment Market (“AIM”) listing rule that requires disclosure of any payment above £10,000 (approximately \$15,000) made to any government or regulatory authority by an oil, gas or mining company. See letter from Calvert and SIF. PWYP has suggested both qualitative and quantitative definitions of de minimis. According to its qualitative definition, de minimis “means an item so insignificant that it is not relevant to a reasonable person in determining the net value of the project’s annual liabilities.” According to its quantitative definition, de minimis “means any payment that exceeds the

29. What would be the advantages or disadvantages of defining "not de minimis" as "material?" Would such a reading be consistent with the language and intent of the statute? Would such a standard be a reasonable means of encouraging consistent disclosure? Would it be necessary for the Commission to provide additional guidance on how to determine materiality if a materiality standard governed this disclosure? If so, what guidance would be appropriate in the context of this information?
30. Should we adopt a definition of "not de minimis" that uses an absolute dollar amount as the threshold? If so, what would be the appropriate dollar amount? Should the "not de minimis" payment threshold be \$100,000, an amount less than \$100,000, such as \$1,000, \$10,000, \$15,000,⁷⁴ or \$50,000, or an amount greater than \$100,000, such as \$200,000, \$500,000, \$1,000,000, or \$10,000,000? Should some other dollar amount be used?
31. The type and amount of payments made by resource extraction issuers may vary greatly, depending on the size of the issuer and the nature and size of a particular project. Should the rules account for variations in size of issuers and projects? Would doing so be consistent with Section 13(q)?
32. Should a payment be considered "not de minimis" if it meets or exceeds a percentage of expenses incurred per project for the year that is the subject of the annual report? Is a per project basis appropriate because Section 13(q) requires an issuer to disclose payment information for each project as well as for each

equivalent of \$1,000 or payments that, in the aggregate, exceed the equivalent of \$15,000." Letter from PWYP.

⁷⁴ See letter from Calvert and SIF and PWYP.

government? Instead of a per project basis, should we base a definition of “not de minimis” on a threshold that uses a percentage of an issuer’s total expenses for the year or its total expenses incurred for all projects undertaken in a particular country for the year?⁷⁵ Should the percentage threshold be based on something else, such as revenues, profits or income? Would using a percentage threshold further the intent of the statute and help minimize the costs associated with providing the disclosure?

33. If a percentage threshold should be used to define “not de minimis,” should the percentage be 1%, 2%, 3%, 4%, 5%, or a higher percentage? Should the definition use a percentage lower than 1%, such as 0.1%, 0.2%, 0.3%, 0.4%, or 0.5%?
34. Should we adopt a definition of “not de minimis” that uses the same dollar amount or the same percentage threshold for all resource extraction issuers, regardless of size?
35. Should we adopt a definition of “not de minimis” that depends on the size of a resource extraction issuer so that the dollar amount or percentage threshold would vary depending on the size of the issuer? For example, should the threshold be \$1,000 for non-accelerated filers, \$10,000 for accelerated filers, and \$100,000 for large accelerated filers? Should some other dollar amount be used for each filer category? If so, what amount? If we use a percentage threshold, should the

⁷⁵ One commentator suggested a definition of “de minimis” that would require an issuer to disclose payments to a government if, in the aggregate, payments across all categories exceeded five percent or more of the issuer’s gross expenses. Once the aggregate amount of payments exceeded the specified threshold, “then all payments in that country otherwise meeting the definition in the Act would be reportable, even though each payment stream would not necessarily be material.” Letter from NMA.

threshold be 1% for non-accelerated filers, 2% for accelerated filers, and 3% for large accelerated filers? Should some other percentage be used for each filer category? If so, what percentage?

36. Should we define “not de minimis” to be an amount that meets or exceeds the lesser of two measures, for example, a dollar amount, such as \$100,000, or a percentage, such as 1%, of an issuer’s expenses, revenues or some other amount for the year? Would such an approach be appropriate to address variations in the size of resource extraction issuers?
37. Should we define payments that are “not de minimis” to mean payments that are significant compared to the total expenses incurred by an issuer for a particular project, or with regard to a particular government for the year?
38. We note that the phrase “not de minimis” is used only in the definition of the term “payment.” Would it be consistent with the statute to require disclosure of payments that are “not de minimis” only if they are related to material projects of a resource extraction issuer?⁷⁶

3. The “Project” Requirement

While Section 13(q) requires a resource extraction issuer to disclose information regarding the type and total amount of payments made to a foreign government or the Federal Government for each project relating to the commercial development of oil,

⁷⁶ Commentators have suggested such an approach, noting that this approach would be consistent with the EITI, which requires disclosure of material payments only. See letters from API and RDS. Under the EITI, countries can determine the appropriate threshold for materiality. See, e.g., *EITI Source Book*, p. 26. Cf. letter from Senator Cardin (stating that “[r]eporting under Sec. 1504 is designed to complement reporting done under the Extractive Industries Transparency Initiative (EITI), but does not mimic it, and purposefully requires reporting at the project level, disaggregated by payment stream.”).

natural gas, or minerals, it does not define the term "project."⁷⁷ We note the EITI does not provide for the disclosure of payments on a per project basis, and thus, does not define the term or provide guidance on how we should define the term. Our rules currently do not include a definition of "project," although, as noted below, our rules include some references to the term "project" that may be useful in considering the term. We understand that, depending upon the particular industry or business in which an issuer operates, and other factors such as the size of an issuer, "project" may be defined in a variety of ways. In light of the fact that neither Section 13(q) nor our current disclosure rules include a definition of the term and to provide flexibility in applying the term to different business contexts, we are not proposing a specific definition for the term. However, we are soliciting comment regarding whether we should define "project," and, if so, what definition would be appropriate.

Request for comment

39. Should we define "project" for purposes of this new disclosure requirement? If so, why? If not, why not?
40. If we should define "project," what definition would be appropriate?⁷⁸ Please be as specific as possible and discuss the basis for your recommendation.

⁷⁷ The legislative history does not provide an indication as to how we should define the term.

⁷⁸ API suggested defining project to mean "technical and commercial activities carried out within a particular geological basin or province to explore for, develop and produce oil, natural gas or minerals. These activities include, but are not limited to, acreage acquisition, exploration studies, seismic data acquisition, exploration drilling, reservoir engineering studies, facilities engineering design studies, commercial evaluation studies, development drilling, facilities construction, production operations, and abandonment. A project may consist of multiple phases or stages." Letters from American Petroleum Institute (December 9, 2010). PWYP has requested that we define project "in relation to each lease, license and/or other concession-level arrangement entered into by a resource extraction issuer," so as to "capture information related to the discrete, project-specific financial flows affiliated with extractive industry development activities." Letter from PWYP.

41. Should we define "project" to mean a project as that term is used by a resource extraction issuer in the ordinary course of business? What are the advantages and disadvantages of such an approach? If the final rules were to use such an approach, should an issuer be required to disclose the basis and methodology it used in defining what constitutes a project?
42. Should we define "project" to mean a field, mining property, refinery or other processing plant, or pipeline or other mode of transport? Should we define "project" to permit the inclusion of more than one field, mining property, refinery or other processing plant, or pipeline or other mode of transport?
43. Should we adopt a definition of "project" that is substantially similar to the definition of "development project" under Rule 4-10(a)(8) of Regulation S-X?⁷⁹ Would reliance on that existing definition, with which oil and natural gas companies are already familiar, help to elicit appropriate payment disclosure under Section 13(q) without over-burdening issuers?⁸⁰ Or is that definition unsuitable for purposes of Section 13(q) because it does not explicitly encompass

⁷⁹ Under that rule, the term "development project" is defined as the "means by which petroleum resources are brought to the status of economically producible. As examples, the development of a single reservoir or field, an incremental development in a producing field, or the integrated development of a group of several fields and associated facilities with a common ownership may constitute a development project." 17 CFR 210.4-10(a)(8). See also Compliance and Disclosure Interpretation ("CDI") 108.01 under the Oil and Gas Rules issued by the Commission's Division of Corporation Finance on October 26, 2009 (available at <http://www.sec.gov/divisions/corpfin/guidance/oilandgas-interp.htm>). The CDI provides in relevant part that a "development project is typically a single engineering activity with a distinct beginning and end, which, when completed, results in the production, processing or transportation of crude oil or natural gas. A project typically has a definite cost estimate, time schedule and investment decision; is approved for funding by management; may include all classifications of reserves; and will be fully operational after the completion of the initial construction or development. The scope and scale of a project are such that, if a project were terminated before completion, for whatever reason, a significant portion of the previously invested capital would be lost."

⁸⁰ One commentator suggested the Commission could use this definition as a basis for defining project because it is well understood by the industry and investors. See letter from RDS.

other types of projects, such as exploration projects, and does not relate to mining activities? What modifications to the Regulation S-X definition of "development project," if any, would be appropriate to provide a definition for "project" for it to be suitable for purposes of the disclosure required by Section 13(q)?

- In particular, similar to Rule 4-10(a)(8) and staff guidance regarding the rule, should we define project as:
 - the means by which oil, natural gas, or mineral resources are brought to the status of being economically producible or commercially developed;
 - typically involving a single engineering activity with a distinct beginning and end;
 - having a definite cost estimate, time schedule, or investment decision, and approved for funding by management;
 - one that, when completed, results in the exploration, extraction or production, processing, transportation or export of oil, natural gas, or minerals; and
 - one that may involve a single reservoir, field or mine, the incremental development of a producing field or mine, or the integrated development of a group of several fields or mines and associated facilities with a common ownership?
- Would it be appropriate to include or exclude any of the aspects listed above? Why or why not?
- Should the definition of project include one that involves more than one engineering activity or an engineering activity that is open-ended? Would a

definition that focuses on the level of engineering activity fail to elicit the disclosure of payments in connection with some projects, for example, an exploration project?

- Would a project always have a definite cost estimate, time schedule, or investment decision, or be approved by management? Should any of these characteristics be excluded from any definition of project? Are there any additional characteristics that we should include in any definition of project?
- Should any definition of project encompass only a single reservoir, field or mine? Why or why not?

44. Should we permit issuers to treat operations in a country as a "project?" Would doing so be consistent with the statute?⁸¹

45. We note that issuers currently use the concept of "reporting unit" for financial reporting purposes (e.g. an operating segment or one level below an operating segment). Should the definition of "project" be consistent with the "reporting unit" concept?⁸² Is that definition consistent with the statute? Would using such a definition ease implementation of the disclosure requirements for resource extraction issuers given that payments currently may be tracked on that basis?

⁸¹ See statement from Senator Cardin (explaining the need for the statute because existing disclosures are "not useful in determining the extent of a company's operations in or its ongoing financial arrangements with a country.") 111 Cong. Rec. S3315 (daily ed. May 6, 2010). PWYP has suggested permitting an issuer to disclose certain payments on an entity level with respect to a particular jurisdiction but only when the payment, such as a corporate income tax, is calculated at the entity level rather than the project level. See letter from PWYP.

⁸² One commentator suggested that we define project to be "consistent with the concepts of operating segments and reporting units under which mining companies currently provide information." The suggested definition would include preparation for, or exploitation of, mineral deposits in an identified geographic area, and "would exclude activities such as prospecting, surveying and exploration, which are undertaken well before a 'project' has materialized." Letter from NMA.

What concerns, if any, are raised by using such a concept as the basis for defining “project?” Are there other concepts, such as an “asset group” or “cash generating unit,” that would provide a more appropriate basis for the definition of “project?”

46. Are there any other factors that we should include in the definition of “project?”
47. Should we define “project” to mean a material project?⁸³ If so, what should be the basis for determining whether a project is material for purposes of the resource extraction payment disclosure rules? Would defining project to mean a material project be consistent with Section 13(q)?
48. Should we permit issuers to aggregate payments by country rather than project?⁸⁴ Would that be consistent with Section 13(q)?

4. Payments by “a Subsidiary . . . or an Entity under the Control of the Resource Extraction Issuer”

Section 13(q) requires a resource extraction issuer to disclose payments made by a subsidiary or an entity under the control of the resource extraction issuer, in addition to

⁸³ Some commentators have suggested defining project in this way. See letters from API; Cravath, Swaine & Moore LLP, Cleary Gottlieb Steen & Hamilton LLP, Davis Polk & Wardwell LLP, Shearman & Sterling LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wilmer Cutler Pickering Hale and Dorr LLP (November 5, 2010) (“Eight Law Firms”); and RDS. But see letter from RWI (stating that “...limiting reporting to material projects contravenes Congress’s intent to implement a level playing field through a project-by-project disclosure standard.”).

⁸⁴ See letter from API suggesting such an approach. In addition, the NMA has suggested permitting disclosure of payments at the country level for prospecting, surveying, and exploration activities, and for payments that constitute commercially sensitive information or are subject to reasonable host government confidentiality restrictions, in addition to payments, such as corporate income tax payments, that are calculated at the country level. Letter from NMA. Another commentator noted that some payments may be made at the entity level rather than the project level, and that establishing systems to apportion entity level payments may be prohibitively expensive and that such apportionment could be somewhat arbitrary. The commentator suggested that compliance costs could be mitigated by allowing entity-level payments to be reported at the country level rather than the project level. See letter from RWI. See also letter from PWYP (“Where . . . certain payments are made at an entity level rather than at the lease/license level . . . this fact should have no bearing on the definition of ‘project’ but, rather, may give rise to a limited reporting allowance whereby issuers could report at an entity level, rather than project-level, for that specific payment only.”).

its own payments, to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals.⁸⁵ We are proposing to use the language from Section 13(q) in the disclosure requirements.

Under our proposal and consistent with the statutory language, a resource extraction issuer would be required to provide disclosure if control is present. Consistent with the definition of control under the securities laws, such as in Exchange Act Rule 12b-2, a resource extraction issuer would need to make a factual determination as to whether it has control of an entity based on a consideration of all relevant facts and circumstances.⁸⁶ At a minimum, under our proposal, payments made by a subsidiary or entity under the control of a resource extraction issuer would be subject to disclosure under this standard if the resource extraction issuer must provide consolidated financial information for the subsidiary or other entity in the issuer's financial statements included in its Exchange Act reports.⁸⁷

Request for comment

49. As noted above, our rules currently include definitions of "subsidiary" and "control," which would apply in this context as well. Should we include a

⁸⁵ 15 U.S.C. 78m(q)(2)(A).

⁸⁶ Under Exchange Act Rule 12b-2 [17 CFR 240.12b-2] and Rule 1.02 of Regulation S-X [17 CFR 210.1.02], "control" is defined to mean "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 shares, by contract, or otherwise." The rules also define "subsidiary" ("A 'subsidiary' of a specified person is an affiliate controlled by such person directly, or indirectly through one or more intermediaries. (See also 'majority-owned subsidiary,' 'significant subsidiary,' and 'totally-held subsidiary.')").

⁸⁷ This would be the case whether the resource extraction issuer provides consolidated financial information under U.S. Generally Accepted Accounting Principles ("GAAP") or International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"). See also letters from API; NMA; and RDS. Those commentators support limiting disclosure of payments made by a subsidiary or other entity to only those entities for which an issuer must consolidate financial information in its Exchange Act reports.

different definition for "subsidiary" or "entity under the control of" a resource extraction issuer? If so, why? How should the definitions vary?

50. Under the definition of control, a resource extraction issuer may be determined to control entities that are not consolidated subsidiaries. Is the requirement to disclose payments by an entity under the control of the issuer even though the issuer does not consolidate the entity appropriate?
51. Under the proposed rules, a resource extraction issuer would be required to provide disclosure for an entity if it is consolidated in the financial statements of the resource extraction issuer presented under U.S. GAAP (or other jurisdictional GAAP that requires a U.S. GAAP reconciliation) and IFRS as issued by the IASB because entities meeting the consolidation requirement generally also meet the definition of control. Are there circumstances under U.S. GAAP and IFRS that would render different consolidation results, such as proportionate consolidation, that we should consider? If so, please describe the circumstances and indicate how the different circumstances should be addressed in the new rules. We understand that entities and operations that are proportionately consolidated are viewed as consolidated entities or operations of an extractive issuer, while investments presented on the equity method are not viewed as consolidated entities or operations. Should our rules specifically include these concepts? For instance, should our rules treat equity investees differently even if they are controlled by the resource extraction issuer? Should our rules, as proposed, include equity investees that the issuer controls but does not consolidate?

52. Are there instances, other than control in which a resource extraction issuer should have to disclose payments made by a subsidiary or other entity? If so, should we revise our proposal to mandate disclosure in those circumstances?⁸⁸ Would resource extraction issuers have access to payment information in those circumstances? Should our rules specify that an issuer would have to disclose payments made by a non-controlled entity only if the issuer is the operator of the joint venture or other project?⁸⁹ Would it be appropriate to require an issuer to disclose payments that correspond to its proportional interest in the joint venture rather than all of the payments made by or for the joint venture?⁹⁰
53. Are there factors or concepts different than the ones discussed above that should determine whether a resource extraction issuer must disclose payments made for a subsidiary or other entity under the issuer's control for the purpose of commercial development of oil, natural gas, or minerals? For example, should the rules require disclosure only of information that the issuer knows or has reason to know?

⁸⁸ One commentator stated that "[d]isclosure of payment information with respect to unconsolidated equity investees and joint venture interests is crucial to fulfill the intent of the legislation as such information provides information necessary for analysts and investors to analyze issuer's future production and assess equity valuation on a risk-adjusted basis. The definition of 'control' must therefore be sufficiently broad to cover all relationships through which an issuer directly or indirectly exerts, or has the right to exert, significant influence, whether sole or shared, over an entity making extraction-related payments to a foreign government." Letter from PWYP.

⁸⁹ We note that, depending on the circumstances, a resource extraction issuer that is the operator of a joint venture may be deemed to control the joint venture, and therefore would be required to provide the payment disclosure for the joint venture pursuant to the disclosure requirements as proposed.

⁹⁰ PWYP supports proportionate reporting with respect to unconsolidated equity investees and joint venture interests. See letter from PWYP. The NMA also supports proportional reporting when an issuer controls a venture but holds less than a 100 percent interest in the venture and further suggests that proportional reporting would be appropriate if an issuer does not wholly own an entity even though it fully consolidates the financial results of that entity. See letter from NMA.

5. Other Matters

Under the disclosure rules concerning oil and gas reserves adopted in 2008,⁹¹ the Commission required disclosure of reserves in the aggregate and by geographic area and for each country containing 15% or more of a registrant's proved reserves.⁹² The oil and gas disclosure rules provide an exception that a registrant need not provide disclosure of the reserves in a country containing 15% or more of the registrant's proved reserves if that country's government prohibits disclosure of reserves in that country.⁹³ Section 13(q) does not contain an exception to the requirement to disclose payments made to foreign governments for the purpose of commercial development of oil, natural gas, or minerals in circumstances when the host country prohibits the disclosure. The provision also does not include an exception for confidentiality clauses in existing or future agreements. Thus, we have not proposed any exceptions to the proposed disclosure requirements under Section 13(q). Nevertheless, we are interested in learning whether the disclosure requirement would potentially cause a resource extraction issuer to violate any host country's laws and whether an exception similar to the exception in the oil and gas disclosure rules would be appropriate for the disclosure requirements under Section 13(q).

In this regard, some commentators have stated that, should a host government prohibit the disclosure of payments made by resource extraction issuers to the host

⁹¹ Modernization of Oil and Gas Reporting, Release No. 33-8995 (December 31, 2008), 74 FR 2158 (January 14, 2009) ("Oil and Gas Adopting Release").

⁹² See Item 1202(a)(2) of Regulation S-K [17 CFR 1202(a)(2)].

⁹³ Instruction 4 to Item 1202(a)(2). In addition, a registrant need not provide disclosure of the reserves in a country containing 15% or more of the registrant's proved reserves if that country's government prohibits disclosure in a particular field and disclosure of reserves in that country would have the effect of disclosing reserves in particular fields.

government, without an appropriate exception for that prohibition, an issuer could be compelled to select between avoiding or abandoning projects in that country and maintaining its registration under the Exchange Act. According to those commentators, such a situation would be contrary to the interests of investors and the principles of competition and comity.⁹⁴

Request for comment

54. Would the disclosure requirement in Section 13(q) and the proposed rules potentially cause a resource extraction issuer to violate any host country's laws? Are there laws that currently prohibit such disclosure? Would the answer depend on the type of payment or the level of aggregation of the payment information required to be disclosed? If there are laws that currently prohibit the type of disclosure required by Section 13(q) and the proposed rules, please identify the specific law and the corresponding country.
55. Should the Commission include an exception to the requirement to disclose the payment information if the laws of a host country prohibit the resource extraction issuer from disclosing the information?⁹⁵ Would such an exception be consistent with the statutory provision and the protection of investors? If we provide such an exception, should it be similar to the exception provided in Instruction 4 to

⁹⁴ See, e.g., letter from Eight Law Firms. But see letter from Senator Cardin, stating that "[t]he language of Sec. 1504 is very clear: there should be no exemptions for confidentiality or for host-country restrictions. It would be too easy for countries who want to avoid disclosures to simply pass their own law against disclosure. The purpose of Sec. 1504 is to not allow for exemptions for confidentiality or other reasons that undermine the principle of transparency and full disclosure."

⁹⁵ See letters from API; Eight Law Firms; NMA; and RDS supporting such an exception. One commentator suggested that laws prohibiting disclosure are uncommon, but "normal exemption procedures conducted on a case-by-case basis are sufficient to deal with such conflicts." Letter from RWI. But see letter from Senator Cardin.

Item 1202 of Regulation S-K?⁹⁶ Should we require the registrant to disclose the project and the country and to state why the payment information is not disclosed? If so, should we revise Item 1202 to require the same disclosure of the country and reason for non-disclosure?

56. Should the rules provide an exception only if a host country's statutes or administrative code prohibits disclosure of the required payment information? Should we provide an exception if a judicial or administrative order or executive decree prohibits disclosing the required payment information as long as the order or decree is in written form? Should we limit any exception provided to circumstances in which such a prohibition on disclosure was in place prior to the enactment of the Act?
57. Should the rules provide an exception for existing or future agreements that contain confidentiality provisions?⁹⁷ Would an exception be consistent with the statute and the protection of investors?
58. Are there circumstances in which the disclosure of the required payment information would jeopardize the safety and security of a resource extraction issuer's operations or employees? If so, should the rules provide an exception for those circumstances?⁹⁸
59. Should we permit a foreign private issuer that is already subject to resource payment disclosure obligations under its home country laws or the rules of its

⁹⁶ See discussion in footnote 93 and accompanying text above regarding the exception for disclosure of certain proved reserves.

⁹⁷ See letter from API supporting such an exception.

⁹⁸ See letter from API suggesting such an exception.

home country stock exchange to follow those home country laws or rules instead of the resource extraction disclosure rules mandated under Section 13(q)?⁹⁹

60. Are there any other circumstances in which an exception to the disclosure requirement would be appropriate? For instance, would it be appropriate to provide an exception for commercially or competitively sensitive information,¹⁰⁰ or when disclosure would cause a resource extraction issuer to breach a contractual obligation?

E. Definition of "Foreign Government"

Under Section 13(q), Congress defined "foreign government" to mean a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government, while granting the Commission the authority to determine the scope of the definition.¹⁰¹ For purposes of the disclosure requirement, we propose to define the term "foreign government" consistent with the statute and to specifically include foreign subnational governments in the definition to provide additional clarity regarding the definition.¹⁰² Resource extraction issuers may be required to pay fees for permits, licenses, concessions, and other entry requirements to a variety of national and subnational foreign governments, including a state, province, county,

⁹⁹ See letter from RDS suggesting such an exception.

¹⁰⁰ See letter from API; NMA; and RDS. But see letter from PWYP (discussing concerns regarding competitiveness and commercially sensitive information and noting a study of "over 100 oil and mining contracts between host governments and extractive companies worldwide found that 'stock exchange disclosures are a widely stated exception in confidentiality clauses and where not explicitly stated, would be interpreted to include such an exception.'" (footnote omitted).

¹⁰¹ 15 U.S.C. 78m(q)(1)(B).

¹⁰² See proposed Regulation S-K Item 105(b)(2), proposed Item 161.B.(2) under Part II of Form 20-F, and proposed paragraph B.(17)(b)(2) under the General Instructions of Form 40-F.

district, municipality or other level of subnational government.¹⁰³ The proposed definition, is intended to capture payments made by resource extraction issuers to any foreign government and would not be limited to payments made to foreign national governments.¹⁰⁴

Section 13(q) requires that a resource extraction issuer disclose payments to the Federal Government in addition to payments made to a foreign government. While Congress left undefined the term "Federal Government," typically that term refers only to the U.S. national government, and not to the states or other subnational governments in the United States.¹⁰⁵ We propose to clarify in the rule text that "Federal Government" means the United States Federal Government.¹⁰⁶

Request for comment

61. Should the definition of foreign government include a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government, as proposed?

¹⁰³ Of course, if a resource extraction issuer makes a payment (that is otherwise covered by the definition of payment) to a third party to be paid to the government on its behalf, disclosure of that payment would be covered under our proposed rule.

¹⁰⁴ This is consistent with the EITI, which recognizes that payments to subnational governments may have to be included within the scope of an EITI program. See Implementing the EITI, p. 34. We also believe this is consistent with the statutory scheme of Section 13(q), which requires an issuer to identify, for each disclosed payment, the government that received the payment, and the country in which the government is located. See Exchange Act Section 13(q)(2)(D)(ii)(V) [15 U.S.C. 78m(q)(2)(D)(ii)(V)].

¹⁰⁵ In this regard, given that the statute requires disclosure of payments made to a "foreign government or the Federal Government," we believe the term "foreign government" is meant to refer to a non-U.S. government.

¹⁰⁶ See proposed Item 105(a) of Regulation S-K, proposed Item 161.A. under Part II of Form 20-F, and proposed paragraph B.(17)(a) under the General Instructions of Form 40-F.

62. We note that the definition of foreign government would include a company owned by a foreign government. We understand that in the case of certain state owned companies, the government would be a shareholder. Thus, certain transactions may occur as transactions between the company and the government and as transactions between company and shareholder. Should we adopt specific rules or provide guidance regarding payments made by state owned companies that distinguish between such types of transactions?
63. Under Section 13(q) and the proposal, the definition of "foreign government" includes "a company owned by a foreign government." We are proposing to include an instruction in the rules clarifying that a company owned by a foreign government is a company that is at least majority-owned by a foreign government.¹⁰⁷ Is this clarification appropriate? Should a company be considered to be owned by a foreign government if government ownership is lower than majority-ownership? Should the rules provide that a company is owned by a foreign government if government ownership is at a level higher than majority-ownership? If so, what level of ownership would be appropriate? Are there some levels of ownership of companies by a foreign government that should be included in or excluded from the proposed definition of foreign government?
64. Should the definition of foreign government include a foreign subnational government, such as a state, province, county, district, municipality or territory of a non-U.S. government, in addition to a non-U.S. national government, as proposed?

¹⁰⁷ See proposed Instruction to Item 105(b)(2) of Regulation S-K; proposed Instruction 2 to Item 161.B.(2) of Form 20-F; and proposed Note 2 to Instruction B.17(b)(2) of Form 40-F.

65. Are there some levels of subnational government that should be excluded from the proposed definition of foreign government? If so, please provide specific examples of those levels of subnational government that should be excluded.
66. Should we also require a resource extraction issuer to disclose amounts paid to the states and other subnational governments in the United States in addition to payments to the Federal Government?
67. Is there additional guidance that we should provide regarding the definition of foreign government?¹⁰⁸

F. Disclosure Required and Form of Disclosure

Section 13(q) mandates that a resource extraction issuer disclose in an annual report the type and total amount of payments made for each project relating to the commercial development of oil, natural gas, or minerals as well as the type and total amount of such payments made to each government.¹⁰⁹ Section 13(q) also mandates the submission of the payment information in an interactive data format, and provides the Commission with the discretion to determine the applicable interactive data standard.¹¹⁰

1. Annual Report Requirement

Section 13(q) mandates that a resource extraction issuer provide the payment disclosure required by that section in an annual report, but otherwise does not specify the location of the disclosure, either in terms of a specific form or in terms of location within a specific form. As proposed, a resource extraction issuer would have to provide the

¹⁰⁸ In this regard, one commentator has requested that we require an issuer to conduct an appropriate level of due diligence to determine whether a company to which it is making a payment is owned by a foreign government. See letter from PWYP.

¹⁰⁹ 15 U.S.C. 78m(q)(2)(A).

¹¹⁰ 15 U.S.C. 78m(q)(2)(C) and (D).

required payment disclosure in its Exchange Act annual report filed on Form 10-K, Form 20-F, or Form 40-F. We preliminarily believe this approach is an appropriate way to implement the Act's disclosure requirements for resource extraction issuers without imposing additional burdens that might be associated with submitting a separate annual report to the Commission.¹¹¹ In addition, to facilitate investors' ability to locate the disclosure within the annual report without over-burdening them with extensive information about resource extraction payments in the body of the report, our proposed rules would require issuers to include a brief statement under a separate heading entitled, "Payments Made By Resource Extraction Issuers," directing investors to the detailed information about payments provided in the exhibits.

While Section 13(q) mandates that a resource extraction issuer provide the payment disclosure required by that section in an annual report, it does not specifically mandate the time period for which a resource extraction issuer must provide the disclosure. Given that the statute requires the disclosure in an annual report and we are proposing to require resource extraction issuers to furnish the disclosure in the annual report on Form 10-K, Form 20-F, or Form 40-F, as applicable, we believe it is reasonable to require resource extraction issuers to provide the mandated payment information for the fiscal year covered by the applicable annual report.

¹¹¹ We received comment that due to the "tight annual reporting deadline," we should not require the payment disclosure to be part of the audited financial statements and that we should keep the reporting separate from annual reporting on Form 10-K and Form 20-F. Letter from API. The commentator recommended requiring the payment disclosure in a separate report with an annual deadline of 150 days following the fiscal year end. *See id.* We note that the statute does not require the payment disclosure to be part of the audited financial statements, and the rules do not propose to do so. Therefore, we preliminarily believe it could be less burdensome for resource extraction issuers, as well as more useful to investors, to provide the disclosure in a form that issuers are already required to file rather than requiring them to furnish a separate report; however, we are soliciting comment about this issue.

Request for Comment

68. Section 13(q) requires disclosure of the payment information in an annual report but does not specify the type of annual report. Should we require resource extraction issuers to provide the payment disclosure mandated under Section 13(q) in its Exchange Act annual report, as proposed?¹¹² Should we require, or permit, resource extraction issuers to provide the payment information in an annual report other than an annual report on Form 10-K, Form 20-F, or Form 40-F? For example, should we require the disclosure in a new form filed annually on the Commission's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR")?¹¹³ Would requiring resource extraction issuers to disclose the information in a separate annual report be consistent with Section 13(q)? Should we require an oil, natural gas, or mining company to file a separate annual report containing all of the specialized disclosures mandated by the Dodd-Frank Act?¹¹⁴ What would be the benefits or burdens of such a form for investors or resource extraction issuers? If we should require, or permit, a separate annual report, what should be the due date of the report (e.g. 30, 60, 90, 120, or 150 days after the end of the fiscal year covered by the report)?
69. If we require resource extraction issuers to provide the disclosure of payment information in their Exchange Act annual reports, should we permit resource extraction issuers to file an amendment to the annual report within a specified

¹¹² See letters from Calvert and SIF and PWYP supporting that approach.

¹¹³ See letters from API and NMA suggesting such an approach.

¹¹⁴ See Sections 1502 and 1503 of the Dodd-Frank Act.

period of time subsequent to the due date of the report, similar to Article 12 schedules or financial statements provided in accordance with Regulation S-X Rule 3-09,¹¹⁵ to provide the payment information? If so, what would be the appropriate time period (e.g. 30, 60 or 90 days after the due date of the report)?

70. As noted above, Section 13(q) mandates that a resource extraction issuer provide the payment disclosure required by that section in an annual report, but it does not specifically mandate the time period for which a resource extraction issuer must provide the disclosure. Is it reasonable to require resource extraction issuers to provide the mandated payment information for the fiscal year covered by the applicable annual report, as proposed? Why or why not? Should the rules instead require disclosure of payments made by resource extraction issuers during the most recent calendar year?
71. Should we also require an issuer to provide the resource extraction payment disclosure in a registration statement under the Securities Act of 1933¹¹⁶ or under the Exchange Act? If so, what time period should the disclosure cover?
72. Should we require an issuer that has a class of securities exempt from Exchange Act registration pursuant to Exchange Act Rule 12g3-2(b)¹¹⁷ to provide the resource extraction payment disclosure in its home country annual report or in a

¹¹⁵ 17 CFR 210.3-09.

¹¹⁶ 15 U.S.C. 77a et seq.

¹¹⁷ 17 CFR 240.12g3-2(b). A foreign private issuer may claim that exemption as long as it meets a foreign listing requirement, publishes its material home country documents in English on its Internet web site or through another electronic information delivery system that is generally available to the public in its primary trading market, and otherwise is not required to file Exchange Act reports. A foreign private issuer typically relies on the Rule 12g3-2(b) exemption in order to establish an unlisted American Depositary Receipt ("ADR") facility for the issuance and trading of ADRs through the over-the-counter market.

report on EDGAR?¹¹⁸ Would such an approach be consistent with the Exchange Act?¹¹⁹

2. Exhibits and Interactive Data Format Requirement

We propose to require a resource extraction issuer to present the mandated payment information in two exhibits to its annual report on Form 10-K, Form 20-F, or Form 40-F, as applicable.¹²⁰ Specifically, the proposed rules would add new exhibits (97) and (98) to Item 601 of Regulation S-K, new paragraphs 17 and 18 to the “Instructions as to Exhibits” in Form 20-F, and new paragraph B(17) of the “General Instructions” in Form 40-F.¹²¹ We believe two exhibits are necessary to provide investors with the information in a format that is useful to them. Resource extraction issuers would be required to file the information in HTML or ASCII format in one exhibit, which would enable investors to easily read the disclosure about payment information without additional computer programs or software. Resource extraction issuers also would be required to file an exhibit with the information electronically tagged in XBRL format and the disclosure would be readable through a viewer. As noted above, Section 13(q)

¹¹⁸ See letters from Calvert and SIF and PWYP supporting such an approach.

¹¹⁹ The Commission has not considered Rule 12g3-2(b)-exempt companies to be subject to Exchange Act reporting and filing requirements. Prior to the amendment to Rule 12g3-2(b) in 2008, we required issuers claiming the Rule 12g3-2(b) exemption to furnish paper copies of their material home country documents to the Commission. The documents were deemed furnished and not filed under the Exchange Act because they were subject to their home country, and not Exchange Act, disclosure rules. (See the discussion of “furnished” vs. “filed” in Section II.F.3 of this release.) Since the 2008 amendment, Rule 12g3-2(b)-exempt companies do not submit or file any document with the Commission, and must comply only with the rule’s Internet publishing requirement.

¹²⁰ See proposed Regulation S-K Items 601(a), (b)(97), and (b)(98); proposed paragraphs 17 and 18 of the Instructions as to Exhibits for Form 20-F, and proposed paragraph B.(17)(a) under the General Instructions of Form 40-F.

¹²¹ See *id.*

requires that the rules issued pursuant to the section require that the information included in the annual report be submitted in an interactive data format. We are proposing to require resource extraction issuers to submit the mandated payment information in XBRL in an exhibit.¹²² Some commentators indicated a preference for XBRL.¹²³

In addition, we propose to require a resource extraction issuer to provide a statement, under an appropriate heading in the issuer's annual report, referring to the payment information provided in the exhibits to the report.¹²⁴ We believe this approach would facilitate access to the information by placing it outside the body of the annual report. By requiring resource extraction issuers to provide the payment information in exhibits to the annual report, the proposed rules would enable anyone accessing EDGAR to determine quickly whether an issuer provided disclosure in accordance with Section 13(q) and the rules issued pursuant to that section. In addition, we are concerned that presenting the information in interactive data format in the body of the annual report

¹²² See proposed Regulation S-K Item 601(b)(98), proposed paragraph 18 under Instructions as to Exhibits for Form 20-F, and proposed paragraph B.(17)(a)(2) under the General Instructions of Form 40-F.

¹²³ See letters from API; Calvert and SIF; and PWYP. Calvert and SIF stated that XBRL "reduces the costs for investors associated with obtaining and assimilating information from issuers, and, at the same time, reduces the costs to issuers submitting data to regulators." In addition, Calvert and SIF noted that "XBRL allows for more standardization and harmonization of international business reporting standards, thereby lowering the costs of compliance and reporting for issuers, while making the information far more valuable and easily interpreted and analyzed by investors." Letter from Calvert and SIF. PWYP recommended XBRL "in order to more seamlessly integrate with existing company filings formatted in XBRL, as well as the Commission's existing XBRL reporting platform, and with external XBRL-based databases managed by private sector companies." Letter from PWYP. Cf. letter from NMA (stating that "issuers should be given the flexibility to disclose the data in any format that would allow users to click through the information in a standard file type (e.g. Microsoft Word, Web-based HTML, Microsoft Excel, or .pdf) to reach data sorted by each of the electronic tags specified in the Act." According to this commentator, while XBRL could satisfy the statutory requirement, "issuers should not be prohibited from using other formats that allow for meaningful use of 'electronic tags'").

¹²⁴ See proposed Item 4(c) under Part I of Form 10-K, proposed Item 16I.A. under Part II of Form 20-F, and proposed paragraph B.(17)(a) under the General Instructions of Form 40-F.

would not be comprehensible. Thus, we believe a brief reference in the body of the filing to the disclosure and the complete presentation in the exhibits to the filing is the most appropriate approach.

Resource extraction issuers currently are required to file their registration statements, current and periodic reports in ASCII or HTML.¹²⁵ Our electronic filing system also uses other formats for reporting related to corporate issuers, such as XML, to process reports of beneficial ownership of equity securities on Forms 3, 4, and 5 under Section 16(a) of the Exchange Act,¹²⁶ and a form of XML known as XBRL to provide financial statement data.¹²⁷ As we explained in the XBRL Adopting Release and the proposing release for asset-backed securities,¹²⁸ electronic formats such as HTML, XML, and XBRL are open standards¹²⁹ that define or “tag” data using standard definitions. The tags establish a consistent structure of identity and context. This consistent structure can be recognized and processed by a variety of different software applications.

In the case of HTML, the standardized tags enable Web browsers to present Web sites’ embedded text and information in a predictable format so that they are human readable. In the case of XML and XBRL, software applications, such as databases,

¹²⁵ Rule 301 under Regulation S-T [17 CFR 232.301] requires electronic filings to comply with the EDGAR Filer Manual, and Section 5.1 of the Filer Manual requires that electronic filings be in ASCII or HTML format. Rule 104 under Regulation S-T [17 CFR 232.104] permits filers to submit voluntarily as an adjunct to their official filings in ASCII or HTML unofficial PDF copies of filed documents.

¹²⁶ 15 U.S.C. 78p(a).

¹²⁷ See Interactive Data to Improve Financial Reporting, Release No. 33-9002 (January 30, 2009), 74 FR 6776 (February 10, 2009) (“XBRL Adopting Release”).

¹²⁸ See Asset-Backed Securities, Release No. 33-9117 (April 7, 2010), 75 FR 23328 (May 3, 2010).

¹²⁹ The term “open standard” is generally applied to technological specifications that are widely available to the public, royalty-free, and at minimal or no cost.

financial reporting systems, and spreadsheets recognize and process tagged information. As noted above, some commentators have indicated we should require these data points in XBRL as we are proposing.¹³⁰

As mandated by Section 13(q),¹³¹ the proposed rules would require a resource extraction issuer to submit the payment information using electronic tags that identify, for any payments made by a resource extraction issuer to a foreign government or the U.S.

Federal Government:

- the total amounts of the payments, by category;
- the currency used to make the payments;
- the financial period in which the payments were made;
- the business segment of the resource extraction issuer that made the payments;
- the government that received the payments, and the country in which the government is located; and
- the project of the resource extraction issuer to which the payments relate.¹³²

In addition, under Section 13(q), a resource extraction issuer would be required to provide the type and total amount of payments made for each project and the type and total amount of payments made to each government in interactive data format.

Consistent with the statute, the proposed rules require a resource extraction issuer to include an electronic tag that identifies the currency used to make the payments. The statute does not otherwise specify how the resource extraction issuer should present the

¹³⁰ See letter from API, Calvert and SIF; and PWYP.

¹³¹ 15 U.S.C. 78m(q)(2)(D)(ii).

¹³² See proposed Regulation S-K Item 601(b)(98), paragraph 18 under Instructions as to Exhibits of Form 20-F, and paragraph B.(17)(a)(2) under the General Instructions of Form 40-F.

type and total amount of payments for each project or to each government. We preliminarily believe it is appropriate to require resource extraction issuers to provide the type and total amount of payments for each project and to each government in the currency in which the payments were made, as we believe it may increase comparability with disclosure provided under EITI programs in other countries.

We expect that some of the electronic tags, such as those pertaining to category, currency, country, and financial period would have fixed definitions and would enable interested persons to evaluate and compare the payment information across companies and governments. Other tags, which could include those pertaining to business segment, government, and project, would allow for issuers to enter information specific to their business.

Section 13(q) requires the Commission, to the extent practicable, to make available online, to the public, a compilation of the information required under paragraph (2)(A) of that section.¹³³ We request comment on the particular form, content, or time period for the compilation.¹³⁴

Request for comment

73. Should we require that information concerning the type and total amount of payments made for each project and to each government relating to the

¹³³ 15 U.S.C. 78m(q)(3)(A). That information includes the type and total amount of payments made by resource extraction issuers to foreign governments or the U.S. Federal Government for the purpose of the commercial development of oil, natural gas, or minerals on a per project and per government basis.

¹³⁴ Section 13(q) provides that “[n]othing in [Section 13(q)(3)(A)] shall require the Commission to make available online information other than the information required to be submitted under the rules issued under paragraph (2)(A).” 15 U.S.C. 78m(q)(3)(B).

commercial development of oil, natural gas, or minerals be provided in the exhibits to Form 10-K, Form 20-F, or Form 40-F, as proposed?

74. Should we require, as proposed, a resource extraction issuer to provide a statement, under an appropriate heading in the issuer's annual report, referring to the payment information provided in the exhibits to the report, as proposed?
75. Should we require a resource extraction issuer to present some or all of the required payment information in the body of the annual report instead of, or in addition to, presenting the information in the exhibits? If you believe we should require disclosure of some or all the payment information in the body of the annual report, please explain what information should be required and why. For example, should we require a resource extraction issuer to provide a summary of the payment information in the body of the annual report? If so, what items of information should be disclosed in the summary?
76. Section 13(q) does not require the resource extraction payment information to be audited or provided on an accrual basis.¹³⁵ Accordingly, the proposed rules do not include such requirements. Should we require resource extraction issuers to have the payment information audited or provide the payment information on an accrual basis? Why or why not? What would be the likely benefits and burdens? Would including such requirements be consistent with the statute?

¹³⁵ One commentator requested that we require issuers to disclose the payment information as a separate section of the audited financial statements that are filed with the Exchange Act annual report and that we require the payment disclosure on both a cash and accrual basis. See letter from Calvert and SIF. See also letter from PWYP (requesting that we require the information to be included in a separate section of the Exchange Act annual report and subject to "rigorous audit or review procedures by the company's independent external auditor").

77. Should we require two new exhibits for the resource extraction disclosure, as proposed?
78. Should we require that the resource extraction payment disclosure be provided in a new exhibit in HTML or ASCII, as proposed? Why or why not?
79. Should we require the resource extraction payment disclosure to be electronically formatted in XBRL and provided in a new exhibit, as proposed? Is XBRL the most suitable interactive data standard for purposes of this rule? If not, why not? Should the information be provided in XML format? If so, why? Are there characteristics of XML, such as ease of entering information into a form, which makes it a better interactive data standard for the payment information than XBRL? Would the use of the XBRL taxonomy based on U.S. GAAP cause confusion in light of the fact that the information required under Section 13(q) is information about cash or in kind payments (that are not computed in accordance with GAAP) made by resource extraction issuers? Should we require an interactive data standard for the payment information other than XML or XBRL?
80. Section 13(q) and our proposed rules require a resource extraction issuer to include an electronic tag that identifies the currency used to make the payments. If the currency in which the payment was made differs from the issuer's reporting currency, should the rules require issuers to convert the payments to the issuer's reporting currency at the applicable rate? If the rules should, as proposed, require disclosure of in kind payments, should the rules require in kind payments to be converted to the host country currency? Should the rules require in kind payments to be converted to the issuer's reporting currency at the applicable rate?

Should the rules require disclosure of the in kind payments in the form in which the payments were made and also require the payments to be converted to the issuer's reporting currency? Should we require issuers to provide a conversion to U.S. dollars for payments made in cash and in kind, and to electronically tag that information?

81. Section 13(q) and our proposed rules require an issuer to include an electronic tag that identifies the financial period in which the payments were made.¹³⁶ Should we require an issuer to identify in the tag the particular fiscal year, quarter, or other period, such as a particular half-year, in which the payments were made?
82. Section 13(q) and our proposed rules require an issuer to include an electronic tag that identifies the issuer's business segment that made the payments.¹³⁷ Should we define "business segment" for purpose of disclosing and tagging the payment information required by Section 13(q)? If so, what definition should we use? Should we instead allow resource extraction issuers to disclose and identify the business segment in accordance with how it operates its business? What are the advantages and disadvantages of allowing an issuer to rely on its definition of business segment?
83. Section 13(q) and our proposed rules require an issuer to include an electronic tag that identifies the project to which the payments relate.¹³⁸ Are there some payments that would not relate to a particular project? If so, should we

¹³⁶ 15 U.S.C. 78m(q)(2)(D)(ii)(III).

¹³⁷ 15 U.S.C. 78m(q)(2)(D)(ii)(IV).

¹³⁸ 15 U.S.C. 78m(q)(2)(D)(ii)(VI).

nevertheless require that each payment be allocated to a particular project?

Should we instead permit an issuer to use only the electronic tag that identifies the government receiving the payments if those payments do not relate to, or cannot be allocated to, a particular project?

84. Section 13(q) requires an issuer to electronically tag "such other information as the Commission may determine is necessary or appropriate in the public interest or for the protection of investors."¹³⁹ Would it be useful to have additional information about the payments electronically tagged? If so, what additional tags should we require? Are there any other items of information that should be electronically tagged?

85. Should we permit issuers to aggregate their payments into three categories: "taxes and royalties," "production entitlements," and "other payments"?¹⁴⁰ Would that approach be consistent with Section 13(q)?

86. Section 13(q)(3) requires the Commission to provide a compilation of the disclosure made by resource extraction issuers. Should the Commission provide the compilation on an annual basis? Should the compilation be provided on a calendar year basis, or would some other time period be more appropriate? Should the compilation provide information as to the type and total amount of payments made on a country basis? What other information should be provided in the compilation?¹⁴¹

¹³⁹ 15 U.S.C. 78m(q)(2)(D)(ii)(VII).

¹⁴⁰ See letter from API.

¹⁴¹ We received a suggestion that the compilation take the form of an online database and summary report. The online database would enable users to search by country and company, as well as by year or multiple years of reporting. The suggested summary report would list the total payments

3. Treatment for Purposes of the Securities Act and the Exchange Act

The statutory language of Section 13(q) does not specify that the information about resource extraction payments must be “filed,” rather, it states that the information should be “include[d] in an annual report[.]”¹⁴² We are proposing that the disclosure required by Section 13(q) would be required to be “furnished” rather than “filed” and not be subject to liability under Section 18 of the Exchange Act, unless the issuer explicitly states that the resource extraction disclosure is filed under the Exchange Act. Issuers that fail to comply with the rules would be subject to violations of Exchange Act Sections 13(a) or 15(d), as applicable.¹⁴³ The disclosure would be treated in the same manner as other furnished documents, such as the certifications required to be submitted as exhibit 32¹⁴⁴ to Exchange Act documents under Rule 13a-14(b)¹⁴⁵ or Rule 15d-14(b)¹⁴⁶ and Section 1350 of Chapter 63 of Title 18 of the United States Code,¹⁴⁷ the Audit Committee Report required by Item 407(d) of Regulation S-K¹⁴⁸ and the Compensation Committee Report required by Item 407(e)(5) of Regulation S-K.¹⁴⁹

by each issuer for each government, total payments within each payment category, the total payments per project for each issuer, and project payments within each payment category. See letter from PWYP.

¹⁴² 15 U.S.C. 78m(q)(2)(A).

¹⁴³ 15 U.S.C. 78m(a) and 15 U.S.C. 78o(d).

¹⁴⁴ Item 601(b)(32)(ii) of Regulation S-K [17 CFR 229.601(b)(32)].

¹⁴⁵ 17 CFR 240.13a-14(b).

¹⁴⁶ 17 CFR 240.15d-14(b).

¹⁴⁷ 18 U.S.C. 1350.

¹⁴⁸ 17 CFR 229.407(d).

¹⁴⁹ 17 CFR 229.407(e)(5).

We believe this approach is consistent with the statute. Section 13(q) does not mandate that the disclosure be included in the annual report on Form 10-K, Form 20-F, or Form 40-F.¹⁵⁰ In addition, we preliminarily believe this approach is appropriate in light of the nature and primary purpose of the disclosure. Section 13(q) requires the Commission, to the extent practicable, to issue rules under the section that support the Federal Government's commitment to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.¹⁵¹ We believe the nature and purpose of the disclosure required by Section 13(q) is qualitatively different from the nature and purpose of existing disclosure that has historically been required under Section 13 of the Exchange Act. As a result, we preliminarily believe it is appropriate to require a resource extraction issuer to furnish the disclosure. Therefore, we are proposing new Instructions to Item 105 of Regulation S-K, Item 16I of Form 20-F, and Instruction B.(17) of Form 40-F, which would state that the disclosure provided in response to those items would not be deemed to be "filed" with the Commission or subject to the liabilities of Section 18 of the Exchange Act, and will not be deemed to be

¹⁵⁰ See letter from NMA.

¹⁵¹ 15 U.S.C. 78m(q)(2)(E). In addition, an author of the legislation has noted that the purpose of the legislation is to provide information to investors. See, e.g., Statement of Senator Cardin in support of Amendment No. 3732 to Restoring American Financial Stability Act (S3217), 111 Cong. Rec. S3316 (daily ed. May 6, 2010) (stating that "Investors need to be able to assess the risks of their investments. Investors need to know where, in what amount, and on what terms their money is being spent in what are often very high-risk operating environments. These environments are often poor developing countries that may be politically unstable, have lots of corruption, and have a history of civil unrest. The investor has a right to know about the payments. Secrecy of payments carries real bottom-line risks for investors. Creating a reporting requirement with the SEC will capture a larger portion of the international extractive industries corporations than any other single mechanism, thereby setting a global standard for transparency and promoting a level playing field. Investors should be able to know how much money is being invested up front in oil, gas, and mining projects. For example, oil companies often pay very large signature payments to secure the rights for an oilfield, long before the first drop of oil is produced. Such payments are in addition to the capital investment required.").

incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the issuer specifically incorporates it by reference.

Request for comment

87. Should we, as proposed, require the resource extraction payment disclosure to be furnished as exhibits to the annual report? If not, why not? How should it be provided?
88. Should we require the resource extraction payment disclosure to be filed as exhibits, rather than furnished, which would affect issuers' liability under the Exchange Act or under the Securities Act (if any such issuer incorporates by reference its annual report into a Securities Act registration statement)?
89. Under Exchange Act section 18, "Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the Exchange Act] or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15, 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."¹⁵² Is it appropriate not to have the disclosures subject to Section 18 liability even if the elements of Section 18 could

¹⁵²

Exchange Act Section 18(a).

otherwise be established? Should we require the resource extraction payment disclosure to be filed for purposes of Section 18 of the Exchange Act, but permit an issuer to elect not to incorporate the disclosure into Securities Act filings?

90. Should the resource extraction payment disclosure be furnished annually on Form 8-K? Would that approach be consistent with the statute? If so, should foreign private issuers, which do not file Forms 8-K, be permitted to submit the resource extraction payment disclosure either in their Form 20-F or Form 40-F, as applicable, or annually on Form 6-K, at their election?

G. Effective Date

Section 13(q) provides that, with respect to each resource extraction issuer, the final rules issued under that section shall take effect on the date on which the resource extraction issuer is required to submit an annual report relating to the issuer's fiscal year that ends not earlier than one year after the date on which the Commission issues the final rules under Section 13(q).¹⁵³ Because the Commission must enact final rules under Section 13(q) at the latest by April 15, 2011,¹⁵⁴ the statute appears to require disclosure in an issuer's annual report relating to the fiscal year ending on or after April 15, 2012.

Request for comment

91. Should we provide a delayed effective date for the final rules, either for all issuers subject to the rules or for certain types of issuers (e.g. smaller reporting

¹⁵³ 15 U.S.C. 78m(q)(2)(F).

¹⁵⁴ Section 13(q)(2)(A) requires that the Commission issue final rules under that section no later than 270 days after the Dodd-Frank Act's enactment. The Act was signed into law on July 21, 2010; therefore the Commission must enact final rules no later than April 15, 2011.

companies or foreign private issuers)?¹⁵⁵ Would doing so be consistent with the statute? Why or why not? If we should provide for a delayed effective date, should issuers be required to provide disclosure in an annual report for the fiscal year ending on or after June 30, 2012, September 30, 2012, December 31, 2012, or some other date?

H. General Request for Comment

We request and encourage any interested person to submit comments regarding:

- the proposed amendments that are the subject of this release;
- additional or different changes; or
- other matters that may have an effect on the proposals contained in this release.

We request comment from the point of view of companies, investors and other market participants. With regard to any comments, we note that such comments are of great assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

III. PAPERWORK REDUCTION ACT

A. Background

The proposed rule and form amendments contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).¹⁵⁶

¹⁵⁵ One commentator has requested that we delay the effective date of the resource extraction payment disclosure rules until fiscal year 2013. See letter from NMA. Another commentator recommended that “first reporting be for the 2012 fiscal year in 2013.” Letter from API.

¹⁵⁶ 44 U.S.C. 3501 *et seq.*

We are submitting the proposal to the Office of Management and Budget for review in accordance with the PRA.¹⁵⁷ The titles for the collections of information are:

- (1) "Regulation S-K" (OMB Control No. 3235-0071);¹⁵⁸
- (2) "Form 10-K" (OMB Control No. 3235-0063);
- (3) "Form 20-F" (OMB Control No. 3235-0288); and
- (4) "Form 40-F" (OMB Control No. 3235-0381).

The regulation and forms were adopted under the Securities Act and the Exchange Act. The regulation and forms set forth the disclosure requirements for periodic reports and registration statements filed by companies to help shareholders make informed investment and voting decisions. The hours and costs associated with preparing and filing the forms constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The proposed rule and form amendments would implement Section 13(q) of the Exchange Act, which was added by Section 1504 of the Act. Section 13(q) requires the Commission to "issue final rules that require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or

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

¹⁵⁸ The paperwork burden from Regulation S-K is imposed through the forms that are subject to the disclosures in Regulation S-K and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burdens imposed by Regulation S-K to be a total of one hour.

the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals, including – (i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals, and (ii) the type and total amount of such payments made to each government.”¹⁵⁹ Section 13(q) also mandates the submission of the payment information in an interactive data format, and provides the Commission with the discretion to determine the applicable interactive data standard.¹⁶⁰

The proposed rule and form amendments would require an issuer to provide the statutorily-mandated information about resource extraction payments in an exhibit filed in HTML or ASCII format, which would enable investors to easily read the disclosure about payment information without additional computer programs or software. A resource extraction issuer also would be required to file another exhibit with the information electronically tagged in XBRL format, which would be readable through a viewer. In addition, the proposed rule and form amendments would require a resource extraction issuer to provide a statement, under an appropriate heading in the issuer’s annual report, referring to the payment information provided in the exhibits to the report.

The same payment disclosure requirements would apply to U.S. and foreign resource extraction issuers. As discussed above, we propose to add new Item 105 to Regulation S-K¹⁶¹ to require a resource extraction issuer to provide information relating to any payment made by it, a subsidiary, or an entity under its control to a foreign

¹⁵⁹ 15 U.S.C. 78m(q)(2)(A).

¹⁶⁰ 15 U.S.C. 78m(q)(2)(C) and (D).

¹⁶¹ See proposed Item 105 of Regulation S-K.

government or the U.S. Federal Government during the fiscal year covered by the annual report for the purpose of the commercial development of oil, natural gas, or minerals.

We also propose to add new Item 4(c) to Form 10-K to require a resource extraction issuer to provide a statement that the information required by Section 13(q) and new Item 105 of Regulation S-K is included in two specified exhibits.¹⁶² In addition, we are proposing to amend Regulation S-K Item 601 to add the two new exhibits to Form 10-K. Because Regulation S-K does not apply to Forms 20-F and 40-F,¹⁶³ we propose to amend those forms to include the same disclosure requirements as those proposed for resource extraction issuers that are not foreign private issuers.¹⁶⁴

Compliance with the proposed rule and form amendments by affected issuers would be mandatory. The disclosure and reports submitted by issuers would not be kept confidential, and there would be no mandatory retention period for the information disclosed.

B. Burden and Cost Estimates Related to the Proposed Amendments

The proposed rule and form amendments would require, if adopted, additional disclosure for a resource extraction issuer's annual report filed on Form 10-K, Form 20-F or Form 40-F, which would increase the burden hour and cost estimates for each of those forms. For purposes of the Paperwork Reduction Act, we estimate the total annual increase in the paperwork burden for all affected companies to comply with our proposed

¹⁶² See proposed Item 4(c) under Part I of Form 10-K.

¹⁶³ While Form 20-F may be used by any foreign private issuer, Form 40-F is only available to a Canadian issuer that is eligible to participate in the U.S.-Canadian Multijurisdictional Disclosure System ("MJDS").

¹⁶⁴ See proposed Item 16I under Part II of Form 20-F and proposed paragraph (17) to General Instruction B of Form 40-F.

collection of information requirements to be approximately 52,932 hours of company personnel time and to be approximately \$11,857,200 for the services of outside professionals. These estimates include the time and cost of collecting the information, preparing and reviewing disclosure, filing documents, and retaining records.

We derived the above estimates by estimating the average number of hours it would take an issuer to prepare and review the proposed disclosure requirements. In deriving our estimates, we recognize that the burdens will likely vary among individual issuers based on a number of factors, including the size and complexity of their operations. We believe that some issuers will experience costs in excess of this average in the first year of compliance with the proposals and some issuers may experience less than these average costs. When determining these estimates, we have assumed that:

- for Form 10-K, 75% of the burden of preparation is carried by the issuer internally and 25% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per hour; and
- for Forms 20-F and 40-F, 25% of the burden of preparation is carried by the issuer internally and 75% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per hour.

The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours. We request comment regarding the allocation of the annual burden. In particular, we request comment regarding whether the proposed rules would add more internal burden hours rather than costs for outside professionals.

We have based our estimates of the effect that the proposed rule and form amendments, if adopted, would have on those collections of information primarily on our review of the most recently completed PRA submissions for the affected rules and forms as well as on PRA submissions for similar rule and form amendments. We expect that the rules' effect will be greatest during the first year of their effectiveness and diminish in subsequent years.

1. Form 10-K

For purposes of the PRA, we estimate that, of the 13,545 Form 10-Ks filed annually, approximately 861 are filed by issuers that would be affected by the proposed rule and form amendments.¹⁶⁵ We further estimate that the annual incremental paperwork burden for the Forms 10-K as a result of the proposed rule and form amendments would be 75 burden hours per affected form.¹⁶⁶

2. Regulation S-K

While the proposed rule and form amendments would make revisions to Regulation S-K, the collection of information requirements for that regulation are reflected in the burden hours estimated for Form 10-K. The rules in Regulation S-K do not impose any separate burden. Consistent with historical practice, we are proposing to retain an estimate of one burden hour to Regulation S-K for administrative convenience.

¹⁶⁵ We derived this number by determining the number of issuers that fall under all the SIC codes that pertain to oil, natural gas, and mining companies and, thus, are most likely to be resource extraction issuers, and subtracting from that figure the number of issuers that file annual reports on Form 20-F and Form 40-F.

¹⁶⁶ In estimating 75 burden hours, we looked to the burden hours associated with the disclosure required by the oil and gas rules adopted in 2008, which estimated an increase of 100 hours for domestic issuers and 150 hours for foreign private issuers. We preliminarily believe that the disclosure required by the proposed rules is less extensive than the disclosure required by the oil and gas rules, and therefore we have estimated 75 burden hours.

3. Form 20-F

For purposes of the PRA, we estimate that, of the 942 Form 20-F annual reports filed each year, approximately 166 are filed by issuers that would be affected by the proposed form amendments.¹⁶⁷ We estimate that the annual incremental paperwork burden for the Forms 20-F as a result of the proposed rule and form amendments would be 75 burden hours per affected form.

4. Form 40-F

For purposes of the PRA, we estimate that, of the 205 Form 40-F annual reports filed each year, approximately 74 are filed by companies that would be affected by the proposed form amendments.¹⁶⁸ We estimate that the annual incremental paperwork burden for the Forms 40-F as a result of the proposed form amendments would be 75 burden hours per affected form.

C. Summary of Proposed Changes to Annual Compliance Burden in Collection of Information

The following tables summarize the estimated changes in annual compliance burden in the collection of information in hours and costs for Exchange Act annual reports as a result of the proposed rule and form amendments. Table 1 illustrates the incremental annual compliance burden of the collection of information in hours and cost for our amendments.

¹⁶⁷ We derived this number by determining the number of issuers that fall under all the SIC codes that pertain to oil, natural gas, and mining companies and, thus, are most likely to be resource extraction issuers, and that file annual reports on Form 20-F.

¹⁶⁸ We derived this number by determining the number of issuers that fall under all the SIC codes that pertain to oil, natural gas, and mining companies and, thus, are most likely to be resource extraction issuers, and that file annual reports on Form 40-F.

Table 1

Form	Number of Responses ¹⁶⁹ (A)	Incremental Burden Hours/Form (B)	Total Incremental Burden Hours (C)=(A)*(B)	Incremental Company (D)=(C)*0.75 (Form 10-K) (E)=(C)*0.25 (Forms 20-F & 40-F)	Incremental Professional (E)=(C)*0.25 (Form 10-K) (E)=(C)*0.75 (Forms 20-F & 40-F)	Incremental Professional Cost (F)=(E)*\$400/hr.
10-K	861	75	64,575	48,431	16,144	\$6,457,600
20-F	166	75	12,450	3,112.5	9,337.5	\$3,735,000
40-F	74	75	5,550	1,387.5	4,162.5	\$1,665,000

Table 2 illustrates the total annual compliance burden of the collection of information in hours and cost resulting from the proposed amendments. That burden was calculated by adding the incremental burdens to the existing burdens.

Table 2

Form	Current Annual Response ¹⁷⁰	Current Burden Hours (A)	Increase in Burden Hours (B)	Proposed Burden Hours (C)=(A)+(B)	Current Professional Costs (D)	Increase in Professional Costs (E)	Proposed Professional Costs (F)=(D)+(E)
10-K	13,545	21,363,548	48,431	21,411,979	\$2,848,473,000	\$6,457,600	\$2,854,930,600
20-F	942	622,907	3,112.5	626,019.5	\$743,089,980	\$3,735,000	\$746,824,980
40-F	205	21,884	1,387.5	23,271.5	\$26,260,500	\$1,665,000	\$27,925,500

D. Solicitation of Comment

We request comment on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and

¹⁶⁹ This number corresponds to the estimated number of forms expected to be affected by the proposed rule and form amendments.

¹⁷⁰ The proposed rule and form amendments would not change the number of annual responses.

clarity of the information to be collected; (iv) evaluate whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and (v) evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

In particular, we request comment and supporting empirical data for purposes of the PRA on whether the proposed rule and form amendments:

- will affect the burden hours and costs required to produce the annual reports on Forms 10-K, 20-F and 40-F; and
- if so, whether the resulting change in the burden hours and costs required to produce those Exchange Act annual reports is the same as or different than the estimated incremental burden hours and costs proposed by the Commission.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090, with reference to File No. S7-42-10. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-42-10, 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 collection 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 of publication.

IV. COST-BENEFIT ANALYSIS

We are proposing the rule and form amendments discussed in this release in order to implement Section 13(q), which was added to the Exchange Act by Section 1504 of the Act. As mandated by Section 13(q), the proposed rule and form amendments would require a resource extraction issuer to disclose in its annual report filed with the Commission certain information relating to any payment made by the issuer, a subsidiary, or an entity under the issuer's control to a foreign government or the U.S. Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. The statutorily required information would include the type and total amount of payments made for each project of the issuer relating to the commercial development of oil, natural gas, or minerals as well as the type and total amount of those payments made to each government. We expect that the proposed rule and form amendments would affect in substantially the same way both U.S. companies and foreign companies that meet Section 13(q)'s definition of "resource extraction issuer," which is an issuer that is required to file an annual report with the Commission and engages in the commercial development of oil, natural gas, or minerals.

We are sensitive to the costs and benefits of the proposed rule and form amendments. Section 1504 of the Dodd-Frank Act added Section 13(q) to the Exchange

Act, which establishes a disclosure requirement for payments made by resource extraction issuers. The rules proposed to implement the statute largely track the statutory provision. The cost-benefit analysis that follows focuses on the benefits and costs related to the aspects of the proposed rules in which we exercised discretion, and not on the overall benefits and costs of the statutory regime for disclosure of payments by resource extraction issuers.

A. Benefits

The proposed rulemaking is intended to implement the requirements of Exchange Act Section 13(q) as set forth in Section 1504 of the Dodd-Frank Act. Overall, we expect that the proposed rules will have the benefit of furthering Congress' goal of promoting international transparency efforts.

The proposed rules would clarify that resource extraction issuers would be required to provide information about certain payments made to foreign governments, including foreign subnational governments. This clarification may reduce uncertainty about compliance for resource extraction issuers and increase transparency with regard to the payments made to foreign governments. It also may provide increased consistency in the application of the requirement across resource extraction sectors to the extent that it is more common for certain resource extraction issuers, such as mining companies, to make payments to subnational governments than national governments.

The proposed rules do not provide a definition of what "other material benefits" should be classified as payments subject to disclosure. Specifically, the Commission is not proposing that social or community payments be included in the disclosure mandated by Section 13(q).

Section 13(q) provides that the resource extraction payment disclosure must be "included in an annual report." As proposed, the rules would specify the forms in which the required payment information must be disclosed and location of the required disclosure. The proposed rules would require a resource extraction issuer to provide the required payment disclosure in its Exchange Act annual report filed on Form 10-K, Form 20-F, or Form 40-F. We preliminarily believe this approach is an appropriate way to implement Section 13(q)'s disclosure requirements for resource extraction issuers without imposing additional burdens that might be associated with submitting a separate annual report to the Commission. To facilitate investors' ability to locate the disclosure within the annual report, our proposed rules would require issuers to provide the payment information in exhibits to the annual report and include a brief statement in the body of the annual report under a separate heading entitled, "Payments Made By Resource Extraction Issuers," directing investors to the detailed information about payments provided in the exhibits.

In this regard, the proposed rules would require that the resource extraction payment disclosure be furnished with the Commission, rather than filed. As noted above, Section 13(q) provides that the resource extraction payment disclosure must be "included in an annual report," but it does not indicate whether the disclosure should be filed or furnished. Information that is furnished, rather than filed, is not subject to liability under Section 18 of the Exchange Act, although issuers that fail to comply with the rules would be subject to violations of Exchange Act Sections 13(a) or 15(d), as applicable.¹⁷¹ By

¹⁷¹ 15 U.S.C. 78(a) and 15 U.S.C. 78o(d).

requiring the resource extraction payment disclosure to be furnished rather than filed, we are subjecting the disclosure to less liability than would exist if the disclosure were filed.

To meet the mandate of Section 13(q), the proposed disclosure would have to be electronically formatted using an interactive data standard. We have considered two alternative standards, XML and XBRL, for this purpose. Either standard would benefit market participants and observers, including investors, by enabling them to more easily search, retrieve and analyze the formatted information. To the extent that requiring the specified information to be presented in XBRL format may promote consistency and standardization in business reporting standards and reduce compliance costs, it could benefit both issuers and users of the information. Moreover, the proposed rule and form amendments would require a resource extraction issuer to provide the required payment disclosure in two exhibits to its Exchange Act annual report – one exhibit formatted in HTML or ASCII so that it is easily readable as text and another exhibit formatted in XBRL and providing all of the electronic tags required by Section 13(q) and the proposed rules. We believe that requiring the specified information to be presented in two separate formats will benefit users of the information by allowing them to access the information in whatever format is most useful for their purposes.

B. Costs

Section 13(q) requires the Commission to adopt rules that support the U.S. federal government's commitment to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.¹⁷² Resource extraction issuers would incur costs in meeting the additional disclosure required for their Exchange Act

¹⁷² 15 U.S.C. 78m(q)(2)(E).

annual reports under Section 13(q) and the proposed rule and form amendments. Those costs would include costs related to tracking and collecting information about different types of payments across projects, governments, countries, subsidiaries and other controlled entities. Those tracking and collecting costs would vary depending upon how an issuer would need to modify its existing systems to track, collect, and report the proposed payment information. While some issuers are already providing some payment information on a voluntary basis under an EITI program, others are currently not reporting any payment information. Moreover, the EITI requires the disclosure of payment information on a per country basis, and not per project. Therefore, we expect that most resource extraction issuers would incur some costs to develop disclosure controls and procedures to record, process, summarize and report the required payment information.¹⁷³ However, we believe these costs are a result of the statutory requirements that we are required to implement.

The proposed rules do not define "other material benefits" that should be considered payments subject to disclosure, which could impose some costs. First, resource extraction issuers that predominantly make payments that would be required to be disclosed pursuant to the proposed rules (e.g. royalties, license fees, bonuses) may be at a competitive disadvantage as compared to resource extraction issuers that predominantly make payments that are not identified in the proposed rules (e.g. social and community payments). Second, to the extent that other types of payments could be used to substitute for explicitly defined payments, resource extraction issuers may try to circumvent the required disclosures by shifting to other, not explicitly defined payments,

¹⁷³ See 17 CFR 240.13a-15(e) and 17 CFR 240.15d-15(e).

and away from payments defined by the statute. This could have the effect of reducing the transparency contemplated by Section 1504 of the Dodd-Frank Act.

The proposed rules would require a resource extraction issuer to provide the required payment disclosure in its Exchange Act annual report filed on Form 10-K, Form 20-F, or Form 40-F. While we preliminarily believe that requiring resource extraction issuers to provide the information in an existing form that they already file would be less burdensome than providing the information in a new separate form, to the extent that issuers have concerns with regard to the time period in which to provide the disclosure in the existing form,¹⁷⁴ the proposed rules could result in increased compliance costs.

The proposed rules would require resource extraction issuers to submit the information required by Section 13(q) in two separate exhibits, one formatted in HTML or ASCII so that it is easily readable as text and another exhibit formatted in XBRL and providing all of the electronic tags required by Section 13(q). The requirement to provide two separately formatted versions of the required information will result in some increased compliance costs for issuers; however, we believe it is appropriate to require the information in readable format as text in addition to the statutorily-mandated interactive data format in order for the information to be readily accessible to different users. In addition, the electronic formatting costs would vary depending upon an issuer's prior experience with XBRL. While many issuers are already familiar with XBRL because they currently use XBRL for their annual and quarterly reports filed with the Commission, issuers not already filing reports using XBRL would incur some start-up costs associated with XBRL.

¹⁷⁴ See letters from API and NMA.

V. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act¹⁷⁵ requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act¹⁷⁶ require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

The Commission is proposing the rule and form amendments discussed in this release to implement the requirements of Exchange Act Section 13(q) as added by Section 1504 of the Dodd-Frank Act. Section 13(q) mandates that the Commission adopt rules requiring resource extraction issuers to disclose in an annual report payments made to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. In addition, Section 13(q) requires the Commission to adopt rules that support the U.S. federal government's commitment to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals.¹⁷⁷

¹⁷⁵ 15 U.S.C. 78w(a)(2).

¹⁷⁶ 15 U.S.C. 78c(f).

¹⁷⁷ 15 U.S.C. 78m(q)(2)(E).

A commentator stated that, should a host government prohibit the disclosure of payments made by resource extraction issuers to the host government, and if the Commission does not adopt an appropriate exception for that prohibition, an issuer could be compelled to select between avoiding or abandoning projects in that country and maintaining its registration under the Exchange Act.¹⁷⁸ According to the commentator, such a situation would harm the competitive position of issuers and be contrary to the interests of their investors. Some commentators have further maintained that, if the Commission adopts a rule requiring the disclosure of payments without regard to the materiality of the project to which the payments relate, that rule would result in voluminous disclosures of immaterial information of little to no benefit to investors, which may harm the competitive position of affected issuers and may harm efficient capital formation.¹⁷⁹

Request for comment

We request comment on whether the proposals, if adopted, would promote efficiency, competition and capital formation or have an impact or burden on competition. In particular, we request comment on the potential effect on efficiency, competition and capital formation should the Commission not adopt certain exceptions or accommodations. Commentators are requested to provide empirical data and other factual support for their views, if possible.

¹⁷⁸ See letter from Eight Law Firms.

¹⁷⁹ See letters from API and Eight Law Firms.

VI. INITIAL REGULATORY FLEXIBILITY ANALYSIS

This Initial Regulatory Flexibility Act Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed rule and form amendments to implement Section 13(q) of the Exchange Act, which concerns certain disclosure obligations of resource extraction issuers. As defined by Section 13(q), a resource extraction issuer is an issuer that is required to file an annual report with the Commission, and engages in the commercial development of oil, natural gas, or minerals.

A. Reasons for, and Objectives of, the Proposed Action

The proposed rule and form amendments are designed to implement the requirements of Section 13(q), which was added by Section 1504 of the Dodd-Frank Act. Specifically, the proposed rule and form amendments would require a resource extraction issuer to disclose in an annual report certain information relating to any payment made by the issuer, a subsidiary, or an entity under the issuer's control to a foreign government or the United States Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. An issuer would have to include that information in an exhibit to its Exchange Act annual report. An issuer also would have to submit the payment information in two exhibits – one formatted in HTML or ASCII and one formatted in XBRL.

B. Legal Basis

We are proposing the rule and form amendments pursuant to Sections 12, 13, 23(a), and 35A of the Exchange Act.

C. Small Entities Subject to the Proposed Amendments

The proposals would affect small entities that are required to file an annual report with the Commission under Section 13(a) or Section 15(d) of the Exchange Act, and are engaged in the commercial development of oil, natural gas, or minerals. Exchange Act Rule 0-10(a)¹⁸⁰ defines an issuer to be a “small business” or “small organization” for purposes of the Regulatory Flexibility Act if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We believe that the proposals would affect small entities that meet the definition of resource extraction issuer under Section 13(q). Based on a review of total assets for Exchange Act registrants filing under certain SICs, we estimate that there are approximately 196 oil, natural gas, and mining companies that are resource extraction issuers and that may be considered small entities.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed rule and form amendments would add to the annual disclosure requirements of companies meeting the definition of resource extraction issuer, including small entities, by requiring them to provide the payment disclosure mandated by Section 13(q) in their Exchange Act annual reports. That information must include:

- the type and total amount of payments made for each project of the issuer relating to the commercial development of oil, natural gas, or minerals; and
- the type and total amount of those payments made to each government.

The same payment disclosure requirements would apply to U.S. and foreign resource extraction issuers. We are proposing to amend Form 10-K and Regulation S-K to require domestic resource extraction issuers to provide the information about payments

¹⁸⁰

17 CFR 240.0-10(a).

made to foreign governments or the U.S. Federal Government. Because Regulation S-K does not apply to Forms 20-F and 40-F,¹⁸¹ we propose to amend those forms to include the same disclosure requirements as those proposed for resource extraction issuers that are not foreign private issuers.¹⁸²

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe there are no federal rules that duplicate, overlap or conflict with the proposed rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposals, we considered the following alternatives:

- (1) Establishing different compliance or reporting requirements which take into account the resources available to smaller entities;
- (2) Exempting smaller entities from coverage of the disclosure requirements, or any part thereof;
- (3) The clarification, consolidation, or simplification of disclosure for small entities; and
- (4) Use of performance standards rather than design standards.

¹⁸¹ While Form 20-F may be used by any foreign private issuer, Form 40-F is only available to a Canadian issuer that is eligible to participate in the U.S.-Canadian Multijurisdictional Disclosure System ("MJDS").

¹⁸² See proposed Item 161 under Part II of Form 20-F and proposed paragraph (17) to General Instruction B of Form 40-F.

Section 13(q) does not contemplate separate disclosure requirements for small entities that would differ from the proposed reporting requirements, or exempting them from those requirements. The proposed rules are designed to implement the payment disclosure requirements of Section 13(q). That statutory section applies to resource extraction issuers, regardless of size. We have requested comment as to whether we should provide an exemption or delayed compliance for smaller reporting companies and whether doing so would be consistent with the statute and the protection of investors.

The proposed rules would require clear disclosure about the payments made by resource extraction issuers to foreign governments and the U.S. Federal Government, which may result in increased transparency about those payments. The proposed requirement to disclose the payment information in exhibits to an issuer's Exchange Act annual report may simplify the process of submitting the proposed payment disclosure. In addition, the required electronic formatting of one of the exhibits would simplify the search and retrieval of payment information regarding resource extraction issuers, including small entities, for investors and other interested persons.

We have used design rather than performance standards in connection with the proposed amendments because, based on our past experience, we believe the proposed amendments would be more useful to investors if there were specific disclosure requirements. In addition, the specific disclosure requirements in the proposed amendments would promote consistent and comparable disclosure among all resource extraction issuers.

G. Solicitation of Comment

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- how the proposed amendments can achieve their objective while lowering the burden on small entities;
- the number of small entity companies that may be affected by the proposed amendments;
- the existence or nature of the potential impact of the proposed amendments on small entity companies discussed in the analysis; and
- how to quantify the impact of the proposed amendments.

Respondents are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),¹⁸³ a rule is "major" if it has resulted, or is likely to result in:

- an annual effect on the economy of \$100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

¹⁸³ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

Request for comment

We request comment on whether our proposals would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries;
- and
- any potential effect on competition, investment or innovation.

VIII. STATUTORY AUTHORITY AND TEXT OF PROPOSED RULE AND FORM AMENDMENTS

We are proposing the rule and form amendments contained in this document under the authority set forth in Sections 12, 13, 23(a), and 35A the Exchange Act.

List of Subjects

17 CFR Parts 229 and 249.

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, we propose to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 229 -- STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 -- REGULATION S-K

1. The authority citation for part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Add § 229.105 to read as follows:

§ 229.105 (Item 105) Disclosure of payments made by resource extraction issuers.

(a) Pursuant to Section 13(q) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(q)), a resource extraction issuer must include in an annual report filed with the Commission information relating to any payment made during the fiscal year covered by the annual report by the resource extraction issuer, a subsidiary of the resource extraction issuer, or an entity under the control of the resource extraction issuer to a foreign government or the United States Federal Government, for the purpose of the commercial development of oil, natural gas, or minerals. Specifically, the information must include:

- (1) The type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;
- (2) The type and total amount of such payments made to each government;
- (3) The total amounts of the payments, by category;
- (4) The currency used to make the payments;
- (5) The financial period in which the payments were made;
- (6) The business segment of the resource extraction issuer that made the payments;
- (7) The government that received the payments, and the country in which the government is located; and
- (8) The project of the resource extraction issuer to which the payments relate.

Instructions to paragraph (a).

(1) The resource extraction issuer must provide the information required by this Item as specified by § 229.601(b)(97) and (b)(98) of this chapter. In addition, the resource extraction issuer must provide a statement, in an appropriately captioned section of the annual report, that the information required by Section 13(q) and this Item is included in exhibits 97 and 98 to the annual report.

(2) The disclosure required by this Item and § 229.601(b)(97) and (b)(98) of this chapter shall not be deemed to be "filed" with the Commission or subject to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically incorporates the information by reference into a document filed under the Securities Act or the Exchange Act. The disclosure required by this Item need not be provided in any filings other than an annual report on Form 10-K (§ 249.310 of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

(b) For the purpose of this item:

(1) Commercial development of oil, natural gas, or minerals includes exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity.

(2) Foreign government means a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government. As used in this item, foreign government includes a foreign national government as well as a foreign subnational government, such as the government of a

state, province, county, district, municipality, or territory under a foreign national government.

(3) Payment means an amount paid that:

(i) Is made to further the commercial development of oil, natural gas, or minerals;

(ii) Is not de minimis; and

(iii) Includes:

(A) Taxes;

(B) Royalties;

(C) Fees (including license fees);

(D) Production entitlements; and

(E) Bonuses.

(4) Resource extraction issuer means an issuer that:

(i) Is required to file an annual report with the Commission; and

(ii) Engages in the commercial development of oil, natural gas, or minerals.

Instruction to paragraph (b)(2).

For purposes of this item, a company owned by a foreign government is a company that is at least majority-owned by a foreign government.

Instruction to paragraph (b)(3)(iii)(A).

A resource extraction issuer must disclose taxes on corporate profits, corporate income, and production. Disclosure of taxes levied on consumption, such as value added taxes, personal income taxes, or sales tax is not required.

3. Amend § 229.601 by revising the exhibit table in paragraph (a), and adding paragraphs (b)(97) and (b)(98), to read as follows:

§ 229.601 (Item 601) Exhibits.

(a) * * *

Exhibit Table

* * * * *

EXHIBIT TABLE													
Securities Act Forms									Exchange Act Forms				
	S-1	S-3	S-4 ¹	S-8	S-11	F-1	F-3	F-4 ¹	10	8-K ²	10-D	10-Q	10-K

* * * * *

(36) through (96) [Reserved]	N/A												
(97) Resource Extraction Issuers Exhibit													X
(98) Resource Extraction Issuers Exhibit (Interactive Data)													X

* * * * *

(b) * * *

(97) Resource Extraction Issuers Exhibit. A resource extraction issuer that is required to disclose information relating to payments made to foreign governments or the United States Federal Government under Exchange Act Section 13(q) (15 U.S.C. 78m(q)) must provide the information required by Item 105 of Regulation S-K (§ 229.105 of this chapter) in an exhibit to its Exchange

Act annual report. This exhibit must be provided in HTML or ASCII format.

Specifically, a resource extraction issuer must provide the following disclosure:

(i) The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;

(ii) The type and total amount of such payments made to each government;

(iii) The total amounts of the payments, by category;

(iv) The currency used to make the payments;

(v) The financial period in which the payments were made;

(vi) The business segment of the resource extraction issuer that made the payments;

(vii) The government that received the payments, and the country in which the government is located; and

(viii) The project of the resource extraction issuer to which the payments relate.

(98) Resource Extraction Issuers Exhibit (Interactive Data). A resource extraction issuer that is required to disclose information relating to payments made to foreign governments or the United States Federal Government under Exchange Act Section 13(q) (15 U.S.C. 78m(q)) must provide the information required by Item 105 of Regulation S-K (§ 229.105 of this chapter) in an exhibit to its Exchange Act annual report. This exhibit must be electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard. This exhibit must include

electronic tags that identify the following information for any payments made by a resource extraction issuer to a foreign government or the United States Federal

Government:

(i) The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;

(ii) The type and total amount of such payments made to each government;

(iii) The total amounts of the payments, by category;

(iv) The currency used to make the payments;

(v) The financial period in which the payments were made;

(vi) The business segment of the resource extraction issuer that made the payments;

(vii) The government that received the payments, and the country in which the government is located; and

(viii) The project of the resource extraction issuer to which the payments relate.

Refer to the EDGAR Filer Manual (§ 232.301 of this chapter) and the corresponding technical specification for resource extraction issuers disclosure for further guidance.

PART 249--FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq., 7202, 7233, 7241, 7262, 7264, and 265; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

5. Amend Form 20-F (referenced in § 249.220f) by adding Item 16I to Part II, and adding Instruction 17 and 18 to the Instructions as to Exhibits, of Form 20-F, to read as follows:

Note: The text of Form 20-F 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 20-F

*** * * * ***

PART II

*** * * * ***

Item 16I. Disclosure of Payments Made By Resource Extraction Issuers

A. If you are a resource extraction issuer, pursuant to Section 13(q) of the Exchange Act (15 U.S.C. 78m(q)), include information relating to any payment made during the fiscal year covered by the annual report by you, your subsidiary, or an entity under your control to a foreign government or the United States Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. Under the heading "Payments Made By Resource Extraction Issuers" in the annual report, provide a statement that the information concerning payments to governments required by Section 13(q) and paragraph A. of this Item is included in exhibits 17 and 18 to the annual report. Include the following information as specified in exhibits 17 and 18 to the annual report:

(1) The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;

(2) The type and total amount of those payments made to each government;

(3) The total amounts of the payments, by category;

(4) The currency used to make the payments;

(5) The financial period in which the payments were made;

(6) The business segment of the resource extraction issuer that made the payments;

(7) The government that received the payments, and the country in which the government is located; and

(8) The project of the resource extraction issuer to which the payments relate:

B. For the purpose of this item:

(1) Commercial development of oil, natural gas, or minerals includes exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity.

(2) Foreign government means a foreign government, a department, agency, or instrumentality of a foreign government, or a company owned by a foreign government. As used in this item, foreign government includes a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government.

(3) Payment means an amount paid that:

(i) Is made to further the commercial development of oil, natural gas, or minerals;

(ii) Is not de minimis; and

(iii) Includes:

(a) Taxes;

(b) Royalties;

(c) Fees (including license fees);

(d) Production entitlements; and

(e) Bonuses.

(4) Resource extraction issuer means an issuer that:

(i) Is required to file an annual report with the Commission; and

(ii) Engages in the commercial development of oil, natural gas, or minerals.

Instructions to Item 16I:

1. Item 16I only applies to annual reports, and not to registration statements on Form 20-F.
2. For purposes of paragraph B.(2), a company owned by a foreign government is a company that is at least majority-owned by a foreign government.
3. For purposes of paragraph B.(3)(iii)(a), a resource extraction issuer must disclose taxes on corporate profits, corporate income, and production. Disclosure of taxes levied on consumption, such as value added taxes, personal income taxes, or sales tax is not required.

4. The exhibits described in paragraph A. of this Item must meet the requirements under Instruction 17 and 18 as to Exhibits of this Form.
5. The disclosure required by paragraph A. of this Item and Instructions 17 and 18 of this Form shall not be deemed to be "filed" with the Commission or subject to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically incorporates the information by reference into a document filed under the Securities Act or the Exchange Act. The disclosure required by this Item need not be provided in any filings other than an annual report on Form 20-F (§ 249.220f of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

* * * * *

INSTRUCTIONS AS TO EXHIBITS

* * * * *

17. The disclosure of payments by resource extraction issuers required by Exchange Act Section 13(q) (15 U.S.C. 78m(q)).

A registrant that is required to disclose the payments made to foreign governments or the United States Federal Government under Exchange Act Section 13(q) and Item 16I must provide the information required by Item 16I.A. in exhibit 17 to its annual report on Form 20-F. This exhibit must provide the following information in HTML or ASCII format:

(a) The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;

(b) The type and total amount of such payments made to each government;

(c) The total amounts of the payments, by category;

(d) The currency used to make the payments;

(e) The financial period in which the payments were made;

(f) The business segment of the resource extraction issuer that made the payments;

(g) The government that received the payments, and the country in which the government is located; and

(h) The project of the resource extraction issuer to which the payments relate.

18. The disclosure of payments by resource extraction issuers required by Exchange Act Section 13(q) (15 U.S.C. 78m(q)) (interactive data).

A registrant that is required to disclose the payments made to foreign governments or the United States Federal Government under Exchange Act Section 13(q) and Item 16I must provide the information required by Item 16I.A. in exhibit 18 to its annual report on Form 20-F. This exhibit must:

(a) Be electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard; and

(b) Include electronic tags that identify the following information specified by Exchange Act Section 13(q)(2)(D)(ii) (15 U.S.C. 78m(q)(2)(D)(ii)) for any payments made by a resource extraction issuer to a foreign government or the United States Federal Government:

- (1) The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;
- (2) The type and total amount of such payments made to each government;
- (3) The total amounts of the payments, by category;
- (4) The currency used to make the payments;
- (5) The financial period in which the payments were made;
- (6) The business segment of the resource extraction issuer that made the payments;
- (7) The government that received the payments, and the country in which the government is located; and
- (8) The project of the resource extraction issuer to which the payments relate.

Refer to the EDGAR Filer Manual (§ 232.301 of this chapter) and the corresponding technical specification for resource extraction issuers disclosure for further guidance.

19. through 99. [Reserved]

* * * * *

6. Amend Form 40-F (referenced in § 249.240f) by adding paragraph (17) to General Instruction B of Form 40-F to read as follows:

Note: The text of Form 40-F 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 40-F

* * * * *

GENERAL INSTRUCTIONS

* * * * *

B. Information to be Filed on this Form

* * * * *

(17) Disclosure of Payments Made By Resource Extraction Issuers.

(a) If you are a resource extraction issuer, pursuant to Section 13(q) of the Exchange Act (15 U.S.C. 78m(q)), disclose information relating to any payment made during the fiscal year covered by the annual report by you, your subsidiary, or an entity under your control to a foreign government or the United States Federal Government for the purpose of the commercial development of oil, natural gas, or minerals. Under the heading "Payments Made By Resource Extraction Issuers" in the annual report, provide a statement that the information concerning payments to governments required by Section 13(q) and paragraph (a) of this Item is included in specified exhibits to the annual report.

(1) Include the following information, provided in HTML or ASCII format, in an exhibit to the annual report:

(i) The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;

- (ii) The type and total amount of those payments made to each government;
- (iii) The total amounts of the payments, by category;
- (iv) The currency used to make the payments;
- (v) The financial period in which the payments were made;
- (vi) The business segment of the resource extraction issuer that made the payments;
- (vii) The government that received the payments, and the country in which the government is located; and
- (viii) The project of the resource extraction issuer to which the payments relate.

(2) Include the following information, electronically formatted using the eXtensible Business Reporting Language (XBRL) interactive data standard in an exhibit to the annual report:

- (i) The type and total amount of payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals;
- (ii) The type and total amount of such payments made to each government;
- (iii) The total amounts of the payments, by category;
- (iv) The currency used to make the payments;
- (v) The financial period in which the payments were made;
- (vi) The business segment of the resource extraction issuer that made the payments;
- (vii) The government that received the payments, and the country in which the government is located; and

(viii) The project of the resource extraction issuer to which the payments relate. Refer to the EDGAR Filer Manual (§232.301 of this chapter) and the corresponding technical specification for resource extraction issuers disclosure for further guidance.

(b) For the purpose of Item 17:

(1) Commercial development of oil, natural gas, or minerals includes exploration, extraction, processing, export, and other significant actions relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity.

(2) Foreign government means a foreign government, a department, agency, or instrumentality of a foreign government, or company owned by a foreign government. As used in this item, foreign government includes a foreign national government as well as a foreign subnational government, such as the government of a state, province, county, district, municipality, or territory under a foreign national government.

(3) Payment means an amount paid that:

(i) Is made to further the commercial development of oil, natural gas, or minerals;

(ii) Is not de minimis; and

(iii) Includes:

(A) Taxes;

(B) Royalties;

(C) Fees (including license fees);

(D) Production entitlements; and

(E) Bonuses.

(4) Resource extraction issuer means an issuer that:

- (i) Is required to file an annual report with the Commission; and
- (ii) Engages in the commercial development of oil, natural gas, or minerals.

Notes to Instruction B.(17)

1. Instruction B.(17) only applies to annual reports, and not to registration statements on Form 40-F.
2. For purposes of paragraph (b)(2), a company owned by a foreign government is a company that is at least majority-owned by a foreign government.
3. For purposes of paragraph (b)(3)(iii)(A), a resource extraction issuer must disclose taxes on corporate profits, corporate income, and production. Disclosure of taxes levied on consumption, such as value added taxes, personal income taxes, or sales tax is not required.
4. The disclosure required by Instruction B.(17) of this Form shall not be deemed to be "filed" with the Commission or subject to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically incorporates the information by reference into a document filed under the Securities Act or the Exchange Act. The disclosure required by this Item need not be provided in any filings other than an annual report on Form 40-F (§ 249.240f of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

* * * * *

7. Amend Form 10-K (referenced in § 249.310) by adding paragraph (c) to

Item 4 under Part I of Form 10-K to read as follows:

Note: The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.

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

FORM 10-K

PART I

Item 4. Specialized Disclosures ***

(c) Disclosure of Payments Made By Resource Extraction Issuers. If you are a resource extraction issuer, as defined under Section 13(q) of the Exchange Act and Item 105(b)(4) of Regulation S-K (§ 229.105(b)(4) of this chapter), provide a statement under the heading "Payments Made By Resource Extraction Issuers" that the information concerning payments to governments required by Section 13(q) and Item 105 of Regulation S-K (§ 229.105 of this chapter) is included in exhibits 97 and 98 to the annual report.

By the Commission.



Elizabeth Murphy
Secretary

Dated: December 15, 2010

*Commissioner Paredes
not participating*

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 229, 239 and 249

[RELEASE NOS. 33-9164; 34-63548; File No. S7-41-10]

RIN 3235-AK83

MINE SAFETY DISCLOSURE

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to our rules to implement Section 1503 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 1503(a) of the Act requires issuers that are operators, or that have a subsidiary that is an operator, of a coal or other mine to disclose in their periodic reports filed with the Commission information regarding specified health and safety violations, orders and citations, related assessments and legal actions, and mining-related fatalities. Section 1503(b) of the Act mandates the filing of a Form 8-K disclosing the receipt of certain orders and notices from the Mine Safety and Health Administration.

DATES: Comments should be received on or before January 31, 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/proposed.shtml>);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-41-10 on the subject line; or

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- 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 S7-41-10. 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 copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Jennifer Zepralka, Senior Special Counsel, or Jennifer Riegel, Attorney-Advisor, Division of Corporation Finance at (202) 551-3300, at the U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing to add new Item 106 to Regulation S-K¹, amend Item 601 of Regulation S-K,² and amend Forms 8-K,³ 10-Q⁴, 10-K⁵, 20-F⁶ and 40-

¹ 17 CFR 229.10 et seq.

² 17 CFR 229.601.

³ 17 CFR 249.308.

⁴ 17 CFR 249.308a.

⁵ 17 CFR 249.310.

F⁷ under the Securities Exchange Act of 1934 (“Exchange Act”).⁸ In addition, we propose to amend General Instruction I.A.3(b) of Form S-3⁹ under the Securities Act of 1933 (“Securities Act”)¹⁰.

I. BACKGROUND AND SUMMARY

Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”)¹¹ requires issuers that are required to file reports with the Commission pursuant to sections 13(a) or 15(d) of the Exchange Act and that are operators, or that have a subsidiary that is an operator, of a coal or other mine to disclose specified information about mine health and safety in their periodic reports filed with the Commission.¹² Section 1503(b) of the Act requires each issuer that is an operator, or that has a subsidiary that is an operator, of a coal or other mine to file a current report on Form 8-K with the Commission reporting receipt of certain shutdown orders and notices of patterns or potential patterns of violations.¹³

The disclosure requirements set forth in Section 1503 of the Act refer to and are based on the safety and health requirements applicable to mines under the Federal Mine Safety and Health Act of 1977 (the “Mine Act”),¹⁴ which is administered by the U.S. Labor Department’s Mine

⁶ 17 CFR 249.220f.

⁷ 17 CFR 249.240f.

⁸ 15 U.S.C. 78a *et seq.*

⁹ 17 CFR 239.13.

¹⁰ 15 U.S.C. 77a *et seq.*

¹¹ Pub. L. No. 111-203 (July 21, 2010).

¹² Section 1503(a) of the Act.

¹³ Section 1503(b) of the Act.

¹⁴ 30 U.S.C. 801 *et seq.*

Safety and Health Administration ("MSHA"). Under the Mine Act, MSHA is required to inspect surface mines at least twice a year and underground mines at least four times a year¹⁵ to determine whether there is compliance with health and safety standards or with any citation, order or decision issued under the Mine Act and whether an imminent danger exists. MSHA also conducts spot inspections¹⁶ and inspections pursuant to miners' complaints.¹⁷ If violations of safety or health standards are found, MSHA inspectors will issue citations to the mine operators. Among other activities under the Mine Act, MSHA also assesses and collects civil monetary penalties for violations of mine safety and health standards.¹⁸

MSHA maintains a data retrieval system on its website that allows users to examine data on inspections, violations, and accidents, as well as information about dust samplings, at specific mines throughout the United States.¹⁹ The information provided by the MSHA data retrieval system is based on data gathered from various MSHA systems. For example, when citations, orders or violations are issued by MSHA to mine operators, the information about such citations, orders or violations is entered by MSHA into MSHA's systems and subsequently reflected in the data retrieval system within a short period of time. The data retrieval system allows a user to search for information based on the identification numbers assigned to specific mines or contractors (MSHA Mine ID or Contractor ID), as well as by operator name, mine name,

¹⁵ 30 U.S.C. 813(a). Seasonal or intermittent operations are inspected less frequently. See Mine Safety and Health Administration, Program Policy Manual, Volume I, Section 103, available at <http://www.msha.gov/REGS/COMPLIAN/PPM/PPMAINTC.HTM>.

¹⁶ 30 U.S.C. 813(i).

¹⁷ 30 U.S.C. 813(g).

¹⁸ 30 U.S.C. 820. See also "MSHA's Statutory Functions" available at <http://www.msha.gov/MSHAINFO/MSHAINF1.HTM>.

¹⁹ See <http://www.msha.gov/DRS/DRSHOME.HTM>.

contractor name or controller name.²⁰ In all cases, the information is displayed in the data retrieval system on a mine-by-mine basis.²¹

In addition, an independent adjudicative agency, the Federal Mine Safety and Health Review Commission (the "FMSHRC"), provides administrative trial and appellate review of legal disputes arising under the Mine Act.²² Most cases deal with civil penalties proposed by MSHA to be assessed against mine operators and address whether the alleged safety and health violations occurred, as well as the appropriateness of proposed penalties.²³ The FMSHRC's administrative law judges decide cases at the trial level and the five-member FMSHRC provides appellate review. Appeals from the FMSHRC's decisions are to the U.S. courts of appeals.²⁴

The disclosure requirements set forth in the Act are currently in effect.²⁵ However, the Act states that the Commission is "authorized to issue such rules or regulations as are necessary or appropriate for the protection of investors and to carry out the purposes of [Section 1503]."²⁶ Accordingly, we are proposing to amend our rules to implement and specify the scope and application of the disclosure requirements set forth in the Act and to require a limited amount of additional disclosure to provide context for certain items required by the Act.

²⁰ The controller is the company or individual that MSHA's Office of Assessments has determined to have ultimate control or ownership of the operator.

²¹ When the disclosure requirements of Section 1503 of the Act were introduced, Senator Rockefeller noted his concern that "there is no requirement to publicly disclose safety records" of mining companies. See SA 3886 (an amendment to SA 3739 to S.3217, 111th Cong. (May 6, 2010); *Press Release: Rockefeller Requires Mining Companies to Disclose Safety Records*, May 7, 2010, available at <http://rockefeller.senate.gov/press/record.cfm?id=324768&>.

²² 30 U.S.C. 815(d).

²³ "About FMSHRC" on <http://www.fmshrc.gov/fmshrc.html>.

²⁴ 30 U.S.C. 816.

²⁵ See Section 1503(f) of the Act.

²⁶ Section 1503(d)(2) of the Act.

Specifically, we are proposing amendments to Form 10-K, Form 10-Q, Form 20-F and Form 40-F to require the disclosure required by Section 1503(a) of the Act and certain additional disclosures. The disclosure requirements for Forms 10-Q and 10-K would be set forth in new Item 106 of Regulation S-K. Because the information required to be disclosed under proposed Item 106 of Regulation S-K would be set forth in an exhibit to the filing, we are proposing to amend Item 601 of Regulation S-K to add a new exhibit to Form 10-K and Form 10-Q. We are proposing to amend Forms 20-F and 40-F to include the same disclosure requirements as those proposed for issuers that are not foreign private issuers. In addition, we are proposing to add a new item to Form 8-K to implement the requirement imposed by Section 1503(b) of the Act, and to amend Form S-3 to add the new Form 8-K item to the list of Form 8-K items the untimely filing of which will not result in loss of Form S-3 eligibility.

II. DISCUSSION OF THE PROPOSED AMENDMENTS

A. Required Disclosure in Periodic Reports

As noted above, the requirements in Section 1503(a) are already in effect. We are proposing to codify the requirements into our disclosure rules in order to facilitate consistent compliance with them by reporting companies.

In order to implement the disclosure requirement set forth in Section 1503(a) of the Act, we are proposing to add new Item 4 to Part II of Form 10-Q and new Item 4(b) to Part I of Form 10-K, which would require the information required by new Items 106 and 601(b)(95) of Regulation S-K; new Item 16J to Form 20-F; and new Paragraph (18) of General Instruction B of Form 40-F. These proposed items would be identical in substance and entitled, "Mine Safety Disclosure." As discussed in detail below, the proposed items would require issuers to provide in their periodic reports and in exhibits to their periodic reports the information listed in Section

1503(a) of the Act and certain additional disclosure designed to provide context for such information.

1. Scope

Section 1503(a) of the Act mandates that specified disclosure be provided in each periodic report filed with the Commission by every issuer that is required to file reports with the Commission pursuant to sections 13(a) or 15(d) of the Exchange Act and that is "an operator, or that has a subsidiary that is an operator, of a coal or other mine." The Act specifies that the term "operator" is to have the meaning given such term in section 3 of the Mine Act.²⁷ The Act also specifies that the term "coal or other mine" is to mean a coal or other mine as defined in section 3 of the Mine Act,²⁸ that is subject to the provisions of the Mine Act.²⁹

²⁷ Section 1503(e)(3) of the Act. Section 3(d) of the Mine Act provides that an "operator" means any owner, lessee, or other person who operates, controls, or supervises a coal or other mine or any independent contractor performing services or construction at such mine. 30 U.S.C. 802.

²⁸ Section 3(h) of the Mine Act:

(1) "coal or other mine" means (A) an area of land from which minerals are extracted in nonliquid form or, if in liquid form, are extracted with workers underground, (B) private ways and roads appurtenant to such area, and (C) lands, excavations, underground passageways, shafts, slopes, tunnels and workings, structures, facilities, equipment, machines, tools, or other property including impoundments, retention dams, and tailings ponds, on the surface or underground, used in, or to be used in, or resulting from, the work of extracting such minerals from their natural deposits in nonliquid form, or if in liquid form, with workers underground, or used in, or to be used in, the milling of such minerals, or the work of preparing coal or other minerals, and includes custom coal preparation facilities. In making a determination of what constitutes mineral milling for purposes of this Act, the Secretary shall give due consideration to the convenience of administration resulting from the delegation to one Assistant Secretary of all authority with respect to the health and safety of miners employed at one physical establishment;

(2) For purposes of titles II, III, and IV, "coal mine" means an area of land and all structures, facilities, machinery tools, equipment, shafts, slopes, tunnels, excavations, and other property, real or personal, placed upon, under, or above the surface of such land by any person, used in, or to be used in, or resulting from, the work of extracting in such area bituminous coal, lignite, or anthracite from its natural deposits in the earth by any means or method, and the work of preparing the coal so extracted, and includes custom coal preparation facilities;

²⁹ Section 1503(e)(2) of the Act.

We are proposing to include references to these definitions in new Item 106³⁰ and Item 601(b)(95)³¹ of Regulation S-K, the instructions to new Item 16J of Form 20-F³² and the notes to new Paragraph (18) of General Instruction B of Form 40-F.³³ Because the Act's definition of "coal or other mine" is limited to those mines that are subject to the provisions of the Mine Act, and the Mine Act applies only to mines located in the United States,³⁴ we are proposing that, for each required disclosure item discussed below,³⁵ the information would be required only for coal or other mines (as defined in the Mine Act) located in the United States. As a result, issuers that operate (or have subsidiaries that operate) mines outside the United States would not have to disclose information about such mines under the proposal. Thus, for example, an issuer that operates mines in both the United States and Canada would only be required to include information about its U.S. mines. While our proposals are limited to implementing the requirements of the Act and, therefore, do not extend to foreign mines, to the extent mine safety issues are material under our current rules, disclosure could be required pursuant to the following items of Regulation S-K: Item 303 (Management's Discussion and Analysis of Financial

³⁰ See proposed Item 106 of Regulation S-K (17 CFR 229.106).

³¹ See proposed Item 601(b)(95) of Regulation S-K (17 CFR 229.601(b)(95)).

³² See instructions to proposed Item 16J under Part II of Form 20-F.

³³ See notes to proposed Paragraph (18) of General Instruction B of Form 40-F.

³⁴ The Mine Act covers each "coal or other mine, the products of which enter commerce, or the operations or products of which affect commerce, and each operator of such mine, and every miner in such mine..." 30 U.S.C. 803. "'Commerce' means trade, traffic, commerce, transportation, or communication among the several States, or between a place in a State and any place outside thereof, or within the District of Columbia or a possession of the United States, or between points in the same State but through a point outside thereof." 30 U.S.C. 802(b). "'State' includes a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, American Samoa, Guam, and the Trust Territory of the Pacific Islands." 30 U.S.C. 802(c).

³⁵ See Section II.A.4 below for a discussion of the proposed disclosure requirements.

Condition and Results of Operations), Item 503(c) (Risk Factors), Item 101 (Description of Business) or Item 103 (Legal Proceedings).

As proposed, we would include smaller reporting companies and foreign private issuers³⁶ within the scope of the proposed rules implementing Section 1503(a) of the Act. We believe their inclusion is consistent with the plain language of Section 1503(a), which applies broadly to issuers that are required to file reports under sections 13(a) or 15(d) of the Exchange Act. Because foreign private issuers are not subject to Regulation S-K, we are proposing to amend Forms 20-F and 40-F to require the specified mine safety disclosure about mines subject to the Mine Act operated by a foreign private issuer (or a subsidiary of such foreign private issuer).³⁷

Finally, we believe that the language of the Act referring to “each coal or other mine” is intended to elicit disclosure of any citations, orders or violations for each distinct mine covered by the Mine Act, and is not intended to permit disclosure by grouping mines by project or geographic region.³⁸ Although this approach may result in issuers reporting a significant volume of information in their periodic reports, this approach accords with the plain language of the Act. As noted above, information on a mine-by-mine basis is currently made publicly available through MSHA’s data retrieval system.

³⁶ See the definition of “smaller reporting company” in 17 CFR 240.12b-2 and the definition of “foreign private issuer” in 17 CFR 240.3b-4.

³⁷ See Section IX below for the text of proposed amendments. As discussed in Section II.B.3 below, we are not proposing to require foreign private issuers to comply with Section 1503(b) of the Act by filing Forms 8-K.

³⁸ To facilitate public input on implementation of the Act, the Commission has provided a series of e-mail links, organized by topic, on its website at <http://www.sec.gov/spotlight/regreformcomments.shtml>. The public comments we received on the topic of mine safety disclosure are available on our website at <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures.shtml>. We received input from a commentator suggesting that the Commission adopt a materiality standard for reporting the matters under Section 1503(a) where an issuer has numerous operations. See letter from Rio Tinto. However, because Section 1503 does not appear to contemplate materiality thresholds, we are not proposing to include such a threshold for the disclosure requirement.

Request for Comment

- (1) Section 1503 of the Act provides definitions of the terms "operator" and "coal or other mine" but does not define the term "subsidiary." Under Item 1-02(x) of Regulation S-X, a "subsidiary" of a specified person is "an affiliate controlled by such person directly, or indirectly through one or more intermediaries," which would apply to this disclosure in the absence of another definition. Is this definition appropriate for purposes of Section 1503, or should we include a different definition for "subsidiary" for purposes of Section 1503 disclosure? If so, how should we define that term?
- (2) In conformity with the language of Section 1503(a), we are proposing to apply the Act's periodic report disclosure requirement only to mines that are subject to the Mine Act, and not to mines in other jurisdictions. Is this approach appropriate? Will issuers that operate (or have subsidiaries that operate) mines in the United States be at a competitive advantage or disadvantage compared to issuers that operate mines in other jurisdictions because of the lack of disclosure about non-U.S. mines? Should we instead expand the disclosure requirement to cover mines in all jurisdictions? If so, how would we address disclosure requirements for mines not subject to the Mine Act? How would we address the disclosure requirements if a jurisdiction does not have clear mine safety regulations?
- (3) Section 1503 of the Act does not contemplate an exception from disclosure for smaller reporting companies. Should the requirements apply to smaller reporting companies, as proposed, or should we exempt smaller reporting companies from the

disclosure requirement or some portion of the disclosure requirement? Are there alternative accommodations we should consider for smaller reporting companies?

- (4) Section 1503 of the Act also does not contemplate any exception from disclosure for foreign private issuers. Should the requirements apply to foreign private issuers, as proposed? If not, why not?
- (5) As proposed, the required disclosure must be provided for each mine for which the issuer or a subsidiary of the issuer is an operator. How burdensome would such disclosure be for issuers to prepare? Could this approach produce such a volume of information that investors will be overwhelmed? Should we instead require disclosure by project or geographic region? Would this approach be consistent with Section 1503(a) of the Act?
- (6) General Instruction I to Form 10-K and General Instruction H to Form 10-Q contain special provisions for the omission of certain information by wholly-owned subsidiaries. General Instruction J to Form 10-K contains special provisions for the omission of certain information by asset-backed issuers. Should either or both of these types of registrants be permitted to omit the proposed mine safety disclosure in the annual reports on Form 10-K and quarterly reports on Form 10-Q?

2. Location of Disclosure

The Act states that companies must include the disclosure in their periodic reports required pursuant to sections 13(a) or 15(d) of the Exchange Act. We are proposing to require issuers that have matters to report in accordance with Section 1503(a) to include brief disclosure in Part II of Form 10-Q, Part I of Form 10-K and Forms 20-F and 40-F noting that they have mine safety violations or other regulatory matters to report in accordance with Section 1503(a),

and that the required information is included in an exhibit to the filing.³⁹ The exhibit would include the detailed disclosure about specific violations and regulatory matters required by Section 1503(a) as implemented in our new rules. We are proposing this approach in order to facilitate access to the information about detailed mine safety matters without overburdening the traditional Exchange Act reports with extensive new disclosures. We note that in the event that mine safety matters raise concerns that should be addressed in other parts of a periodic report, such as risk factors, the business description, legal proceedings or management's discussion and analysis, inclusion of this new disclosure would not obviate the need to discuss mine safety matters as appropriate.

We are not proposing any particular presentation requirements for the new disclosure, although we encourage issuers to use tabular presentations whenever possible if to do so would facilitate investor understanding.

Request for Comment

(7) Because the Act states that issuers must include the mine safety disclosure in each periodic report filed with the Commission, we are proposing to require the disclosure in each filing on Forms 10-Q, 10-K, 20-F and 40-F. For issuers that file using the domestic forms (Forms 10-Q and 10-K), should we, instead only require the disclosure annually? Would such an approach be consistent with the Act?

(8) As proposed, we would not specify a particular presentation for the disclosure.

Should we require a specific presentation, tabular or otherwise? If so, please provide details on an appropriate presentation.

³⁹ Proposed Item 4 under Part II of Form 10-Q, proposed Item 4(b) under Part I of Form 10-K, proposed Item 16J under Part II of Form 20-F and proposed paragraph B.(18) under the General Instructions to Form 40-F.

- (9) We are proposing to require the information to be presented in an exhibit to the periodic report, with brief disclosure in the body of the report noting that the issuer has mine safety matters to report and referring to the required exhibit. Is this approach appropriate? Should we instead require the information to be presented in the body of the periodic report?
- (10) As noted above, Section 1503(a) requires the disclosure to be included in periodic reports. Should we also require the information to be included in registration statements?
- (11) Should we require the disclosure to be provided in an interactive data format? Why or why not? Would investors find interactive data to be a useful tool to analyze the information provided and generate statistics for their own use? If so, what format would be most appropriate for providing standardized data disclosure – for example, eXtensible Markup Language (XML) or eXtensible Business Reporting Language (XBRL)? Could the use of interactive data make it possible for issuers to reduce reporting costs by using the same data that is already available through MSHA's data retrieval system?

3. Time periods covered

Section 1503(a) of the Act states that each periodic report must include disclosure "for the time period covered by such report." Accordingly, we are proposing that each Form 10-Q would include the required disclosure for any orders, violations or citations received, penalties assessed or legal actions initiated during the quarter covered by the report.⁴⁰ We are also

⁴⁰ As noted in Sections II.A.4.f and j below, we are also proposing to require disclosure of the total amounts of assessments of penalties outstanding as of the last day of the quarter and of any developments material to previously reported legal actions that occur during the quarter.

proposing that each Form 10-K would include disclosure covering both the fourth quarter of the issuer's fiscal year, and cumulative information for the entire fiscal year. We believe this is consistent with Section 1503(a), since a Form 10-K covers both the fourth quarter and the entire year. For each of Forms 20-F and 40-F, the disclosure would be required for the issuer's fiscal year.

Because mine operators have the right to contest orders, violations or citations they receive through the administrative process,⁴¹ there is a possibility an operator's challenge would result in dismissal of the order, violation or citation or in a reduction in the severity of the order, violation or citation below the level that triggers disclosure under Section 1503(a). One mining company⁴² has suggested that we not require disclosure of citations that, prior to the periodic filing, have been dismissed or resolved such that they fall below the reportable level, or alternatively that the issuer be able to elaborate its position with respect to citations, such as whether the citations have been or will be challenged or if the issuer believes the severity of the citation is unwarranted. Based on the language of Section 1503(a) of the Act, we are not proposing to allow issuers to exclude information about orders, violations or citations that were received during the time period covered by the report but subsequently were dismissed or reduced. However, the proposal would not prohibit the inclusion of additional information to provide context to the required disclosure. We would expect that issuers will include disclosure that complies with our existing disclosure requirements when providing any such context.

Request for Comment

- (12) We are proposing to require the Form 10-K to include both disclosure about orders, citations, violations, assessments and legal actions received or initiated during

⁴¹ See 30 U.S.C. 815(d).

⁴² See letter from Rio Tinto.

the fourth quarter and the aggregate data for the whole year. Is this approach consistent with Section 1503(a)? Would it be consistent with Section 1503(a) to limit the information to the fourth quarter data? Alternatively, should we require the Form 10-K to include only fourth quarter information, or only the full year information?

- (13) As proposed, issuers would be required to report all orders, violations or citations received during the period covered by the report, regardless of whether such order, violation or citation was subsequently dismissed or reduced below a reportable level prior to the filing of the periodic report. Should we instead allow such orders, violations or citations to be excluded from the disclosure?

4. Required Disclosure Items

Section 1503(a) of the Act includes a list of items to be disclosed in periodic reports. We are reiterating those items in new proposed Item 106 of Regulation S-K.⁴³ In addition, we are proposing instructions to certain of the disclosure items specified in Section 1503(a) to clarify the scope of the disclosure we would expect issuers to provide in order to comply with the statute's requirements. In addition, in order to provide context to investors, we are proposing one additional disclosure item not required by the Act that would require issuers to briefly describe the categories of violations, orders or citations included in the other items required by Section 1503(a).

⁴³ In this release, we reference new Item 106 of Regulation S-K when discussing the proposed disclosure requirements, but note that the same analyses apply to the corresponding provisions in proposed Item 16J of Form 20-F and proposed Paragraph (18) of General Instruction B of Form 40-F.

We discuss each disclosure item below. Under our proposal, each issuer that is required under Section 1503(a) to provide this disclosure⁴⁴ would be required to provide the following for each coal or other mine⁴⁵ for the time period covered by the report (as discussed above).⁴⁶

- a. The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under section 104 of the Mine Act for which the operator received a citation from MSHA.

Section 104 of the Mine Act requires MSHA inspectors to issue various citations or orders for violations of health or safety standards.⁴⁷ Violations are cited by MSHA inspectors, giving the operator time for abatement of the violation. A violation of a mandatory safety standard that is reasonably likely to result in a reasonably serious injury or illness under the unique circumstance contributed to by the violation is referred to by MSHA as a "significant and substantial" violation (commonly called a "S&S" violation).⁴⁸ In writing each citation or order, the MSHA inspector determines whether the violation is "S&S" or not.⁴⁹ The MSHA data

⁴⁴ See Section II.A.1 above.

⁴⁵ See Section II.A.1 above.

⁴⁶ See Section II.A.3 above. Note that compliance with Section 1503 of the Act is currently required, regardless of whether we adopt the proposed changes to our disclosure rules.

⁴⁷ 30 U.S.C. 814.

⁴⁸ Secretary of Labor v. Mathies Coal Company, 6 FMSHRC 1 (January 1984). See also MSHA Program Policy Manual February 2003 (Release I-13) Vol. 1, p.21, located at <http://www.msha.gov/regs/complian/ppm/PDFVersion/PPM%20Vol%20I.pdf> ("MSHA Program Policy Manual Vol. 1") which provides guidelines for interpreting Section 104(d)(1) and (e)(1) of the Mine Act [30 U.S.C. 814(d)(1) and (e)(1)]. In determining whether conditions created by a violation could significantly and substantially contribute to the cause and effect of a mine safety or health hazard, inspectors must determine whether there is an underlying violation of a mandatory health or safety standard, whether there is a discrete safety or health hazard contributed to by the violation, whether there is a reasonable likelihood that the hazard contributed to will result in an injury or illness, and whether there is a reasonable likelihood that the injury or illness in question will be of a reasonably serious nature. *Id.*

⁴⁹ MSHA Program Policy Manual Vol. 1, p. 23.

retrieval system currently provides information about all citations and orders issued and notes which of those citations or orders are "S&S."⁵⁰

Because the language of Section 1503(a)(1)(A) references violations that could "significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under section 104" of the Mine Act, we are proposing to require disclosure under this item of all citations received under section 104 of the Mine Act that note an S&S violation.

Request for Comment

(14) Is it appropriate to limit this disclosure item to only S&S violations, or should we require disclosure of every violation under section 104 of the Mine Act?⁵¹

b. The total number of orders issued under section 104(b) of the Mine Act.

Section 104(b) of the Mine Act covers violations that had previously been cited under section 104(a) that, upon follow-up inspection by MSHA, are found not to have been totally abated within the prescribed time period, which results in the issuance of an order requiring the mine operator to immediately withdraw all persons (except certain authorized persons) from the mine. The proposed rule would implement the Act's requirement to disclose this information.

c. The total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health and safety standards under section 104(d) of the Mine Act.

Section 104(d) of the Mine Act covers similar violations as discussed above, except that the standard is that the violation could significantly and substantially contribute to the cause and

⁵⁰ The MSHA data retrieval system can be accessed at <http://www.msha.gov/drs/drshome.HTM>.

⁵¹ MSHA reports that in 2009 (preliminary), of the 175,079 citations and orders issued and not vacated, 33% were designated S&S. In 2008, of the 174,473 citations and orders issued by MSHA and not vacated, 30% were designated S&S. See U.S. Department of Labor, Mine Safety and Health Administration, Mine Safety and Health at a Glance (May 19, 2010), available at <http://www.msha.gov/MSHAINFO/FactSheets/MSHAFACT10.HTM>.

effect of a safety or health hazard, but the conditions do not cause imminent danger, and the inspector finds that the violation is caused by an unwarrantable failure of the operator to comply with the health and safety standards. The proposed rule would implement the Act's requirement to disclose this information.

d. The total number of flagrant violations under section 110(b)(2) of the Mine Act.

Section 110(b)(2) of the Mine Act is a penalty provision that provides that violations that are deemed to be "flagrant" may be assessed a maximum civil penalty. The term "flagrant" with respect to a violation means "a reckless or repeated failure to make reasonable efforts to eliminate a known violation of a mandatory health or safety standard that substantially and proximately caused, or reasonably could have been expected to cause, death or serious bodily injury."⁵² The proposed rule would implement the Act's requirement to disclose this information.

e. The total number of imminent danger orders issued under section 107(a) of the Mine Act.

An imminent danger order is issued under section 107(a) of the Mine Act if the MSHA inspector determines there is an imminent danger in the mine. The order requires the operator of the mine to cause all persons (except certain authorized persons) to be withdrawn from the mine until the imminent danger and the conditions that caused such imminent danger cease to exist. This type of order does not preclude the issuance of a citation under section 104 or a penalty under section 110. The proposed rule would implement the Act's requirement to disclose this information.

⁵² 30 U.S.C. 820(b)(2).

f. The total dollar value of proposed assessments from MSHA under the Mine Act.

Each issuance of a citation or order by MSHA results in the assessment of a civil penalty against the mine operator. Penalties are assessed according to a formula that considers several factors, including a history of previous violations, size of operator's business, negligence by the operator, gravity of the violation, operator's good faith in trying to correct the violation promptly and the effect of the penalty on the operator's ability to stay in business.⁵³

Because Section 1503(a) requires issuers to disclose the total dollar value of proposed assessments "for the time period covered by" the periodic report, we are proposing to require that issuers disclose the total dollar amount of assessments of penalties proposed by MSHA during the time period covered by the report. We are also proposing that the disclosure include the cumulative total of all proposed assessments of penalties outstanding as of the last day of the period covered by the report. We understand that proposed assessments may remain outstanding for extended periods of time, and believe such disclosure would provide a clearer picture of the most current health and safety issues for the issuer, as well as information about the magnitude of outstanding penalty assessments.

When any civil penalty is proposed to be assessed by MSHA, the mine operator has 30 days following receipt of the notice of proposed penalty to pay the penalty or file a contest and request a hearing before a FMSHRC administrative law judge.⁵⁴ Because Section 1503(a)(1)(F) of the Act references the total dollar amount of proposed assessments from MSHA during the time period covered by the report, we are proposing that this disclosure include any dollar amounts of penalty assessments proposed during the time period that the issuer is contesting with

⁵³ 30 U.S.C. 815(b)(1)(B).

⁵⁴ See 30 CFR § 100.7. If the proposed penalty is not paid or contested within 30 days of receipt, the proposed penalty becomes a final order of the FMSHRC and is not subject to review by any court or agency.

MSHA or the FMSHRC. However, the proposal would not prohibit the inclusion of additional information noting that certain proposed assessments of penalties are being contested to provide context to the required disclosure. We would expect that issuers will include disclosure that complies with our existing disclosure requirements when providing any such context.

Request for Comment

(15) As proposed, the new rules would require disclosure of the total dollar amounts of assessments of penalties proposed by MSHA during the time period covered by the report, and also the cumulative total of all proposed assessments of penalties outstanding as of the date of the report. Is this approach appropriate?

(16) As proposed, issuers would be required to include in the total dollar amount any proposed assessments of penalties that are being contested. Should issuers be permitted to exclude proposed assessments that are being contested? Should issuers be permitted to note the contested amounts separately?

g. The total number of mining-related fatalities.

Section 1503(a)(1)(G) of the Act sets forth the requirement to disclose the total number of mining-related fatalities, and our proposed rule would set forth this requirement. We note that Section 1503(a)(1)(G) is the only provision of Act that does not specifically reference the Mine Act, a specific notice, order or citation from MSHA, or the FMSHRC. However, because, as discussed above,⁵⁵ the application of Section 1503 is limited to mines that are subject to the provisions of the Mine Act, we believe that this disclosure requirement encompasses mining-related fatalities only at mines that are subject to the Mine Act. MSHA regulations require the

⁵⁵ See Section II.A.1 above.

reporting of all fatalities at a mine.⁵⁶ MSHA has also established policies and procedures for determining whether a fatality is unrelated to mining activity (commonly referred to as “non-chargeable” to the mining industry).⁵⁷ Since the MSHA regulations provide a comprehensive scheme of regulation, reporting and assessment for mine-related fatalities, we believe the disclosure required by this section is intended to include all fatalities that are required to be disclosed under MSHA regulations, unless the fatality is determined to be “non-chargeable” to the mining industry.

MSHA regulations require the operator of a mine to contact MSHA at once without delay and within 15 minutes at a toll-free number, once the operator knows or should know that an accident has occurred involving: (a) a death of an individual at the mine; (b) an injury of an individual at the mine which has a reasonable potential to cause death; (c) an entrapment of an individual at the mine which has a reasonable potential to cause death; or (d) any other accident.⁵⁸ In addition, MSHA regulations require each operator to prepare and file a report with MSHA of each accident, occupational injury, or occupational illness occurring at each mine, indicating therein whether such injury or illness resulted in death.⁵⁹

MSHA investigates all deaths on mine property.⁶⁰ Deaths that have been determined to be “non-chargeable” are not counted in the statistics MSHA uses to assess the safety

⁵⁶ See 30 CFR §§ 50.10 and 50.20.

⁵⁷ See MSHA Accident/Illness Investigation Handbook, Chapter 2 Release 2 (February 2004) p.9 located at <http://www.msha.gov/READROOM/HANDBOOK/PH00-I-5.pdf> (“MSHA Accident/Illness Handbook”).

⁵⁸ 30 CFR § 50.10; see also Section 103(j) of the Mine Act [30 U.S.C. §813(j)].

⁵⁹ 30 C.F.R. § 50.20. See also Item 18 of Section C of MSHA Form 7000-1 located at <http://www.msha.gov/forms/70001inb.htm>.

⁶⁰ See MSHA Accident/Illness Handbook at p. 9.

performance of the mining industry.⁶¹ These “non-chargeable” deaths include, among other things, homicides, suicides, deaths due to natural causes, and deaths involving trespassers.⁶² In cases where it is questionable whether a death is chargeable to the mining industry, MSHA may refer the case to its Fatality Review Committee.⁶³ Each of the four members of the Fatality Review Committee conducts an independent review of the facts and circumstances surrounding the questionable death to determine whether it is chargeable to the mining industry.⁶⁴

The proposed disclosure requirement encompasses all fatalities required to be reported pursuant to MSHA regulations, unless the fatality has been determined to be “non-chargeable” to the mining industry. We believe that this interpretation of the statutory language is appropriate because it will result in consistency among reporting obligations.

Request for Comment

(17) As proposed, we would require disclosure of mining-related fatalities only at mines that are subject to the Mine Act. However, many foreign jurisdictions already require mine operators to report mining-related fatalities.⁶⁵ Would it be more appropriate to instead require disclosure of mining-related fatalities at all mines operated by companies that file periodic reports with the Commission, regardless of the location of the mine? For example, under such an approach, a foreign private issuer would have to disclose all mining-related fatalities at mines in its home country

⁶¹ Id. at p. 10.

⁶² Id. See also MSHA Fatal Injury Guideline Matrix located at <http://www.msha.gov/Fatals/Chargeability/ChargeabilityMatrix.pdf>.

⁶³ MSHA Accident/Illness Handbook at p. 10.

⁶⁴ Id.

⁶⁵ See e.g., Mines Safety and Inspection Act 1994 (Western Australia); Mine Health and Safety Act, 1996, Department of Mineral Resources Regulations, Chapter 23 – Reporting of Accidents and Dangerous Occurrences (Republic of South Africa).

or any other jurisdiction, and domestic issuers would be required to disclose mining-related fatalities at mines outside of the United States. Would this be appropriate? How difficult would it be for issuers to compile and report this information? Would such an approach impose significant costs on issuers?

(18) Should we, as proposed, require disclosure of all fatalities required to be reported pursuant to MSHA regulations, unless the fatality has been determined to be “non-chargeable” to the mining industry? Should we add an instruction to the rule specifying this interpretation of the disclosure requirement? Would it be more appropriate to instead require disclosure of all fatalities regardless of the determination that it was “non-chargeable”? Should we provide further guidance as to the timing of reporting for fatalities that are under review by MSHA’s Fatality Review Committee?

(19) If we were to require disclosure of mining-related fatalities regardless of the location of the mine, what standard, if any, should we apply for determining whether a fatality is related or unrelated to mining activity? For example, would it be appropriate to apply the MSHA framework to non-U.S. jurisdictions, or to look to each non-U.S. jurisdiction’s mine safety regulatory scheme for guidance?

- h. A list of mines for which the issuer or a subsidiary received written notice from MSHA of a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of the Mine Act.

If MSHA determines that a mine has a "pattern" of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards, under section 104(e) of the Mine Act and MSHA regulations the agency is required to notify the operator of the existence of such pattern. The proposed rule would implement the Act's requirement to disclose this information.

- i. A list of mines for which the issuer or a subsidiary received written notice from MSHA of the potential to have such a pattern.

MSHA regulations state that MSHA will give the operator written notice of the potential to have a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of the Mine Act.⁶⁶ The proposed rule would implement the Act's requirement to disclose this information.

⁶⁶ See 30 CFR 104.4.

j. Any pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.

The FMSHRC is an independent agency established by the Mine Act that provides administrative trial and appellate review of legal disputes arising under the Mine Act.⁶⁷ We are proposing that any legal actions before the FMSHRC involving a coal or other mine for which the issuer or a subsidiary of the issuer is the operator be disclosed in the periodic report covering the time period during which the legal action was initiated. This disclosure would include, but not be limited to, any actions brought by the issuer or a subsidiary of the issuer before the FMSHRC to contest citations or penalties imposed by MSHA.⁶⁸ As proposed, the new rules would require the information about pending legal actions to be updated in subsequent periodic reports if there are developments material to the legal action that occur during the time period covered by such report.⁶⁹ Mine operators frequently contest proposed assessments⁷⁰ and we believe that information about the resolution of pending legal actions would be useful in this context.

As proposed, the disclosure required by this item would include the date the pending legal action was instituted and by whom (e.g., MSHA or the mine operator), the name and location of mine involved, and a brief description of the category of violation, order or citation

⁶⁷ 30 U.S.C. 815(d).

⁶⁸ Other types of cases that would be disclosed include, for example, those relating to orders to close a mine, miners' charges of safety related discrimination or miners' requests for compensation after a mine is idled by a closure order. See "About FMSHRC" at <http://www.fmshrc.gov/fmshrc.html>.

⁶⁹ See Section IX below for the text of proposed amendments.

⁷⁰ See Number of Penalties Assessed and Percent Contested, January 2007 – July 2010 (Graphs and Charts), as of 09/09/2010, available at <http://www.msha.gov/stats/ContestedCitations/Civil%20Penalties%20Assessed%20and%20Contested.pdf>. The graphs illustrate that during the time period between January 2007 through July 2010, the percent of penalties contested ranged from approximately 10% to approximately 30% of the number of penalties assessed, and the percent of penalty dollars contested ranged from approximately 30% to approximately 75% of the penalty dollars assessed.

underlying the proceeding. We believe this limited additional information is necessary to make the information more useful to investors by putting the disclosure in context.

Request for Comment

(20) As proposed, information about pending legal actions would be disclosed in the periodic report covering the period in which the action was initiated, with updates in subsequent reports for developments material to the pending action. Is this appropriate? Should we instead limit the disclosure to only those legal actions initiated during the period covered by the periodic report? Should we specifically require issuers to provide disclosure when a contested assessment has been vacated during the time period covered by the report?

(21) Is the contextual information we are proposing to require to be included for each pending legal action appropriate? Should we require any other information about pending legal actions to be disclosed?

k. A brief description of each category of violations, orders and citations reported

Although not required by Section 1503 of the Act, we are proposing to require issuers to provide a brief description of each category of violations, orders and citations reported under new Items 106(a)(1) and 106(a)(2) of Regulation S-K⁷¹ so that investors can understand the basis for the violations, orders or citations referenced. For example, we would expect that an issuer that reports receipt of an order under section 107(a) of the Mine Act would include disclosure stating that such orders are issued for situations in which MSHA determines an imminent danger exists and result in orders of immediate withdrawal from the area of the mine affected by the condition. We believe this is appropriate to provide

⁷¹ This proposed requirement would also apply to the corresponding categories of citations, orders and violations to be reported under proposed Item 16J(a) and (b) of Form 20-F and proposed Paragraph (18)(a) and (b) to General Instruction B of Form 40-F.

investors with context to the disclosure required by Section 1503(a) of the Act. We are concerned that without such a requirement, investors may be presented with disclosure that simply references the various provisions of the Mine Act, and would have to research the Mine Act and MSHA's rules to be able to assess the information.

Request for Comment

(22) Will the proposed disclosure providing a brief description of each category of violations, orders and citations reported be useful for investors, or would the information otherwise provided in the proposed exhibit to the periodic report be sufficient? Is there any other disclosure we should require in order to put the disclosures required by Section 1503(a) of the Act in context for investors?

B. Form 8-K Filing Requirement

1. Triggering events

Section 1503(b) of the Act requires each issuer that is an operator, or has a subsidiary that is an operator, of a coal or other mine to report on Form 8-K the receipt of certain notices from MSHA.⁷² We are proposing to revise Form 8-K to add new Item 1.04, which would require filing of Form 8-K within four business days of the receipt by an issuer (or a subsidiary of the issuer) of:

- An imminent danger order under section 107(a) of the Mine Act;⁷³
- Written notice from MSHA of a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and

⁷² Section 1503(b) of the Act.

⁷³ See Section II.A.4.e. above for a description of an imminent danger order issued under section 107(a) of the Mine Act [30 U.S.C. 817(a)].

substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of the Mine Act;⁷⁴ or

- Written notice from MSHA of the potential to have a pattern of such violations.⁷⁵

These orders and notices are also required to be disclosed under Section 1503(a) of the Act in issuers' periodic reports. We believe the plain language of Section 1503 of the Act requires such orders and notices to be reported both in issuers' Forms 8-K and their periodic reports. For example, if an issuer receives from MSHA one of the orders or notices specified above during the second quarter of the year, the issuer would file a Form 8-K reporting the receipt of the order or notice within four business days of receipt, include information about such order or notice in accordance with new Regulation S-K Item 106 in its Form 10-Q for the second quarter and include information regarding this violation in the annual cumulative total for the fiscal year in its Form 10-K for that fiscal year.

Request for Comment

- (23) The events that would trigger filing under proposed Item 1.04 are also events that are required to be disclosed in periodic reports under Section 1503(a) of the Act and our proposed Item 106 of Regulation S-K. Should we revise our proposal to minimize duplicative disclosure such as by not requiring repetition of information previously reported? Would such an approach be consistent with the Act? Would

⁷⁴ See Section II.A.4.h. above for a description of the written notice regarding a pattern of violations under section 104(e) of the Mine Act [30 U.S.C. 814(e)].

⁷⁵ See Section II.A.4.i. above for a description of the written notice from MSHA of the potential to have a pattern of violations under section 104(e) of the Mine Act [30 U.S.C. 814(e)].

our proposed disclosure approach be unduly burdensome for issuers or confusing to investors?

2. Required disclosure and filing deadline

Section 1503(b) of the Act does not specify the disclosure that issuers should provide in the required Form 8-K filing. We are proposing that new Item 1.04 of Form 8-K require, in each case, disclosure of the date of receipt of the order or notice, the category of order or notice, and the name and location of the mine involved.

In addition, Section 1503(b) of the Act does not specify a filing deadline for the required Form 8-K. Consistent with our approach to other Form 8-K items, we are proposing that the current report under new Item 1.04 be required to be filed no later than four business days after the triggering event. We believe that, because the triggering events are clear and do not require management to make rapid materiality judgments, the four business day deadline provides adequate time for issuers to prepare accurate and complete information.

Request for Comment

- (24) Is there any other information that should be required to be disclosed under proposed Item 1.04 of Form 8-K? Will the information that we are proposing to require in the Form 8-K be useful for investors?
- (25) Should the filing period for a Form 8-K under proposed Item 1.04 be four business days, as proposed, or should the filing period be longer? What factors should we consider in deciding whether to make the filing period longer?

3. Treatment of Foreign Private Issuers

Foreign private issuers are not required to file current reports on Form 8-K.⁷⁶ Instead, they are required to file under the cover of Form 6-K⁷⁷ copies of all information that the foreign private issuer makes, or is required to make, public under the laws of its jurisdiction of incorporation, files, or is required to file, under the rules of any stock exchange, or otherwise distributes to its security holders.⁷⁸ We do not propose to change these reporting requirements.⁷⁹ As described above,⁸⁰ we are proposing changes to Forms 20-F and 40-F that would require a foreign private issuer to disclose in each annual report the items described in Section 1503(a) of the Act. The proposed amendments include the same information that will be required of other issuers, including disclosure of the receipt during the foreign private issuer's past fiscal year of any imminent danger order issued under section 107(a) of the Mine Act,⁸¹ written notice from MSHA of a pattern of violations of mandatory health or safety standards that are of such a nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of the Mine Act,⁸² or written notice from MSHA of the potential to have a pattern of such violations.⁸³

⁷⁶ See Exchange Act Rules 13a-11 and 15d-11 [17 CFR 240.13a-11 and 15d-11].

⁷⁷ Referenced in 17 CFR 249.306.

⁷⁸ See Exchange Act Rule 13a-6 [17 CFR 240.13a-16].

⁷⁹ This approach is consistent with the manner in which the Commission implemented Sections 306 and 406 of the Sarbanes-Oxley Act of 2002. See *Insider Trades During Pension Fund Blackout Periods*, SEC Release No. 34-47225 (Jan. 22, 2003) [68 FR 4338] and *Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002*, SEC Release No. 33-8177 (Jan. 23, 2003) [68 FR 5110]. See also letter from Rio Tinto.

⁸⁰ See Section II.A. above for a description of all the proposed disclosure requirements to Forms 20-F and 40-F.

⁸¹ See Section II.A.4.e. above.

⁸² See Section II.A.4.h. above.

⁸³ See Section II.A.4.i. above.

Request for Comment

(26) Should we require foreign private issuers to file disclosure about the receipt of imminent danger orders or notices of a pattern or potential pattern of violations within four days under cover of Form 8-K, Form 6-K or a special report on Form 20-F? Should we otherwise require a foreign private issuer to promptly disclose the receipt of such order or notices? Does a divergent treatment of U.S. issuers and foreign private issuers in connection with current reporting disadvantage U.S. issuers? Should this be addressed in our rules, and if so, how? To what extent, if any, would foreign private issuers have additional burdens or costs associated with reporting these events on a current basis?

C. Amendment to General Instruction I.A.3.(b) of Form S-3

We are proposing to amend General Instruction I.A.3.(b) of Form S-3 to provide that an untimely filing on Form 8-K regarding new Item 1.04 would not result in loss of Form S-3 eligibility. Under our existing rules, the untimely filing on Form 8-K of certain items does not result in loss of Form S-3 eligibility, so long as Form 8-K reporting is current at the time the Form S-3 is filed. We believe that it is appropriate to add proposed Item 1.04 to the list of Form 8-K items in General Instruction I.A.3.(b) of Form S-3.

In the past, when we have adopted new disclosure requirements that differed from the traditional periodic reporting obligations of companies, we have acknowledged concerns about the potentially harsh consequences of the loss of Form S-3 eligibility, and addressed such concerns by specifying that untimely filing of Forms 8-K relating to certain topics would not

result in the loss of Form S-3 eligibility.⁸⁴ We note that Section 1503(b) of the Act does not address the Securities Act implications of a failure to timely file a Form 8-K. Therefore, we are proposing to provide that untimely filing of the new Item 1.04 Form 8-K would not result in the loss of Form S-3 eligibility.

We are not proposing to include new Item 1.04 in the list in Rules 13a-11(c) and 15d-11(c) under the Exchange Act of Form 8-K items eligible for a limited safe harbor from liability under Section 10(b) or Rule 10b-5 under the Exchange Act.⁸⁵ In 2004, when we adopted the limited safe harbor, we noted our view that the safe harbor is appropriate if the triggering event for the Form 8-K requires management to make a rapid materiality determination.⁸⁶ The filing of an Item 1.04 Form 8-K is triggered by an event that does not require management to make a rapid materiality determination, and we believe that it is not necessary to extend the safe harbor to this new item. We solicit comment below on whether this treatment is appropriate for proposed Item 1.04.

Request for Comment

(27) Should we, as proposed, amend General Instruction I.A.3(b) of Form S-3 to add proposed Item 1.04 to the list of items on Form 8-K with respect to which an issuer's failure timely to file the Form 8-K will not result in the loss of Form S-3 eligibility? Why or why not? If we were to adopt a current reporting requirement for foreign

⁸⁴ See *Selective Disclosure and Insider Trading*, SEC Release No. 33-7881 (Aug. 15, 2000) [65 FR 51715]; *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, SEC Release No. 33-8400 (March 16, 2004) [69 FR 15594] (the "Additional Form 8-K Disclosure Release").

⁸⁵ Rules 13a-11(c) and 15d-11(c) each provides that "[n]o failure to file a report on Form 8-K that is required solely pursuant to Item 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e) or 6.03 of Form 8-K shall be deemed a violation of" Section 10(b) of the Exchange Act or Rule 10b-5 thereunder.

⁸⁶ Additional Form 8-K Disclosure Release at 69 FR 15607.

private issuers for the information covered by Section 1503(b) of the Act, should we approach Form F-3 eligibility in the same manner?

(28) As proposed, we would not include proposed Item 1.04 in the list of items in Rules 13a-11(c) and 15d-11(c) with respect to which the failure to file a report on Form 8-K will not be deemed to be a violation of Section 10(b) or Rule 10b-5.

Should we instead add proposed Item 1.04 to the safe harbor? Why or why not?

III. GENERAL REQUEST FOR COMMENT

We request and encourage any interested person to submit comments on any aspect of our proposals, other matters that might have an impact on the amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

IV. PAPERWORK REDUCTION ACT

A. Background

Certain provisions of the proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA).⁸⁷ We are submitting the proposed amendments to the Office of Management and Budget (OMB) for review in accordance with the PRA.⁸⁸ The titles for the collection of information are:

- (A) "Regulation S-K" (OMB Control No. 3235-0071);
- (B) "Form 10-K" (OMB Control No. 3235-0063);
- (C) "Form 10-Q" (OMB Control No. 3235-0070);

⁸⁷ 44 U.S.C. 3501 *et seq.*

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

- (D) "Form 8-K" (OMB Control No. 3235-0060);
- (E) "Form 20-F" (OMB Control No. 3235-0288); and
- (F) "Form 40-F" (OMB Control No. 3235-0381).

These regulations and forms were adopted under the Securities Act and the Exchange Act. They set forth the disclosure requirements for periodic and current reports filed by companies to inform investors.⁸⁹ The hours and costs associated with preparing disclosure, filing forms and retaining records constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

As discussed in more detail above, the proposed rule and form amendments would implement Section 1503 of the Act. Section 1503(a) requires issuers that are operators, or that have a subsidiary that is an operator, of a coal or other mine to disclose in their periodic reports filed with the Commission information regarding specified health and safety violations, orders and citations, related assessments and legal actions, and mining-related fatalities. Section 1503(b) of the Act mandates the filing of a Form 8-K disclosing the receipt of certain orders and notices from MSHA. We are proposing to add new Items 106 and 601(b)(95) to Regulation S-K and amend Forms 10-Q, 10-K, 20-F and 40-F under the Exchange Act to implement and, to a limited degree, enhance the disclosure requirement set forth in Section 1503(a) of the Act. We are also proposing to add new Item 1.04 to Form 8-K to implement the requirement of Section 1503(b) of the Act. In addition, we are proposing to amend General Instruction I.A.3(b) of Securities Act Form S-3.

⁸⁹ Forms 20-F and 40-F may also be used by foreign private issuers to register a class of securities under the Exchange Act. In addition, Form 20-F sets forth many of the disclosure requirements for registration statements filed by foreign private issuers under the Securities Act.

Issuers are currently required to comply with the provisions of Section 1503 of the Act, therefore the Act has already increased the burdens and costs for issuers by requiring the disclosure set forth in Sections 1503(a) and (b) of the Act. Most of the information called for by the new disclosure requirements is publicly disclosed by MSHA and readily available to issuers, who receive the notices, orders and citations directly from MSHA and can also access the information via MSHA's data retrieval system. Further, the proposed disclosure item for periodic reports requiring disclosure of mining-related fatalities is already subject to a collection of information under MSHA regulations.⁹⁰ Our proposed amendments would incorporate the Act's requirements into Regulation S-K and related forms, and would require certain additional disclosure to provide context to the disclosure items required by the Act.

We anticipate that the proposed new Items 106 and 601(b)(95) of Regulation S-K would increase existing disclosure burdens for annual reports on Form 10-K and quarterly reports on Form 10-Q by requiring disclosure about certain mine health and safety violations designated by the Act. Because Regulation S-K does not apply directly to Forms 20-F and 40-F,⁹¹ we propose to amend those forms to include the same disclosure requirements as those proposed for issuers that are not foreign private issuers.⁹² We anticipate that new Item 1.04 of Form 8-K would increase the existing disclosure burden for current reports on Form 8-K by requiring issuers to file a Form 8-K upon receipt of three types of notices or orders from MSHA relating to mine health and safety concerns and specifying the information required about the orders or notices required to be disclosed.

⁹⁰ 30 CFR §§ 50.10 and 50.20.

⁹¹ While Form 20-F may be used by any foreign private issuer, Form 40-F is only available to a Canadian issuer that is eligible to participate in the U.S.-Canadian Multijurisdictional Disclosure System ("MJDS").

⁹² Proposed Item 16J under Part II of Form 20-F and proposed paragraph (18) to General Instruction B of Form 40-F.

Compliance with the proposed amendments would be mandatory. Responses to the information collections would not be kept confidential, and there would be no mandatory retention period for the information disclosed.

B. Burden and Cost Estimates Related to the Proposed Amendments

We anticipate that the proposed rule and form amendments, if adopted, would increase the burdens and costs for issuers that would be subject to the proposed amendments. For purposes of the PRA, we estimate the total annual increase in paperwork burden for all affected companies to comply with our proposed collection of information requirements to be approximately 1,677 hours of company personnel time and approximately \$263,500 for the services of outside professionals. These estimates include the time and the cost of implementing disclosure controls and procedures, preparing and reviewing disclosure, filing documents and retaining records. In deriving our estimates, we assume that:

- For Forms 10-K, 10-Q and 8-K, an issuer incurs 75% of the annual burden required to produce each form, and outside firms, including legal counsel, accountants and other advisors retained by the issuer incur 25% of the annual burden required to produce the form at an average cost of \$400 per hour;⁹³ and
- For Forms 20-F and 40-F, a foreign private issuer incurs 25% of the annual burden required to produce each form, and outside firms retained by the issuer incur 75% of the burden require to produce each form at an average cost of \$400 per hour.

⁹³ The \$400 per hour cost for outside legal services 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).

The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours.

We have based our estimates of the effect that the adopted rule and form amendments would have on those collections of information primarily on our understanding that the information required to be disclosed is readily available to issuers, and that therefore the burden imposed by the disclosure requirements is mainly in formatting the information in order to comply with our disclosure requirements and ensuring that appropriate disclosure controls and procedures are in place to facilitate reporting of the information. In this regard, we note that mine operators receive the relevant notices, citations and similar information directly from MSHA, and that issuers could also access the information via MSHA's publicly available data retrieval system.

1. Regulation S-K

While the proposed rule and form amendments would make revisions to Regulation S-K, the collection of information requirements for that regulation are reflected in the burden hours estimated for Forms 10-K and 10-Q. The rules in Regulation S-K do not impose any separate burden. Consistent with historical practice, we are proposing to retain an estimate of one burden hour to Regulation S-K for administrative convenience.

2. Form 10-K

Based on a review of companies filing under certain SICs, as well as a review of companies that are currently providing disclosure of mine safety violations in Commission filings in accordance with Section 1503 of the Act, we estimate that, of the 13,545 Form 10-Ks filed annually, approximately 95 are filed by companies that operate, or have a subsidiary that operates, a mine subject to the Mine Act, and that therefore would be affected by the proposed

rule and form amendments. For purposes of the PRA, we assume that each such filer would have disclosures about mine safety violations to include in its Form 10-K. We further estimate that the proposed rule and form amendments would add 5 burden hours to the total burden hours required to produce each Form 10-K.

3. Form 20-F

Based on a review of companies filing under certain SICs, as well as a review of companies that are currently providing disclosure of mine safety violations in Commission filings in accordance with Section 1503 of the Act, we currently estimate that of the 942 Form 20-F annual reports filed annually by foreign private issuers, approximately 15 are filed by companies that operate, or have a subsidiary that operates, a mine subject to the Mine Act, and that therefore would be affected by the proposed rule and form amendments. For purposes of the PRA, we assume that each such filer would have disclosures about mine safety violations to include in its Form 20-F. As with Form 10-K, we estimate that the proposed rule and form amendments would add 5 burden hours to the total burden hours required to produce each Form 20-F.

4. Form 40-F

Based on a review of companies filing under certain SICs, as well as a review of companies that are currently providing disclosure of mine safety violations in Commission filings in accordance with Section 1503 of the Act, we currently estimate that of the 205 Form 40-F annual reports filed annually by foreign private issuers, approximately 15 are filed by companies that operate, or have a subsidiary that operates, a mine subject to the Mine Act, and that therefore would be affected by the proposed rule and form amendments. For purposes of the PRA, we assume that each such filer would have disclosures about mine safety violations to

include in its Form 40-F. As with Forms 10-K and 20-F, we estimate that the proposed rule and form amendments would add 5 burden hours to the total burden hours required to produce each Form 40-F annual report.

5. Form 10-Q

Based on a review of companies filing under certain SICs, as well as a review of companies that are currently providing disclosure of mine safety violations in Commission filings in accordance with Section 1503 of the Act, we estimate that, of the 32,462 Form 10-Qs filed annually, approximately 285 are filed by companies that operate, or have a subsidiary that operates, a mine subject to the Mine Act, and that therefore would be affected by the proposed rule and form amendments.⁹⁴ For purposes of the PRA, we assume that each such filer would have disclosures about mine safety violations to include in each Form 10-Q. We further estimate that the proposed rule and form amendments would add 5 burden hours to the total burden hours required to produce each Form 10-Q.

6. Form 8-K

We estimate that companies annually file 115,795 Form 8-Ks. Only companies that are operators, or have subsidiaries that are operators, of coal or other mines (as defined in the Mine Act, and subject to the Mine Act) are required to comply with the proposed new Form 8-K requirement. For purposes of the PRA, we estimate that there will be approximately 95 Form 8-K filers under new Item 1.04, which is based on our estimate of the number of Form 10-K filers that operate, or have a subsidiary that operates, a mine subject to the Mine Act, and that therefore would be affected by the proposed rule and form amendments. In addition, we understand that

⁹⁴ We estimate that approximately 95 companies with a Form 10-Q filing obligation would be affected by the proposed rule and form amendments. Each such company would file three quarterly reports on Form 10-Q per year. 95 companies x 3 Forms 10-Q per year=285 Forms 10-Q.

the triggering events for Form 8-K filing set forth in Section 1503(b)(2) – the receipt of written notice from MSHA that the coal or other mine has a pattern of violations or the potential to have such a pattern – are very rare, while the triggering event set forth in Section 1503(b)(1) – the receipt of an imminent danger order – is more common.⁹⁵ For purposes of this calculation, we assume that each potential filer under proposed Item 1.04 of Form 8-K would file three Forms 8-K per year under new Item 1.04 and we estimate that the proposed amendments to Form 8-K would add 1 burden hour to the total burden hours required to produce each Form 8-K.

C. Summary of Proposed Changes to Annual Compliance Burden in Collection of Information

The table below illustrates the total incremental annual compliance burden of the collection of information in hours and in cost under the proposed amendments for annual reports, quarterly reports and current reports on Form 8-K under the Exchange Act (Table 1). There is no change to the estimated burden of the collection of information under Regulation S-K because the burdens that Regulation S-K imposes are reflected in our revised estimates for the forms. The burden estimates were calculated by multiplying the estimated number of annual responses by the estimated average number of hours it would take a company to prepare and review the proposed disclosure requirements.

⁹⁵ See U.S. Department of Labor, Office of Inspector General, *In 32 Years MSHA Has Never Successfully Exercised Its Pattern of Violations Authority*, Report Number 05-10-005-06-001 (Sept. 29, 2010). According to data available on MSHA's website, 631 and 562 imminent danger orders under Section 107(a) were issued during fiscal 2010 and 2009, respectively. See *Violations Data Set* (as of Nov. 12, 2010), available at <http://www.msha.gov/OpenGovernmentData/OGIMSHA.asp> (on file with the Division of Corporation Finance). Note that this number includes all imminent danger orders issued to all companies subject to MSHA's jurisdiction, not only to reporting companies that are subject to the disclosure requirements of Section 1503 of the Act.

Form	Current Annual Response	Current Burden Hours	Increase in Burden Hours	Proposed Burden Hours	Current Professional Costs (\$)	Increase in Professional Costs (\$)	Proposed Professional Costs (\$)
10-K	13,545	21,363,548	356	21,363,904	2,848,473,000	47,500	2,848,520,500
20-F	942	622,907	19	622,926	743,089,980	22,500	743,112,480
40-F	205	21,884	19	21,903	26,260,500	22,500	26,283,000
10-Q	32,462	4,559,793	1,069	4,560,862	607,972,400	142,500	608,114,900
8-K	115,795	493,436	214	493,650	65,791,500	28,500	65,820,000

D. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;
- Evaluate the accuracy of our estimates of the burden of the proposed collections of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;
- Evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- Evaluate whether the proposed amendments would have any effects on any other collections of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of

Information and Regulatory Affairs, Washington, DC 20503, and send a copy of the comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-41-10. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-41-10 and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street NE, Washington DC 20549-0213. Because the OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication.

V. COST-BENEFIT ANALYSIS

A. Introduction and Objectives of Proposals

We are proposing the rule and form amendments discussed in this release to implement the disclosure requirements set forth in Section 1503 of the Act and to require limited additional disclosure to provide context for certain items required by that Section. Section 1503(a) of the Act requires issuers that are operators, or that have a subsidiary that is an operator, of a coal or other mine to disclose in their periodic reports filed with the Commission information regarding specified health and safety violations, orders and citations, related assessments and legal actions, and mining-related fatalities. Section 1503(b) of the Act mandates the filing of a Form 8-K disclosing the receipt of certain orders and notices from the Mine Safety and Health Administration.

As discussed in detail above, the disclosure requirements set forth in Section 1503 of the Act refer to and are based on the safety and health requirements applicable to mines under the Mine Act and administered by MSHA. MSHA inspectors issue citations, orders and decisions

directly to mine operators during the course of inspections and MSHA assesses and collects civil monetary penalties for violations. Information on a mine-by-mine basis about inspections, violations, and accidents is publicly available on MSHA's data retrieval system on its website.⁹⁶ Therefore, we believe the information required to be disclosed under Section 1503 of the Act and our proposed rules is readily available to issuers. Further, because the disclosure requirements set forth in Section 1503 are currently in effect, we assume that issuers have already begun to develop the necessary controls and procedures to review and prepare the information required by Section 1503 of the Act for filing with the Commission, such that the additional incremental disclosure we are proposing to provide context for certain items required by that Section will not require issuers to implement additional controls and procedures.

We are proposing amendments to Form 10-K, Form 10-Q, Form 20-F and Form 40-F to provide for the disclosure required by Section 1503(a) of the Act and certain additional disclosures. New Item 106 of Regulation S-K, new Item 16J of Form 20-F and new Paragraph (18) of General Instruction B of Form 40-F would detail the information to be disclosed in accordance with Section 1503(a) of the Act, and the proposed amendment to Item 601 of Regulation S-K would set forth the exhibit requirement for Form 10-K and Form 10-Q for the information required to be disclosed under proposed Item 106 of Regulation S-K. We are also proposing amendments to Form 8-K to add new Item 1.04 to implement the requirement imposed by Section 1503(b) of the Act. Finally, we propose to amend General Instruction I.A.3.(b) of Form S-3 to add new Form 8-K Item 1.04 to the list of Form 8-K items the untimely filing of which will not result in loss of Form S-3 eligibility.

⁹⁶ See <http://www.msha.gov/DRS/DRSHOME.HTM>.

The Commission is sensitive to the costs and benefits that would be imposed by the proposed rule and form amendments. The discussion below focuses on the costs and benefits of the decisions made by the Commission to fulfill the mandates of the Act, rather than the cost and benefits of the mandates of the Act itself. However, to the extent that the Commission helps achieve the benefits intended by the Act, the two types of benefits are not entirely separable.

B. Benefits

The proposed rulemaking is intended to implement the requirements of Section 1503 of the Act. Our proposed Regulation S-K and form amendments would implement the requirements of the Act by reiterating the disclosure items listed in Section 1503, which are currently in effect. We are also proposing to require limited additional disclosure in periodic reports addressing:

- brief descriptions of the categories of violations, orders or citations disclosed in response to the Section 1503(a) disclosure requirement;
- total dollar values of proposed penalty assessments from MSHA; and
- descriptions of legal actions pending before the FMSHRC and developments material to previously reported pending legal actions.

In addition, our proposed amendment to Form 8-K would require additional disclosure beyond that specifically designated by Section 1503(b) of the Act by specifying the information required about the orders or notices required to be disclosed, and specifying a four business day filing deadline for Forms 8-K filed under proposed Item 1.04.

We believe the enhanced disclosures in periodic reports about the categories of violations will improve the ability of investors to understand the statutorily required information about mine safety violations without having extensive knowledge of the Mine Act and the violations,

orders and citations referenced therein. We believe that investors would also benefit from the proposed disclosure in periodic reports of the total dollar value of the assessments and the description of legal actions and developments relating to legal actions because it would place the required disclosures in context.

Our proposed amendment to Form 8-K specifying that the form is to be filed within four business days of receipt of the order or notice designated under Section 1503(b) of the Act would provide issuers and investors with certainty about the timing of that disclosure requirement.

Our proposed rule and form amendments also specify for issuers how, in what form, and when to report the mine safety information required by the Act. These rules are designed to facilitate compliance with the new statutory requirements.

C. Costs

The vast majority of the costs resulting from the disclosures required by Section 1503 of the Act arise whether or not we adopt rules to implement the Section. Moreover, the information required to be disclosed under Section 1503 is already subject to an extensive recordkeeping regime under MSHA and is readily available to issuers via MSHA's data retrieval system. The primary costs to result from this rulemaking are costs associated with the formatting and filing of the information and certain additional disclosures we are proposing: the description of the incidents, total dollar value of the proposed penalty assessments and the description of legal actions, as noted above. Given that this information should be readily available to issuers and the additional information does not require a substantial amount of additional disclosure, we believe that these costs would be small.⁹⁷

⁹⁷ For purposes of the PRA, we estimate the total cost of the disclosure to be approximately 1,677 hours of company personnel time and approximately \$263,500 for the services of outside professionals. However, this amount includes the costs associated with the disclosure requirement of Section 1503 of the Act, as well as our proposed additional disclosure. As discussed above, the proposed additional disclosure is only a small portion of the burden

D. Request for Comment

We request data to quantify the costs and the value of the benefits described above. We seek estimates of these costs and benefits, as well as any costs and benefits not already defined, that may result from the adoption of these proposed amendments. We also request qualitative feedback on the nature of the benefits and costs described above and any benefits and costs we may have overlooked.

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 Act⁹⁸ requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Section 2(b)⁹⁹ of the Securities Act and Section 3(f)¹⁰⁰ 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 consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

Our proposed amendments would implement the requirements of Section 1503 of the Act. We have proposed a few additional disclosure requirements to provide investors with context for the information required to be disclosed under Section 1503. We believe the

of the disclosure requirement; therefore, we believe the costs of the additional disclosure would be a small fraction of the total amount disclosed for PRA purposes.

⁹⁸ 15 U.S.C. 78w(a).

⁹⁹ 15 U.S.C. 77b(b).

¹⁰⁰ 15 U.S.C. 78c(f).

additional disclosure will improve the ability of investors to understand the statutorily required information about mine safety violations without having extensive knowledge of the Mine Act and the orders, citations and violations referenced therein.

We do not believe that the additional disclosure we have proposed in our rulemaking would impose a burden on competition. Section 1503 of the Act imposed the substance of the disclosure requirements set forth in our proposals. The additional disclosure that we have proposed to require is not substantial, but rather brief descriptions to place the mine safety disclosures in context. In addition, we believe the additional information should be readily available to issuers. Accordingly, since the additional disclosure is designed to provide context to the information required to be disclosed by Section 1503 of the Act, and does not place a significant burden on the issuer, we believe that it will not impose a burden on competition. Likewise, we do not expect that the additional disclosure we are proposing to require would have a significant impact on capital formation.

We believe that the proposed clarifications to the mine safety information required by the Act will provide direction and consistency as to how, in what form, and when to report the relevant information. We believe that the specifications in the rulemaking will improve the efficiency of the reporting process for issuers and provide for a more efficient and effective review of the information by investors.

The loss of eligibility by an issuer to use Form S-3 could significantly restrict the ability of a company to raise capital and may be a disproportionately large negative consequence of an untimely filing of a Form 8-K. To address this potential burden on capital formation, we are proposing to revise the eligibility rules under Form S-3 so that an untimely filing of a report under new Item 1.04 of Form 8-K would not result in a loss of eligibility to use that form.

We request comment on whether the proposed amendments would promote efficiency, competition, and capital formation or have an impact or burden on competition. Commentators are requested to provide empirical data and other factual support for their view to the extent possible.

VII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA)¹⁰¹ we solicit data to determine whether the proposed rule amendments constitute a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

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. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Initial Regulatory Flexibility Analysis has been prepared in accordance with the Regulatory Flexibility Act.¹⁰² It relates to proposed revisions to Regulation S-K and forms under the Securities Act and the Exchange Act regarding disclosure about mine safety.

¹⁰¹ 5 U.S.C. 603.

¹⁰² 5 U.S.C. 601.

A. Reasons for, and Objectives of, the Proposed Action

We are proposing rulemaking to implement the disclosure requirements set forth in Section 1503 of the Act and to require limited additional disclosure to provide context for certain items required by the Act. Section 1503(a) of the Act requires issuers that are operators, or that have a subsidiary that is an operator, of a coal or other mine to disclose in their periodic reports filed with the Commission information regarding specified health and safety violations, orders and citations, related assessments and legal actions, and mining-related fatalities. Section 1503(b) of the Act mandates the filing of a Form 8-K disclosing the receipt of certain orders and notices from MSHA.

B. Legal Basis

We are proposing the amendments pursuant to Sections 7, 10, and 19(a) of the Securities Act, Sections 12, 13, 15 and 23 of the Exchange Act, and Section 1503 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

C. Small Entities Subject to the Proposed Action

The proposed amendments would affect some companies that are small entities. The Regulatory Flexibility Act defines “small entity” to mean “small business,” “small organization,” or “small governmental jurisdiction.”¹⁰³ The Commission's rules define “small business” and “small organization” for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission. Securities Act Rule 157¹⁰⁴ and Exchange Act Rule 0-10(a)¹⁰⁵ define a company, other than an investment company, to be a “small business” or “small

¹⁰³ 5 U.S.C. 601(6).

¹⁰⁴ 17 CFR 230.157.

¹⁰⁵ 17 CFR 240.0-10(a).

organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We believe that our proposals would affect small entities that (i) are required to file reports under Sections 13(a) or 15(d) of the Exchange Act and (ii) operate, or have a subsidiary that operates, a coal or other mine, and therefore are required to provide mine safety disclosure under Section 1503 of the Act. We estimate that there are approximately 25 companies that would currently be required to provide the Section 1503 disclosure and that may be considered small entities. We note that there are a significant number of small entities that are exploration stage mining companies that would be required to provide the Section 1503 disclosure if such companies were to become operators, or have subsidiaries that become operators, of coal or other mines subject to the Mine Act.

D. Reporting, Recordkeeping, and other Compliance Requirements

The disclosure requirements we are proposing today are intended to implement the disclosure requirements set forth in Section 1503 of the Act and to require additional disclosure to provide context for certain items required by the Act. These amendments would require small entities that are required to file reports under Sections 13(a) or 15(d) of the Exchange Act and operate, or have a subsidiary that operates, a coal or other mine to provide mine safety disclosure under applicable rules and forms.

Small entities would be required to include the disclosure in their annual report on Form 10-K, Form 20-F or Form 40-F and, if applicable, quarterly report on Form 10-Q and current report on Form 8-K. We are proposing amendments to Form 10-K, Form 10-Q, Form 20-F and Form 40-F to require the disclosure required by Section 1503(a) of the Act and certain additional disclosures. New Item 106 of Regulation S-K, new Item 16J of Form 20-F and new Paragraph (18) of General Instruction B of Form 40-F would detail the information to be disclosed in accordance with Section 1503(a) of the Act, and the proposed amendment to Item 601 of

Regulation S-K would set forth the exhibit requirement for Form 10-K and Form 10-Q for the information required to be disclosed under proposed Item 106 of Regulation S-K. We are also proposing amendments to Form 8-K to add new Item 1.04 to implement the requirement imposed by Section 1503(b) of the Act. Finally, we propose to amend General Instruction I.A.3.(b) of Form S-3 to add new Form 8-K Item 1.04 to the list of Form 8-K items the untimely filing of which will not result in loss of Form S-3 eligibility.

E. Duplicative, Overlapping, or Conflicting Federal Rules

Section 1503 of the Act imposed the disclosure requirements set forth in Sections 1503(a) and (b) of the Act, regardless of whether the Commission adopts rules to implement those provisions. Our proposed amendments incorporate the Act's requirements into Regulation S-K and related forms. The disclosure requirement of Section 1503(a)(1)(G) of the Act, which requires disclosure of mining-related fatalities, overlaps to some extent with a disclosure requirement under MSHA rules. MSHA requires companies to report immediately any death of an individual at a mine,¹⁰⁶ which MSHA then makes available to the public through its data retrieval system on its website, www.msha.gov.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed disclosure amendments, we considered the following alternatives:

- (1) Establishing differing compliance or reporting requirements or timetables which take into account the resources available to smaller entities;
- (2) Exempting smaller entities from coverage of the disclosure requirements, or any part thereof;

¹⁰⁶ See 30 CFR 50.10.

- (3) The clarification, consolidation, or simplification of disclosure for small entities; and
- (4) Use of performance standards rather than design standards.

Section 1503 of the Act requires all entities, including small entities, that are required to file reports under Sections 13(a) or 15(d) of the Exchange Act and operate, or have a subsidiary that operates, a coal or other mine to provide mine safety disclosure under applicable rules and forms. These requirements apply without regard to whether we adopt rules to implement them. The proposed amendments implement the disclosure requirements set forth in Section 1503 of the Act, and require additional disclosure to provide context for certain items required by the Act. Given the statutory disclosure requirements in Section 1503 of the Act, the Act does not appear to contemplate separate compliance or reporting requirements for smaller entities. We nevertheless solicit comment on the propriety of a complete or partial exemption from the requirements for smaller entities.

Our proposed amendments would require clear and straightforward disclosure of the information required by Section 1503 of the Act. We have used design rather than performance standards in connection with the proposed amendments. By specifying in the Act the disclosure required, Congress appears to have contemplated that consistent, comparable disclosure would be provided. We believe that the specific disclosure requirements in the proposed amendments would promote consistent and comparable disclosure among all companies that operate, or have a subsidiary that operates, a coal or other mine. Further, based on our past experience, we believe that specific disclosure requirements for this information would be more useful to investors than would a performance standard.

Currently, small entities are subject to some different compliance or reporting requirements under Regulation S-K and the proposed amendments would not affect these

requirements. The proposed disclosure requirements would apply to small entities to the same extent as larger issuers. We do not believe these disclosures will create a significant new burden, and we believe this approach is consistent with the requirements of the Act.

G. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- How the proposed amendments can achieve their objective while lowering the burden on small entities;
- The number of small entities that may be affected by the proposed amendments;
- The existence or nature of the potential impact of the proposed amendments on small entities discussed in the analysis; and
- How to quantify the impact of the proposed amendments.

Respondents are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

IX. STATUTORY AUTHORITY AND TEXT OF THE PROPOSED AMENDMENTS

The amendments contained in this release are being adopted under the authority set forth in Sections 7, 10, and 19(a) of the Securities Act; Sections 12, 13, 15 and 23 of the Exchange Act and Section 1503 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

List of Subjects

17 CFR Parts 229, 239 and 249

Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENTS

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II, of the Code of Federal Regulations as follows:

PART 229 - STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 - REGULATION S-K

1. The authority citation for part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Section 229.106 is added to read as follows:

§ 229.106 (Item 106) Mine safety disclosure.

(a) A registrant that is the operator, or that has a subsidiary that is an operator, of a coal or other mine shall provide the information specified below for the time period covered by the report:

(1) For each coal or other mine of which the registrant or a subsidiary of the registrant is an operator, identify the mine and disclose:

(i) The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or

health hazard under section 104 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 814) for which the operator received a citation from the Mine Safety and Health Administration.

(ii) The total number of orders issued under section 104(b) of such Act (30 U.S.C. 814(b)).

(iii) The total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under section 104(d) of such Act (30 U.S.C. 814(d)).

(iv) The total number of flagrant violations under section 110(b)(2) of such Act (30 U.S.C. 820(b)(2)).

(v) The total number of imminent danger orders issued under section 107(a) of such Act (30 U.S.C. 817(a)).

(vi) The total dollar value of proposed assessments from the Mine Safety and Health Administration under such Act (30 U.S.C. 801 et seq).

Instruction to Item 106(a)(1)(vi): Registrants must provide the total dollar value of assessments proposed by MSHA during the period covered by the report, and also provide the total dollar value of all outstanding assessments as of the last day of the period covered by the report, regardless of whether the registrant has challenged or appealed the assessment.

(vii) The total number of mining-related fatalities.

(2) A list of coal or other mines, of which the registrant or a subsidiary of the registrant is an operator, that receive written notice from the Mine Safety and Health Administration of:

(i) A pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of such Act (30 U.S.C. 814(e)); or

(ii) the potential to have such a pattern.

(3) For each violation, order or citation disclosed in response to (a)(1) and (a)(2) above, a brief description of category of violation, order or citation.

(4) Any pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.

Instruction to Item 106(a)(4): The registrant must report any legal actions commenced during the time period covered by the report, as well as any developments material to a legal action previously reported under this provision occurring during the period covered by the report.

Registrants must disclose the date the action was instituted, by whom, the name and location of the mine involved, and a brief description of the category of violation, order or citation underlying the proceeding.

(b) *Definitions*. For purposes of this Item:

(1) The term *coal or other mine* means a coal or other mine, as defined in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802), that is subject to the provisions of such Act (30 U.S.C. 801 et seq).

(2) The term *operator* has the meaning given the term in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802).

Instructions to Item 106:

1. The registrant must provide the information required by this Item as specified by § 229.601(b)(95) of this chapter. In addition, the registrant must provide a statement, in an

appropriately captioned section of the periodic report, that the information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and this Item is included in exhibit 95 to the periodic report.

2. When the disclosure required by this item is included in an exhibit to an annual report on Form 10-K, the information is to be provided for the fourth quarter of the registrant's fiscal year, as well as for the entire fiscal year.

3. Amend § 229.601 by revising the exhibit table in paragraph (a), and adding paragraph (b)(95), to read as follows:

§ 229.601 (Item 601) Exhibits.

(a) ***

Exhibit Table

EXHIBIT TABLE													
Securities Act Forms									Exchange Act Forms				
	<u>S-1</u>	<u>S-3</u>	<u>S-4¹</u>	<u>S-8</u>	<u>S-11</u>	<u>F-1</u>	<u>F-3</u>	<u>F-4¹</u>	<u>10</u>	<u>8-K²</u>	<u>10-D</u>	<u>10-Q</u>	<u>10-K</u>

(36) through (97) [Reserved]	N/A												
(95) Mine Safety Disclosure Exhibit												X	X

(b) * * *

(95) Mine Safety Disclosure Exhibit. A registrant that is an operator, or that has a subsidiary that is an operator, of a coal or other mine must provide the information required by Item 106 of Regulation S-K (§ 229.106 of this chapter) in an exhibit to its Exchange Act annual or quarterly report. For purposes of this Item:

1. The term *coal or other mine* means a coal or other mine, as defined in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802), that is subject to the provisions of such Act (30 U.S.C. 801 et seq).

2. The term *operator* has the meaning given the term in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802).

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

4. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 77mm, 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 404 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

5. Amend Form S-3 (referenced in § 239.13) by revising General Instruction

I.A.3.(b) to read as follows:

Note-The text of Form S-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM S-3
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form S-3 * * *

A. Registrant Requirements. * * *

3. * * *

(b) has filed in a timely manner all reports required to be filed during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement, other than a report that is required solely pursuant to Item 1.01, 1.02, 1.04, 2.03, 2.04, 2.05, 2.06, 4.02(a) or 5.02(e) of Form 8-K (§ 249.308 of this chapter). If the registrant has used (during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement) Rule 12b-25(b) (§ 240.12b-25(b) of this chapter) under the Exchange Act with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by that rule.

* * * * *

PART 249 -- FORMS, SECURITIES EXCHANGE ACT OF 1934

6. The authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

7. Amend Form 20-F (referenced in § 249.220f) by adding Item 16J, and adding Instruction 19 to the Instructions as to Exhibits, of Form 20-F, to read as follows:

Note-The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 20-F

* * * * *

Item 16J. Mine Safety Disclosure

If the registrant is the operator, or has a subsidiary that is an operator, of a coal or other mine, include the information set forth below for the time period covered by the annual report. In an appropriately captioned section of the annual report, provide a statement that the information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and this Item is included in a specified exhibit to the annual report. Include the following information in an exhibit to the annual report.

- (a) For each coal or other mine of which the registrant or a subsidiary of the registrant is an operator, identify the mine and disclose:
 - (i) The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under section 104 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 814) for which the operator received a citation from the Mine Safety and Health Administration.
 - (ii) The total number of orders issued under section 104(b) of such Act (30 U.S.C. 814(b)).
 - (iii) The total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under section 104(d) of such Act (30 U.S.C. 814(d)).

(iv) The total number of flagrant violations under section 110(b)(2) of such Act (30 U.S.C. 820(b)(2)).

(v) The total number of imminent danger orders issued under section 107(a) of such Act (30 U.S.C. 817(a)).

(vi) The total dollar value of proposed assessments from the Mine Safety and Health Administration under such Act (30 U.S.C. 801 et seq).

Instruction to Item 16J(a)(vi): Registrants must provide the total dollar value of assessments proposed by MSHA during the period covered by the report, and also provide the total dollar value of all outstanding assessments as of the last day of the period covered by the report, regardless of whether the registrant has challenged or appealed the assessment.

(vii) The total number of mining-related fatalities.

(b) A list of coal or other mines, of which the registrant or a subsidiary of the registrant is an operator, that receive written notice from the Mine Safety and Health Administration of:

(i) A pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of such Act (30 U.S.C. 814(e)); or

(ii) the potential to have such a pattern.

(c) For each violation, order or citation disclosed in response to (a) and (b) above, a brief description of the category of violation, order or citation.

(d) Any pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.

Instructions to Item 16J(d): 1. Item 16J only applies to annual reports, and not to registration statements on Form 20-F.

2. The exhibit described in this Item must meet the requirements under Instruction 19 as to Exhibits of this Form.

3. The registrant must report any legal actions commenced during the time period covered by the report, as well as any developments material to a legal action previously reported under this provision occurring during the period covered by the report. Registrants must disclose the date the action was instituted, by whom, the name and location of the mine involved, and a brief description of the category of violation, order or citation underlying the proceeding.

* * * * *

Instruction to Item 16J

For purposes of this Item:

1. The term *coal or other mine* means a coal or other mine, as defined in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802), that is subject to the provisions of such Act (30 U.S.C. 801 et seq).

2. The term *operator* has the meaning given the term in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802).

* * * * *

INSTRUCTIONS AS TO EXHIBITS

* * * * *

19. The mine safety disclosure required by Item 16J.

A registrant that is the operator, or that has a subsidiary that is an operator, of a coal or other mine must provide the information specified in Item 16J in an exhibit to its annual report on Form 20-F.

20 through 99. [Reserved]

* * * * *

8. Amend Form 40-F (referenced in § 249.240f) by adding Paragraph (18) to General Instruction B. to read as follows:

* * * * *

(18) Mine safety disclosure. If the registrant is the operator, or has a subsidiary that is an operator, of a coal or other mine, include the information set forth below for the time period covered by the annual report. In an appropriately captioned section of the annual report, provide a statement that the information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and this Item is included in a specified exhibit to the annual report. Include the following information in an exhibit to the annual report.

(a) For each coal or other mine of which the registrant or a subsidiary of the registrant is an operator, identify the mine and disclose:

(i) The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under section 104 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 814) for which the operator received a citation from the Mine Safety and Health Administration.

(ii) The total number of orders issued under section 104(b) of such Act (30 U.S.C. 814(b)).

(iii) The total number of citations and orders for unwarrantable failure of the mine operator to comply with mandatory health or safety standards under section 104(d) of such Act (30 U.S.C. 814(d)).

(iv) The total number of flagrant violations under section 110(b)(2) of such Act (30 U.S.C. 820(b)(2)).

(v) The total number of imminent danger orders issued under section 107(a) of such Act (30 U.S.C. 817(a)).

(vi) The total dollar value of proposed assessments from the Mine Safety and Health Administration under such Act (30 U.S.C. 801 et seq).

Instruction to paragraph (18)(a)(vi): Registrants must provide the total dollar value of assessments proposed by MSHA during the period covered by the report, and also provide the total dollar value of all outstanding assessments as of the last day of the period covered by the report, regardless of whether the registrant has challenged or appealed the assessment.

(vii) The total number of mining-related fatalities.

(b) A list of coal or other mines, of which the registrant or a subsidiary of the registrant is an operator, that receive written notice from the Mine Safety and Health Administration of:

(i) A pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of such Act (30 U.S.C. 814(e)); or

(ii) the potential to have such a pattern.

(c) For each violation, order or citation disclosed in response to (a) and (b) above, a brief description of the category of violation, order or citation.

(d) Any pending legal action before the Federal Mine Safety and Health Review Commission involving such coal or other mine.

Instruction to paragraph (18)(d): The registrant must report any legal actions commenced during the time period covered by the report, as well as any developments material to a legal action previously reported under this provision occurring during the period covered by the report. Registrants must disclose the date the action was instituted, by whom, the name and location of the mine involved, and a brief description of the category of violation, order or citation underlying the proceeding.

* * * * *

Notes to Paragraph (18) of General Instruction B:

For purposes of this Item:

1. The term *coal or other mine* means a coal or other mine, as defined in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802), that is subject to the provisions of such Act (30 U.S.C. 801 et seq).
2. The term *operator* has the meaning given the term in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802).
3. Instruction B(18) only applies to annual reports, and not to registration statements on Form 40-F.

* * * * *

9. Amend Form 8-K (referenced in § 249.308) by adding Item 1.04 under the caption "Information to Be Included in the Report" after the General Instructions to read as follows:

Note: The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 8-K

* * * * *

General Instructions

* * * * *

Information to Be Included in the Report

* * * * *

Item 1.04 Mine Safety – Reporting of Shutdowns and Patterns of Violations.

(a) If the registrant or a subsidiary of the registrant has received, with respect to a coal or other mine of which the registrant or a subsidiary of the registrant is an operator

- an imminent danger order issued under section 107(a) of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 817(a));
- a written notice from the Mine Safety and Health Administration that the coal or other mine has a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of such Act (30 U.S.C. 814(e)); or
- a written notice from the Mine Safety and Health Administration that the coal or other mine has the potential to have such a pattern,

disclose the following information:

- (1) The date of receipt by the issuer or a subsidiary of such order or notice.
- (2) A brief description of the category of order or notice.
- (3) The name and location of the mine involved.

Instructions to Item 1.04.

1. The term "coal or other mine" means a coal or other mine, as defined in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802), that is subject to the provisions of such Act (30 U.S.C. 801 et seq).

2. The term "operator" has the meaning given the term in section 3 of the Federal Mine Safety and Health Act of 1977 (30 U.S.C. 802).

* * * * *

10. Amend Form 10-Q (referenced in § 249.308a) by adding Item 4 in Part II to read as follows:

Note-The text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 10-Q

* * * * *

PART II

* * * * *

Item 4. Specialized Disclosures* * *

If applicable, provide a statement that the information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and

Consumer Protection Act and Item 106 of Regulation S-K (17 CFR 229.106) is included in exhibit 95 to the quarterly report.

* * * * *

11. Amend Form 10-K (referenced in § 249.310) by adding paragraph (b) to Item 4 in Part I to read as follows:

Note-The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM 10-K

* * * * *

PART I

* * * * *

Item 4. Specialized Disclosures * * *

(b) If applicable, provide a statement that the information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 106 of Regulation S-K (17 CFR 229.106) is included in exhibit 95 to the annual report.

* * * * *

By the Commission.



Elizabeth M. Murphy
Secretary

December 15, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63560 / December 16, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3218 / December 16, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13150

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

On August 28, 2008, Alvin L. Dahl, CPA ("Dahl") was suspended from appearing or practicing before the Commission as an accountant as a result of settled public administrative proceedings instituted by the Commission against Dahl pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.¹ Dahl consented to the entry of the order without admitting or denying the findings therein but for the Commission's finding that a final judgment and permanent injunction and other relief had been previously entered against him. This order is issued in response to Dahl's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

The Commission's complaint alleged that Dahl, while serving as Chief Financial Officer, aided and abetted 21st Century Technologies, Inc.'s ("21st Century") violations of Securities Exchange Act of 1934 ("Exchange Act") Section 13(a) and Rules 12b-20, 13a-1, and 13a-13 thereunder when he prepared 21st Century's false and misleading Form 10-K for 2003 and Forms 10-Q for the first and second quarters of 2004. The complaint further alleged that Dahl violated Exchange Act Rule 13a-14 when he certified that those filings were complete and accurate, even though they contained material omissions concerning certain of 21st Century's reported investments. The complaint alleged, among other things, that Dahl knew at the time he certified certain filings that (i) a supposed "commercial loan" was actually a loan to prevent a foreclosure on a personal residence; and (ii) the recipient of another loan was misidentified in 21st Century's

¹ See Accounting and Auditing Enforcement Release No. 2869 dated August 28, 2008. Dahl was permitted, pursuant to the order, to apply for reinstatement after 12 months upon making certain showings.

filings with the Commission in order to avoid potential stigma from association with the entity that received the loan, which was involved in pornography.

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

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."² This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Dahl, it appears that he has complied with the terms of the August 28, 2008 order denying him the privilege of appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Dahl, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

² Rule 102(e)(5)(i) provides:

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

IT IS FURTHER ORDERED that the Fair Fund be terminated and that the Administrator be discharged after the above-referenced fees and expenses have been paid and any remaining funds in the Distribution Fund have been transferred to the United States Treasury.

By the Commission

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 232

RELEASE NO. 33-9165; File No. S7-18-10

RIN 3235-AK70

**EXTENSION OF FILING ACCOMMODATION FOR STATIC POOL INFORMATION
IN FILINGS WITH RESPECT TO ASSET-BACKED SECURITIES**

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Commission is adopting an amendment to Rule 312 of Regulation S-T to further extend its application for eighteen months. Rule 312 provides a temporary filing accommodation for filings with respect to asset-backed securities that allows static pool information required to be disclosed in a prospectus of an asset-backed issuer to be provided on an Internet website under certain conditions. Under this rule, such information is deemed to be included in the prospectus included in the registration statement for the asset-backed securities. As a result of the extension, the rule will apply to filings with respect to asset-backed securities filed on or before June 30, 2012.

EFFECTIVE DATE: December 31, 2010.

FOR FURTHER INFORMATION CONTACT: Jay Knight, Attorney-Adviser, Division of Corporation Finance, at (202) 551-3370, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3720.

SUPPLEMENTARY INFORMATION: We are adopting an amendment to Rule 312¹ of Regulation S-T.²

¹ 17 CFR 232.312.

I. BACKGROUND AND DISCUSSION OF THE AMENDMENT

In December 2004, we adopted new and amended rules and forms to address the registration, disclosure and reporting requirements for asset-backed securities (“ABS”) under the Securities Act of 1933³ (the “Securities Act”) and the Securities Exchange Act of 1934⁴ (the “Exchange Act”).⁵ As part of this rulemaking, we adopted Regulation AB,⁶ a new principles-based set of disclosure items forming the basis for disclosure with respect to ABS in both Securities Act registration statements and Exchange Act reports. Compliance with the revised rules was phased in; full compliance with the revised rules became effective January 1, 2006. One of the significant features of Regulation AB is Item 1105, which requires, to the extent material, static pool information to be provided in the prospectus included in registration statements for ABS offerings.⁷ While the disclosure required by Item 1105 depends on factors such as the type of underlying asset and materiality, the information required to be disclosed can be extensive. For example, a registrant may be required to disclose multiple performance metrics in periodic increments for prior securitized pools of the sponsor for the same asset type in the last five years.⁸

² 17 CFR 232.10 et seq.

³ 15 U.S.C. 77a et seq.

⁴ 15 U.S.C. 78a et seq.

⁵ See Asset-Backed Securities, Release No. 33-8518 (Dec. 22, 2004) [70 FR 1506] (adopting release related to Regulation AB and other new rules and forms related to asset-backed securities) (hereinafter, the “2004 Adopting Release”).

⁶ 17 CFR 229.1100 et seq.

⁷ See Form S-1 (17 CFR 239.11) and Form S-3 (17 CFR 239.13) under the Securities Act. Static pool information indicates how groups, or static pools, of assets, such as those originated at different intervals, are performing over time. By presenting comparisons between originations at similar points in the assets’ lives, the data allows the detection of patterns that may not be evident from overall portfolio numbers and thus may reveal a more informative picture of material elements of portfolio performance and risk.

⁸ 17 CFR 229.1105.

As described in the 2004 Adopting Release, in response to the Commission's proposal to require material static pool information in prospectuses for ABS offerings, many commentators representing both ABS issuers and investors requested flexibility in the presentation of such information. In particular, commentators noted that the required static pool information could include a significant amount of statistical information that would be difficult to file electronically on EDGAR as it existed at that time and difficult for investors to use in that format.

Commentators accordingly requested the flexibility for ABS issuers to provide static pool information on an Internet website rather than as part of an EDGAR filing.⁹ In response to these comments, we adopted Rule 312 of Regulation S-T, which permits, but does not require, the posting of the static pool information required by Item 1105 on an Internet website under the conditions set forth in the rule.¹⁰ We recognized at the time that a Web-based approach might allow for the provision of the required information in a more efficient, dynamic and useful format than was currently feasible on the EDGAR system. At the same time, we explained that we continued to believe at some point for future transactions the information should also be submitted with the Commission in some fashion, provided investors continue to receive the information in the form they have requested. Accordingly, we adopted Rule 312 as a temporary filing accommodation applicable to filings filed on or before December 31, 2009.¹¹ We explained that we were directing our staff to consult with the EDGAR contractor, EDGAR filing agents, issuers, investors and other market participants to consider how static pool information could be filed with the Commission in a cost-effective manner without undue burden or expense

⁹ See 2004 Adopting Release, Section III.B.4.b.

¹⁰ 17 CFR 232.312(a). Instead of relying on Rule 312, an issuer can include information required by Item 1105 of Regulation AB physically in the prospectus or, if permitted, through incorporation by reference from an Exchange Act report.

¹¹ 17 CFR 232.312(a); see also 2004 Adopting Release, Section III.B.4.b.

that still allows issuers to provide the information in a desirable format. We also noted, however, that it might be necessary, among other things, to extend the accommodation.¹²

On December 15, 2009, we adopted a one-year extension of the filing accommodation.¹³ In the adopting release for the extension (“2009 Static Pool Extension Adopting Release”), we noted the staff’s experience with the rule and that a vast majority of residential mortgage-backed security issuers and a significant portion of ABS issuers in other asset classes have relied on the accommodation provided by the rule to disclose static pool information on an Internet website. We also noted that the staff of the Division of Corporation Finance was, at the time, engaged in a broad review of the Commission’s regulation of ABS including disclosure, offering process, and reporting of ABS issuers and that along with this review, the staff of the Division of Corporation Finance was continuing to explore whether it was feasible to provide a filing mechanism for static pool information that fulfills the Commission’s objectives. We also stated our belief that a proposal for a longer-term solution for providing static pool disclosure would be better considered together with other proposals on the regulations relating to the offer and sale of ABS.

On April 7, 2010, we proposed significant revisions to Regulation AB and other rules regarding the offering process, disclosure and reporting for asset-backed securities (the “2010 ABS Proposals”).¹⁴ In that release, we proposed to revise Rule 312 to remove the temporary accommodation set to expire on December 31, 2010. In lieu thereof, under the proposal, ABS issuers would be required to file all static pool information on EDGAR; however, we proposed to

¹² 2004 Adopting Release, Section III.B.4.b.

¹³ Extension of Filing Accommodation for Static Pool Information in Filings With Respect to Asset-Backed Securities, Release No. 33-9087 (Dec. 15, 2009) [74 FR 67812] (the “2009 Static Pool Extension Adopting Release”).

¹⁴ Asset-Backed Securities, Release No. 33-9117 (Apr. 7, 2010) [75 FR 23328] (the “2010 ABS Proposing Release”).

allow that such information be filed in Portable Document Format (PDF).¹⁵ Also, in lieu of providing the static pool information in the prospectus, we proposed to allow issuers to file the disclosure on Form 8-K and incorporate it by reference. The comment period for the 2010 ABS Proposals expired on August 2, 2010.

On August 30, 2010, we proposed to extend the temporary filing accommodation set forth in Rule 312 of Regulation S-T for eighteen months so that it would apply to filings with respect to ABS filed on or before June 30, 2012.¹⁶ We received three comment letters that addressed the proposed extension.¹⁷ All three commentators expressed support for the Rule 312 filing accommodation and the proposed extension.¹⁸ The ASF cited the strong preference among both its issuer and investor members for Web-based presentation of static pool information due to its utility and effectiveness and the current lack of an adequate filing alternative.¹⁹ SIFMA and CNH Capital agreed that a long-term solution for providing static pool disclosure would be better considered together with other proposals to revise the regulations governing the offer and sale of ABS.²⁰ With regard to the duration of an extension, ASF requested that the filing accommodation be made permanent or, in the alternative, extended for five years;²¹ CNH Capital requested that the duration of the extension be synchronized with the timing of implementation

¹⁵ Portable Document Format (PDF) is a file format created by Adobe Systems in 1993 for document exchange. PDF captures formatting information from a variety of desktop publishing applications, making it possible to send formatted documents and have them appear on the recipient's monitor or printer for free as they were intended. To view a file in PDF format, you need Adobe Reader, an application distributed by Adobe Systems.

¹⁶ Extension of Filing Accommodation for Static Pool Information in Filings With Respect to Asset-Backed Securities, Release No. 33-9137 (Aug. 30, 2010) [75 CFR 54059] (hereinafter, the "Proposing Release").

¹⁷ The public comment letters we received are available online at <http://www.sec.gov/comments/s7-18-10/s71810.shtml>.

¹⁸ See letters from the American Securitization Forum ("ASF"), CNH Capital America LLC ("CNH Capital"), and the Securities Industry and Financial Markets Association ("SIFMA").

¹⁹ See letter from ASF.

²⁰ See letters from SIFMA and CNH Capital.

²¹ See letter from ASF.

of the other disclosure requirements that were proposed in the 2010 ABS Proposing Release but have not yet been adopted;²² and SIFMA supported the Commission's proposal to extend the temporary accommodation for the filing of static pool information for eighteen months.²³

We are adopting as proposed an eighteen-month extension to the temporary filing accommodation provided by Rule 312. As we stated in the Proposing Release, we believe a proposal for a long-term solution for providing static pool disclosure would be better considered together with other proposals to revise the regulations governing the offer and sale of ABS. Additionally, on July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").²⁴ Among other things, the Act mandates a number of significant changes to the regulation of ABS offerings. In order to provide ample time for the Commission and its staff to give proper consideration to comments received on the 2010 ABS Proposals and in light of the changes to the regulations of ABS offerings that are mandated by the Act, we are adopting the extension to the temporary filing accommodation set forth in Rule 312 of Regulation S-T for an additional eighteen months so that it would apply to filings with respect to ABS filed on or before June 30, 2012. Although we are adopting an eighteen-month extension of Rule 312, we may take action on the 2010 ABS Proposals, including the static pool proposal, at any time before the expiration of the extension.

Under the extension, the temporary filing accommodation set forth in Rule 312 of Regulation S-T will apply to filings with respect to ABS filed on or before June 30, 2012. During the extension, the existing requirements of Rule 312 will continue to apply. Pursuant to these requirements, the registrant must disclose its intention to provide static pool information

²² See letter from CNH Capital.

²³ See letter from SIFMA.

²⁴ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

through a website in the prospectus included in the registration statement at the time of effectiveness and provide the specific Internet address where the static pool information is posted in the prospectus filed pursuant to Rule 424.²⁵ The registrant must maintain such information on the website unrestricted and free of charge for a period of not less than five years, indicate the date of any updates or changes to the information, undertake to provide any person without charge, upon request, a copy of the information as of the date of the prospectus if a subsequent update or change is made to the information and retain all versions of the information provided on the website for a period of not less than five years in a form that permits delivery to an investor or the Commission. In addition, the registration statement for the ABS must contain an undertaking pursuant to Item 512(l) of Regulation S-K²⁶ that the information provided on the website pursuant to Rule 312 is deemed to be part of the prospectus included in the registration statement.²⁷

The Administrative Procedure Act generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective. This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.²⁸ Because the temporary filing accommodation expires on December 31, 2010, we believe it is necessary to make the amendment effective December 31st so that there is no gap between which an issuer would be required to convert its static pool data into an EDGAR filing. In addition, this extension creates no new requirements but maintains a voluntary accommodation that relieves a

²⁵ 17 CFR 230.424.

²⁶ 17 CFR 229.512(l).

²⁷ 17 CFR 232.312. As we indicated in the 2004 Adopting Release, if the conditions of Rule 312 are satisfied, then the information will be deemed to be part of the prospectus included in the registration statement and thus subject to all liability provisions applicable to prospectuses and registration statements, including Section 11 of the Securities Act [15 U.S.C. 77k]. 2004 Adopting Release, Section III.B.4.b.

²⁸ See 5 U.S.C. 553(d).

registrant from the obligation to file static pool data on EDGAR, provided it makes the information available on a website. The Commission therefore believes the extension grants or recognizes an exemption or relieves a restriction. On the basis of the foregoing, the Commission finds good cause to make the amendment effective December 31, 2010.

II. PAPERWORK REDUCTION ACT

Rule 312 of Regulation S-T was adopted in 2004 along with other new and amended rules and forms to address the registration, disclosure and reporting requirements for ABS under the Securities Act and the Exchange Act. In connection with this prior rulemaking, we submitted a request for approval of the "collection of information" requirements contained in the amendments and rules to the Office of Management and Budget ("OMB") in accordance with the Paperwork Reduction Act of 1995 ("PRA").²⁹ OMB approved these requirements.³⁰

Item 1105 of Regulation AB³¹ requires certain static pool information, to the extent material, to be provided in prospectuses included in registration statements for ABS offerings.³² Rule 312 is a temporary filing accommodation that permits the posting of the static pool information required by Item 1105 on an Internet website under the conditions set forth in the rule.³³ The amendment to Rule 312 further extends the existing temporary filing accommodation provided by the rule for an additional eighteen months. As is the case today, issuers may choose whether or not to take advantage of the accommodation. The conditions of Rule 312 remain otherwise unchanged. The disclosure requirements themselves, which are contained in Forms S-

²⁹ 44 U.S.C. 3501 *et seq.*

³⁰ The collections of information to which Rule 312 of Regulation S-T relates are "Form S-1" (OMB Control No. 3235-0065) and "Form S-3" (OMB Control No. 3235-0073).

³¹ 17 CFR 229.1105.

³² See Form S-1 and Form S-3 under the Securities Act.

³³ 17 CFR 232.312(a).

I and S-3 under the Securities Act and require the provision of the information set forth in Item 1105 of Regulation AB, also remain unchanged. Therefore, the amendment will not result in an increase or decrease in the costs and burdens imposed by the “collection of information” requirements previously approved by the OMB. No commentator suggested the extension would impose any new paperwork burden.

III. BENEFIT-COST ANALYSIS

In this section, we examine the benefits and costs of the amendment. In the Proposing Release, we requested that commentators provide views, supporting information and estimates on the benefits and costs that may result from the adoption of the proposed amendment. No commentator addressed the cost-benefit analysis of the Proposing Release.

A. Benefits

We initially adopted the filing accommodation provided by Rule 312 of Regulation S-T because commentators requested flexibility in the presentation of required static pool information. Given the large amount of statistical information involved, those commentators argued for a Web-based approach that would allow issuers to present the information in an efficient manner and with greater functionality and utility than might have been available if an EDGAR filing was required. We believe this greater functionality and utility has enhanced an investor’s ability to access and analyze the static pool information because investors have been able to access static pool information in more user-friendly formats than was initially capable with filings on EDGAR and also removed the burden on issuers of duplicating the information in each prospectus as well as easing the burdens of updating such information.³⁴ As we discussed in the 2004 Adopting Release, since the information is deemed to be part of the prospectus

³⁴ See Section I above and 2004 Adopting Release, Section V.D.

included in the registration statement, the rule is designed to give investors access to accurate and reliable information.

By further extending the accommodation provided by Rule 312, these benefits to both issuers and investors will continue to apply. As noted in the 2009 Static Pool Extension Adopting Release, based on the staff's experience since Rule 312 became effective in 2006, the vast majority of residential mortgage-backed security issuers and a significant portion of ABS issuers in other asset classes have relied on the accommodation provided by the rule to disclose static pool information on an Internet website.³⁵ If we did not further extend the accommodation provided by Rule 312 as we are doing today, static pool information would have been required in EDGAR filings beginning on January 1, 2011. We believe this would have resulted in costs for issuers as they attempt to adjust their procedures in a short period of time in order to present the information in a format acceptable to the EDGAR system and could have resulted in costs to investors if the information filed on EDGAR was presented in a less useful format.

As indicated above, on April 7, 2010, we issued a release proposing to require the filing of static pool information on EDGAR at the same time we proposed other amendments addressing the disclosure, offering process and reporting of ABS issuers.³⁶ We believe that the eighteen-month extension to the temporary filing accommodation contained in Rule 312 will benefit both investors and issuers by maintaining a consistent approach to the filing of static pool information while we and our staff consider comments received on the proposed amendment to static pool filing together with our other proposals regarding the offering and sale of asset-backed securities and in light of the changes to the regulations of ABS offerings that are mandated by the Dodd-Frank Act.

³⁵ See Section I of the 2009 Static Pool Extension Adopting Release.

³⁶ See 2010 ABS Proposing Release.

B. Costs

We do not believe the eighteen-month extension of the Rule 312 accommodation will impose any new or increased costs on issuers. In the Cost-Benefit Analysis section of the 2004 Adopting Release, we noted that ABS issuers electing the Web-based accommodation provided by Rule 312 would incur costs related to the maintenance and retention of static pool information posted on a website and might also incur start-up costs.³⁷ While it is likely that certain of those costs will continue to impact ABS issuers that elect the Web-based approach during the extension period, we do not believe the amendment will impose any new or increased costs for ABS issuers because it does not change any other conditions to the accommodation or the underlying filing and disclosure obligations. As a result of the extension of the accommodation, ABS issuers will be able to continue their current practices for an additional eighteen months.

For investors, there may be costs associated with the static pool information not being electronically filed with the Commission. For example, when information is electronically filed with the Commission, investors and staff can access the information from a single, permanent, and centralized location, the EDGAR website.³⁸ We think these costs are mitigated by the fact that ABS issuers relying on the Rule 312 accommodation must ensure that the prospectus for the offering contains the Internet website address where the static pool information is posted, the website must be unrestricted and free of charge, such information must remain on the Internet website for five years with any changes clearly indicated and the issuer must undertake to

³⁷ See 2004 Adopting Release, Section V.D.

³⁸ See, e.g., comment letter from EDGAROnline dated December 9, 2009, on the Extension of Filing Accommodation for Static Pool Information in Filings With Respect to Asset-Backed Securities, Release No. 33-9074 (Oct. 19, 2009) [74 FR 54767] (the "2009 Static Pool Extension Proposing Release"). EDGAROnline commented that extending the filing accommodation will hinder the quality and comparability of information because investors will not be able to depend on a common repository for cross issuer comparisons. The public comments on the 2009 Static Pool Extension Proposing Release are available at <http://www.sec.gov/comments/s7-23-09/s72309.shtml>.

provide the information to any person free of charge, upon request, if a subsequent update or change is made. Furthermore, because the information is deemed included in the prospectus under Rule 312, it is subject to all liability provisions applicable to prospectuses and registration statements.

Investors and issuers may have incurred costs to adjust their processes in anticipation of the lapse of the Rule 312 accommodation and potential reversion to a requirement to file static pool information on EDGAR. In this case, benefits to investors or issuers of not having to change their procedures regarding static pool reporting in a short time frame would be diminished by any costs already incurred in anticipation of the change. We believe such anticipatory action and any associated costs are minimal.

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

Section 2(b) of the Securities Act requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

As discussed in greater detail above, Rule 312 of Regulation S-T was adopted as a temporary filing accommodation so that issuers of ABS could present static pool information on an Internet website. The amendment to Rule 312 of Regulation S-T that we are adopting today further extends its application for eighteen months. We are not changing the conditions of Rule 312 or to the disclosure obligations to which it applies. We do not believe that the eighteen-month extension will impose a burden on competition. We also believe the extension of the filing accommodation will continue to promote efficiency and capital formation by permitting

ABS issuers to disclose static pool information in a format that is more useful to investors and cost-effective and not unduly burdensome for ABS issuers.

We requested comment on whether the proposed amendment, if adopted, would promote efficiency, competition, and capital formation. We did not receive any comments directly responding to this request.

V. REGULATORY FLEXIBILITY ACT CERTIFICATION

In Part VII of the Proposing Release, the Commission certified pursuant to 5 U.S.C. 605(b) that the proposed amendment to Rule 312 of Regulation S-T would not have a significant economic impact on a substantial number of small entities. While the Commission encouraged written comments regarding this certification, no commentators responded to this request or indicated that the amendment as adopted would have a significant economic impact on a substantial number of small entities.

VI. STATUTORY AUTHORITY AND TEXT OF THE AMENDMENT

The amendment described is being adopted under the authority set forth in Sections 6, 7, 10, 19 and 28 of the Securities Act of 1933 (15 U.S.C. 77f, 77g, 77j, 77s and 77z-3).

List of Subjects

17 CFR Part 232

Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENT

For the reasons set out in the preamble, the Commission hereby amends title 17, chapter II, of the Code of Federal Regulations as follows:

PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

1. The authority citation for part 232 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

2. Amend §232.312 paragraph (a) introductory text by removing “December 31, 2010” and in its place adding “June 30, 2012” in the first sentence.

By the Commission.



Elizabeth M. Murphy
Secretary

December 16, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63571 / December 17, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-12591

In the Matter of	:	ORDER TERMINATING THE FAIR
	:	FUND, DISCHARGING THE
	:	DISTRIBUTION FUND
	:	ADMINISTRATOR AND
Banc of America Securities LLC,	:	CANCELLING THE
	:	ADMINISTRATOR'S BOND
	:	
	:	
Respondent.	:	

On March 14, 2007, Banc of America Securities LLC ("BAS") consented to the entry of an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934, which directed, among other things, that BAS pay disgorgement of \$10 million and civil penalties of \$16 million, for a total payment of \$26 million, and that established a Fair Fund to provide for the distribution of funds to investors that were harmed by BAS' conduct as described in the Order. The Order required a Distribution Fund Administrator ("DFA") to be appointed by the Commission to develop a distribution plan. In the companion Order Appointing Distribution Fund Administrator and Directing Submission of Proposed Distribution Plan, the Commission appointed Francis McGovern as the DFA. That Order directed the DFA to develop a Distribution Plan for the distribution of the Fair Fund according to a methodology to be developed by the DFA in consultation with, and acceptable to, the staff of the Commission. A Proposed Distribution Plan was developed and submitted by August 2007.

On August 9, 2007, the Office of the Secretary, under its delegated authority, issued an order publishing the Notice of a Proposed Plan of Distribution (the "Distribution Plan") (Securities Exchange Act Release No. 34-56234). Among other things, the Notice stated that all persons desiring to comment on the Distribution Plan could submit their views, in writing, no later than September 10, 2007 to the Office of the Secretary, by e-mail or regular mail. No comments were received during that thirty day period. Thereafter, on September 20, 2007, the Commission issued an Order approving the Distribution Plan. The Plan provided for the distribution of the Fair Fund to customers of BAS that were harmed by BAS's conduct, under both a primary plan of distribution and a plan of residual

distribution. The Plan further provided that any amount remaining in the Fair Fund after all distributions were made, would be transferred to the U.S. Treasury.

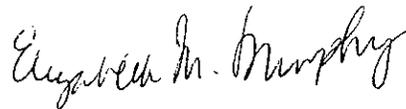
On May 30, 2008, the Commission entered an order directing disbursement of \$26,619,141, consisting of the \$26 million in disgorgement and civil penalties and \$619,141 in interest accrued by the claims deadline. On June 23, 2008, checks were mailed to all of the eligible recipients. All distributions have been made. Some of the eligible recipients did not cash their checks, even after several reminders. As of now, the amount of \$398,863.45 remains in the Fair Fund.

The DFA submitted a Final Accounting pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans, which was approved by the Commission. Pursuant to the DFA's Final Accounting, the \$398,863.45 remaining in the Fair Fund is to be transmitted to the U.S. Treasury.

Accordingly, IT IS ORDERED that:

- A. The Fair Fund is terminated and the \$398,863.45 remaining in the Fair Fund is to be transmitted to the U.S. Treasury;
- B. The Distribution Fund Administrator is discharged; and
- C. The Administrator's bond is to be released and cancelled immediately.

By the Commission.



Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63570/December 17, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-14164

In the Matter of

**C-3D Digital, Inc.,
California Clean Air, Inc.,
CEC Properties, Inc.,
Censtor Corp.,
The Centennial Group, Inc.,
Century Technologies, Inc., and
Chief Consolidated Mining 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 C-3D Digital, Inc., California Clean Air, Inc., CEC Properties, Inc., Censtor Corp., The Centennial Group, Inc., Century Technologies, Inc., and Chief Consolidated Mining Co.:

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. C-3D Digital, Inc. (CIK No. 850218) is an expired Utah corporation located in Universal City, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). C-3D 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, 2002, which reported a net loss of \$855,107 for the prior three

months. As of December 7, 2010, the company's common stock (symbol "CDDT") was traded on the over-the-counter markets.

2. California Clean Air, Inc. (CIK No. 1119697) is a revoked Nevada corporation located in Vista, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). California Clean 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 \$500,790 for the prior nine months.

3. CEC Properties, Inc. (CIK No. 74454) is a void Delaware corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CEC Properties 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 October 31, 2001, which reported a net loss of \$72,489 for the prior twelve months. As of December 7, 2010, the company's common stock (symbol "CECI") was traded on the over-the-counter markets.

4. Censtor Corp. (CIK No. 932094) is a dissolved California corporation located in Los Gatos, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Censtor is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 1999. On April 13, 2004, Censtor filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of California, and the case was terminated on December 23, 2005.

5. The Centennial Group, Inc. (CIK No. 810909) is a forfeited Delaware corporation located in Orange, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Centennial Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 1994, which reported a net loss of \$1.6 million for the prior three months. On December 13, 1991, Centennial Group filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was dismissed on February 1993.

6. Century Technologies, Inc. (CIK No. 887736) is a Colorado corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Century 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, 1996, which reported a net loss of \$255,840 for the prior three months. As of December 7, 2010, the company's stock (symbol "CNTK") was traded on the over-the-counter markets.

7. Chief Consolidated Mining Co. (CIK No. 19913) is an Arizona corporation located in Eureka, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Chief Consolidated 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, 2008, which reported a net loss of \$2.7 million

for the prior twelve months. As of December 7, 2010, the company's common stock (symbol "CFCM") was quoted on the Pink Sheets.

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].

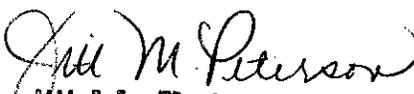
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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


By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-63573; File No. 4-622]

Credit Rating Standardization Study

AGENCY: Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Securities and Exchange Commission is requesting public comment to help inform its study pursuant to Section 939(h) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 on the feasibility and desirability of: standardizing credit ratings terminology, so that all credit rating agencies issue credit ratings using identical terms; standardizing the market stress conditions under which ratings are evaluated; requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity.

DATES: The Commission will accept comments regarding issues related to the study on or before [Insert date 45 days from publication in the Federal Register].

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-622 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and

Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. All submissions should refer to File Number 4-622. 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>). 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: Randall W. Roy, Assistant Director, Division of Trading and Markets, at (202) 551-5522; Alan A. Dunetz, Branch Chief, Division of Trading and Markets, at (212) 336-0072; Kevin S. Davey, Securities Compliance Examiner, at (212) 336-0075; Kristin A. Devitto, Securities Compliance Examiner, at (212) 336-0038; Mark M. Attar, Branch Chief, Division of Trading and Markets, at (202) 551-5889; or Raymond A. Lombardo, Branch Chief, Division of Trading and Markets, at (202) 551-5755, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010

DISCUSSION:

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") into law. Under Section 939(h) of the Dodd-Frank Act, the Securities and Exchange Commission (the "Commission") is required to study the feasibility and desirability of: (A) standardizing credit ratings terminology, so that all credit rating agencies issue credit ratings using identical terms; (B) standardizing the market stress conditions under which ratings are evaluated; (C) requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under

standardized conditions of economic stress; and (D) standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity. Not later than one year after the date of enactment of the Dodd-Frank Act, the Commission must submit to Congress a report containing the findings of the study and the recommendations, if any, of the Commission with respect to the study.

REQUEST FOR COMMENT:

The Commission believes that submissions by interested parties with a wide range of views, including those of investors who use credit ratings, portfolio managers, credit rating agencies, investment firms, underwriters, issuers, regulators and the academic community, will provide valuable information as it conducts the study required by Section 939(h) of the Dodd-Frank Act. Accordingly, the Commission requests commenters' views on each of the topics to be addressed in the Commission's study under Section 939(h) of the Dodd-Frank Act. In particular, the Commission seeks commenters' views in response to the following questions:

- (1) Is it feasible and desirable to standardize credit ratings terminology, so that all credit rating agencies issue credit ratings using identical terms?
 - a. Do commenters agree that the term "credit ratings terminology" as used in Section 939(h) of the Dodd-Frank Act refers to the symbols and numbers credit rating agencies use to denote credit ratings and the definitions and meanings they promulgate for those symbols and numbers? If not, what other (or additional) credit rating terminology should this study focus on? Commenters who identify other terminologies should indicate for all subsequent questions whether they are discussing the other terminologies or ratings symbols and numbers and their corresponding definitions and meanings.

- b. Are there credit rating terminologies used by different credit rating agencies that are currently comparable? If so, please identify and explain how they are comparable.
- c. Identify differences in the credit rating terminologies used by credit rating agencies. What is the significance of these differences?
- d. What issues do commenters encounter when they seek to compare ratings from different credit rating agencies?
- e. Some credit rating agencies employ multiple credit rating scales designed to distinguish between different types of issues and/or issuers. For example, a credit rating agency may employ different credit rating symbols for ratings of long term securities, short term securities, money market funds, claims paying abilities of insurance companies, and issues and/or issuers in different jurisdictions. Do commenters believe that some types of credit rating symbols used by credit rating agencies are more or less suitable to standardization? Is it feasible or desirable to use a single credit rating scale for all types of issues and issuances? Should a standardized credit rating scale include separate symbols for different types of credit ratings? If so, what separate credit symbols should be included in the standardized credit rating terminology? Alternatively, should credit rating terminologies for some types of issues or issuers not be standardized? If so, for which types of issuers or issuances?
- f. The credit ratings of some credit rating agencies address probability of default while the ratings of other credit rating agencies address expected loss. Other rating scales may address other metrics such as, for example, distance to distress (e.g., with respect to the public finance ratings of some credit rating agencies). Do commenters believe that it is more or less desirable to have credit ratings of different credit rating agencies address different risks? Why?

- g. Some credit rating agencies employ credit rating modifiers including, for example, “credit watch” and “rating outlook” to indicate a view as to the likelihood that a credit rating may change. Do commenters believe that it is feasible or desirable to include such credit rating modifiers in a standardized credit rating terminology? Why?
- h. If commenters believe that standardizing credit ratings terminology is desirable and feasible:
- i. What level of detail should be included in the standardized credit rating terminology?
 - ii. What mix of quantitative and qualitative factors should be referenced in each rating definition?
 - iii. Should a standardized credit rating terminology address likelihood of default, expected loss, or some other metric?
 - iv. Some credit rating agencies issues a number of broad categories of credit ratings that can be further delineated using identifiers (e.g., pluses and minuses) to allow additional gradations of ratings. How many gradations of credit quality should be included in a standardized terminology for credit ratings?
 - v. Should a standardized credit rating terminology employ a separate terminology for certain asset classes (e.g., for structured finance ratings)? Are there asset classes or types of ratings, such as short term or financial strength ratings, where a separate terminology should be considered?
 - vi. What organizations or combination of organizations should be responsible for developing and administering the standardized credit rating terminology? For example, should the Commission develop and administer the standardized terminology? Should an independent board or organization be formed to develop and administer the standardized terminology?

- vii. What time period should be allowed for credit rating agencies to map their existing ratings to a new credit rating terminology, or for private contracts and investment management agreements that reference credit ratings to be changed to refer to the standardized terminology?
- viii. Do commenters believe that it would be more desirable for credit rating agencies to retain their existing credit rating terminologies and make publicly available detailed information on how each credit rating agency's ratings can be mapped to a standardized terminology? Or would it be more desirable if the credit rating agency used only the standardized terminology?

(2) Is it feasible and desirable to standardize the market stress conditions under which credit ratings are evaluated?

- a. Under what market stress conditions are credit ratings currently evaluated?
- b. To what degree do commenters believe that credit rating agencies currently identify the market stress conditions under which credit ratings are evaluated? To the extent these market stress conditions are identified by credit rating agencies, do commenters believe that the market stress conditions used by different credit rating agencies at comparable credit rating levels are similar? If so, how are they similar? If not, how do they differ?
- c. Do commenters believe that market stress conditions can be defined in a consistent manner across different industry sectors and geographic regions?
- d. Do commenters believe that standardized market stress conditions are equally relevant to the evaluation of all asset classes or issuers? For example, are there some asset classes or issuers where the relative degree of idiosyncratic risk versus systemic risk differs? If so, are market stress conditions less relevant, for example, to asset classes and issuers where there is a higher level of idiosyncratic risk?

- e. If commenters believe that it is feasible and desirable to standardize the market stress conditions under which credit ratings are evaluated:
 - i. What parameters should be defined in these market stress conditions? For example, unemployment rates, declines in GDP and financial market declines are widely referenced indicators of market stress. What others parameters do commenters believe should be defined?
 - ii. How should market stress conditions differ across different industry sectors and geographic regions?
 - iii. Should these stress conditions reference specific historical market stresses such as, for example, the Great Depression or the 2008 financial crisis?
 - iv. Should each credit rating level have its own specifically defined stress conditions?

(3) Is it feasible and desirable to require a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress?

- a. To what extent do credit rating agencies or others assign a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations?
 - i. To what extent do commenters believe that the correspondence is similar for comparable ratings from different credit rating agencies?
 - ii. To what extent do commenters believe that the correspondence is similar across industry sectors and geographical regions?
 - iii. To what extent do commenters believe that the correspondence is constant throughout the economic cycle?
 - iv. To what extent do commenters believe that the correspondence has been constant over time? For example, do commenters believe that the range of default

probabilities and loss expectations corresponding to the credit ratings of different credit rating agencies have become more or less conservative over time?

- b. Does the ability to assign a correspondence between credit ratings and a range of default probabilities and loss expectations in a sector vary depending on the degree to which a rating methodology for that sector is more or less quantitative in nature? Are there other factors, such as the quality or amount of historical performance data or structural complexity that may make it more or less difficult to assign a correspondence between credit ratings and a range of default probabilities and loss expectations?
- c. Does the likelihood of rating transitions for similarly rated assets vary among asset classes? If so, how should variation in the likelihood of rating transitions be addressed when a quantitative correspondence is assigned between credit ratings and a range of default probabilities and loss expectations?
- d. Is there a role for market based measures such as credit spreads or option-based approaches (i.e., Merton-type models which provide a distance to default measure based on equity prices) in determining a correspondence between credit ratings and a range of default probabilities and loss expectations?
- e. If commenters believe that requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress is feasible and desirable:
 - i. What factors should be considered in determining the range of default probabilities and loss expectations associated with each rating? Should specific time horizons be specified for each default probability and loss expectation range? If so, how many different time horizons should be specified for each credit rating, and what are appropriate time horizons?

- ii. The ratings of some credit rating agencies primarily address probability of default while others address expected loss. Should credit rating agencies be allowed to choose whether their ratings address one or the other? Should a single rating address both probability of default and loss expectation or should default probabilities and loss severity be addressed separately?
- iii. What are the views of commenters on how the accuracy of the quantitative correspondence assigned by a given credit rating agency between its credit ratings and a range of default probabilities and loss expectations should be measured?

(4) Is it feasible and desirable to standardize credit rating terminology across asset classes, so that named credit ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity?

- a. To what degree do commenters believe that credit ratings are currently comparable across asset classes? For example, do commenters believe that credit ratings of structured finance products or municipal securities are comparable to credit ratings in other sectors?
- b. In cases where credit rating agencies currently use the same credit rating terminology for multiple asset classes, what is the view of commenters on the adequacy and transparency of the procedures credit rating agencies use to achieve comparability?
- c. What mix of quantitative and qualitative factors should be considered when standardizing credit rating terminology across asset classes, so that named credit ratings correspond to a standard range of default probabilities and expected losses?
 - i. To what degree should standardization be based on quantitative factors such as, for example, historical performance metrics including rating transition and default studies? What other quantitative factors should be considered?

- ii. To what degree should standardization be based on qualitative factors such as, for example, analyst judgment regarding the comparability of credits from different sectors? What other qualitative factors should be considered?
- d. Are there asset classes where the risk characteristics of the asset class, limitations on the quality of data, structural complexity, limitations on historical performance data, or other factors make it more difficult to apply to that asset class a standardized credit rating terminology which applies to other asset classes and issuers so that named ratings correspond to a standard range of default probabilities and expected losses?

All interested parties are invited to submit their views, in writing, on these questions.

By the Commission.



Elizabeth M. Murphy
Secretary

Dated: December 17, 2010

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9166 / December 20, 2010

SECURITIES EXCHANGE ACT OF 1934
Release No. 63579 / December 20, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3221 / December 20, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14167

In the Matter of	:	ORDER INSTITUTING PUBLIC
	:	ADMINISTRATIVE AND CEASE-AND-
MOORE STEPHENS WURTH	:	DESIST PROCEEDINGS PURSUANT
FRAZER & TORBET LLP	:	TO SECTION 8A OF THE
	:	SECURITIES ACT OF 1933 AND
and	:	SECTION 4C OF THE SECURITIES
	:	EXCHANGE ACT OF 1934 AND RULE
K. DEAN YAMAGATA, CPA,	:	102(e) OF THE COMMISSION'S
	:	RULES OF PRACTICE, MAKING
Respondents.	:	FINDINGS, AND IMPOSING
	:	REMEDIAL SANCTIONS AND A
	:	CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 4C¹ of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of

¹ Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . ; (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

the Commission's Rules of Practice² against Moore Stephens Wurth Frazer & Torbet LLP and Kerry Dean Yamagata (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 themselves and over the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds³ that

Summary

1. This matter concerns Respondents' improper professional conduct in connection with annual audits and quarterly reviews of the financial statements of China Energy Savings Technology, Inc. ("China Energy") in 2004 and 2005, and Respondents' violation of the document retention requirements of Regulation S-X. China Energy materially overstated its Earnings Per Share ("EPS") in its fiscal year ("FY") 2004 annual report. China Energy also materially overstated its revenues and net income in its FY 2005 annual report and two quarterly reports. Respondents failed to conduct the relevant audits and reviews in accordance with the standards and rules of the Public Company Accounting Oversight Board ("PCAOB"). Although Respondents determined that the China Energy engagement involved high risks, Respondents did not exercise professional skepticism and due professional care, and Respondents otherwise violated professional standards. Respondents issued unqualified audit opinions, which were included in China Energy's FY 2004 and 2005 annual reports. Respondents also issued interim review reports which contained no reservations, before China Energy filed its quarterly reports in FY 2005.

² Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

³ The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

Respondents

2. Moore Stephens Wurth Frazer & Torbet, LLP (hereinafter "MSWFT") is a public accounting firm registered with the PCAOB and located in Orange County, California. MSWFT served as China Energy's auditor for the fiscal years ended September 30, 2004 and September 30, 2005, and also reviewed the quarterly financial statements of China Energy for the periods December 31, 2004 through December 31, 2005.

3. Kerry Dean Yamagata, CPA, age 53, is a partner at MSWFT and was the engagement partner for MSWFT's China Energy engagements. As such, Yamagata exercised final authority on all significant decisions relating to MSWFT's China Energy audits and reviews. Yamagata is a Certified Public Accountant, licensed in California, and a resident of Chino Hills, California.

Other Relevant Entity

4. China Energy Savings Technology, Inc. is a Nevada shell corporation. In 2004 and 2005, China Energy indirectly acquired ownership of Shenzhen Dicken Industrial Development, Ltd. ("Dicken Industrial"), a company located in the People's Republic of China ("PRC") that claimed to manufacture and sell energy savings equipment. China Energy was listed on the NASDAQ National Market System between April 2005 and February 2006. In September 2006, the Commission instituted administrative proceedings pursuant to Section 12(j) of the Exchange Act against China Energy. China Energy did not answer the order instituting proceedings and the registration of its securities with the Commission was revoked in December 2006. On December 4, 2006, the Commission filed a civil injunctive action against China Energy, a Chinese national named Chiu Wing Chiu ("Chiu") and certain other entities and individuals, alleging violations of the antifraud and registration provisions of the federal securities laws. In March 2009, the U.S. District Court for the Eastern District of New York entered a final judgment in that litigation that permanently enjoined China Energy, Chiu, and the other liability defendants from violations of the antifraud and registrations provisions and ordered the payment of various penalties and approximately \$35 million in disgorgement and interest, and certain other ancillary relief. In July 2009, in granting summary judgment to the Commission against the relief defendants in the litigation, the U.S. District Court found that the relief defendants were Chiu's nominees and that Chiu was an owner of China Energy and had exercised control over China Energy.

Facts

Respondents Encounter Audit Conditions That Should Have Caused Them to Exercise Heightened Skepticism

5. In 2004, as required by PCAOB standards, MSWFT conducted an initial assessment of the risks associated with the China Energy engagement. AU § 312, *Audit Risk and Materiality in Conducting an Audit*; AU § 316, *Consideration of Fraud in a Financial Statement Audit*. The audit team rated the risks relating to improper revenue recognition, management override of controls and overstated assets as "high." The team also concluded that revenue recognition was "the key issue" in the engagement.

6. Throughout the engagement, Yamagata and the MSWFT team were aware of significant problems with China Energy's internal controls. During the FY 2004 audit, MSWFT tested China Energy's internal controls over sales and over cash receipts and disbursements, and the team concluded that those controls were not operating effectively and could not be relied upon. In its Form 10-K for FY 2005, China Energy's management reported that it was unable to complete its assessment of internal control over financial reporting, and MSWFT disclaimed an opinion on the effectiveness of such controls.

7. During the engagement, Respondents learned information that contradicted China Energy's disclosures in its annual reports. China Energy claimed in its filings that Dicken Industrial's operations were located on a single floor of a building in Shenzhen, PRC. When the audit team arrived at that location to begin their audit field work for FY 2004, however, none of Dicken Industrial's inventory was at the site. Only inventory belonging to a much smaller research and development subsidiary was on site. Instead, the company claimed that Dicken Industrial's inventory was actually in three other locations, including two cities hundreds of miles from Shenzhen.

8. MSWFT also encountered difficulties in conducting certain audit procedures and relied on affiliates to complete material aspects of the audit work. The MSWFT audit team was unable to observe inventory or obtain bank or customer confirmations when it arrived in Shenzhen to conduct the FY 2004 audit field work. After the team returned to the U.S., MSWFT hired personnel from an affiliated Beijing firm to observe Dicken Industrial's inventory and obtain bank confirmations. The same Beijing affiliate performed inventory observation and obtained bank confirmations for the FY 2005 audit.

China Energy Misstates EPS in FY 2004.

9. China Energy materially overstated EPS in its annual report for FY 2004. At the time, China Energy lacked accounting personnel trained in U.S. Generally Accepted Accounting Principles ("GAAP") and was unable to complete an EPS calculation. At China Energy's request, MSWFT prepared the initial EPS calculation. In making the calculation, however, a MSWFT accountant used the wrong number of shares (7.8 million shares, instead of 11.3 million), which had the effect of overstating EPS by \$0.15, or approximately 41%. Yamagata reviewed the draft calculation but did not identify the error.

10. China Energy adopted the EPS calculation without change and included the overstated EPS in the company's annual report on Form 10-KSB for FY 2004 filed on January 15, 2005. In June 2005, in response to questions from the Division of Corporation Finance, the error was identified and China Energy filed an amended Form 10-KSB for FY 2004 that restated EPS from \$0.51 to \$0.36.

China Energy Recognizes Revenues Improperly In FY 2005.

11. In FY 2005, China Energy reported total revenues of Rmb 391.5 million. Over 50% of these revenues (Rmb 200.5 million) derived from transactions with four customers, and were booked in the last three quarters of the FY. China Energy prematurely recognized revenue from two of the customers and improperly recognized revenue from the remaining two customers, causing China Energy's financial statements to be materially false and misleading for the quarters ended March 31, 2005 and June 30, 2005, and for the FY ended September 30, 2005. MSWFT questioned China Energy about this revenue recognition during the March 31 quarterly review and during the FY 2005 year-end audit. Yamagata, however, acquiesced in China Energy's improper revenue recognition and accepted the company's explanations, even though those explanations were inconsistent with the company's prior representations and with contracts and other company records.

12. China Energy claimed to sell its products under two types of contracts. For ordinary sales, the customer agreed to pay, and China Energy recognized revenue, upon shipment. For "Energy Savings" contracts, China Energy and the customer first signed a preliminary agreement. China Energy then delivered, installed and tested its product. The customer and China Energy then signed a final agreement, in which the customer agreed to pay China Energy on a monthly basis, based on the expected "Energy Savings" from the equipment supplied by China Energy. China Energy disclosed in its annual reports that it recognized revenue for Energy Savings contracts only on execution of the final agreement.

13. During the quarter ended March 31, 2005, China Energy recognized revenue of Rmb 79 million from two customers located in the cities of Chongqing and Hangzhou, which was 85% of China Energy's total revenues for the quarter. China Energy told MSWFT that these transactions were Energy Savings contracts. During the quarterly review, MSWFT questioned China Energy about the transactions and China Energy continued to maintain that these were Energy Savings contracts. When MSWFT sought to obtain documentation, however, China Energy was unable to produce final customer agreements to pay or other documentation indicating that revenue recognition was proper. After MSWFT advised China Energy that it could not recognize the revenue, China Energy claimed, for the first time, that the transactions were ordinary sales and revenue could be recognized upon shipment. China Energy provided to MSWFT copies of shipping documents that it claimed were also sales contracts for these customers. Instead of continuing to insist on seeing copies of the contracts or other underlying documentation showing that the revenue was properly booked, Yamagata asked the company to add a statement to its management representation letter that the transactions were regular sales contracts. MSWFT then gave China Energy an interim review report that contained no reservations. On May 23, 2005, China Energy filed a Form 10-QSB for the quarter ended March 31, 2005, which included revenues of Rmb 79 million, as ordinary sales.

14. During the FY 2005 audit, MSWFT obtained the testing records and the agreements to pay for these customers, showing that both transactions were in fact Energy Savings contracts, and therefore that it was premature and improper for China Energy to have recognized the revenue on those transactions in the quarter ended March 31. Based on the dates on the documents MSWFT obtained, the Chongqing revenues should not have been recognized until the quarter ended June 30, and the Hangzhou revenues should not have been recognized until the September 30 fiscal year end.

15. During the quarter ended June 30, 2005, China Energy recognized new Energy Savings revenues of Rmb 69 million. This was 87% of the total revenues recognized by China Energy that quarter and included additional revenues from the Hangzhou customer (Rmb 29.9 million) and revenues from two new Energy Savings contracts for customers located in the cities of Xinjiang (Rmb 23.3 million) and Shanghai (Rmb 15.8 million). During MSWFT's quarterly review, China Energy informed MSWFT that the Chongqing and Hangzhou ordinary sales contracts from the previous quarter now had been converted into Energy Savings contracts. MSWFT asked no questions concerning either the "conversion" or the new Energy Savings revenues recognized during the quarter, and MSWFT provided China Energy with an interim review report for the quarter that contained no reservations. On August 22, 2005, China Energy filed a Form 10-QSB for the quarter ended June 30, 2005; the quarterly financial statements included the Rmb 69 million in Energy Savings revenues. As noted above, the Hangzhou revenues should not have been recognized until year-end. No testing documents or agreements to pay are known to exist for the other two customers, and therefore the Xinjiang and Shanghai revenues should not have been recognized at all.

16. During the final quarter of FY 2005, China Energy recognized an additional Rmb 52.5 million in Energy Savings revenues from the Xinjiang and Shanghai customers. This amount was 41% of the total revenues recognized by China Energy that quarter.

17. During the FY 2005 audit, MSWFT identified the Xinjiang and Shanghai revenue as a problem and advised China Energy that it needed to provide sufficient written documents and explanation to support revenue recognition. China Energy responded that, as of November 21, 2005 (over seven weeks after the end of the FY), installation of the equipment was "most[ly] completed," which indicated that the company had not completed the steps necessary to recognize the revenue under its disclosed policy (i.e., completion of installation and testing and execution of final agreements to pay by the customers). According to MSWFT's email records, during the audit MSWFT received a 17-page fax from China Energy containing further explanation of China Energy's reasons for recognizing revenue from the Xinjiang and Shanghai transactions. MSWFT did not retain the fax in its workpapers or other files. Email records indicate that MSWFT continued to have significant concerns regarding the Xinjiang and Shanghai transactions after reviewing the fax. China Energy never provided documentation that the equipment purportedly delivered to Xinjiang and Shanghai had been tested or that these customers had entered into a final agreement to pay. Without evidence of such agreement, it was improper for China Energy to recognize any revenues from the Xinjiang and Shanghai customers. Nevertheless, Yamagata allowed China Energy to recognize total revenues of Rmb 91.6 million for FY 2005 from these two customers. On December 20, 2005, China Energy filed a Form 10-K for FY 2005, which contained China Energy's audited financial statements for FY 2005. These financial statements included the Energy Savings revenues as described above.

Also included in the Form 10-K was MSWFT's audit report, which was unqualified, except for the disclaimer as to internal controls.

Legal Standards and Analysis

18. Section 4C of the Exchange Act and Rule 102(e)(1)(ii) provide that the Commission may temporarily or permanently deny an accountant the privilege of appearing or practicing before it if it finds, after notice and opportunity for hearing, that the accountant engaged in improper professional conduct. Under Section 4C(b) of the Exchange Act and Rule 102(e)(1)(iv), improper professional conduct includes negligent conduct in the form of repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

19. The applicable professional standards of care for accountants practicing before the Commission include, but are not limited to, Article 2 under Regulation S-X (17 C.F.R. § 210.2-01 et. seq.) and the standards and rules of the PCAOB. The standards of care may overlap, and one failure may constitute or contribute to another.

20. Certain conditions require auditors to exercise heightened skepticism, AU § 316.46; *In re Gregory M. Dearlove, CPA, Exch. Act Rel. No. 57244*, p. 8 (Jan. 31, 2008). This was true in this case after Respondents: (i) concluded that the risks of the China Energy engagement were high as to significant accounts; (ii) concluded that China Energy's internal controls were not operating effectively and could not be relied upon; (iii) became aware of facts concerning inventory and operations which, although not materially inconsistent with financial statement assertions, contradicted China Energy's public disclosures; and (iv) encountered difficulties in conducting important audit procedures. Nevertheless, Respondents Yamagata and MSWFT violated applicable professional standards by failing to: (i) obtain sufficient competent evidential matter regarding Energy Savings revenues through inspection, observation, inquiries, and confirmations to afford a reasonable basis for MSWFT's opinion regarding the FY 2005 financial statements of China Energy, as required by AU § 326.01, *Evidential Matter*; (ii) exercise professional skepticism and due professional care regarding Energy Savings revenues in the performance of the audit of China Energy for FY 2005, as required by AU § 230.01, *Due Professional Care in the Performance of Work*, and AU § 230.07; (iii) document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached in the FY 2005 audit, as required by PCAOB Auditing Standard No. 3, *Audit Documentation*, paragraph 12; (iv) properly supervise assistants, including assistants engaged from outside the firm, in the FY 2004 audit of China Energy, as required by AU § 311.01, *Planning and Supervision*; and (v) ensure the independence of MSWFT in connection with the audit of EPS in FY 2004, as required by Regulation S-X and AU §§ 150.02, paragraph 2, *Generally Accepted Auditing Standards*, 220 *Auditor Independence*.

21. Respondents Yamagata and MSWFT further violated applicable professional standards in reviewing the financial statements of China Energy for the quarters ended March 31, 2005 and June 30, 2005. Respondents Yamagata and MSWFT became aware of information concerning significant sales transactions that gave them cause to believe that the information in

the interim financial statements may not have been in conformity with GAAP in all material respects, AU § 722.22, *Interim Financial Information*; nevertheless Respondents failed to perform additional interim review procedures, such as reading the sales contracts or discussing the transactions with senior marketing personnel, AU § 722.22. Respondents also failed to consider the reasonableness and consistency of management's response to inquiries concerning the significant sales transactions, AU § 722.17.

22. Rule 2-06 under Regulation S-X provides that for a period of seven years after an accountant concludes an audit or review of an issuer's financial statements, the accountant shall retain records relevant to the audit or review, including workpapers and other documents that form the basis of the audit or review, and memoranda, correspondence, communications, other documents and records (including electronic records), which:

- A. Are created, sent or received in connection with the audit or review, and
- B. Contain conclusions, opinions, analyses, or financial data related to the auditor or review.

The rule requires that such documents shall be retained whether they support the auditor's final conclusions regarding the audit or review, or contain information or data, relating to a significant matter, that is inconsistent with the auditor's final conclusions regarding that matter or the audit or review. Nevertheless, Respondents failed to retain correspondence received from China Energy which contained conclusions and opinions relating to significant revenue recognition issues.

23. Rule 2-01(c)(4)(i) under Regulation S-X provides that an accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides non-audit services to an audit client, including any bookkeeping or other service related to the accounting records or financial statements of the audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements. Rule 2-02(b) under Regulation S-X requires the accountant's report to state whether the audit was made in accordance with generally accepted auditing standards ("GAAS"), which require that the accountant be independent of the client. "[R]eferences in Commission rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB . . ." *SEC Release No. 34-49708*. Respondent MSWFT's independence from China Energy was impaired under Rule 2-01(c)(4)(i) due to the firm's preparation of an EPS calculation that was subject to audit procedures by MSWFT in connection with the audit of China Energy's FY 2004 financial statements. Nevertheless, MSWFT violated Rule 2-02(b) by stating incorrectly in its audit report that the audit was performed in accordance with the standards of the PCAOB. Respondent Yamagata was a cause of such violation.

Findings

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

25. Based on the foregoing, the Commission finds that Respondents Yamagata and MSWFT violated Rule 2-06 under Regulation S-X (17 C.F.R. § 210.2-06).

26. Based on the foregoing, the Commission finds that Respondent MSWFT violated Rule 2-02(b) under Regulation S-X (17 C.F.R. § 210.2-02(b)) and that Respondent Yamagata was a cause of such violation.

Undertakings

MSWFT Shall Retain an Independent Consultant

27. MSWFT has undertaken to retain, within thirty days after the entry of this Order, an independent consultant ("Independent Consultant"), not unacceptable to the Commission staff. The Independent Consultant will review and evaluate the audit and interim review policies and procedures of MSWFT regarding: (i) training in client fraud detection; (ii) auditor independence; (iii) client acceptance and retention; (iv) document retention; (v) use of and supervision of affiliate firms and personnel (taking into consideration PCAOB Staff Audit Practice Alert No. 6, dated July 12, 2010); (vi) third party confirmations; (vii) work paper sign-off and dating; and (viii) audit committee communications. The Independent Consultant's review and evaluation will assess the foregoing areas to determine whether MSWFT's policies and procedures are adequate and sufficient to ensure compliance with Commission regulations and with PCAOB standards and rules. MSWFT will cooperate fully with the Independent Consultant and will provide reasonable access to firm personnel, information, and records as the Independent Consultant may reasonably request for the Independent Consultant's reviews and evaluations. MSWFT will provide to the Commission staff a copy of the engagement letter detailing the scope of the Independent Consultant's responsibilities.

28. Within sixty days of being retained, the Independent Consultant will issue a written report ("Report") to MSWFT: (a) summarizing the Independent Consultant's review and evaluation; and (b) making recommendations, where appropriate, reasonably designed to ensure that audits conducted by MSWFT comply with Commission regulations and with PCAOB standards and rules. The Independent Consultant will provide a copy of the Report to the Commission staff and the PCAOB staff when the Report is issued.

29. MSWFT will adopt, as soon as practicable, all recommendations of the Independent Consultant in the Report. Provided, however, that within thirty days of issuance of the Report, MSWFT may advise the Independent Consultant in writing of any recommendation that it considers to be unnecessary, unduly burdensome, or impractical. MSWFT need not adopt any such recommendation at that time, but instead may propose in writing to the Independent Consultant and the Staff an alternative policy or procedure designed to achieve the same objective or purpose. MSWFT and the Independent Consultant will engage in good-faith negotiations in an effort to reach agreement on any recommendations objected to by MSWFT.

In the event that the Independent Consultant and MSWFT are unable to agree on an alternative proposal within thirty days, MSWFT will abide by the determinations of the Independent Consultant.

30. Within sixty days of issuance of the Report, but not sooner than thirty days after a copy of the Report is provided to the Commission staff, MSWFT will certify to the Staff in writing that it has adopted and has implemented or will implement all recommendations of the Independent Consultant ("Certification of Compliance"). MSWFT will provide a copy of the Certification of Compliance to the PCAOB staff.

31. MSWFT will not accept any new issuer audit clients with operations located in the People's Republic of China, the Hong Kong Special Administrative Region, and Taiwan, between the date of this Order and the issuance of the Certification of Compliance.

32. Six months after issuance of the Certification of Compliance, the Independent Consultant will undertake a follow-up review and evaluation of MSWFT's compliance with the matters certified. Within thirty days after the completion of the follow-up review and evaluation, the Independent Consultant will issue a supplemental written report to MSWFT certifying the firm's compliance, describing any matters on which the Independent Consultant is unable to certify compliance, and making recommendations, where appropriate, reasonably designed to ensure that audits of MSWFT comply with Commission regulations and with PCAOB standards and rules. The Independent Consultant will provide a copy of the supplemental report to the Commission staff and to the PCAOB staff.

33. Upon request, and for good cause shown, the Commission staff may extend any of the above procedural dates.

34. MSWFT will require the Independent 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 Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with MSWFT, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with MSWFT, or any of its 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.

35. MSWFT shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, 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 Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-5720B SP2, 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 undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Yamagata's and Respondent MSWFT's Offers.

Accordingly, pursuant to Section 8A of the Securities Act and Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice, it is hereby ORDERED that:

A. Respondents Yamagata and MSWFT cease and desist from committing or causing any violations and any future violations of Rules 2-02(b) and 2-06 under Regulation S-X (17 C.F.R. §§ 210.2-02(b) and 210.2-06);

B. Respondent MSWFT is censured;

C. Respondents MSWFT and Yamagata, jointly and severally, shall, within thirty days of the entry of this Order, pay disgorgement of audit fees of \$100,000 and prejudgment interest of \$29,500. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. 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 MSWFT and Yamagata 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 Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-5720B SP2;

D. Respondent Yamagata is denied the privilege of appearing or practicing before the Commission as an accountant;

E. After two years from the date of this order, Respondent Yamagata 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 Yamagata'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 Yamagata, or the public accounting firm with which he is associated, is registered with the PCAOB in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent Yamagata, or the registered public accounting firm with which he is associated, has been inspected by the PCAOB and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent Yamagata has resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

(d) Respondent Yamagata acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

F. The Commission will consider an application by Respondent Yamagata 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 Yamagata'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

*Chairman Schapiro
not participating*

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-63576; File No. S7-45-10]

RIN 3235-AK86

Registration of Municipal Advisors

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: Section 975 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") amended Section 15B of the Securities Exchange Act of 1934 (as amended, the "Exchange Act") to require municipal advisors, as defined below, to register with the Securities and Exchange Commission ("Commission" or "SEC") effective October 1, 2010. To enable municipal advisors to temporarily satisfy this requirement, the Commission adopted an interim final temporary rule and form, Exchange Act rule 15Ba2-6T and Form MA-T, effective October 1, 2010. Rule 15Ba2-6T will expire on December 31, 2011.

The Commission is proposing new rules 15Ba1-1 through 15Ba1-7 and new Forms MA, MA-I, MA-W, and MA-NR under the Exchange Act. These proposed rules and forms are designed to give effect to provisions of Title IX of the Dodd-Frank Act that, among other things, would establish a permanent registration regime with the Commission for municipal advisors and would impose certain record-keeping requirements on such advisors.

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>); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-45-10 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 S7-45-10. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments will also be 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; 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: Martha Haines, Assistant Director and Chief, Office of Municipal Securities, at (202) 551-5681; Dave Sanchez, Attorney Fellow, Office of Municipal Securities, at (202) 551-5540; Victoria Crane, Assistant Director, Office of Market Supervision, at (202) 551-5744; Ira Brandriss, Special Counsel, Office of Market Supervision, at (202) 551-5651; Jennifer Dodd, Special Counsel, Office of Market Supervision, at (202) 551-5653; Steve Kuan, Special Counsel, Office of Market Supervision, at (202) 551-5624; Daniel Gien, Attorney-Adviser, Office of Market Supervision, at (202) 551-5747; Yue Ding, Law Clerk, Office

of Market Supervision, at (202) 551-5842; or any of the above at Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

The Commission is proposing rules 15Ba1-1 to 15Ba1-7 [17 CFR 240.15Ba1-1 to 240.15Ba1-7] under the Exchange Act, and Forms MA, MA-I, MA-W, and MA-NR [17 CFR 249.1300, 1310, 1320, and 1330].

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I. INTRODUCTION

A. Background

On July 21, 2010, President Obama signed into law the Dodd-Frank Act.¹ The Dodd-Frank Act was enacted, among other things, to promote the financial stability of the United States by improving accountability and transparency in the financial system.² With Section 975 of Title IX of the Dodd-Frank Act, Congress amended Section 15B of the Exchange Act³ to, among other things,

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 15 U.S.C. 78o-4. All references in this Release to the Exchange Act refer to the Exchange Act as amended by the Dodd-Frank Act.

make it unlawful for municipal advisors⁴ to provide certain advice to, or solicit, municipal entities⁵ or certain other persons without registering with the Commission.⁶

1. Overview of Municipal Securities Market

a. Municipal Advisors

Until the passage of the Dodd-Frank Act, the activities of municipal advisors were largely unregulated and municipal advisors were generally not required to register with the Commission or any other federal, state or self-regulatory entity with respect to their municipal advisory activities. As discussed below in this section, some entities that are now subject to registration as municipal advisors pursuant to Section 15B of the Exchange Act, and rules or regulations promulgated thereunder, currently are subject to regulation by various federal and state regulators in other capacities. These entities include brokers, dealers, municipal securities dealers, investment advisers, and banks. Such regulations, however, generally do not apply to their activities as municipal advisors.

Municipal advisors engage in municipal advisory activities in a variety of contexts. For example, municipal advisors participate in the majority of issuances of municipal securities.⁷ According to the Municipal Securities Rulemaking Board (“MSRB” or “Board”), approximately

⁴ See *infra* Section II.A.1. (discussing the term “municipal advisor”).

⁵ See *infra* note 82, and accompanying text (discussing the term “municipal entity”).

⁶ See Section 975(a)(1)(B) of the Dodd-Frank Act; 15 U.S.C. 78o-4(a)(1)(B).

⁷ With respect to the issuance of municipal securities, municipal advisors (which may include entities registered as broker-dealers acting as municipal advisors) engage in such activities as assisting municipal entities in developing a financing plan, assisting in the selection of other parties to the financing such as bond counsel and underwriters, coordinating the rating process, ensuring adequate disclosure, and evaluating and negotiating the financing terms. See Jayaraman Vijayakumar and Kenneth N. Daniels, 2006, The Role and Impact of Financial Advisors in the Market for Municipal Bonds (“Vijayakumar and Daniels”), *Journal of Financial Services Research*, 30:43, at 46.

\$315 billion (70%)⁸ of the municipal debt issued in 2008 was issued with the participation of municipal advisors commonly referred to as “financial advisors.”⁹ Research also suggests that participation by municipal advisory firms in the issuance of municipal securities is rising, with the MSRB noting a 63% participation rate in 2006, a 66% participation rate in 2007, and a 70% participation rate in 2008.¹⁰ A study that looked at historical involvement by “financial advisors” identified participation rates of approximately 50% in a nearly twenty-year period ending in 2002.¹¹

Municipal advisors also engage in municipal advisory activities with respect to municipal financial products.¹² For example, as derivatives have developed in the municipal securities market, some municipal advisory firms developed expertise in that area. These municipal advisory firms are generally referred to as “swap advisors.”¹³ Swap advisors may provide advice solely with respect to a municipal derivative transaction or may provide such advice in connection with other types of municipal advisory activities.

In addition, municipal advisors may provide advice to municipal entities concerning investment strategies. These advisory firms assist in investing proceeds from bond offerings as well

⁸ See Municipal Securities Rulemaking Board, “Unregulated Municipal Market Participants: A Case for Reform” (Apr. 2009), available at http://www.msrb.org/News-and-Events/Press-Releases/Press-Releases/~//media/Files/Special-Publications/MSRBReportonUnregulatedMarketParticipants_April09.ashx (“MSRB Study”).

⁹ See *id.* (referring to municipal advisors as “financial advisors”). Approximately 43% of the \$453 billion of municipal debt issued in 2008 (by par amount of bonds) (or 62% of the \$315 billion of municipal debt issued with financial advisors) was issued with the assistance of “financial advisors” that were not part of dealer firms regulated by the MSRB. *Id.*

¹⁰ See *id.*

¹¹ See Arthur Allen and Donna Dudney, May 2010, Does the Quality of Financial Advice Affect Prices? *The Financial Review* 45: 389 (“Allen and Dudney”) (analyzing data from 1984 to 2002).

¹² See *infra* note 93 and accompanying text (discussing the term “municipal financial products”).

¹³ See MSRB study, *supra* note 8.

as manage other public monies. Such public monies include, for example, the general funds of states and local governments, public pension plans and funds dedicated to other public programs, such as public transportation, police and fire protection, public health, and public education. In addition, municipal advisors provide risk management, asset allocation, financial planning and cash management services and help state and local governments find and evaluate other advisors that manage public funds and provide other types of services.¹⁴ As discussed in more detail below, unless excluded, these firms generally will have to register as municipal advisors under Section 15B of the Exchange Act.¹⁵ Municipal advisors subject to registration may include federal and state registered investment advisers, depending on the activities in which they are engaged.¹⁶

Depending on their role with respect to investment strategies for municipal entities, commercial banks subject to regulation by various federal and state regulators may also engage in activities that would subject them to registration as municipal advisors. Such commercial banks may act as trustees with respect to an issuance of municipal securities or otherwise provide advice with respect to municipal financial products. Other persons that are subject to registration as municipal advisors include those who solicit municipal entities on behalf of the types of municipal advisors discussed above, as well as on behalf of brokers, dealers, municipal securities dealers and other parties.

¹⁴ See Investment Advisers Act Release No. IA-2910 (August 3, 2009), 74 FR 39840, 39840-41 (August 7, 2009) (“Political Contributions Proposed Rule”).

¹⁵ See *infra* Section II.A.1. (discussing the term “municipal advisor”).

¹⁶ See *id.*

b. Municipal Entities and Municipal Financial Products

The municipal securities market consists of over 51,000 issuers,¹⁷ a diverse group that includes states, their political subdivisions such as cities, towns and counties, and their instrumentalities such as school districts or port authorities. These public bodies are governed by state and local laws, including state constitutions, statutes, city charters, and municipal codes.¹⁸ Such constitutions, statutes, charters, and codes impose on municipal issuers a vast and varied multiplicity of requirements relating to governance, budgeting, accounting, and other financial matters.¹⁹ The governing bodies of municipal issuers are as varied as the types of issuers, ranging from state governments, cities, towns, and counties with elected officials to commissions and other special purpose enterprises having appointed members.²⁰ Municipal securities are issued by government entities to pay for a variety of public projects, for cash flow and other governmental needs, and to fund non-governmental private projects by acting as a conduit on behalf of private organizations that wish to obtain tax-exempt interest rates.²¹ As of March 31, 2010, municipal issuers had an outstanding principal amount of securities in excess of \$2.8 trillion.²² In 2009 alone, 15,055 new issuances of municipal securities took place, with a value of over \$474.5 billion.²³ As

¹⁷ See Report on Transactions in Municipal Securities, Office of Economic Analysis and Office of Municipal Securities, the Division of Trading and Markets, U.S. Securities and Exchange Commission, (July 1, 2004).

¹⁸ See American Bar Association, Disclosure Roles of Counsel in State and Local Government Securities Offerings 1 (Third Edition, 2009) (“Disclosure of Bond Counsel”).

¹⁹ See id. at 2.

²⁰ See id. at 78.

²¹ The Internal Revenue Code delineates the purposes for which tax-exempt municipal bonds may be issued for the benefit of organizations other than states and local governments, i.e., conduit borrowers. See 26 U.S.C. 142-145, 1394.

²² See Federal Reserve Board, Flow of Funds Accounts, Flows and Outstandings, First Quarter 2010.

²³ See The Bond Buyer Yearbook 14 (SourceMedia Inc.) (2010).

of 2009, the average daily trading volume for the municipal bond market was \$12.5 billion, as compared to \$16.8 billion in the corporate bond market and \$407.9 billion in the Treasury bond market.²⁴

Presently, there is no definitive public information regarding the size of the municipal securities derivative market. Estimates of the size of the market have been reported to range from \$100 billion to \$300 billion, annually, in notional principal amount.²⁵ Estimates of the number of municipal issuers that have engaged in derivative transactions also vary. Since interest rate swaps are bilateral contracts entered into privately, there is no comprehensive data on how many municipal issuers are active in the \$450 trillion interest-rate swap market, although some anecdotal evidence suggests a relatively wide use. For instance, a review of Pennsylvania Department of Community and Economic Development records revealed that 185 school districts, towns and counties in Pennsylvania have engaged in derivative transactions since 2003, when the state's law was explicitly changed to allow for such transactions.²⁶ However, other estimates have pointed to a less widespread use of derivatives among municipal issuers.²⁷ Since 2008, the use of derivatives by

²⁴ See SIFMA, Average Daily Trading Volume in the U.S. Bond Markets, available at http://www.google.com/url?q=http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/CM-US-Bond-Market-Trading-Volume-SIFMA.xls&sa=U&ei=5EHsTLvBFoT58AbPqdGjAQ&ved=0CBYQFjAA&usg=AFQjCNHv-FKlpdi_QB8m7jgvg2ssJJ1ikg (last visited November 23, 2010).

²⁵ See MSRB Study, supra note 8.

²⁶ See Martin Z. Braun, Deutsche Bank Swap Lures County as Budgets Crumble, Bloomberg (November 26, 2008).

²⁷ In a 2007 study, Standard & Poor's identified 750 municipal issuers that used swaps. See Joe Mysak, California Declares War on State Bond Short-Sellers, Bloomberg Businessweek (Apr. 27, 2010). In October 2009, Moody's undertook a review of the state and local governments that it rates with outstanding swaps and identified 500 of such entities. See id. Moody's also estimated that Pennsylvania issuers accounted for 22% of all municipal derivative transactions, suggesting that broad participation by municipal entities in Pennsylvania did not translate into broad participation by municipal entities nationwide. See Joe Mysak, Swaps Nightmares Become Real for Amateur Financiers, Bloomberg (Dec. 15,

municipal entities has declined and many municipal entities have terminated existing interest rate swaps.²⁸

According to recently available United States census data, as of 2008, there were approximately 2,550 state and local government employee retirement systems.²⁹ These “public pension plans” had over \$2.2 trillion of assets and represented one-third of all U.S. pension assets.³⁰ Public pension plans might seek advice with respect to municipal financial products. In addition, third parties might solicit these public pension plans on behalf of firms seeking to provide services to these plans.³¹

College savings plans (“529 Plans”) that comply with Section 529 of the Internal Revenue Code (“IRC”) provide tax advantages designed to encourage saving for future college costs.³² 529 Plans are sponsored by states, state agencies, or educational institutions. 529 plan assets have increased from \$8.6 billion in 2000 to \$104.9 billion in the fourth quarter of 2008, and the number of 529 plan participants has increased from 1.3 million in 2000 to 11.2 million in the fourth quarter of 2008.³³ Like public pension plans, 529 Plans might be solicited on behalf of third parties seeking

2009).

²⁸ See, e.g., Michael McDonald, Wall Street Collects \$4 Billion From Taxpayers as Swaps Backfire, Bloomberg (Nov. 10, 2010), available at <http://www.bloomberg.com/news/2010-11-10/wall-street-collects-4-billion-from-taxpayers-as-swaps-backfire.html>.

²⁹ See U.S. Census Bureau, State & Local Government Employee Retirement Systems, available at <http://www.census.gov/govs/retire>.

³⁰ See Federal Reserve Board, Flow of Funds Accounts, Flows and Outstanding, First Quarter 2009 (at table L.119).

³¹ See Investment Advisers Act Release No. IA-3043 (July 1, 2010), 75 FR 41018, 41019 (July 14, 2010) (“Political Contributions Final Rule”).

³² See 26 U.S.C. 529.

³³ See Investment Company Institute, 529 Plan Program Statistics, December 2008 (May 22, 2009), available at http://www.ici.org/research/stats/529s/529s_12-08.

to do business with such plans.³⁴ 529 Plans might also seek advice with respect to municipal financial products and the issuance of municipal securities.³⁵

In addition to public pension plans and 529 Plans, state and local government agencies also maintain other pools of assets including their general funds and other special funds. Governmental entities generally invest such funds in a combination of individualized investments, investment agreements or local government investment pools ("LGIPs").³⁶

2. Historical Regulation of Municipal Securities and Municipal Advisors

a. Municipal Securities Market

The Securities Act of 1933 ("Securities Act")³⁷ and the Exchange Act³⁸ were both enacted with broad exemptions for municipal securities from all of their provisions except for the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act.³⁹ In the

³⁴ See Political Contributions Final Rule, *supra* note 31, at 41019.

³⁵ See MSRB, Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market, Interpretative Notice of Rule D-12, dated January 18, 2001, available at <http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/Definitional/Rule-D-12.aspx?tab=2> (citing Letter from Catherine McGuire, Chief Counsel, Division of Trading and Markets, Commission, to Diane G. Klinke, General Counsel, MSRB, dated February 26, 1999, in response to letter from Diane G. Klinke, General Counsel, MSRB, to Catherine McGuire, Chief Counsel, Division of Trading and Markets, Commission, dated June 2, 1998).

³⁶ 45 states have LGIPs with assets totaling more than \$250 billion. See Jeff Pentages, Local Government Investment Pools and the Financial Crisis: Lessons Learned, October 2009, Government Finance Review 25. States have several trillion dollars in state funds, including general funds, public pension plans, and 529 plans. See e.g., The National Association of State Treasurers, Reforming Corporate Governance, State Government News (June/July 2003), available at <http://www.csg.org/knowledgecenter/docs/sgn0307ReformingCorporate.pdf>.

³⁷ 15 U.S.C. 77a *et seq.*

³⁸ 15 U.S.C. 78a *et seq.*

³⁹ See, e.g., Securities Act Section 3(a)(2) (15 U.S.C. 77c(a)(2)); Securities Act Section 12(a)(2) (15 U.S.C. 77l(a)(2)); Exchange Act Section 3(a)(12) (15 U.S.C. 78c(a)(12)); Exchange Act Section 3(a)(29) (15 U.S.C. 78c(a)(29)).

early 1970s, the municipal securities market was still relatively small.⁴⁰ Up until that time, the standard issue was usually a general obligation bond, with fairly standard features, and the typical participants were banks, underwriters, and bond counsel.⁴¹

The regulation of the market for municipal securities at the federal level essentially began in 1975. Congress, as part of the Securities Act Amendments of 1975 (“1975 Amendments”) created a limited regulatory scheme for the municipal securities market at the federal level.⁴² That scheme included mandatory registration with the Commission of brokers and dealers in municipal securities and gave the Commission broad rulemaking and enforcement authority over such brokers and dealers. At the same time, however, Congress prohibited the Commission from requiring issuers of municipal securities to file disclosures, such as a prospectus, with the Commission before selling municipal securities to investors. Thus, the Commission’s oversight of the municipal securities market has been focused on the intermediaries between municipal entities and investors, rather than on municipal entities themselves. In addition, the 1975 Amendments authorized the creation of the MSRB and granted it authority to promulgate rules concerning broker and dealer transactions in municipal securities.

As noted above, pursuant to the 1975 Amendments, all brokers and dealers that underwrite or trade municipal securities are required to register with the Commission.⁴³ If a person engages in the activities of a broker or dealer in municipal securities and does not satisfy an exception from the

⁴⁰ There were \$235.4 billion of bonds outstanding in 1975 after an issuance of \$58 billion in that year. See The Bond Buyer’s Municipal Finance Statistics, 1975 (June 1976).

⁴¹ See Ann Judith Gellis, Municipal Securities Market: Same Problems – No Solutions, 21 Del. J. Corp. L. 427, 428 (1996).

⁴² See, e.g., Exchange Act Sections 15(c)(1), 15(c)(2), 15B(c)(1), 15B(c)(2), 17(a), 17(b), and 21(a)(1) (15 U.S.C. 78o(c)(1), 78o(c)(2), 78o-4(c)(1), 78o-4(c)(2), 78q(a), 78q(b), and 78u(a)(1)).

⁴³ See 15 U.S.C. 78o-4(a)-(b).

registration provisions of the Exchange Act, such person must register with the Commission and may have to join a self-regulatory organization (“SRO”) such as the Financial Industry Regulatory Authority, Inc. (“FINRA”). The Exchange Act defines a “municipal securities dealer” as any person (including a separately identifiable department or division of a bank) engaged in the business of buying and selling municipal securities for its own account other than in a fiduciary capacity, through a broker or otherwise⁴⁴ and requires such person to register with the Commission.⁴⁵ All brokers, dealers, and municipal securities dealers that engage in municipal securities transactions also must register with the MSRB and may not act in contravention of its rules.⁴⁶

Since 1975, the municipal securities market has grown and evolved significantly to encompass a wide variety of bond structures⁴⁷ and credit enhancement. Municipal bond insurance was first introduced in 1971 and letter of credit-supported municipal bonds became very popular after the introduction of variable rate municipal bonds in the early 1980’s.⁴⁸ In 1988, auction rate securities were introduced into the municipal market.⁴⁹ In addition, the municipal securities market has experienced a proliferation of complex derivative products beginning generally with interest

⁴⁴ See 15 U.S.C. 78c(a)(30).

⁴⁵ See 15 U.S.C. 78o-4(a)-(b).

⁴⁶ See MSRB rule A-12. These requirements for registration with the Commission and MSRB were in effect prior to passage of the Dodd-Frank Act and remain in effect.

⁴⁷ Although it is helpful to think of municipal securities as either (1) general obligation bonds backed by the “full faith and credit” or an unlimited taxing power of the issuing entity or (2) revenue bonds, these general categories mask a broad range of diversity and complexity in the underlying security for municipal bonds. See Gary Gray and Patrick Cusatis, *Municipal Derivative Securities – Uses and Valuation 21* (1995) (discussion of revenue bonds). See also *Disclosure of Bond Counsel*, *supra* note 18, at 54-55 (discussion of conduit bonds).

⁴⁸ See Gray and Cusatis, *supra* note 47, at 30-31. The Commission notes that although the use of letters of credit and bond insurance have declined since 2008, these forms of credit enhancement remain an option for municipal entities to consider when issuing municipal securities.

⁴⁹ See *id.* at 41.

rate swap transactions in the mid 1980's.⁵⁰ The availability of such a variety of financing options has led to an increasing reliance on external advisors by municipal entities that issue municipal securities to assist them in deciding among the multiplying array of structural choices for their debt and to help them negotiate with the multiplying number of intermediaries.⁵¹

b. Municipal Advisors

As discussed above, many market professionals are involved in issuing municipal securities and advising municipal entities with respect to municipal financial products. Historically, however, municipal advisors have been largely unregulated. For example, Commission staff has taken the position that financial advisors that limit their advisory activities to advising municipal issuers as to the structuring of their financings rather than providing advice for compensation regarding the investment of assets may not need to register as investment advisers.⁵² Also, while dealers who act as municipal financial advisors are subject to regulation,⁵³ those regulations apply primarily to their business as dealers rather than their activities as municipal financial advisors.⁵⁴ Only in limited circumstances do those rules also apply to their municipal advisory activities.⁵⁵

⁵⁰ See *id.* at 49. Municipal market derivatives must often be structured in accordance with the provisions of the tax code and other laws that apply to the issuance of tax-exempt financings. See David L. Taub, *Understanding Municipal Derivatives*, August 2005, Government Finance Review 21. Therefore, the most common use for derivatives in the municipal securities market is the execution of interest rate swaps to hedge issuers' interest rate exposure for new, anticipated, or outstanding debt. See *id.*

⁵¹ See Vijayakumar and Daniels, *supra* note 7, at 43-44.

⁵² See Division of Investment Management: Staff Legal Bulletin No. 11, Applicability of the Advisers Act to Financial Advisors of Municipal Securities Issuers (Sep. 19, 2000), available at <http://www.sec.gov/interps/legal/slbim11.htm> (explaining the staff's views as to the circumstances under which financial advisors (a) may be investment advisers, and (b) may give advice to issuers of municipal securities regarding the investment of offering proceeds without being deemed to be investment advisers).

⁵³ See *supra* notes 43-46, and accompanying text.

⁵⁴ See, e.g., 17 CFR 240.15Ba2-2.

⁵⁵ For example, MSRB rule G-37 currently prohibits a broker, dealer or municipal securities

Additionally, approximately fifteen states, as well as a number of municipalities, have rules relating to the conduct of some municipal advisors (generally, financial advisors and swap advisors). For example, these governmental entities have enacted pay-to-play prohibitions that range from broad proscriptions relating to all state and local contracts to narrowly defined rules that only apply to specific situations.⁵⁶ Some state and local entities also require certain types of municipal advisors to disclose actual or apparent conflicts of interest.⁵⁷

As discussed in more detail below, the Dodd-Frank Act amended the Exchange Act to require municipal advisors to register with the Commission.⁵⁸ In addition, the Exchange Act, as amended by the Dodd-Frank Act, grants the MSRB regulatory authority over municipal advisors,⁵⁹ and imposes a fiduciary duty on municipal advisors when advising municipal entities.⁶⁰

B. Interim Final Temporary Rule 15Ba2-6T and Form MA-T

The registration requirement for municipal advisors became effective on October 1, 2010.⁶¹ Consequently, municipal advisors must now be registered in order to continue their municipal advisory activities. To enable municipal advisors to temporarily satisfy the registration

dealer from engaging in “municipal securities business with an issuer within two years after any contribution to an official of such issuer...” MSRB rule G-37. The rule further defines “municipal securities business” to include, among other things, underwriting and the provision of financial advisory services. See id.

⁵⁶ See MSRB study, supra note 8.

⁵⁷ See id.

⁵⁸ See Section 975(a)(1)(B) of the Dodd-Frank Act; 15 U.S.C. 78o-4(a)(1)(B).

⁵⁹ See 15 U.S.C. 78o-4(b).

⁶⁰ See 15 U.S.C. 78o-4(c). Specifically, Exchange Act Section 15B(c)(1) provides that: “A municipal advisor and any person associated with such municipal advisor shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor, and no municipal advisor may engage in any act, practice, or course of business which is not consistent with a municipal advisor’s fiduciary duty or that is in contravention of any rule of the Board.” 15 U.S.C. 78o-4(c)(1).

⁶¹ See Section 975(i) of the Dodd-Frank Act.

requirement, and to make relevant information available to the public and municipal entities, the Commission adopted interim final temporary rule 15Ba2-6T⁶² under the Exchange Act on September 1, 2010.⁶³ Pursuant to rule 15Ba2-6T, a municipal advisor must temporarily satisfy the statutory registration requirement by submitting certain information electronically through the Commission's public website on Form MA-T.⁶⁴

Form MA-T requires a municipal advisor to indicate the purpose for which it is submitting the form (i.e., initial application, amendment or withdrawal), provide certain basic identifying and contact information concerning its business, indicate the nature of its activities, and supply information about its disciplinary history and the disciplinary history of its associated municipal advisor professionals.⁶⁵

The interim final temporary rule provides that, unless rescinded, a municipal advisor's temporary registration by means of Form MA-T will expire on the earlier of (1) the date that the municipal advisor's registration is approved or disapproved by the Commission pursuant to a final rule establishing a permanent registration regime; (2) the date on which the municipal advisor's temporary registration is rescinded by the Commission; or (3) December 31, 2011.⁶⁶ The temporary registration procedure was developed as a transitional step toward the implementation of a permanent registration regime for municipal advisors. Accordingly, as discussed in more detail

⁶² 17 CFR 240.15Ba2-6T.

⁶³ See Securities Exchange Act Release No. 62824 (September 1, 2010), 75 FR 54465 (September 8, 2010) ("Temporary Registration Rule Release").

⁶⁴ 17 CFR 249.1300T. A municipal advisor that completes the temporary registration form and receives confirmation from the Commission that the form was filed is temporarily registered for purposes of Section 15B. Approximately 800 firms and individuals have registered on Form MA-T as municipal advisors.

⁶⁵ See Temporary Registration Rule Release, supra note 63, for a full description of the requirements of Form MA-T.

⁶⁶ See 17 CFR 240.15Ba2-6T(e).

below, the Commission is proposing rules and forms that, if adopted, would establish a permanent registration regime for municipal advisors that would require registration by all persons meeting the definition of municipal advisor, including those persons currently registered on Form MA-T. In discussing the proposed permanent registration regime, the Commission addresses issues, concerns, and suggestions relevant to this proposal raised by commenters in response to the interim final temporary rule.⁶⁷

II. DISCUSSION

Section 15B(a)(1) of the Exchange Act, as amended by the Dodd-Frank Act, makes it unlawful for a municipal advisor⁶⁸ to provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, or to undertake a solicitation of a municipal entity or obligated person, unless the municipal advisor is registered with the Commission.⁶⁹ Section 15B(a)(2) of the Exchange Act, as amended by the Dodd-Frank Act, provides that a municipal advisor may be registered by filing with the Commission an application for registration in such form and containing such information and documents concerning the municipal advisor and any person associated with the municipal advisor as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for

⁶⁷ The Commission received seven comment letters in response to the interim final temporary rule. The comment letters are available on the Commission's Internet website at <http://www.sec.gov/comments/s7-19-10/s71910.shtml>. The Commission also received one comment letter in response to SEC regulatory initiatives under the Dodd-Frank Act that discussed municipal advisors in connection with pay-to-play rules and, therefore, is outside the scope of this release relating to the registration of municipal advisors. This comment letter is available on the Commission's Internet website at <http://www.sec.gov/comments/df-title-ix/municipal-securities-municipal-advisors/municipal-securities-municipal-advisors.shtml>.

⁶⁸ See *infra* Section II.A.1. (discussing the term "municipal advisor").

⁶⁹ See 15 U.S.C. 78o-4(a)(1)(B). For a discussion of the terms "municipal entity," "obligated person," "municipal financial product," and "solicitation of a municipal entity or obligated person," see *infra* Section II.A.1.b.

the protection of investors.⁷⁰

Consistent with the requirements of the Dodd-Frank Act, as discussed in detail below, the Commission is proposing new rules and forms that, if adopted, would establish a permanent Commission registration regime for municipal advisors. The Commission believes that the information disclosed pursuant to the proposed rules and forms would provide significant value to the Commission in its oversight of municipal advisors and their activities in the municipal securities markets. The information provided pursuant to these rules and forms would also aid municipal entities and obligated persons in choosing municipal advisors, engaging in transactions with municipal advisors, or participating in municipal securities transactions in which a municipal advisor is also engaged.

A. Proposed Rules for the Permanent Registration of Municipal Advisors

1. Proposed Rule 15Ba1-1: Definition of “Municipal Advisor” and Related Terms

a. Statutory Definition of “Municipal Advisor”

Section 15B(e)(4)(A) of the Exchange Act,⁷¹ as amended by the Dodd-Frank Act, defines the term “municipal advisor” to mean a person (who is not a municipal entity⁷² or an employee of a municipal entity) (i) that provides advice to or on behalf of a municipal entity or obligated person⁷³ with respect to municipal financial products⁷⁴ or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such

⁷⁰ See 15 U.S.C. 78o-4(a)(2).

⁷¹ 15 U.S.C. 78o-4(e)(4)(A).

⁷² See *infra* note 82, and accompanying text (discussing the term “municipal entity”).

⁷³ See *infra* note 86, and accompanying text (discussing the term “obligated person”).

⁷⁴ See *infra* note 93, and accompanying text (discussing the term “municipal financial products”).

financial products or issues, or (ii) that undertakes a solicitation of a municipal entity.⁷⁵

The statutory definition of a “municipal advisor” is broad and includes persons that traditionally have not been considered to be municipal financial advisors. Specifically, the definition of a “municipal advisor” includes “financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors” that engage in municipal advisory activities.⁷⁶ These persons are included if they provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities (including advice with respect to the structure, timing, terms and other similar matters concerning such financial products or issues) or undertake a solicitation of a municipal entity or obligated person (i.e., “municipal advisory activities”).⁷⁷

The definition of “municipal advisor” explicitly excludes “a broker, dealer, or municipal securities dealer serving as an underwriter,”⁷⁸ as well as attorneys offering legal advice or providing services that are of a traditional legal nature and engineers providing engineering advice.⁷⁹ Further, the definition of “municipal advisor” excludes “any investment adviser registered under the

⁷⁵ See infra note 103, and accompanying text (discussing the term “solicitation of a municipal entity or obligated person”).

⁷⁶ See 15 U.S.C. 78o-4(e)(4).

⁷⁷ The proposed definition of “municipal advisory activities” has the same meaning as the definition of “municipal advisory services” in connection with rule 15Ba2-6T. Thus, in proposed rule 15Ba1-1 the Commission is proposing to define “municipal advisory activities” to mean “advice to or on behalf of a municipal entity (as defined in Section 15B(e)(8) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(8)) or obligated person (as defined in Section 15B(e)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(10)) with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or a solicitation of a municipal entity or obligated person.” Proposed rule 15Ba1-1(e).

⁷⁸ See infra note 105 (defining the term “underwriter”).

⁷⁹ See 15 U.S.C. 78o-4(e)(4)(C).

Investment Advisers Act of 1940, or persons associated with such investment advisers who are providing investment advice” and “any commodity trading advisor registered under the Commodity Exchange Act or persons associated with a commodity trading advisor who are providing advice related to swaps.”⁸⁰

Consequently, the statutory definition of “municipal advisor” includes distinct groups of professionals that offer different services and compete in distinct markets. The three principal types of municipal advisors are: (1) financial advisors, including, but not limited to, broker-dealers already registered with the Commission, that provide advice to municipal entities with respect to their issuance of municipal securities and their use of municipal financial products; (2) investment advisers that advise municipal pension funds and other municipal entities on the investment of funds held by or on behalf of municipal entities (subject to certain exclusions from the definition of a “municipal advisor”); and (3) third-party marketers and solicitors.

b. Interpretation of the Term “Municipal Advisor”; Definition of Related Terms

As noted above, Section 15B(e)(4) defines the term “municipal advisor” to mean, in part, a person (who is not a municipal entity or an employee of a municipal entity) that (i) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, or (ii) undertakes a solicitation of a municipal entity or obligated person.⁸¹ The Commission discusses below the terms “municipal entity,” “obligated person,” “municipal financial products,” and “solicitation of a municipal entity or obligated person” as well as other terms relating to the definition of “municipal advisor.”

The registration requirement for municipal advisors under Section 15B of the Exchange Act

⁸⁰ See *id.*

⁸¹ See 15 U.S.C. 78o-4(e)(4).

applies to every person, including every natural person, who provides the types of advice described in the definition of “municipal advisor” – whether that person is an organized entity, sole proprietor, employee of a municipal advisory firm, or otherwise. For clarity, the Commission refers to each organized entity that is a municipal advisor, including sole proprietors, as a “municipal advisory firm,” and each municipal advisor that is a natural person, including sole proprietors, as a “natural person municipal advisor.”

Municipal Entity

Exchange Act Section 15B(e)(8) provides that the term “municipal entity” means “any State, political subdivision of a State, or municipal corporate instrumentality of a State, including - (A) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (B) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (C) any other issuer of municipal securities.”⁸² To provide additional clarification with respect to clause (B) of the definition of “municipal entity,” the Commission notes that the definition includes, but is not limited to, public pension funds, local government investment pools and other state and local governmental entities or funds, as well as participant-directed investment programs or plans such as 529, 403(b), and 457 plans.

One commenter asked whether “small issuers such as individual charter schools (that are deemed public schools by the state with individual charters)” would be included in the definition of “municipal entity.”⁸³ Charter schools are considered to be public schools and generally derive their charter from a political subdivision of a state (for example, local school boards, state universities,

⁸² 15 U.S.C. 78o-4(e)(8).

⁸³ See letter from Brad R. Jacobsen, dated September 7, 2010 (“Jacobsen Letter”).

community colleges or state boards of education)⁸⁴ and, therefore, would fall under the definition of municipal entity.⁸⁵

Obligated Person

Exchange Act Section 15B(e)(10) provides that the term “obligated person” means “any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in an offering of municipal securities.”⁸⁶ One commenter stated that this definition in Exchange Act Section 15B(e)(10) is “potentially very broad” and asked for clarification regarding the definition.⁸⁷ In particular, the commenter encouraged the Commission to interpret the definition of “obligated person” for purposes of the definition of “municipal advisor” consistently with the definition of “obligated person” for purposes of rule 15c2-12.⁸⁸

The Commission believes that the definition of “obligated person” for purposes of the definition of “municipal advisor” should be consistent with the definition of “obligated person” for

⁸⁴ See, e.g., US Charter Schools, Answers to Frequently Asked Questions, available at http://www.uscharterschools.org/pub/uscs_docs/o/faq.html (last visited November 2, 2010).

⁸⁵ 15 U.S.C. 78o-4(e)(8). Charter schools, or persons that operate charter schools such as charter school management organizations that are organized as non-profit corporations, may issue municipal securities through a municipal entity for capital needs such as facilities that are not provided for by state funding or other reasons. See, e.g., US Charter Schools, Charter School Facilities: A Resource Guide on Development and Financing, available at http://www.uscharterschools.org/gb/dev_fin/financing.htm (last visited November 23, 2010). In that instance, the charter school or charter school management organization would be an obligated person with respect to the issuance of municipal securities and any related municipal financial products.

⁸⁶ 15 U.S.C. 78o-4(e)(10). Obligated persons can include entities acting as conduit borrowers such as private universities, non-profit hospitals, and private corporations.

⁸⁷ See letter from John J. Wagner, Kutak Rock LLP, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated September 28, 2010 (“Kutak Rock Letter”).

⁸⁸ See id. Rule 15c2-12 relates to municipal securities disclosures. See 17 CFR 240.15c2-12.

purposes of rule 15c2-12. Rule 15c2-12 defines the term “obligated person” to mean “any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the Offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities).”⁸⁹ Thus, pursuant to the exemptive authority granted in Section 15B(a)(4) of the Exchange Act, the Commission proposes to exempt from the definition of “obligated person” providers of municipal bond insurance, letters of credit, or other liquidity facilities. Specifically, proposed rule 15Ba1-1(i) provides that the term “obligated person” shall not include providers of municipal bond insurance, letters of credit, or other liquidity facilities.⁹⁰ The Commission believes that this interpretation does not conflict with the goals of the Dodd-Frank Act to provide further protections for certain entities that participate in borrowings in the municipal securities market and would help ensure uniformity among rules relating to such market. Providers of municipal bond insurance, letters of credit, or other liquidity facilities are generally non-governmental providers of credit enhancements.⁹¹ As providers of credit enhancement, these entities are not borrowing funds through a municipal entity and, therefore, the Commission believes they do not require the type of protection that should be applicable with respect to those who borrow funds through municipal entities in municipal securities transactions. In addition, the Commission notes that this interpretation would further uniformity among rules

⁸⁹ See 17 CFR 240.15c2-12(f)(10). “Offering” as used in this definition is defined in rule 15c2-12(a). See 17 CFR 240.15c2-12(a).

⁹⁰ See proposed rule 15Ba1-1(i). See also Securities Exchange Act Release No. 34961 (November 10, 1994), 59 FR 59590 (November 17, 1994).

⁹¹ The Commission notes that a municipal entity that provides credit enhancement could be an obligated person for purposes of the proposed rule.

relating to the definition of obligated persons in the municipal securities market.⁹²

Municipal Financial Products; Investment Strategies

Section 15B(e)(5) provides that the term “municipal financial product” means “municipal derivatives, guaranteed investment contracts, and investment strategies.”⁹³ Exchange Act Section 15B(e)(3) provides that “the term ‘investment strategies’ includes plans or programs for the investment of the proceeds of municipal securities that are not municipal derivatives, guaranteed investment contracts, and the recommendation of and brokerage of municipal escrow investments.”⁹⁴ One commenter requested that the Commission clarify the term “investment strategies” for purposes of the definition of “municipal financial products.”⁹⁵ The Commission notes that the definition of “investment strategies” provides that it “includes” plans or programs for the investment of the proceeds of municipal securities and, therefore, the Commission interprets the definition to mean that it includes, without limitation, the investment of the proceeds of municipal securities. Further, the Commission interprets this definition to include plans, programs, or pools of assets that invest funds held by or on behalf of a municipal entity, and, therefore, any person that provides advice with respect to such funds must register as a municipal advisor unless it is covered by one of the exclusions discussed below. Consistent with this interpretation, proposed rule 15Ba1-1(b) provides that the term “investment strategies” includes “plans, programs or pools of assets that

⁹² See Kutak Rock Letter.

⁹³ 15 U.S.C. 78o-4(e)(5).

⁹⁴ 15 U.S.C. 78o-4(e)(3).

⁹⁵ See letter from Carolyn Walsh, Vice President and Senior Counsel, Center for Securities, Trust and Investments, American Bankers Association (“ABA”), and Deputy General Counsel, ABA Securities Association, to Elizabeth M. Murphy, Secretary, Commission, dated October 13, 2010 (“ABA Letter”). See also letter from Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), to Martha Haines, Assistant Director and Chief, Office of Municipal Securities, Commission, dated November 15, 2010 (“SIFMA Letter”) (suggesting interpretations of the term “investment strategies”).

invest funds held by or on behalf of a municipal entity.”⁹⁶ In proposing this interpretation of the term “investment strategies,” the Commission considered the statutory definitions of “municipal advisor” and “municipal entity.” Specifically, the Commission noted that the definition of a “municipal entity” includes “any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof.”⁹⁷ Based on these definitions, the Commission believes it was Congress’s intent to include in the definition of “municipal advisor” persons that provide advice with respect to plans, programs or pools of assets that invest funds held by, or on behalf of, a municipal entity, such as a 529 college savings plan, LGIP or public pension plan. Such plans, programs, and pools of assets are generally funded from sources other than proceeds of municipal securities, such as families who wish to save for a child’s college expenses, general monies of state and local governments being temporarily invested prior to their budgeted expenditure, and pension contributions from employees and state and local government employers. As a result, the Commission does not believe that it was Congress’s intent to limit the requirement to register as a municipal advisor only to those persons that provide advice with respect to plans or programs for the investment of proceeds from municipal securities. Also, because every bank account of a municipal entity is comprised of funds “held by or on behalf of a municipal entity,” money managers providing advice to municipal entities with respect to their bank accounts could be municipal advisors. The Commission notes, however, that to the extent a person is providing advice to a pooled investment vehicle in which a municipal entity has invested funds along with other investors that are not municipal entities, the pooled investment vehicle would not be considered funds “held by or on behalf of a municipal entity” and, therefore, the person providing

⁹⁶ Proposed rule 15Ba1-1(b).

⁹⁷ 15 U.S.C. 78o-4(e)(8)(B).

advice to the pooled investment vehicle would not have to register as a municipal advisor.⁹⁸

One commenter that asked for clarification regarding the definition of the term “investment strategies” stated that it assumes that “once the proceeds of a municipal securities offering are commingled with other operating funds or the general funds of the municipal entity that they lose their characteristic as ‘proceeds’ under the statute, and the provision of advice by a bank to the municipal entity with respect to the investment of such operating or general funds would not make the bank a ‘municipal advisor’ under the statute.”⁹⁹ Further, this commenter stated that it assumes that “the proceeds of a municipal securities offering that are used to fund a municipal pension plan, once deposited in the plan and commingled with other funds, would likewise lose their characteristic as proceeds under the statute; and the provision of advice by a bank to the municipal entity with respect to the investment of plan assets would not make the bank a ‘municipal advisor’ under the statute.”¹⁰⁰

As noted above, the Commission is proposing to interpret the term “investment strategies” to include plans, programs or pools of assets that invest funds held by or on behalf of a municipal entity, as well as plans or programs for the investment of the proceeds of municipal securities that are not municipal derivatives or guaranteed investment contracts, or the recommendation of or brokerage of municipal escrow investments. Municipal entities utilizing the services of advisors with respect to plans, programs or pools of assets that invest funds are subject to the same risks

⁹⁸ To the extent that the pooled investment vehicle is a LGIP, the pooled investment vehicle would be considered to be funds “held by or on behalf of” a municipal entity and, therefore, a person providing advice with respect to a LGIP would have to register as a municipal advisor. See also supra note 36 (discussing LGIPs).

⁹⁹ See ABA Letter. See also SIFMA Letter (suggesting that moneys in a commingled account would not be considered proceeds unless the municipal entity specifically communicates that such investment is being made with proceeds of an issue of municipal securities).

¹⁰⁰ See ABA Letter.

regardless of whether those funds are the proceeds of municipal securities. The Commission does not have any evidence that the competency of the advisors or quality of advice needed by municipal entities with respect to the proceeds of municipal securities and municipal escrow investments is any different than with respect to the investment of other public funds – which may exceed the amount of proceeds of municipal securities or municipal escrow investments. Furthermore, this approach avoids any need to trace the investment of proceeds of municipal securities commingled with other public funds and eliminates the potential for abuse from the artificial commingling of the proceeds of municipal securities with other public funds solely to avoid registration as a municipal advisor and compliance with any rules or regulations relating to such advisors.

Municipal Derivatives

The term “municipal derivatives” is not defined in Section 15B of the Exchange Act. Accordingly, the Commission is proposing, in rule 15Ba1-1(f), that the term “municipal derivatives” means “any swap (as defined in Section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)) and Section 3(a)(69) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(69)), including any rules and regulations thereunder) or security-based swap (as defined in Section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)), including any rules and regulations thereunder) to which a municipal entity is a counterparty, or to which an obligated person, acting in its capacity as an obligated person, is a counterparty.”¹⁰¹ Thus, the Commission is including in the definition of “municipal derivatives” the definitions of “swap” and “security-based swap,” as those terms are defined by statute (and any rules or regulations thereunder). The Commission believes it is appropriate to use such definitions for purposes of defining the term “municipal derivatives” where the counterparty is a municipal entity or obligated person.

¹⁰¹ See proposed rule 15Ba1-1(f).

Solicitation of a Municipal Entity or Obligated Person

The definition of “municipal advisor” in Exchange Act Section 15B(e)(4) includes a person that undertakes a solicitation of a municipal entity or obligated person.¹⁰² Exchange Act Section 15B(e)(9) provides that the term “solicitation of a municipal entity or obligated person” means “a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser (as defined in section 202 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-2]) 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 a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity.”¹⁰³ As a result of this definition, the Commission notes that, unless an exclusion applies, any third-party solicitor that seeks business on behalf of a broker, dealer, municipal securities dealer, municipal advisor or investment adviser from a municipal entity must register as a “municipal advisor.” For example, a third-party solicitor that seeks business on behalf of an investment adviser from a municipal pension fund or a local government investment pool must register as a “municipal advisor.” In addition, the determination regarding whether a solicitation of a municipal entity requires a person to register as a municipal advisor is not based on the number, or size, of

¹⁰² See 15 U.S.C. 78o-4(e)(4)(A)(ii). The Commission notes that the definition of “municipal advisor” under Section 15B(e)(4)(A) means, in part, a person that “undertakes a solicitation of a municipal entity.” *Id.* In defining the phrase “solicitation of a municipal entity,” Section 15B includes within that phrase, the words “or obligated person.” See 15 U.S.C. 78o-4(e)(9). Section 15B(a)(1)(B) also includes solicitations of obligated persons. Thus, the Commission interprets the definition of “municipal advisor” to include the solicitation of a municipal entity or obligated person.

¹⁰³ 15 U.S.C. 78o-4(e)(9).

investments that are solicited. Thus, the Commission would consider a solicitation of a single investment of any amount in a municipal entity to require the person soliciting the municipal entity to register as a municipal advisor.

As noted above, the definition of “solicitation of municipal entity or obligated person” applies to solicitations on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation. Accordingly, persons soliciting on behalf of affiliated entities would not fall within the definition of municipal advisor and would not be required to register pursuant to Section 15B of the Exchange Act. The statute would not, however, preclude such persons from registering as municipal advisors and being subject to the rules and regulations applicable to registered municipal advisors. For example, a person that makes a direct or indirect communication with a municipal entity or obligated person on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser that controls, is controlled by, or is under common control with the person undertaking such communication, where the communication is for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity, may voluntarily file Form MA or MA-I, as applicable, and apply to register as a municipal advisor. By registering as a municipal advisor, such person must comply with all federal securities laws and rules or regulations promulgated thereunder relating to registered municipal advisors, including the obligation to comply with MSRB rules that apply to municipal advisors.¹⁰⁴

¹⁰⁴

Recently proposed amendments to the Investment Advisers Act seek to permit investment advisers to pay any “regulated municipal advisor” to solicit government entities on its

c. Exclusions from the Definition of “Municipal Advisor”

Broker, Dealer, or Municipal Securities Dealer Serving as an Underwriter

The definition of “municipal advisor” in proposed rule 15Ba1-1(d) would clarify that the exclusion from the definition for a broker, dealer, or municipal securities dealer serving as an underwriter¹⁰⁵ does not apply when such persons are acting in a capacity other than as an underwriter on behalf of a municipal entity or obligated person.¹⁰⁶ The Commission interprets the exclusion to apply solely to a broker, dealer, or municipal securities dealer serving as an underwriter on behalf of a municipal entity or obligated person in connection with the issuance of municipal securities.¹⁰⁷ Thus, a broker, dealer or municipal securities dealer would not be excluded from the definition of a “municipal advisor” if the broker, dealer or municipal securities dealer engages in municipal advisory activities when acting in a capacity other than as an underwriter on behalf of a municipal entity or obligated person. For example, a broker-dealer advising a municipal entity with

behalf. See Investment Advisers Act Release No. IA-3110 at 69 (November 19, 2010). Such solicitors may include affiliated entities of the investment adviser. As part of its deliberations with respect to the Dodd-Frank Act, Congress expressed its intent that municipal advisors be permitted to solicit government clients and be subject to regulation as municipal advisors. See *id.* at n. 217. Allowing entities to register as municipal advisors and subject themselves to the regulatory regime for municipal advisors as a condition to being paid as solicitors on behalf of affiliated investment advisers does not contravene this Congressional intent.

¹⁰⁵ The term “underwriter” is defined in Section 2(a)(11) of the Securities Act of 1933. See 15 U.S.C. 77b(a)(11).

¹⁰⁶ See 15 U.S.C. 78o-4(e)(4)(C) (providing that the definition of “municipal advisor” does not include a broker, dealer, or municipal securities dealer serving as an underwriter (as defined in section 2(a)(11) of the Securities Act of 1933)).

¹⁰⁷ See Temporary Registration Rule Release, *supra* note 63, at 54467, n.19. See also S. REP. NO. 176, 111th Cong., 2d. Sess. 148 (2010) (“Senate Report”) (noting the need to subject activities such as solicitation of a municipal entity to engage an investment adviser to MSRB regulation). The Commission believes that Congress excluded a broker, dealer or municipal securities dealer acting as an underwriter on behalf of a municipal entity or obligated person in connection with the issuance of municipal securities because such activity is already subject to MSRB rules.

respect to the investment of bond proceeds or the advisability of a municipal derivative, would be a municipal advisor with respect to those activities. In addition, a broker-dealer acting as a placement agent for a private equity fund that solicits a municipal entity or obligated person to invest in the private equity fund would be a municipal advisor with respect to that activity. The Commission notes that including such activities within the scope of municipal advisory activities is consistent with the Exchange Act.¹⁰⁸

One commenter asked for clarification regarding whether a broker-dealer or another entity that provides advice or assistance to a municipal entity on an informal non-contractual (and non-compensated) basis would have to register as a municipal advisor.¹⁰⁹ This commenter believes that such persons should not have to register as municipal advisors.¹¹⁰ Another commenter, however, stated that “[a]ny advisor who provides ‘free’ service will be compensated at some point for this service. The services being rendered are the trigger for registration and the corresponding fiduciary duty, not the title of the relationship, the terms of the contract, or the compensation received. Such advisor should not be permitted to avoid registration and fiduciary responsibilities.”¹¹¹ Similarly,

¹⁰⁸ See Exchange Act Section 15B(e)(4)(A) and (B) (including placement agents and solicitors that undertake a solicitation of a municipal entity in the definition of municipal advisor); Senate Report; Letter from Senator Christopher J. Dodd, U.S. Senate Committee on Banking, Housing and Urban Affairs, to Elizabeth M. Murphy, Secretary, Commission, dated February 2, 2010.

¹⁰⁹ See Kutak Rock Letter. See also letter from Amy Natterson Kroll and W. Hardy Callcott, Bingham McCutchen LLP, to Elizabeth M. Murphy, Secretary, Commission, dated October 13, 2010 (“Bingham Letter”) (stating that it urges “the Commission to clarify that providing uncompensated introductions to potential underwriters or other potential financing participants does not constitute a ‘solicitation’ that would trigger registration as a municipal advisor”).

¹¹⁰ See Kutak Rock Letter.

¹¹¹ See letter from Steve Apfelbacher, President, National Association of Independent Public Finance Advisors, to Commission, dated October 8, 2010 (“NAIPFA Letter”). See also Bingham Letter (acknowledging that “clean energy services companies ultimately do

another commenter stated that individuals that offer “‘free’ or ‘voluntary’ Municipal Securities Advisory Services should not be exempt from registration.”¹¹²

In defining the term “municipal advisor” in Exchange Act Section 15B(e)(4), Congress did not distinguish between those municipal advisors who are compensated for providing advice and those who are not compensated for providing advice. Thus, consistent with Congress’s definition of the term “municipal advisor,” the Commission does not believe the issue of whether a municipal advisor is compensated for providing municipal advice should factor into the determination of whether the municipal advisor must register with the Commission.¹¹³

Registered Investment Advisers

Proposed rule 15Ba1-1(d)(2)(ii) would clarify the exclusion from the definition of “municipal advisor” in Exchange Act Section 15B(e)(4)(C) for Commission-registered investment advisers.¹¹⁴ Specifically, consistent with the Commission’s interpretation in connection with rule 15Ba2-6T, proposed rule 15Ba1-1(d)(2)(ii) would provide that the term “municipal advisor” shall

receive compensation for their projects – but they do not get paid separately (either by municipal entities, or by the firms providing financing) for making introductions”).

¹¹² See letter from Joy A. Howard, Principal, WM Financial Strategies, to Commission, dated October 5, 2010 (“Howard Letter”).

¹¹³ The Commission notes that in defining the term “solicitation of a municipal entity or obligated person” Congress included language that such solicitation means, in part, “a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation.” “Indirect compensation” has been interpreted by other regulatory agencies to include non-monetary compensation. For example, the Commodity Futures Trading Commission (“CFTC”) has interpreted the term “indirect compensation,” in the context of the registration requirements and procedures for introducing brokers, to include, among other things, soft compensation such as research. See CFTC Release on Introducing Brokers and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators; Registration and Other Regulatory Requirements, 48 FR 35248, 35251 (August 3, 1983) (the CFTC’s definition of “introducing broker” excludes those persons who are not compensated, directly or indirectly, for their activities as introducing brokers).

¹¹⁴ See proposed rule 15Ba1-1(d)(2)(ii).

not include: “An investment adviser registered under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) or a person associated with such registered investment adviser, unless the registered investment adviser or person associated with the investment adviser engages in municipal advisory activities other than providing investment advice that would subject such adviser or person associated with such adviser to the Investment Advisers Act of 1940.”¹¹⁵

Thus, the Commission interprets the exclusion from the definition of “municipal advisor” in Exchange Act Section 15B(4)(C) for registered investment advisers and their associated persons who are providing investment advice, to mean that a registered investment adviser or an associated person of a registered investment adviser would not have to register as a “municipal advisor” with respect to the provision of any investment advice subject to the Investment Advisers Act.¹¹⁶ A registered investment adviser or an associated person of a registered investment adviser must register with the Commission as a municipal advisor if the adviser or associated person engages in any municipal advisory activities that would not be investment advice subject to the Investment Advisers Act.¹¹⁷ For example, a Commission-registered investment adviser that provides advice with respect to how a municipal entity should structure or issue municipal securities would be required to register as a municipal advisor.¹¹⁸ A Commission-registered investment adviser that

¹¹⁵ See id. See also Temporary Registration Rule Release, supra note 63, at 54467.

¹¹⁶ See id. The staff interprets broadly the term “advice” with respect to the Investment Advisers Act. See supra note 52 (noting the Division of Investment Management: Staff Legal Bulletin No. 11). For purposes of the Commission’s interpretation under proposed rule 15Ba1-1(d)(2)(ii), the Commission interprets “advice” to include any activity that constitutes “advice” subject to the Investment Advisers Act.

¹¹⁷ Similarly, a municipal advisor registered under Section 15B of the Exchange Act may be required to register as an investment adviser if its business includes providing investment advice that is subject to the Investment Advisers Act. Commission staff has provided guidance with respect to circumstances under which a municipal advisor may be required to register as an investment adviser. See Staff Legal Bulletin No. 11, supra note 52.

¹¹⁸ The Commission notes that a person that provides advice as to whether and how a municipal

solicits a municipal entity on behalf of a municipal advisor would also be required to register as a municipal advisor. The Commission believes that this interpretation is in furtherance of the goals of the Dodd-Frank Act to regulate persons that engage in municipal advisory activities.

Commodity Trading Advisors

Consistent with the Commission's interpretation in connection with rule 15Ba2-6T, the Commission interprets the exclusion in the Dodd-Frank Act for registered commodity trading advisors and their related persons providing advice related to swaps to apply only to such persons when they are providing advice related to swaps, as that term is defined in Section 1a(47) of the Commodity Exchange Act and Section 3(a)(69) of the Exchange Act,¹¹⁹ and any rules or regulations promulgated thereunder.¹²⁰ Accordingly, proposed rule 15Ba1-1(d)(2)(iii) would provide that the exclusion from the definition of "municipal advisor" in Exchange Act Section 15B(e)(4)(C) for registered commodity trading advisors, or any person associated with a registered commodity trading advisor, is only available to a commodity trading advisor or person associated with a commodity trading advisor, to the extent such commodity trading advisor or associated person of the commodity trading advisor is providing advice related to swaps. The exclusion would not apply to the commodity trading advisor or associated person of the commodity trading advisor to the extent he or she engages in municipal advisory activities other than the provision of advice related to swaps.¹²¹ A commodity trading advisor, or an associated person of a commodity trading advisor,

entity should issue municipal securities would not have to register with the Commission as an investment adviser. *See id.* (stating "[w]e would not consider a financial advisor to be an investment adviser if it limits its activities to providing advice as to whether and how a municipality should issue debt securities").

¹¹⁹ 7 U.S.C. 1a(47) and 15 U.S.C. 78c(a)(69). The exclusion would not apply when such persons are providing advice with respect to security-based swaps.

¹²⁰ *See* Temporary Registration Rule Release, *supra* note 63, at 54467.

¹²¹ *See* proposed rule 15a1-1(d)(2)(iii).

must register with the Commission as a municipal advisor if the commodity trading advisor, or an associated person of a commodity trading advisor, engages in any municipal advisory activities that do not include advice related to swaps.¹²² For example, if an advisor is providing advice to a municipal entity with respect to engaging in a swap transaction and provides advice to the municipal entity with respect to the structure of a municipal securities offering, the advisor would have to register with the Commission as a municipal advisor and would be subject to regulation by the MSRB as a municipal advisor. In addition, a commodity trading advisor must register with the Commission if the advisor provides advice with respect to swaps on behalf of a municipal entity or obligated person, but is not registered as a commodity trading advisor.

Attorneys, Engineers and Other Professionals

The definition of municipal advisor in Exchange Act Section 15B(e)(4) excludes professionals such as attorneys offering legal advice and engineers providing engineering advice.¹²³ One commenter noted that the definition of “municipal advisor” does not contemplate a specific exclusion for accountants offering “traditional accounting advice.”¹²⁴ In discussing what is “traditional accounting advice,” the commenter noted the engagement of accountants by municipal entities in connection with the issuance of municipal securities for the purpose of consenting to the use of accountant prepared or audited financial statements and/or providing bring down or comfort letters¹²⁵ relating to such financial statements.¹²⁶

¹²² See id.

¹²³ See 15 U.S.C. 78o-4(e)(4)(C).

¹²⁴ See Kutak Rock Letter.

¹²⁵ In auditing literature, bring down and comfort letters are referred to as “letters for underwriters.” See AU Sec. 634, Letters for Underwriters. Thus, the Commission is proposing to use the term “letters for underwriters” for this purpose.

¹²⁶ See Kutak Rock Letter.

Because accountants may provide advice to municipal entities that includes advice about the structure, timing, terms, and other similar matters concerning the issuance of municipal securities, the Commission does not believe it is appropriate to exclude these professionals from the definition of municipal advisor entirely. Accountants may also be engaged by municipal entities to provide other services, such as conducting feasibility studies or preparing financial projections.¹²⁷ In addition, as noted by this commenter, in defining “municipal advisor” in Exchange Act Section 15B(e)(4), Congress only excluded attorneys offering legal advice or services of a traditional legal nature, or engineers providing engineering advice.¹²⁸ At this time, the Commission believes that it is not necessary or appropriate to exclude all accountants from the definition of “municipal advisor.”

The Commission believes, however, that the preparation or audit of financial statements, or the issuance of letters for underwriters¹²⁹ by accountants would not constitute the provision of advice within the meaning of Exchange Act Section 15B(e)(4)(A)(i).¹³⁰ Accordingly, in proposed rule 15Ba1-1(d)(2)(vi), the Commission proposes to exclude from the definition of a “municipal advisor” accountants preparing financial statements, auditing financial statements, or issuing letters for underwriters for, or on behalf of, a municipal entity or obligated person.¹³¹

In addition, with respect to the exclusion from the definition of “municipal advisor” for attorneys offering legal advice or services of a traditional legal nature, the Commission interprets

¹²⁷ See *id.* See also Howard Letter (stating that certified public accountants that provide advice on bond issues “clearly meet the definition of ‘Municipal Advisor’ under the Act and should be subject to registration”).

¹²⁸ See Kutak Rock Letter. See also 15 U.S.C. 78o-4(e)(4)(C).

¹²⁹ See *supra* note 125.

¹³⁰ See 15 U.S.C. 78o-4(e)(4)(A)(i).

¹³¹ See proposed rule 15Ba1-1(d)(2)(vi).

this exclusion to apply only when the legal services are to a client of the attorney that is a municipal entity or obligated person. Accordingly, proposed rule 15Ba1-1(d)(2)(iv) provides that the term “municipal advisor” shall not include any attorney unless the attorney engages in municipal advisory activities other than offering legal advice or providing services that are of a traditional legal nature to a client of the attorney that is a municipal entity or obligated person.¹³² Generally, the Commission interprets advice provided by a lawyer to its client with respect to the structure, timing, terms and other similar matters concerning municipal financial products or the issuance of municipal securities to be services of a traditional legal nature if such advice is provided within a lawyer-client relationship specifically related to such products in conjunction with related legal advice. Thus, for example, advice comparing the structures, terms, or associated costs of issuance of different types of securities or financial instruments (such as fixed rate bonds or variable rate demand obligations) given by an attorney hired to advise a municipal entity client embarking on a bond offering, would be considered to be services of a traditional legal nature, as would advice concerning the tax consequences of alternative financing structures or advice recommending a particular financing structure due to legal considerations such as the limitations included in existing contracts and indentures to which the issuer is a party. However, advice which is primarily financial in nature, such as advice concerning the financial feasibility of a project or financing, advice estimating or comparing the relative cost to maturity of an issuance depending on various interest rate assumptions or advice recommending a particular structure as being financially advantageous under prevailing market conditions, would be primarily financial advice and not services of a traditional legal nature.

With respect to the exclusion from the definition of “municipal advisor” for engineers

¹³² See proposed rule 15Ba1-1(d)(2)(iv).

providing engineering advice, one commenter requested that the Commission include in this exclusion “activity which is incidental to engineering services.”¹³³ In addition, this commenter urged the Commission to “distinguish purely informational and educational activities which do not rise to the level of advice from individualized advice about the appropriate investment for a particular state or local government entity.”¹³⁴ Moreover, this commenter stated that “a clean energy services company should not also be required to register as a municipal advisor simply because it provides cash-flow modeling and other similar information that is inextricably linked to the engineering analysis, even if that modeling is individualized to the municipal entity.”¹³⁵ In addition, the commenter urged the Commission to define “advice” to “exclude feasibility studies that are a necessary part of any engineering projects, including clean energy services projects.”¹³⁶

As discussed above and below, the exclusions from the definition of “municipal advisor” included by Congress in Section 15B(e)(4) of the Exchange Act were limited.¹³⁷ With respect to engineers, the exclusion applies to engineers providing “engineering advice.” For example, costing out engineering alternatives would not subject an engineer to registration as a municipal advisor because such activity would be considered engineering advice. The exclusion does not include circumstances in which the engineer is engaging in municipal advisory activities, including cash-flow modeling or the provision of information and education relating to municipal financial products or the issuance of municipal securities, even if those activities are incidental to the provision of engineering advice. In addition, the exclusion does not include circumstances in which

¹³³ See Bingham Letter.

¹³⁴ Id.

¹³⁵ Id.

¹³⁶ Id.

¹³⁷ See 15 U.S.C. 78o-4(e)(4)(C).

the engineer is preparing feasibility studies concerning municipal financial products or the issuance of municipal securities that include analysis beyond the engineering aspects of the project and, therefore, an engineer preparing such studies would be subject to registration as a municipal advisor.¹³⁸

Employees of a Municipal Entity

Exchange Act Section 15B(e)(4)(A) provides that the term “municipal advisor” excludes employees of a municipal entity.¹³⁹ One commenter suggested that the Commission clarify that this exclusion from the definition of “municipal advisor” would include any person serving as an appointed or elected member of the governing body of a municipal entity, such as a board member, county commissioner or city councilman.¹⁴⁰ This commenter stated that because these persons are not technically “employees” of the municipal entity (but rather are “unpaid volunteers”), these persons would not fall within the exclusion from the definition of “municipal advisor” for “employees of a municipal entity” and, therefore, may have to register as municipal advisors.¹⁴¹

The Commission believes that the exclusion from the definition of a “municipal advisor” for “employees of a municipal entity” should include any person serving as an elected member of the governing body of the municipal entity to the extent that person is acting within the scope of his or

¹³⁸ A “feasibility study” is a report detailing the economic practicality of and the need for a proposed capital program. It frequently analyzes demand for the product or service being sold and forecasts financial statements or other operating statistics. The feasibility study may include a user or other rate analysis to provide an estimate of revenues that will be generated for the purpose of substantiating that debt service can be met from pledged revenues. In addition, the feasibility study may provide details of the physical, operating, economic or engineering aspects of the proposed project, including estimates of construction costs, completion dates and drawdown schedules. See MSRB Glossary of Municipal Securities Terms, available at http://www.msrb.org/msrb1/glossary/glossary_db.asp?sel=f.

¹³⁹ 15 U.S.C. 78o-4(e)(4)(A).

¹⁴⁰ See Kutak Rock Letter.

¹⁴¹ See id. See also 15 U.S.C. 78o-4(e)(4)(A).

her role as an elected member of the governing body of the municipal entity. "Employees of a municipal entity" should also include appointed members of a governing body to the extent such appointed members are ex officio members of the governing body by virtue of holding an elective office.¹⁴² The Commission does not believe that appointed members of a governing body of a municipal entity that are not elected ex officio members should be excluded from the definition of a "municipal advisor." The Commission believes that this interpretation is appropriate because employees and elected members are accountable to the municipal entity for their actions. In addition, the Commission is concerned that appointed members, unlike elected officials and elected ex officio members, are not directly accountable for their performance to the citizens of the municipal entity.

Banks

Another commenter stated that the Commission should exempt from the definition of a "municipal advisor" banks providing "traditional banking services" and banks and trust companies that provide "investment advisory services."¹⁴³ As support, this commenter stated that banks are currently well-regulated and banks that offer trustee services are subject to rigorous and frequent

¹⁴² This would include persons appointed to fill the remainder of the term for an elective office.

¹⁴³ See ABA Letter. In providing examples of the types of activities in which banks and trust companies engage, this commenter stated that: "[o]n the commercial side of the bank, these services and products include direct loans, checking accounts, and CDs. Banks of all sizes also frequently are asked to respond to RFP requests from municipal entities regarding investment products offered by the banking entity, such as interest-bearing bank deposits, money market mutual funds, or other exempt securities. Banks also are significant investors in the securities issued by municipalities and provide credit or, through their affiliates, underwriting services to municipalities when the city or township wants to buy a fire truck or build a new school or other similar facility. Furthermore, for over one hundred and fifty years, banks and trust companies have provided fiduciary services to municipal entities in the United States. In this capacity banks often manage investment accounts for local towns and act as trustees with respect to bond proceeds, escrow accounts, governmental pension plans and other similar capacities." Id.

examination, as well as extensive regulation by the various federal or state banking regulators.¹⁴⁴

The Commission notes that Congress included in the statutory definition of “municipal advisor” a limited number of exclusions from the definition, and such exclusions did not include banks in any capacity. As discussed below, under “Request for Comment,” among other things, the Commission is seeking comment on whether the definition of a “municipal advisor” should exclude banks providing advice to a municipal entity or obligated person concerning transactions that involve a “deposit,” as defined in Section 3(l) of the Federal Deposit Insurance Act,¹⁴⁵ at an “insured depository institution,” as defined in Section 3(c)(2) of the Federal Deposit Insurance Act.¹⁴⁶ Such an exclusion, if adopted, would result in excluding banks from the definition of a “municipal advisor” to the extent that the bank is providing advice to a municipal entity or obligated person with respect to such traditional banking products as insured checking and savings accounts and certificates of deposit, while not excluding from the definition of a “municipal advisor” a bank that is providing advice to a municipal entity or obligated person concerning other municipal advisory activities. The Commission notes that, similarly, banks are not excluded from the requirement to register as municipal securities dealers.

Request for Comment

The Commission requests comments generally on its proposals discussed above and also requests comment on the following specific issues:

- In light of our understanding of Congressional objectives and intent, are the Commission’s interpretations under the definition of “municipal advisor” and related terms, and the exclusions from the definition of “municipal advisor” appropriate?

¹⁴⁴ See *id.*

¹⁴⁵ 12 U.S.C. 1813(l).

¹⁴⁶ 12 U.S.C. 1813(c)(2).

Should any of these interpretations be modified or clarified in any way?

- The Commission notes that the definition of “municipal entity” includes, but is not limited to, public pension funds, local government investment pools and other state and local governmental entities or funds as well as participant-directed investment programs or plans such as 529, 403(b), and 457 plans. Is the Commission’s interpretation of “municipal entity” for purposes of the proposed definition of “municipal advisor” appropriate? Is additional clarification necessary? If so, how should the Commission further clarify this interpretation?
- In what circumstances with respect to municipal financial products or the issuance of municipal securities should charter schools be considered municipal entities? In what circumstances with respect to municipal financial products or the issuance of municipal securities should charter schools be considered obligated persons? To what extent do state laws vary in their treatment of charter schools in ways that would affect their classification as municipal entities or obligated persons?
- The Commission proposes to exempt from the definition of “obligated person” providers of municipal bond insurance, letters of credit, or other liquidity facilities so that the definition of “obligated person” for purposes of the proposed rules is consistent with the definition of “obligated person” in rule 15c2-12 under the Exchange Act. Should the proposed definition be modified or clarified in any way? Should the term “obligated person” for purposes of municipal advisor registration be consistent with the definition of “obligated person” for purposes of rule 15c2-12? If so, why? If not, why not? Should the Commission include additional exemptions from the definition of “obligated person”? If so, please explain and provide specific examples.

- The Commission proposes to interpret the term “investment strategies” to include plans or programs for the investment of the proceeds of municipal securities (other than municipal derivatives and guaranteed investment contracts), plans, programs or pools of assets that invest funds held by or on behalf of a municipal entity, or the recommendation of or brokerage of municipal escrow investments. Should the Commission modify or clarify this interpretation in any way? If so, why? If not, why not? Please provide any suggested alternative language. Should the Commission exclude plans, programs or pools of assets that invest funds held by or on behalf of a municipal entity that are not proceeds of the issuance of municipal securities from the definition of investment strategies? If so, why? If not, why not? If the Commission were to limit investment strategies to “plans or programs for the investment of the proceeds of municipal securities (other than municipal derivatives and guaranteed investment contracts) or the recommendation of or brokerage of municipal escrow investments,” how should the Commission determine when funds should no longer be considered “proceeds of municipal securities?” What obligations should parties other than the municipal entity have in determining whether funds held by or on behalf of a municipal entity are proceeds of municipal securities?
- As noted above, to the extent a person is providing advice to a pooled investment vehicle in which one or more municipal entities are investors along with other investors that are not municipal entities, the pooled investment vehicle would not be considered funds “held by or on behalf of a municipal entity” and, therefore, a person providing advice to the pooled investment vehicle would not be required to register as a municipal advisor. Should the Commission modify or clarify this interpretation in any way? If so, why? If

not, why not? Please provide any suggested alternative language. Should the Commission provide that such interpretation should apply only if the investors that are not municipal entities are the primary investors in the pooled investment vehicle? If so, how, and above what level, should the Commission determine that investors that are not municipal entities are the primary investors in the pooled investment vehicle? Should such a determination be based on a dollar amount or a percentage of the pooled investment vehicle's assets? Should the Commission provide that this pooled investment vehicle interpretation would no longer apply if the municipal entity (or municipal entities) investing in the pooled investment vehicle becomes the primary investor in the pooled investment vehicle subsequent to the initial investment? If so, above what level of investment should a municipal entity (or municipal entities) be considered to be the primary investor in the pooled investment vehicle? Should such a determination be based on a dollar amount or a percentage of the pooled investment vehicle's assets?

- As discussed above, the Commission is proposing to interpret the term "investment strategies" to include plans, programs or pools of assets that invest funds held by or on behalf of a municipal entity. Thus, commingled proceeds, regardless of when they lose their characteristic as proceeds, would still constitute "funds held by or on behalf of a municipal entity" and, therefore, any advice with respect to such funds would be municipal advice, unless subject to an exclusion. Is this interpretation too broad? Please explain and include a discussion of concerns, if any, such an interpretation could raise.
- In interpreting the term "solicitation of a municipal entity or obligated person," the Commission notes that, unless an exclusion applies, any third-party solicitor that seeks

business on behalf of an investment adviser from a municipal entity or obligated person, such as a municipal pension fund or a local government investment pool, must register as a municipal advisor. In addition, the Commission notes that the determination regarding whether a solicitation of a municipal entity or obligated person requires a person to register as a municipal advisor is not based on the number, or the size, of investments that are solicited. Thus, the Commission would consider a solicitation of a single investment by a municipal entity or obligated person in any amount to require the person soliciting the municipal entity or obligated person to register as a municipal advisor. Do these interpretations require further clarification? If so, how? Should these interpretations be modified in any way? Please explain and provide suggested alternative language, as appropriate. Is there a de minimis number or size of investments that should be allowed to be solicited before a person is required to register as a municipal advisor? If so, what should this de minimis amount be? Please explain the rationale for providing for a de minimis exception.

- Should the Commission, as proposed, permit the voluntary registration by persons that solicit a municipal entity or obligated person on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser that controls, is controlled by, or is under common control with the person undertaking such solicitation? If not, why not? Should the Commission permit voluntary registration by any other group of persons? If so, which persons and why?
- In interpreting the term “solicitation of a municipal entity or obligated person,” the Commission also notes that such solicitation must be “for the purpose of obtaining or retaining an engagement . . . in connection with municipal financial products [or] the

issuance of municipal securities.” Are there types of obligated persons to which this definition should not apply in connection with the issuance of municipal securities? If so, please identify the types of obligated persons to which the definition should not apply and explain why. Are there types of municipal financial products (such as municipal derivatives which include swaps or security-based swaps where an obligated person is the counterparty) to which this definition should not apply? If so, please identify the types of municipal financial products to which the definition should not apply and explain why.

- Proposed rule 15Ba1-1(f) would define the term “municipal derivatives” to mean “any swap (as defined in Section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)) and Section 3(a)(69) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(69)), including any rules and regulations thereunder) or security-based swap (as defined in Section 3a(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)), including any rules and regulations thereunder) to which a municipal entity is a counterparty, or to which an obligated person, acting in its capacity as an obligated person, is a counterparty.” Should this definition be clarified or modified in any way? If so, how? Should the definition of municipal derivatives specifically include other financial products? For example, should the definition specifically include options, forwards or futures? If so, which products and why? Should this definition include a financial product that is composed of multiple components where one or more of such components is derivative in nature, such as a structured note or convertible bond?¹⁴⁷ Should this definition include financial products, in addition to swaps and security-based

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See SIFMA Letter.

swaps, that are based on municipal securities that are exempted securities under the Exchange Act or are exempt from registration under the Securities Act? Should it include an over-the-counter option contract with a municipal entity? If so, which additional financial products should be included in the definition and why?

- Is our interpretation of the exclusion from the definition of a “municipal advisor” for a broker, dealer, or municipal securities dealer serving as an underwriter appropriate? Specifically, the Commission interprets this exclusion to mean that a broker-dealer acting as an underwriter or placement agent that solicits a municipal entity to invest in a security, or a broker-dealer acting as an underwriter that also advises a municipal entity with respect to the investment of proceeds of municipal securities or the advisability of a municipal derivative would be a municipal advisor. Should these interpretations be modified in any way, or further clarified? If so, how?
- Consistent with Congress’s definition of the term “municipal advisor,” the Commission does not believe that whether a municipal advisor is compensated for providing municipal advice should factor into the determination regarding whether the municipal advisor must register with the Commission. Are there any persons who engage in uncompensated municipal advisory activities, or municipal advisory activities for indirect compensation, that the Commission should exclude from the definition of “municipal advisor”? Please explain.
- The Commission would interpret the exclusion from the definition of “municipal advisor” in Exchange Act Section 15B(4)(C) for Commission-registered investment advisers and their associated persons who are providing investment advice, to mean that a Commission-registered investment adviser or an associated person of a Commission-

registered investment adviser would not have to register as a “municipal advisor” with respect to the provision of any advice that would subject the adviser (or associated person) to the Investment Advisers Act. Should this interpretation be modified or clarified in any way? If so, how?

- As a result of the changes in the threshold for registration as an investment adviser,¹⁴⁸ fewer entities will be required to register as investment advisers under the federal securities laws and will instead be subject to state registration requirements. Investment advisers that are not registered with the Commission would not be exempt from registration as municipal advisors to the extent that they are engaging in municipal advisory activities. Should state-registered investment advisers be exempt from the definition of “municipal advisor” to the extent they are providing advice that otherwise would be subject to the Investment Advisers Act, but for the operation of a prohibition to, or exemption from, Commission registration?
- Should the Commission’s interpretation of the exclusion from the definition of a “municipal advisor” for registered commodity trading advisors and their associated persons providing advice related to swaps be modified in any way, or further clarified? If so, how?
- The Commission proposes to exclude from the definition of a “municipal advisor” persons preparing financial statements, auditing financial statements, or issuing letters for underwriters for, or on behalf of, a municipal entity or obligated person. Should persons providing these accounting services be excluded from the definition of “municipal advisor”? Are there additional types of services that an accountant provides

¹⁴⁸ See 15 U.S.C. 80b-3a(a).

that should not require the registration of an accountant as a municipal advisor? If so, what additional types of accounting services should qualify an accountant for an exclusion from the definition of “municipal advisor”? Are there activities that are incidental to the provision of accounting services or inextricably linked to accounting services that can only reasonably be performed by an accountant that might otherwise constitute advice with respect to the issuance of municipal securities or municipal financial products?

- Should the Commission expand the exclusion from the definition of “municipal advisor” beyond engineers providing engineering advice? If so, why and how should such exclusion be expanded? If not, why not? How should the Commission interpret the term “engineering advice”? Are there activities that are “incidental to the provision of engineering advice” or “inextricably linked to engineering advice” that can only reasonably be performed by an engineer that might otherwise constitute advice with respect to the issuance of municipal securities or municipal financial products? As discussed above, the Commission does not interpret the exclusion of engineers providing engineering advice to include circumstances in which the engineer is preparing feasibility studies concerning municipal financial products or the issuance of municipal securities that include analysis beyond the engineering aspects of the project and, therefore, an engineer preparing such studies would be subject to registration as a municipal advisor. Is this an appropriate interpretation? Please explain.
- The Commission proposes to exclude from the definition of municipal advisor attorneys offering legal advice or services of a traditional legal nature. As discussed above, the Commission interprets this exclusion to apply only when the legal services are to a client

of the attorney that is a municipal entity or obligated person. Is this an appropriate interpretation? Please explain. Should the Commission provide an exclusion for all activities of an attorney as long as that attorney has an attorney-client relationship with the municipal entity or obligated person? Why or why not? Should the scope of the exclusion for attorneys be different for attorneys for obligated persons? Why or why not? Neither the Dodd-Frank Act nor the proposed rule defines the term “services of a traditional legal nature.” Is the meaning of the term sufficiently clear? If not, should the Commission provide additional interpretive guidance? How should the Commission interpret the term?

- Are there other types of professional activities that should be excluded from the definition of a “municipal advisor”? Please explain.
- The Commission is proposing to exclude from the definition of “municipal entity” elected members of a governing body of a municipal entity, but to include appointed members of a municipal entity’s governing body unless such appointed members are ex officio members of the governing body by virtue of holding an elective office. Are these distinctions appropriate? Please explain. Are there other persons associated with a municipal entity who might not be “employees” of a municipal entity that the Commission should exclude from the definition of a “municipal advisor”?
- Should employees of obligated persons be excluded from the definition of “municipal advisor” to the extent they are providing advice to the obligated person, acting in its capacity as an obligated person, in connection with municipal financial products or the issuance of municipal securities? One commenter¹⁴⁹ expressed concern that volunteers

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See Jacobsen Letter.

at entities such as charter schools could be required to register as municipal advisors.

Are there types of persons other than employees of obligated persons that should be excluded from the definition of “municipal advisor?” If yes, please provide examples of the specific types of persons and the specific circumstances under which they should be excluded.

- Should the Commission exclude from the definition of a “municipal advisor” banks providing advice to a municipal entity or obligated person concerning transactions that involve a “deposit,” as defined in Section 3(l) of the Federal Deposit Insurance Act¹⁵⁰ at an “insured depository institution,” as defined in Section 3(c)(2) of the Federal Deposit Insurance Act,¹⁵¹ such as insured checking and savings accounts and certificates of deposit? Should the Commission exclude from the definition of a “municipal advisor” banks that respond to requests for proposals (“RFPs”) from municipal entities regarding other investment products offered by the banking entity, such as money market mutual funds or other exempt securities? Should the Commission exclude from the definition of “municipal advisor” a bank that provides to a municipal entity a listing of the options available from the bank for the short-term investment of excess cash (for example, interest-bearing bank accounts and overnight or other periodic investment sweeps) and negotiates the terms of an investment with the municipal entity?¹⁵² Should the Commission exclude from the definition of “municipal advisor” a bank that provides to a municipal entity the terms upon which the bank would purchase for the bank’s own account (to be held to maturity) securities issued by the municipal entity, such as bond

¹⁵⁰ See supra note 145.

¹⁵¹ See supra note 146.

¹⁵² See SIFMA Letter.

anticipation notes, tax anticipation notes, or revenue anticipation notes?¹⁵³ Should the Commission exclude from the definition of “municipal advisor” a bank that directs or executes purchases and sales of securities or other instruments with respect to funds in a trust account or other fiduciary account in accordance with predetermined investment criteria or guidelines, including on a discretionary basis?¹⁵⁴ Should the Commission exclude from the definition of a “municipal advisor” banks and trust companies that provide other fiduciary services to municipal entities, such as acting as trustees with respect to governmental pension plans and other similar capacities? Should banks and trust companies be exempt from the definition of “municipal advisor” to the extent they are providing advice that otherwise would subject them to registration under the Investment Advisers Act, but for the operation of a prohibition to or exemption from registration? Please explain any response to these questions and to the extent that an exemption is recommended, please provide suggested exemptive language.

- Should the Commission exclude from the definition of “municipal advisor” a broker-dealer that provides a municipal entity with price quotations with respect to particular securities (or securities having particular characteristics) which the broker-dealer would be prepared to sell as principal or acquire for the municipal entity?¹⁵⁵ Should the Commission exclude from the definition of “municipal advisor” a broker-dealer that provides to a municipal entity a list of securities meeting specified criteria that are readily available in the marketplace, but without making a recommendation as to the merits of any investment particularized to the municipal entity’s specific circumstances

¹⁵³ See id.

¹⁵⁴ See id.

¹⁵⁵ See id.

or investment objectives?¹⁵⁶

- Should the Commission exclude from the definition of “municipal advisor” an entity that provides to clients investment advice, such as research information and generic trade ideas or commentary that does not purport to meet the needs or objectives of specific clients, and is provided to a municipal entity as part of its ongoing ordinary communications?¹⁵⁷
- Should the Commission permit registration of only separately identifiable departments or divisions of a bank (“SIDs”)? Please explain. Would the following suggested rule text, based on MSRB rule G-1 relating to SIDs engaged in municipal securities dealer activities, provide appropriate conditions for determining whether and when a SID engaged in municipal advisory activities may register as a municipal advisor: “(a) A separately identifiable department or division of a bank, as such term is used in Section 3(a)(30) of the Securities Exchange Act of 1934, is that unit of the bank which conducts all of the municipal advisory activities of the bank, provided that: (1) Such unit is under the direct supervision of an officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal advisory activities, including the supervision of all bank employees engaged in the performance of such activities; and (2) There are separately maintained in or separately extractable from such unit's own facilities or the facilities of the bank, all of the records relating to the bank's municipal advisory activities, and further provided that such records are so maintained or otherwise accessible as to permit independent examination thereof and enforcement of applicable provisions of the Exchange Act, the rules and regulations

¹⁵⁶ See id.

¹⁵⁷ See id.

thereunder and the rules of the MSRB relating to municipal advisors; (b) The fact that directors and senior officers of the bank may from time to time set broad policy guidelines affecting the bank as a whole and which are not directly related to the day-to-day conduct of the bank's municipal advisory activities, shall not disqualify the unit hereinbefore described as a separately identifiable department or division of the bank or require that such directors or officers be considered as part of such unit; and (c) The fact that the bank's municipal advisory activities are conducted in more than one geographic organizational or operational unit of the bank shall not preclude a finding that the bank has a separately identifiable department or division for purposes of this rule, provided, however, that all such units are identifiable and that the requirements of paragraphs (1) and (2) of section (a) of this rule are met with respect to each such unit. All such geographic, organizational or operational units of the bank shall be considered in the aggregate as the separately identifiable department or division of the bank for purposes of this rule.”? Should this language be clarified or modified in any way? Please provide suggested alternative language, as appropriate. Are there reasons that the language of MSRB rule G-1, as modified, should not be used for SIDs engaging in municipal advisory activities? Please explain.

- Are there other exclusions from the definition of “municipal advisor” that the Commission should consider? Please explain.

2. Proposed Rule 15Ba1-2

a. Application for Municipal Advisor Registration

As discussed above, the registration requirement for municipal advisors under Section 15B of the Exchange Act applies to every person, including every natural person, who provides the types of advice described in the definition of a “municipal advisor” – whether that person is an organized

entity, sole proprietor, employee of a municipal advisory firm, or otherwise.¹⁵⁸ The information that is appropriate to seek from a firm before it can be allowed to register may be different from the information that is appropriate to seek from an individual. Thus, as described in detail below, the Commission is proposing the submission of Form MA by municipal advisory firms and the submission of Form MA-I by natural person municipal advisors. A sole proprietor is included in the definition of “municipal advisory firm” and “natural person municipal advisor.” As a result, a sole proprietor would have to complete both Form MA and Form MA-I.

The Commission is proposing rule 15Ba1-2, which would establish the procedures by which a municipal advisor may apply to the Commission for registration. The proposed rule provides that an application for the registration of a municipal advisor must be filed electronically with the Commission on proposed new Form MA or Form MA-I, in accordance with the instructions to Forms MA or MA-I, as applicable.¹⁵⁹

Proposed rule 15Ba1-2(a) would require a municipal advisory firm, including those currently registered on Form MA-T, to apply for registration with the Commission as a municipal advisor by completing Form MA in accordance with the instructions to the form, and filing Form MA electronically with the Commission. Proposed rule 15Ba1-2(b) would require a natural person municipal advisor, which would include an individual employee of a firm who meets the definition of municipal advisor, to apply for registration with the Commission as a municipal advisor by completing Form MA-I in accordance with the instructions to the form and electronically filing the

¹⁵⁸ See supra Section II.A.1. (discussing the definition of the term “municipal advisor”).

¹⁵⁹ If the Commission adopts the registration rule as proposed, municipal advisors may be required to file the forms required by the proposed rule in paper until such time as an electronic filing system is operational and capable of receiving the forms. Municipal advisors would be notified as soon as the electronic system can accept filing of the forms. At such time, the Commission may require each municipal advisor to promptly re-file electronically the applicable forms.

form with the Commission.¹⁶⁰

Each Form MA and MA-I would be considered filed upon acceptance by the Commission. As noted above, proposed rule 15Ba1-2 would require Forms MA and MA-I to be filed electronically with the Commission.¹⁶¹ Similarly, the Commission's registration forms for broker-dealers and investment advisers – Forms BD and ADV – are currently filed electronically through the Central Registration Depository ("CRD") system operated by FINRA and the Investment Adviser Registration Depository ("IARD") system operated by FINRA, respectively. The Commission is considering whether forms for the permanent registration as a municipal advisor should be submitted through the Commission's Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR"), or otherwise.¹⁶² Filings required to be made on a day that the Commission's electronic filing system is closed would be considered timely filed, if filed electronically no later than the following business day.¹⁶³ Information required by the forms would be made publicly

¹⁶⁰ See infra note 233.

¹⁶¹ The Commission is also proposing that Forms MA-W (relating to withdrawals from registration) and MA-NR (relating to appointments of agent for service of process by non-resident municipal advisors and non-resident general partners and managing agents of municipal advisors) be filed electronically. Form MA-W would also constitute a "report" for purposes of Sections 15B(c), 17(a), 18(a), 32(a) (15 U.S.C. 78o-4(c), 78q(a), 78r(a), 78ff(a)) and other applicable provisions of the Exchange Act. See proposed rule 15Ba1-3(d). As a consequence, it would also be unlawful for a municipal advisor to willfully make or cause to be made, a false or misleading statement of a material fact or omit to state a material fact in Form MA-W.

¹⁶² If the registration forms are required to be submitted through EDGAR, 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). In addition, the Commission is considering whether a fee would be charged for filing Forms MA, MA-I, MA-NR or MA-W. For example, the MSRB, in conjunction with or on behalf of the Commission, has the authority to charge reasonable fees for the submission of information to information systems developed for the purpose of serving as a repository of information from municipal market participants. See Section 15B(b)(3) of the Exchange Act (15 U.S.C. 78o-4(b)(3)).

¹⁶³ See proposed rule 15Ba1-2(c).

available unless otherwise noted below. In addition, Forms MA and MA-I would constitute “reports” for purposes of Sections 15B(c), 17(a), 18(a), 32(a) (15 U.S.C. 78o-4(c), 78q(a), 78r(a), 78ff(a)) and other applicable provisions of the Exchange Act.¹⁶⁴ As a consequence, it would be unlawful for a municipal advisor to willfully make or cause to be made, a false or misleading statement of a material fact or omit to state a material fact in Form MA or Form MA-I.

Request for Comment

The Commission requests comments generally on the proposed registration procedures and also requests comment on the following specific issues:

- Forms MA and MA-I would have to be filed electronically for purposes of registering with the Commission. Should the proposed rule include an option for the forms to be filed in paper rather than electronically? If so, please explain under what circumstances it would be appropriate for allowing paper filings of the forms.
- Are there any other issues concerning the filing of forms electronically about which the Commission should be made aware? If so, what are they?
- Are there specific capabilities that the Commission should consider in developing an electronic registration system? For example, should the system have the capability to cross-check other electronic registration systems, such as IARD and CRD? If so, which systems and why?
- Is EDGAR the best vehicle for filing of the required forms with the Commission? If not, what vehicle would be superior and why? Should the Commission allow the filing of documents in electronic media other than EDGAR? If so, please make specific recommendations.

¹⁶⁴ See proposed rule 15Ba1-2(d).

- Would requiring the filing of the forms on EDGAR be an appropriate way to make the requested information publicly available? Should the Commission require website posting of the information instead or in addition? What advantages, if any, would website posting have over requiring that the information be filed, and made publicly available, on EDGAR?
- Does the method for submitting documents in electronic format as opposed to paper format create any issues or hardships for any group of potentially affected firms?

b. Instructions and Glossary

The Commission is proposing a set of instructions (“Instructions”), which include general instructions for proper completion and submission of each of the proposed Forms MA, MA-I, MA-W and MA-NR (“General Instructions”), specific instructions for the completion of Form MA and Form MA-I (“Instructions to Form MA” and “Instructions to Form MA-I”, respectively), and a glossary of terms (“Glossary”) intended to help municipal advisors complete the forms for registration. These Instructions and Glossary are attached to this release, together with proposed Forms MA, MA-I, MA-W and MA-NR.¹⁶⁵ The instructions are intended to answer basic questions concerning completion of the forms. Generally, the definitions in the Glossary are derived from Form ADV,¹⁶⁶ the terms in Exchange Act Section 15B(e),¹⁶⁷ and the definitions in proposed rule 15Ba1-1.¹⁶⁸ For ease of reference, we are proposing one Glossary that would apply to all of the

¹⁶⁵ Proposed Form MA-W would be used for withdrawal from registration as a municipal advisor, and proposed Form MA-NR would be used for the appointment of an agent for service of process by a non-resident municipal advisor or a non-resident general partner or managing agent of a municipal advisor. See *infra* Sections II.A.3.b. and II.A.5. (discussing Forms MA-W and MA-NR, respectively).

¹⁶⁶ See 17 CFR 279.1.

¹⁶⁷ See 15 U.S.C. 78o-4(e).

¹⁶⁸ See proposed rule 15Ba1-1.

proposed forms. All terms in the forms that appear in italics are defined or described in the Glossary.¹⁶⁹

General Instruction 1 would direct an applicant looking for more information about the Commission's rules with respect to municipal advisors and the Exchange Act to the Commission's website. General Instruction 2 explains who should file Forms MA, MA-I, MA-NR and MA-W, including who may voluntarily register as a municipal advisor. General Instruction 3 would instruct an applicant with respect to the organization of Form MA (for example, that Form MA also includes Schedules A, B, C, and D, as well as Criminal Action, Regulatory Action, and Civil Judicial Action Disclosure Pages, as described further below), and would require that an applicant complete all items in Form MA. General Instruction 4 would provide comparable instructions as to the organization and completion of Form MA-I and the schedules and disclosure pages required by that form. General Instruction 5 would instruct that domestic municipal advisors would be required to execute the Domestic Execution Page to Form MA, while non-resident municipal advisors would be required to execute the Non-Resident Municipal Advisor Execution Page. General Instruction 6 would provide that with respect to Form MA-I, a municipal advisor would sign Item 7 of that form. General Instruction 7 would set forth the applicable person to sign Form MA or MA-I on behalf of the applicant, and that such person would be the sole proprietor (in the case of a sole proprietorship), a general partner (in the case of a partnership), an authorized principal (in the case of a corporation), and for all others, an authorized individual who participates in managing or directing the municipal advisor's affairs, or in the case of a natural person, the natural person filing

¹⁶⁹ There are a number of terms in the Glossary. In addition to those described elsewhere in this release, the Glossary also includes definitions or descriptions of the following terms: charged, Chief Compliance Officer, contingent fees, discretionary authority, enjoined, federal banking agency, felony, foreign financial regulatory authority, found, investigation, investment-related, involved, minor rule violation, misdemeanor, order, person, proceeding, resign, and supervised person.

the form on its own behalf, and that in all cases the signature should be a typed name. General Instructions 8 and 9 discuss when to update Forms MA and MA-I respectively, as discussed further herein.¹⁷⁰ General Instruction 10 would provide that an applicant would complete and file all of the forms electronically, and would provide the website for the electronic filing system once the appropriate web address has been confirmed. General Instruction 11 would provide the instructions for electronic filing with the Commission. General Instructions 12 and 13 would provide instructions for how and when an applicant would complete a self-certification as to its qualifications as a municipal advisor and ability to comply with federal securities laws. General Instruction 14 would discuss the requirement for a non-resident municipal advisor to attach a legal opinion to its Non-Resident Municipal Advisor Execution Page to Form MA.

The General Instructions would also inform an applicant that the Commission collects information for regulatory purposes, that filing the Form MA or MA-I is mandatory for municipal advisors that are required to register with the Commission, that the Commission will not accept forms that do not include the required information, and that the Commission will maintain and make publicly available the information submitted on the forms.

The Instructions also would provide some instructions specific to each of Form MA and Form MA-I. Instruction 1 to Form MA would explain that a municipal advisor that has taken over the business of another municipal advisor or has changed its structure or legal status would be a new organization with registration obligations under the Exchange Act. A municipal advisor that is acquiring or assuming substantially all of the assets and liabilities of the advisory business of a registered municipal advisor would file a new application for registration on Form MA within 30 calendar days of the succession, and once the new registration is effective, Form MA-W (as

¹⁷⁰ See infra Section II.A.4.

described below) must be filed to withdraw the registration of the acquired municipal advisor. If a new municipal advisor is 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, the applicant may amend the existing registration to reflect the changes by filing an amendment within 30 calendar days after the change or reorganization. Instruction 2 to Form MA would explain that the response to Item 4 of Form MA (described below) should reflect the applicant's current municipal advisory activities, except with respect to its responses regarding the types of compensation the applicant expects to accept, or the types of municipal advisory activities in which the applicant expects to engage, during the next year. Instruction 3 to Form MA would explain that Schedule D is to be completed if any response to Form MA requires further explanation, or if the applicant wishes to provide additional information.

Instruction 1 to Form MA-I would explain that the applicant must enter its CRD number (if assigned), his or her social security number,¹⁷¹ and the addresses of all offices at which he or she will be physically located or supervised, in Item 1 of the form. Instruction 2 to Form MA-I would clarify that for purposes of completing Item 2 to Form MA-I, the applicant must enter all the other names that the applicant is using, has used, is known, or has been known, other than the applicant's legal name, since the age of 18, which would include nicknames, aliases, and names used before and after marriage. Instruction 3 to Form MA-I would make clear that for purposes of Item 3, with respect to the applicant's residential history for the past 5 years, post office boxes may not be used to complete the response and the applicant may not leave any gaps in residential history greater than 3 months. Instruction 4 to Form MA-I would provide that with respect to Item 4 of Form MA-I, the

¹⁷¹ An applicant's social security number would not be made publicly available. This information is necessary in connection with the Commission's enforcement and examination functions pursuant to Section 15B(c) of the Exchange Act (15 U.S.C. 78o-4(c)).

applicant's employment history for the past 10 years must be provided with no gaps greater than 3 months, and that the history should account for full-time and part-time employment, self-employment, military service and homemaking, and that unemployment, full-time education, extended travel, and other similar statuses should be included. Instruction 5 to Form MA-I for Item 5 of the form would explain that with respect to other businesses in which the applicant is engaged, the following information would be required: the name and address of the other business; nature of the business; position, title, or relationship with the other business, including duties; start date of the relationship with the other business; and the approximate number of hours per month devoted to the other business. Instruction 6 to Form MA-I for Item 6 would also make clear that responses to certain disclosure questions (discussed further below) could make the individual applicant subject to a statutory disqualification. As with Form MA, Instruction 7 to Form MA-I would indicate that the form would be signed (in Item 7 of Form MA-I) by typing a signature in the designated field, and would make clear that by typing a name, the signatory acknowledges and represents that the entry constitutes in every way, use, or aspect, his or her legally binding signature.

Request for Comment

The Commission requests comment generally on the proposed Instructions and Glossary and also requests comment on the following specific issues:

- Are the proposed General Instructions to Forms MA, MA-I, MA-W and MA-NR, and the specific Instructions to Forms MA and MA-I, sufficiently clear? If not, identify any instructions that should be clarified and, if possible, offer alternatives.
- Are the proposed definitions in the Glossary appropriate and sufficiently clear? If not, why not and how should they be modified or clarified? Please suggest alternate language, as applicable.

- Would it be useful if the Commission were to provide any additional instructions or define any additional terms in the Glossary? If so, what are they?
- Are there alternatives to requiring applicants to provide their social security number that the Commission should consider? If so, what are they?

c. Information Requested in Form MA

Proposed Form MA, which would be the form submitted by municipal advisors that are municipal advisory firms, is modeled primarily on Form ADV (Part 1)¹⁷² used for the registration of investment advisers with the Commission, with appropriate changes made to reflect the differences in the activities of municipal advisors and the markets that they serve. More specifically, applicants would be required to provide the information described below. The items are drafted broadly to apply to the different types of municipal advisors that may register with the Commission. If adopted, the contents of the proposed form (unless otherwise specified) would be publicly available.

Form MA would ask for information about the municipal advisor and persons associated with the advisor. The Commission believes it is necessary to obtain the requested information to decide whether to grant or deny an application for registration, to manage the Commission's regulatory and examination programs, and to make such information available to the MSRB to better inform its regulation of municipal advisors. Specifically, the information would assist the Commission in identifying municipal advisors, their owners, and their business models, and in determining whether a municipal advisor might present sufficient concerns as to warrant the Commission's further attention in order to protect their clients. In addition, the information would assist the Commission in understanding the kinds of activities in which the applicant participates that form the basis for registration. The information would also be useful to the Commission in

¹⁷² See 17 CFR 279.1.

tailoring any requests for additional information that the Commission may send to a municipal advisor. Furthermore, the required information would assist the Commission in the preparation of the Commission's inspection and examination of municipal advisors and the MSRB in determining what regulations for municipal advisors may be necessary or appropriate and how such regulations might be best accomplished. In determining what information to propose to be disclosed, the Commission has also considered the broader public interest in the availability of information about municipal advisors to the public (including clients and prospective clients).

Form MA would require the applicant to provide information describing itself and its business through a series of fill-in-the-blank, multiple choice, and check-the-box questions. Form MA would first require a municipal advisor to indicate whether it is submitting the form for initial registration as a municipal advisor, submitting an annual update to a registration as a municipal advisor, or submitting an amendment (other than an annual update) to a registration as a municipal advisor.¹⁷³

Request for Comment

The Commission requests comment generally on proposed Form MA and also requests comment on the following specific issues:

- The Commission requests comment generally on the organization of the form and the clarity of the language it has used.
- Is the use of Form MA for purposes of registration, submitting an annual update, and submitting an amendment (other than an annual update) appropriate? Would the use of the same form for multiple purposes be confusing for applicants? Would it be preferable to have a separate form for each of these purposes? Would these requirements be

¹⁷³

Amendments to Form MA are discussed further below. See infra Section II.A.4.

confusing or otherwise difficult for a municipal advisor to comply with?

- Are there any issues concerning the public availability of information provided on Forms MA and MA-I about which the Commission should be made aware? If so, what are they and how might they be addressed?

Item 1: Identifying Information

Proposed Form MA would require a municipal advisor to indicate the full legal name of the municipal advisor and, if different, the name under which it primarily conducts its municipal advisor-related business; the address of its principal office and place of business,¹⁷⁴ the telephone and fax numbers at that location; and any website addresses.¹⁷⁵ In addition, the municipal advisor would be required to supply the name of its Chief Compliance Officer, if any, and title of any other person whom the municipal advisor has authorized to receive information and respond to questions about the registration (the “contact person”), as well as the address, telephone number and fax number, if any, and e-mail address, if any, of the Chief Compliance Officer and any other contact person. Further, Item 1 of Form MA would require an applicant to list on Schedule D any additional names under which it conducts municipal advisor-related business and the offices at which such business is conducted. The Commission is requesting this identifying and contact information to assist the Commission and the staff in evaluating applications for registration and overseeing registered municipal advisors.

¹⁷⁴ Proposed rule 15Ba1-1(j) would define principal office and place of business to mean: “the executive office of the municipal advisor from which the officers, partners, or managers of the municipal advisor direct, control, and coordinate the activities of the municipal advisor.” See also Glossary.

In addition, the municipal advisor must supply its mailing address, if it is different from its principal office and place of business.

¹⁷⁵ If the applicant has more than one website, it would be required to list all its website addresses on Schedule D.

Form MA would also require a municipal advisor to provide its Employer Identification Number (used with respect to Internal Revenue Service matters), or, if a sole proprietor, a social security number.¹⁷⁶ If the municipal advisor is also registered with the Commission as an investment adviser, broker, dealer, or municipal securities dealer, or if it has previously registered with the Commission as a municipal advisor on Form MA-T, it would be required to provide its related SEC file number or numbers. In addition, if the municipal advisor has a number (a “CRD Number”) assigned to it either under the CRD system or the IARD system, it would be required to provide its CRD Number. If it is otherwise registered with the Commission, it would also be required to disclose its other SEC file numbers.¹⁷⁷

This information would allow the Commission to more effectively cross-reference those entities applying for registration as municipal advisors to those who are registered as brokers, dealers, municipal securities dealers, investment advisers, or otherwise registered¹⁷⁸ with the Commission. The ability to cross-reference would allow the Commission to assemble more complete information concerning a municipal advisor who is also registered as a broker, dealer, municipal securities dealer, investment adviser, or otherwise registered with the Commission to inform the Commission’s decision as to whether to approve an application for registration as a

¹⁷⁶ We are proposing to ask for the social security number of sole proprietors to permit the electronic filing system to distinguish between persons who share the same name. This information is necessary in connection with the Commission’s enforcement and examinations functions pursuant to Section 15B(c) of the Exchange Act (15 U.S.C. 78o-4(c)). To protect the privacy of these persons, the social security numbers would not be available on the public disclosure system. Similarly, the public disclosure system would not report the home address of a sole proprietor who reports its home address as its principal office and place of business.

¹⁷⁷ The Commission is also proposing that applicants would be required to disclose any state registration numbers.

¹⁷⁸ For example, the Commission notes that pursuant to Section 764 of the Dodd-Frank Act, security-based swap dealers will be required to register with the Commission. See Section 764(a) of the Dodd-Frank Act; 15 U.S.C. 78oF(a).

municipal advisor. The ability to cross-reference would also permit the Commission to plan for and carry out efficient and effective examinations of registered municipal advisors that are also otherwise registered.¹⁷⁹ In addition, by obtaining all of an applicant's regulatory file numbers, the Commission would be able to cross-reference disciplinary information that is submitted to the CRD or IARD systems with that submitted on Form MA, and would be able to gain a more complete understanding of a municipal advisor's structure and business.

Item 1 of Form MA would also require the applicant to state whether it maintains, or intends to maintain some or all of its books and records required to be kept under MSRB or Commission rules somewhere other than at its principal office and place of business, and if so to provide (on Schedule D) information about the other location. Form MA would also require an applicant to disclose on Schedule D all of the entities with which it is affiliated, and whether it is affiliated with a business that is registered with a foreign financial regulatory authority, and if so to provide (on Schedule D) the name, in English, of each foreign financial regulatory authority and country with which the affiliated person is registered. This information would help inform the Commission as to the structure of the municipal advisor's business, which would help staff prepare for examinations of the municipal advisor.

Request for Comment

The Commission requests comment generally on Item 1 of proposed Form MA and also requests comment on the following specific issues:

- Is the identifying and contact information requested under Item 1 of Form MA appropriate? Should the Commission request disclosure of additional or different information?

¹⁷⁹ See 15 U.S.C. 78o-4(c)(7) (providing that examinations shall be conducted by the Commission).

- Would any of the information required to be disclosed under Item 1 be difficult for a municipal advisor to provide?
- Would the use of other identifying numbers be more useful or appropriate? Please explain.
- Is there information requested under Item 1 that should not be publicly disclosed? Please explain.
- Would information as to an applicant's affiliated entities be useful for gaining an understanding of a municipal advisor's relationship with other entities? Would it be useful to prospective municipal advisory clients? Is there different information that would provide a better understanding of a municipal advisor's relationship with other entities? If so, what information? Is providing the information requested overly burdensome? If so, why? Should the disclosure required by Item 1-K be limited to affiliates that engage in financial activities?

Item 2: Form of Organization

Item 2 of proposed Form MA would require a municipal advisor to specify whether it is organized as a corporation, partnership, sole proprietorship, limited liability company, limited liability partnership, limited partnership, or other; the month of its annual fiscal year end; the date on which it was organized; and state where it was organized (either the U.S. state or the country outside the U.S.). This information would assist the Commission in evaluating the applications for registration and overseeing registered municipal advisors.

Item 2 would also require an applicant to specify whether it is a public reporting company under Section 12 or 15(d) of the Exchange Act, and if so, provide its Commission assigned Central Index Key ("CIK") number. This information would provide a signal that additional public

information is available about the municipal advisor and/or its control persons.

Request for Comment

The Commission requests comment generally on Item 2 of proposed Form MA and also requests comment on the following specific issues:

- Would the information requested to be disclosed in Item 2 be useful in evaluating a municipal advisor? Is there additional information under Item 2 that should be disclosed? Please explain.
- Are the forms of organization listed under Item 2-A appropriate? Are there additional forms of organization that should be listed?
- To what extent would it be beneficial to require disclosure of whether a municipal advisor is a public reporting company? If a municipal advisor is a public reporting company, is there additional information on Form MA that should be disclosed about the advisor?
- In addition to providing a current CIK number, should municipal advisors be required to disclose all previously issued CIK numbers for that municipal advisor? Would such historical CIK numbers be helpful in accessing the information filed with regulators relating to a municipal advisor? Would SEC and CRD numbers be sufficient for tracking all regulatory filings by a municipal advisor? Please explain.

Item 3: Successions

Item 3 of Form MA would require applicants to disclose whether they are succeeding to the business of a registered municipal advisor, the date of succession, and disclose on Schedule D the name of, and registration information for, the firm they are succeeding. As discussed below, depending on whether the succession is a result of a merger or acquisition, or a reorganization, the

succeeding firm would be able to register by either submitting a new Form MA or amending the Form MA of its predecessor.¹⁸⁰ This information would assist the Commission, among other things, in overseeing registered municipal advisors and in determining whether there has been a change in control of a municipal advisor.¹⁸¹

Request for Comment

The Commission requests comment generally on Item 3 of proposed Form MA and also requests comment on the following specific issues:

- Would the information requested to be disclosed in Item 3 provide information that would help inform an understanding of the relationship between a municipal advisor and its successor, and whether the succession involves a change of control or a change of corporate form? Is there additional information under Item 3 that should be disclosed? Please explain.
- Is there additional information about a succession that would be useful to have disclosed on the Form MA? For example, should the applicant disclose the reason for the succession?

Item 4: Information About Applicant's Business

Item 4 would require an applicant to provide information regarding the approximate number of employees it has, approximately how many of those employees engage in municipal advisory activities, approximately how many of those employees are registered representatives of a broker-dealer or an investment adviser, approximately how many firms or other persons that are not employees or associated persons of the applicant solicit municipal advisory clients on the

¹⁸⁰ See *infra* Section II.A.6. (discussing proposed rule 15Ba1-6 regarding registration of a successor to a municipal advisor).

¹⁸¹ See *id.*

applicant's behalf (if the number entered includes firms, the names of such firms would be required to be disclosed on Schedule D), and approximately how many employees also do business independently on the applicant's behalf as affiliates of the applicant (the names of these employees would be required to be disclosed on Schedule D).¹⁸²

Item 4 would also require the applicant to approximate the number of clients with whom it engaged in municipal advisory activities in the past fiscal year, and to specify by checking the appropriate box(es) whether its clients include: municipal entities, non-profit organizations (e.g., 501(c)(3) organizations) who are obligated persons, corporations or other businesses not listed who are obligated persons, other types of entities, or whether the applicant only engages in solicitation and does not serve clients in the context of its municipal advisory activities. Applicants would also have to specify approximately the number of municipal entities or obligated persons that were solicited by the applicant on behalf of a third-party during its most recently completed fiscal year, including any clients that it both solicits and with which it engages in other municipal advisory activities; and whether it solicits public pension funds, 529 plans, local or state government investment pools, hospitals, colleges, or other types of municipal entities or obligated persons (and which other types of municipal entities or obligated persons), as well as whether the applicant only serves clients and does not engage in solicitation at all in the context of its municipal advisory activities.

Applicants would also be required to disclose whether they are compensated by hourly charges, fixed fees (not contingent on the issuance of municipal securities), contingent fees, subscription fees (for a newsletter or other publications), or otherwise. If the applicant receives

¹⁸² Instruction 2 to Form MA would provide guidance to newly-formed municipal advisors for completing Item 4.

compensation from anyone other than clients, the applicant would be required to provide an explanation of such arrangement.

Disclosure of information relating to the number of a municipal advisor's employees and compensation arrangements would provide the Commission with a clearer understanding of the business structure of registered municipal advisors, including the size of the advisors, the number of its employees that engage in municipal advisory activities, and in what capacity these employees engage in such activities. Information about compensation arrangements also would identify possible conflicts of interest that the municipal advisor may have with its clients.

Item 4 would also require the municipal advisor to indicate the general types of municipal advisory activities in which it engages. The following eleven activities are listed: (1) advice concerning the issuance of municipal securities (including, without limitation, advice concerning the structure, timing, terms and other similar matters, such as the preparation of feasibility studies, tax rate studies, appraisals and similar documents, related to an offering of municipal securities), (2) advice concerning the investment of the proceeds of municipal securities (including, without limitation, advice concerning the structure, timing, terms and other similar matters concerning such investments), (3) advice concerning municipal escrow investments (including, without limitation, advice concerning their structure, timing, terms and other similar matters), (4) advice concerning the investment of other funds of a municipal entity or obligated person (including, without limitation, advice concerning the structure, timing, terms and other similar matters concerning such investments), (5) advice concerning guaranteed investment contracts (including, without limitation, advice concerning their structure, timing, terms and other similar matters), (6) advice concerning the use of municipal derivatives (including, without limitation, advice concerning their structure, timing, terms and other similar matters), (7) solicitation of investment advisory business from a

municipal entity or obligated person (including, without limitation, municipal pension plans) on behalf of an unaffiliated person or firm (e.g., third party marketers, placement agents, solicitors and finders), (8) solicitation of business other than investment advisory business from a municipal entity or obligated person on behalf of an unaffiliated broker, dealer, municipal securities dealer, municipal advisor or investment adviser (e.g., third party marketers, placement agents, solicitors and finders), (9) advice or recommendations concerning the selection of other municipal advisors or underwriters with respect to municipal financial products or the issuance of municipal securities, (10) brokerage of municipal escrow investments, or (11) other (specify). Applicants who check “other” activities would be required to provide a narrative description of such activities. The listed activities are those in which the Commission understands that municipal advisors engage, and are derived from the definition of municipal advisor in Exchange Act Section 15B(e)(4).¹⁸³ This information would assist the Commission in understanding the scope of activities in which a municipal advisor engages, in identifying possible conflicts of interest, in preparing for on-site inspections and examinations, and would provide the Commission with data useful to making regulatory policy.

Request for Comment

The Commission requests comment generally on Item 4 of proposed Form MA and also requests comment on the following specific issues:

- Is the information requested to be disclosed in Item 4 information that would best help inform an understanding of the scope of a municipal advisor’s business? Is there additional information under Item 4 that should be disclosed? Please explain. Is any of the requested information unnecessary or not useful? Please explain.

¹⁸³ See 15 U.S.C. 78o-4(e)(4).

- Is there other information that would be helpful to request regarding the structure of a municipal advisor, in addition to the number of employees, to help provide a clear understanding of the municipal advisor's business structure?
- Are there other types of compensation arrangements for municipal advisors that should be listed under Item 4?
- Are there additional types of municipal advisory activities that should be included in the list of activities provided to municipal entities and obligated persons under Item 4?

Please explain, and provide suggested language, as appropriate.

Item 5: Other Business Activities

Item 5 would require applicants to provide information about their other business activities. Specifically, an applicant would be asked whether it is actively engaged in business as a (1) broker-dealer, municipal securities dealer or government securities broker or dealer, (2) registered representative of a broker-dealer, (3) commodity pool operator (whether registered or exempt from registration), (4) commodity trading advisor (whether registered or exempt from registration), (5) futures commission merchant, (6) major swap participant,¹⁸⁴ (7) major security-based swap participant,¹⁸⁵ (8) swap dealer¹⁸⁶ or security-based swap dealer,¹⁸⁷ (9) trust company, (10) real estate broker, dealer, or agent, (11) insurance company, broker, or agent, (12) banking or thrift institution (including a separately identifiable department or division of a bank), (13) investment adviser

¹⁸⁴ See Exchange Act Rule 3(a)(66) (15 U.S.C. 78c(a)(66)), as amended by Section 761(a) of the Dodd-Frank Act, and the rules and regulations thereunder.

¹⁸⁵ See Exchange Act Rule 3(a)(67) (15 U.S.C. 78c(a)(67)), as amended by Section 761(a) of the Dodd-Frank Act, and the rules and regulations thereunder.

¹⁸⁶ See Exchange Act Rule 3(a)(76) (15 U.S.C. 78c(a)(76)), as amended by Section 761(a) of the Dodd-Frank Act, and the rules and regulations thereunder.

¹⁸⁷ See Exchange Act Rule 3(a)(71) (15 U.S.C. 78c(a)(71)), as amended by Section 761(a) of the Dodd-Frank Act, and the rules and regulations thereunder.

(including financial planners), (14) lawyer or law firm,¹⁸⁸ (15) accountant or accounting firm,¹⁸⁹ (16) engineering firm,¹⁹⁰ or (17) other financial product advisor and if so, to specify. An applicant would also be asked to state whether it is actively engaged in any other business, and if such other business is its primary business. If an applicant's primary business is not one of those enumerated above, it would be required to describe the other business on proposed Schedule D to Form MA. This information would assist the Commission, among other things, in identifying conflicts of interests for municipal advisors, preparing for inspections and examinations of municipal advisors, and would assist the Commission and the MSRB in understanding municipal advisors in the context of their activities for regulatory purposes.

Request for Comment

The Commission requests comment generally on proposed Item 5 of Form MA and also requests comment on the following specific issues:

- Would the information requested to be disclosed in Item 5 help inform an understanding of the other business activities in which a municipal advisor engages? Is there additional information under Item 5 that should be disclosed? Please explain.
- Are there additional categories of other business activities that should be listed under Item 5? Please explain, and provide examples, as appropriate. Is any of the requested information unnecessary or not useful? Please explain.

¹⁸⁸ See supra section II.A.1.c. (discussing the definition of "municipal advisor" and under what circumstances attorneys would be excluded from such definition). Lawyer and law firm applicants would also be required to disclose the jurisdictions where licensed.

¹⁸⁹ See supra section II.A.1.c. (discussing the definition of "municipal advisor" and under what circumstances accountants would be excluded from such definition). Accountant and accounting firm applicants would also be required to disclose the jurisdictions where licensed.

¹⁹⁰ See supra section II.A.1.c. (discussing the definition of "municipal advisor" and under what circumstances engineers would be excluded from such definition).

Item 6: Financial Industry Affiliations of Associated Persons

Item 6 would require an applicant to provide information about its associated persons (i.e., any person associated with a municipal advisor) and the types of activities in which the associated persons are engaged.¹⁹¹ The proposed list of activities under Item 6 is broader than that in Item 5, which allows the Commission to elicit more complete information about the associated persons of a municipal advisor who are actually providing advice or are controlling the firm, which would inform the Commission's regulatory and examination programs. Specifically, under Item 6, a municipal advisor would have to disclose if an associated person is a (1) broker-dealer, municipal securities dealer, or government securities broker or dealer; (2) investment company (including mutual funds), (3) investment adviser (including financial planners), (4) swap dealer, (5) security-based swap dealer, (6) major swap participant, (7) major security-based swap participant, (8) commodity pool operator (whether registered or exempt from registration), (9) commodity trading advisor (whether registered or exempt from registration), (10) futures commission merchant, (11) banking or thrift institution, (12) trust company, (13) accountant or accounting firm, (14) lawyer or law firm, (15) insurance company or agency, (16) pension consultant, (17) real estate broker or dealer, (18) sponsor or syndicator of limited partnerships, (19) engineer or engineering firm, (20) other municipal advisor. Also, an applicant would need to disclose on Schedule D of proposed

¹⁹¹ Section 15B(e)(7) provides that the term "person associated with a municipal advisor" or "associated person of an advisor" means "(A) any partner, officer, director, or branch manager of such municipal advisor (or any person occupying a similar status or performing similar functions); (B) any other employee of such municipal advisor who is engaged in the management, direction, supervision, or performance of any activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities; and (C) any person directly or indirectly controlling, controlled by, or under common control with such municipal advisor." 15 U.S.C. 78o-4(e)(7). For purposes of Form MA, the Glossary would define "associated person or associated person of a municipal advisor" to have the same meaning as in Exchange Act Section 15B(e)(7) (15 U.S.C. 78o-4(e)(7)), but would exclude employees that are solely clerical or administrative.

Form MA each associated person, including any foreign associated persons, that is a municipal advisor, broker-dealer, municipal securities dealer, government securities broker or dealer, investment adviser, registered swap dealer, banking or thrift institution, or trust company. For each associated person identified on Schedule D, the applicant would be required to provide information regarding the nature of the affiliation between the municipal advisor and the associated person, as well as any foreign registrations of the associated person. The information provided would assist the Commission in having a clearer understanding of the types of business activities in which associated persons are engaged and the possible conflicts of interest those activities may create.

Request for Comment

The Commission requests comment generally on Item 6 of proposed Form MA and also requests comment on the following specific issues:

- Would the information requested to be disclosed in Item 6 inform a meaningful understanding of the relationship between a municipal advisor and its associated persons and the kinds of activities in which they engage? If not, why not? Is there additional information under Item 6 that should be disclosed, such as additional categories of activities in which an associated person might be engaged? Please explain. Should any of the categories be deleted?

Item 7: Participation or Interest in Municipal Advisory Client Transactions

Item 7 would require applicants to disclose information about participation and interest of the municipal advisor or its associated persons in the transactions of its municipal advisory clients. The purpose of Item 7 is to identify possible conflicts of interest that the municipal advisor and its associated persons may have with the municipal advisor's clients. For example, a municipal advisor that receives commissions or other payments for sales of securities to clients may have a

conflict of interest with its clients. This type of practice gives the municipal advisor and its personnel an incentive to base investment recommendations on the amount of compensation they will receive rather than on the client's best interests.

Specifically, Item 7 would require an applicant to disclose whether it, or any of its associated persons, have a proprietary interest in the securities or other investment or derivative product transactions of its clients, such as whether it buys securities or other investment or derivative products from, or sells them to, its clients. An applicant would also be asked to disclose whether it or its associated persons recommend purchases or sales of securities or other investment or derivative products to clients for which the municipal advisor or its associated persons serve as underwriter or purchaser representative, or have any other sales interest; whether it or its associated persons have certain discretionary authority over securities or other investment transactions for its clients; and whether it or its associated persons recommend brokers, dealers, or investment advisers to its clients, and if so, whether those brokers, dealers, or investment advisers are associated persons of the municipal advisor. Item 7 would also require the municipal advisor to disclose whether it or its associated persons give or receive compensation for municipal advisory client referrals.

Request for Comment

The Commission requests comment generally on Item 7 of proposed Form MA and also requests comment on the following specific issues:

- Would the information requested to be disclosed in Item 7 be appropriate for identifying potential conflicts of interest between municipal advisors and/or associated persons and the municipal advisors' clients? Should any be deleted? Why?
- Is there additional information under Item 7 that should be disclosed to provide a clearer understanding of potential conflicts of interest? Please explain.

Item 8: Control Persons

In Item 8, applicants would be asked to identify on Schedules A and B every person that directly or indirectly controls the applicant, or that the applicant directly or indirectly controls.¹⁹² An initial applicant would be required to complete proposed Schedules A and B. Schedule A would require information about the applicant's executive officers and persons that directly own 5% or more of the applicant. Schedule B would request information about persons that indirectly own 25% or more of the applicant. Schedule C would be used to amend information previously reported on Schedules A and B. Applicants would also be asked to identify, on Schedule D, any person that controls the applicant's management or policies if not otherwise identified. Further information would be requested with respect to control persons that are public reporting companies under Sections 12 or 15(d) of the Exchange Act.¹⁹³ For control persons that do not have a CRD number, Schedules A, B, and C would require disclosure of their social security number and date of birth, IRS tax number or employer ID number.¹⁹⁴ The proposed information that would be requested and

¹⁹² The term "control" is defined in the Glossary to mean "the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise." Further, the Glossary provides that: (a) each of the municipal advisor's officers, partners, or directors exercising executive responsibility (or persons having similar status or functions) is presumed to control the municipal advisor; (b) a person is presumed to control a corporation if the person: (i) directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or (ii) has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities; (c) a person is presumed to control a partnership if the person has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership; (d) a person is presumed to control a limited liability company ("LLC") if the person: (i) directly or indirectly has the right to vote 25 percent or more of a class of the interests of the LLC; (ii) has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or (iii) is an elected manager of the LLC; and (e) a person is presumed to control a trust if the person is a trustee or managing agent of the trust. See Glossary.

¹⁹³ Section 8-B of proposed Schedule D to Form MA would require the name and CIK number of each control person listed on Schedule A, B, C or Section 8-A of Schedule D.

¹⁹⁴ The Commission would not make this information publicly available.

the proposed definition of control are consistent with that requested and used by the Commission in other contexts.¹⁹⁵ This information would help to inform the Commission's understanding of the ownership structure of the municipal advisor and in identifying who ultimately controls the municipal advisor, including its policies and procedures, which would provide useful information in preparing for examinations and also in identifying potential conflicts of interest. The information requested also would inform the Commission about changes in control of the municipal advisor.

Request for Comment

The Commission requests comment generally on Item 8 of proposed Form MA and also requests comment on the following specific issues:

- Would the information requested to be disclosed in Item 8 be appropriate for understanding the ownership structure of a municipal advisor and identifying possible conflicts of interest? Is there additional information under Item 8 that should be disclosed? Please explain. Should any be deleted? Why?
- Is the proposed definition of "control" broad enough to elicit information that would provide an understanding of a municipal advisor's structure and its control persons? Should additional or different information be requested? If so, what information?

Item 9: Disclosure Information

Section 975(c)(3) of the Dodd-Frank Act amended Section 15B of the Exchange Act to direct the Commission, by order, to censure, place limitations on the activities, functions, or operations, suspend for a period not exceeding twelve months, or revoke the registration of any

¹⁹⁵ The proposed requested information and definition of "control" are consistent with the information requested and definition used for investment advisers required to register on Form ADV. See 17 CFR 279.1.

municipal advisor, if it finds¹⁹⁶ that such municipal advisor has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (A),¹⁹⁷ (D),¹⁹⁸ (E),¹⁹⁹ (G)²⁰⁰ or (H),²⁰¹ of paragraph (4) of Section 15(b) of the Exchange Act; has been convicted of any offense specified in Section 15(b)(4)(B)²⁰² of the Exchange Act within ten years of the commencement of the proceedings under Section 15B(c); or is enjoined from any action, conduct, or practice specified in Section 15(b)(4)(C)²⁰³ of the Exchange Act.²⁰⁴ Item 9 of Form MA includes questions intended to

¹⁹⁶ Such findings must be on the record after notice and opportunity for hearing and include a finding that the particular disciplinary action is in the public interest. See 15 U.S.C. 78o-4(c)(2).

¹⁹⁷ See 15 U.S.C. 78o(b)(4)(A) (e.g., making false or misleading statements of a material fact in a report filed with, or preceding before, the Commission).

¹⁹⁸ See 15 U.S.C. 78o(b)(4)(D) (e.g., violating or being unable to comply with the Securities Act, the Investment Advisers Act, the Investment Company Act, the Commodity Exchange Act, the Exchange Act, the rules or regulations under any of such statutes, or the rules of the MSRB).

¹⁹⁹ See 15 U.S.C. 78o(b)(4)(E) (e.g., aiding and abetting violations of, or failing to supervise to prevent violations of, the Securities Act, the Investment Advisers Act, the Investment Company Act, the Commodity Exchange Act, the Exchange Act, the rules or regulations under any of such statutes, or the rules of the MSRB).

²⁰⁰ See 15 U.S.C. 78o(b)(4)(G) (e.g., being found by a foreign financial regulatory authority to have made false or misleading statements of material facts; violated or been unable to comply with foreign regulations; or aided and abetted violations of, or failed to supervise to prevent violations of, foreign regulations).

²⁰¹ See 15 U.S.C. 78o(b)(4)(H) (e.g., being subject to a final order of a State securities commission, an appropriate Federal banking agency, or the National Credit Union Administration that bars such person from associating with an entity regulated by such authority or agency, or prohibits such person from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities).

²⁰² See 15 U.S.C. 78o(b)(4)(B) (e.g., being convicted within the ten years preceding application for registration of certain felonies or misdemeanors, including felonies and misdemeanors involving the purchase and sale of securities or arising out of the conduct of the business of a broker, dealer, municipal securities dealer, or municipal advisor).

²⁰³ See 15 U.S.C. 78o(b)(4)(C) (e.g., being enjoined by order from acting as an investment adviser, underwriter, broker, dealer, municipal securities dealer or municipal advisor).

²⁰⁴ The Commission has the same authority with respect to municipal securities dealers. See 15 U.S.C. 78o-4(c).

solicit information from a municipal advisor concerning certain of its activities or activities of its associated persons that could subject the municipal advisor to disciplinary actions by the Commission under such subparagraphs of Section 15(b)(4) of the Exchange Act.

The information proposed to be required by Item 9 would be used to determine whether to grant the applicant's application for registration, institute proceedings to determine whether registration should be denied, place limitations on the applicant's activities as a municipal advisor, and to focus on-site examinations.²⁰⁵ Also, in addition to its value for the Commission's oversight of the municipal securities markets generally, the Commission proposes to seek this information because it may indicate that a municipal advisor could be statutorily disqualified from acting as a municipal advisor.²⁰⁶ In addition, the Commission would make this information available to municipal entities and obligated persons who engage municipal advisors, to investors who may purchase securities from offerings in which municipal advisors have participated, and to other regulators.

The disciplinary information to be disclosed is substantially similar to the information required to be disclosed in Form BD²⁰⁷ for broker-dealers and in Form ADV²⁰⁸ for investment advisers. The requested information is also consistent with the disclosure requirements of Form MA-T.²⁰⁹ In addition to information with respect to investment-related activities, Form MA would

²⁰⁵ See also supra Section II.B. (discussing approval or denial of registration).

²⁰⁶ See id.

²⁰⁷ See 17 CFR 249.501.

²⁰⁸ See 17 CFR 279.1.

²⁰⁹ On Form MA-T, the disclosure required with respect to orders entered against the municipal advisor by regulatory authorities, and whether any court has enjoined the municipal advisor or associated person in connection with investment related activities are limited to the past 10 years. On Form MA, the Commission is not proposing any time limitation on this disclosure for the reasons discussed in this Section II.A.2.c.

additionally request parallel information for municipal advisory activities. Specifically, as discussed below, Form MA asks questions concerning the disciplinary history of the municipal advisor and of its associated persons.²¹⁰

In Form MA-T, the Commission limited the disciplinary history disclosure requirements to “associated municipal advisor professionals.”²¹¹ The Commission limited the disclosure requirements to this subgroup of associated persons to obtain information about those associated persons who are closely associated with an advisor’s municipal advisory activities, *i.e.*, those who are primarily engaged in an advisor’s municipal advisory activities, have supervisory responsibilities over those primarily engaged in municipal advisory activities, are engaged in day-to-day management of the conduct of an advisor’s municipal advisory activities, or are responsible for executive management of the advisor.²¹² Due to the short time-frame between the passage of the Dodd-Frank Act and the deadline for registration of municipal advisors on October 1, 2010, the Commission believed it was appropriate to limit the disclosure requirement to this subgroup of associated persons. In connection with the proposed permanent registration regime, however, the Commission believes it is appropriate to propose in Item 9 that a municipal advisor disclose the

²¹⁰ See *supra* note 191 (discussing the definition of “person associated with a municipal advisor” or “associated person of a municipal advisor”).

²¹¹ The Commission defined the term “associated municipal advisor professional” in the glossary section of Form MA-T to mean: (A) any associated person of a municipal advisor primarily engaged in municipal advisory activities; (B) any associated person of a municipal advisor who is engaged in the solicitation of municipal entities or obligated persons; (C) any associated person who is a supervisor of any persons described in subparagraphs (A) or (B); (D) any associated person who is a supervisor of any person described in subparagraph (C) up through and including, the Chief Executive Officer or similarly situated official designated as responsible for the day-to-day conduct of the municipal advisor’s municipal advisory activities; and (E) any associated person who is a member of the executive or management committee of the municipal advisor or a similarly situated official, if any; and excludes any associated person whose functions are solely clerical or ministerial.

²¹² See Temporary Registration Rule Release, *supra* note 63, at 54469.

disciplinary history, as applicable, of all its associated persons, as that term is defined in Exchange Act Section 15B(e)(7).²¹³ Specifically, Item 9 would require disclosure with respect to any partner, officer, director or branch manager of a municipal advisor, and any other employee who is engaged in the management, direction, supervision, or performance of any municipal advisory activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities; and any person that directly or indirectly controls, is controlled by, or under common control with the municipal advisor. As a result, Form MA would capture information with respect to employees that engage in municipal advisory activities, even if that is not their primary activity. Form MA also would require disclosure with respect to controlling persons and other affiliates of the municipal advisor.

The Commission believes that “associated person” as defined in Exchange Act Section 15B(e)(7) (15 U.S.C. 78o-4(e)(7)) (and as it is proposed to be defined) is an appropriate definition to use²¹⁴ because it would allow the Commission to obtain, and municipal entities, obligated persons, investors and other regulators to have access to, information about the municipal advisor’s supervisory and management personnel, employees engaged in the management, direction, supervision, or performance of activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, and control persons. This information would help provide a clear understanding regarding the persons associated with municipal advisors.

In addition, the Commission notes that the time-period limits proposed for disclosure on

²¹³ See 15 U.S.C. 78o-4(e)(7).

²¹⁴ The definition of “associated person of a municipal advisor” in the Glossary would be consistent with the definition of “associated person” in Exchange Act Section 15B(e)(7) (15 U.S.C. 78o-4(e)(7)). The definition would exclude, however, employees who are solely clerical or administrative. This exclusion would be consistent with the comparable term on Form ADV, which also excludes employees who are solely clerical or administrative.

Form MA are consistent with the disclosure reporting requirements on Form BD, adopted pursuant to Section 15(b)(1) of the Exchange Act. Specifically, with respect to felonies and misdemeanors involving municipal advisor-related business,²¹⁵ investments or an investment-related business, Form MA would require disclosures of matters within the last ten years.²¹⁶ With respect to all other matters proposed to be identified on Form MA (including federal, state, and foreign regulatory actions and actions taken by SROs), no time limit is placed on disclosure. For example, a municipal advisor would be required to disclose whether the municipal advisor or any associated person was ever enjoined by any domestic or foreign court in connection with any municipal advisor-related or investment-related activity. Disclosure would also be required concerning any orders entered against the municipal advisor or any associated person of the municipal advisor by any federal or state regulatory agency other than the SEC and Commodity Futures Trading Commission (“CFTC”) or by any foreign financial regulatory authority. The Commission believes that, for purposes of the permanent registration regime, it is important to collect information about matters within these timeframes because, under the Exchange Act, the Commission could use such matters to form the basis for an action to suspend or revoke a municipal advisor’s registration.²¹⁷

The questions asked in Item 9 are generally consistent with the disciplinary disclosure questions asked on Form BD. Unlike on Form BD, Item 9 asks for information regarding actions relating to municipal advisor-related business, in addition to investment-related business.

²¹⁵ The Commission proposes that the term “municipal advisor-related” would mean “[c]onduct that pertains to municipal advisory activities (including, but not limited to, acting as, or being an associated person of, a municipal advisor).” Glossary.

²¹⁶ As is the case with respect to brokers and dealers pursuant to Section 15(b)(4) of the Exchange Act (15 U.S.C. 78o(b)(4)), Section 15B(c)(2) of the Exchange Act (15 U.S.C. 78o-4(c)(2)), as amended by the Dodd-Frank Act, limits the Commission’s ability to impose sanctions on municipal advisors for conviction of felonies and misdemeanors to convictions occurring within ten years preceding the filing of any application for registration.

²¹⁷ See Section 15B(c)(2) of the Exchange Act.

Specifically, Item 9 of the proposed form would ask for information regarding convictions, pleading and charges related to felonies and certain misdemeanors. It would ask for information regarding whether the SEC or the CFTC has ever: found the municipal advisor or any associated person to have made a false statement or omission; found the municipal advisor or any associated person to have been involved in a violation of its regulations or statutes; found the municipal advisor or any associated person to have been a cause of a municipal advisor- or investment-related business having its authorization to do business denied, suspended, revoked, or restricted; entered an order against the municipal advisor or any associated person in connection with municipal advisor- or investment-related activity; or, imposed a civil money penalty on the municipal advisor or any associated person, or ordered the municipal advisor or any associated person to cease and desist from any activity. Item 9 of the form would also ask for similar information with respect to other federal regulatory agencies, any state regulatory agency, or any foreign financial regulatory authority. Item 9 would ask for information regarding whether any SRO or commodity exchange ever found the municipal advisor or any associated person to have made a false statement or omission; found the municipal advisor or any associated person 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); found the municipal advisor or any associated person to have been the cause of a municipal advisor- or investment-related business having its authorization to do business denied, suspended, revoked, or restricted, or disciplined the municipal advisor or any associated person by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities. It would also ask whether the municipal advisor or its associated persons have had authorization to do business or to act as an advisor, attorney, or federal contractor revoked or suspended. In addition, Item 9 would ask for information about

pending regulatory proceedings; and civil proceedings related to municipal advisor- or investment-related activities, including pending proceedings.

These questions are designed to elicit responses that would enable the Commission to institute proceedings against the municipal advisor, if appropriate, and also to make the information available to the public. Section 15B(c)(2) of the Exchange Act provides that the Commission shall censure, place limitations on the activities, functions and operations of, suspend, or revoke the registration of a municipal securities dealer or municipal advisor if it finds that doing so is in the public interest and that the municipal advisor has committed the kinds of acts, is subject to the kinds of orders or findings, has been convicted of the kinds of offenses, or is enjoined from the kinds of actions, conduct and practices enumerated in Section 15(b)(4) of the Exchange Act.²¹⁸ Section 15(b)(4) of the Exchange Act²¹⁹ provides that the Commission shall censure, place limitations on the activities, functions and operations of, suspend, or revoke the registration of a broker or dealer if it finds that doing so is in the public interest and that the broker or dealer, or any person associated with the broker or dealer, has made false or misleading statements with respect to material facts in any registration or report filed with the Commission; has been convicted in the ten years preceding any application for registration or any time thereafter of any felony or misdemeanor or of a substantially equivalent crime by a foreign court of competent jurisdiction which the Commission finds involves or arises out of certain activities, including conduct of the business of a municipal advisor; or is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as, among other things, a municipal advisor, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security. If a municipal advisor answers "yes" to any of the disciplinary

²¹⁸ See 15 U.S.C. 78o-4(c)(2).

²¹⁹ See 15 U.S.C. 78o(b)(4).

history questions in Item 9, the municipal advisor would be required to complete a Disclosure Reporting Page (“DRP”) to Form MA.

Proposed Form MA includes separate DRPs to report information relating to criminal, regulatory, and civil actions involving the municipal advisor or its associated persons. Each would require detailed information about the action, such as the entities or regulatory authorities involved, where the charges were filed and when, a description of the charge and the circumstances related to it, in the case of municipal advisor- and investment-related charges – the product type, and the status of the charge, including resolution details as appropriate. Consistent with the limitations set forth in Section 15(b)(4)(B)²²⁰ of the Exchange Act, however, information on the criminal DRP would be limited to matters within the last ten years. If a municipal advisor or associated person that is registered through the investment adviser or broker-dealer registration systems (the “IARD” or “CRD”, respectively) has submitted a DRP with Forms ADV, BD, or U4 to the IARD or CRD, or a municipal advisor has previously submitted disclosure to the Commission with a prior registration on Form MA-T, for the matter that reports the information required by a DRP to Form MA, information included with respect to Forms MA-T, ADV, BD, or U4 as applicable, could be incorporated by reference (to the extent possible, depending on the technical capabilities of the electronic filing system).

The Commission believes that it is important to collect the information that would be required by the DRPs to assist it in deciding whether to grant or institute proceedings to deny an application for registration, to revoke a registration, to manage the Commission’s regulatory and examination programs, and to make such information available to the MSRB to better inform its regulation of municipal advisors and the municipal securities market generally.

²²⁰ 15 U.S.C. 78o(b)(4)(B). See also 15 U.S.C. 78o-4(c)(2).

Request for Comment

The Commission requests comment generally on Item 9 of proposed Form MA and also requests comment on the following specific issues:

- How might the disclosures regarding associated persons whose actions are covered by Item 9 of Form MA be improved?
- Are the questions in Item 9 sufficient for providing information to investors, municipal entities, obligated persons, and regulators regarding the disciplinary history of municipal advisors and associated persons?
- Should additional or other questions be included? Please provide examples of any additional questions that should be included.
- Would the questions in Item 9 impose an excessive burden on municipal advisors to answer?
- Does expanding the disciplinary history disclosure requirement in Item 9 of Form MA to associated persons of municipal advisors, rather than limiting it to associated municipal advisor professionals (as in Form MA-T), include persons whose disciplinary history is sufficiently relevant to a municipal advisor's activities to warrant disclosure?
- Are the timeframes to the questions in Item 9 appropriate? Would the public and municipal entities find the full history of disciplinary information important and useful rather than putting time limitations on disclosure of criminal information? Are the timeframes too long, such that they would require disclosure of information that is no longer useful or relevant, or such that they would impose an undue burden on applicants for registration?
- Would including the disciplinary questions in Form MA impose undue hardship on, or

have other consequences for, small municipal advisors?

- Would the ability to incorporate by reference to disciplinary disclosures on Form BD and Form ADV for registered broker-dealers and investment advisers, respectively, or to disclosures made with a previous registration on Form MA-T, make it more difficult for municipal entities, obligated persons, investors and others to obtain this information than if it were included in Form MA itself?
- Would the ability of municipal advisors to incorporate by reference such disclosures on Forms MA-T, BD, ADV, and U4 significantly reduce the burden on municipal advisors, and particularly small municipal advisors, to complete Form MA?

Item 10: Small Businesses

As described further in Section VII below, the Commission is required by the Regulatory Flexibility Act (“RFA”)²²¹ to consider the effect of its regulations on small entities. The Commission’s rules do not define “small business” or “small organization” for purposes of municipal advisors. The Small Business Administration (“SBA”) defines small business for purposes of entities that provide financial investment and related activities as a business that had annual receipts of less than \$7 million during the preceding fiscal year and is not affiliated with any person that is not a small business or small organization.²²² The Commission is using the SBA’s definition of small business to define municipal advisors that are small entities for purposes of the RFA.

Item 10 of Form MA would enable the Commission to determine how many applicants meet the SBA’s definition of “small business” or “small organization” as applied to municipal advisors, by requiring each applicant to disclose whether it had annual receipts of less than \$7 million during

²²¹ 5 U.S.C. 601 *et seq.*

²²² See 13 CFR 121.201.

its most recent fiscal year (or the time it has been in business, if it has not completed its first fiscal year in business). The applicant would also be required to disclose whether any business or organization with which it is affiliated had annual receipts of more than \$7 million in its most recent fiscal year (or the time it has been in business, if it has not completed its first fiscal year in business).

Request for Comment

The Commission requests comment generally on Item 10 of proposed Form MA and also requests comment on the following specific issues:²²³

- Are the questions asked in Item 10 sufficiently clear? If not, please explain.
- Should the Commission request any other information to make its determination?

Execution and Self-Certification

Proposed Form MA would include an execution page that must be signed and attached to any initial application for registration, as well as to any amendments to Form MA. The proposed execution page is similar in purpose to the execution page of Form ADV,²²⁴ but deletes references to state registration, bonding requirements and other inapplicable components, and would require a non-resident municipal advisor to execute a separate form (Form MA-NR) to designate agent for service of process.

Form MA would be electronically “signed” by an authorized person of the advisor before the form could be electronically submitted. The authorized person would sign the form by typing his or her name and submitting the form on behalf of the advisor. An authorized person would sign one of two different execution pages, depending on whether the advisor is resident in the United

²²³ See also *infra* Section VII (discussing the impact of the proposed rules on municipal advisors that are small entities).

²²⁴ See 17 CFR 279.1.

States or a “non-resident” municipal advisor.²²⁵ By signing the domestic municipal advisor execution page, the authorized person would affirm that the information in Form MA is true and correct, and would appoint certain officials as agents for service of process in states where the advisor maintains its principal office or place of business. Specifically, a domestic municipal advisor would appoint an official in the state where it maintains its principal office and place of business. This appointment would allow private parties and the Commission to bring actions against the municipal advisor by delivering necessary papers to the appointed agent.²²⁶ The agent would be able to receive any process, pleadings, or other papers in any action that arises out of or relates to or concerns municipal advisory activities of the municipal advisor. As proposed, the agent also could receive service for investigation and administrative proceedings.

The execution page for resident and non-resident municipal advisors would require certification that the books and records of the municipal advisor will be preserved and available for inspection and would authorize any person with custody of the books and records to make them available to federal representatives. With respect to non-resident municipal advisors, the execution page also provides that by signing the Form MA, the non-resident municipal advisor agrees to provide, at its own expense, to the Commission, copies of all books and records that the municipal

²²⁵ Proposed rule 15Ba1-1(h) defines a “non-resident” as: “(1) [i]n the case of an individual, one who resides in or has his principal office and place of business in any place not in the United States; (2) [i]n the case of a corporation, one incorporated in or having its principal office and place of business in any place not in the United States; and (3) [i]n the case of a partnership or other unincorporated organization or association, one having its principal office and place of business in any place not in the United States.” This definition is consistent with the definition of “non-resident broker-dealer” in rule 15b1-5 under the Exchange Act. See 17 CFR 240.15b1-5. See also 17 CFR 275.0-2 (defining the term “non-resident” for purposes of serving non-residents in connection with Form ADV). In addition, non-resident municipal advisors and non-resident general partners and managing agents of municipal advisors would submit Form MA-NR. See infra Section II.A.5. (discussing proposed Form MA-NR).

²²⁶ Appointment of agent for service of process for non-resident municipal advisors is discussed further below. See infra Section II.A.5. (discussing proposed Form MA-NR).

advisor is required to maintain by law. The Commission believes that before granting registration to a domestic or non-resident municipal advisor, it is appropriate to obtain assurance that such person 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 inspection and examination by the Commission.

The authorized person of a municipal advisor completing the execution pages and the municipal advisor would also be required to certify that the municipal advisor and every natural person associated with it has met, or within any applicable required timeframes will meet, such standards of training, experience, and competence, and such other qualifications, including testing, for a municipal advisor and natural persons associated with it, required by the Commission, the MSRB, or any other relevant SRO. The authorized person and municipal advisor would also be required to certify that the municipal advisor has conducted an initial or annual review, as applicable, of the municipal advisor's business and has reasonably determined that the municipal advisor: 1) can carry out the activities described in the items that are checked in Item 4.K (Applicant's Business Relating to Municipal Securities) of Form MA;²²⁷ 2) can comply with all applicable regulatory obligations; and 3) has met such regulatory obligations during the last year (or such shorter period if the application is an initial application for registration). For these purposes, such applicable regulatory obligations are obligations under the federal securities laws and rules promulgated thereunder and applicable rules promulgated by the MSRB, or any other relevant SRO. The authorized person and the municipal advisor would also be required to certify that the municipal advisor has documented this review process and will maintain all documents relating to

²²⁷

Factors that should be considered in determining whether a municipal advisor can carry out the described activities would include, but not be limited to, whether the municipal advisor has, with respect to the described activities: the appropriate technology systems and equipment; the appropriate financial resources; adequate staffing with appropriate skill sets, training, and expertise; and adequate facilities, such as office space, as appropriate.

such review in accordance with proposed rule 15Ba1-7 under the Exchange Act.²²⁸ Proposed rule 15Ba1-4(e) would require such certification in conjunction with filing of an initial application for registration as a municipal advisor and annually thereafter.²²⁹

Failure to make the certifications required by the execution pages would be a basis for the Commission to commence proceedings to deny an application for registration.²³⁰ In addition, if an applicant becomes unable to comply with the certifications, this would be a basis for the Commission to commence proceedings to revoke a municipal advisor's registration.²³¹

Additionally, proposed rule 15Ba1-5 would require a non-resident municipal advisor, other than a natural person, including non-resident sole proprietors (i.e., non-resident municipal advisory firms) to provide an opinion of counsel that the municipal advisor can, as a matter of law, provide the Commission with access to the books and records of the municipal advisor, as required by law, and that the municipal advisor can, as a matter of law, submit to onsite inspection and examination by the Commission. General Instruction 14 would provide that a non-resident municipal advisor filing Form MA must attach the opinion as an Exhibit to its execution page. 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 a municipal advisor. Providing an

²²⁸ Proposed rule 15Ba1-7(a)(8) would require a municipal advisory firm to make and keep true, accurate, and current, a record of the initial or annual review, as applicable, conducted by the municipal advisor of such municipal advisor's business in connection with its self-certification on Form MA.

²²⁹ See proposed rule 15Ba1-4(e). The proposed rule would require the annual self-certification to be filed by municipal advisory firms within 90 days of the end of a municipal advisor's fiscal year, or of the end of the calendar year for municipal advisors that are sole proprietors.

²³⁰ See infra Section II.B. (discussing grounds for denial of registration of a municipal advisor's registration). The Commission also notes that if the execution page to Form MA is not completed, the Form MA would be incomplete and the electronic filing system would not permit the Form MA to be filed.

²³¹ See supra notes 218 and 219, and accompanying text (discussing grounds for revocation of registration of a municipal advisor's registration and other sanctions).

opinion of counsel that a municipal advisor can provide access to its books and records and can be subject to onsite inspection and examination would allow the Commission to better evaluate a municipal advisor'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 generally on the execution pages of proposed Form MA and also requests comment on the following specific issues:

- Are the instructions relating to execution sufficiently clear? If not, please explain and suggest additional or alternative language.
- Should there be additional or alternative representations required of a person who executes Form MA?
- Are there alternative methods to obtain consent to service of process?
- Are the requirements for domestic municipal advisors, as set forth on the execution page for domestic municipal advisors appropriate? Should these requirements be changed in any way? Please explain.
- Are the requirements for non-resident municipal advisors, as set forth on the execution page for non-resident municipal advisors appropriate? Should these requirements be changed in any way? Please explain.
- Should the Commission's definition of "non-resident" be modified in any way?
- Does requiring a non-resident municipal advisor to certify that it will provide the Commission with access to the municipal advisor's books and records and submit to onsite inspection and examination by the Commission, ensure that the Commission can

legally, under applicable foreign law, obtain prompt access to a non-resident municipal advisor's books and records and examine a non-resident municipal advisor onsite? Are there other factors or alternatives that are relevant to ensure that the Commission can legally, under applicable foreign law, obtain prompt access and examine a non-resident municipal advisor onsite?

- Are there any factors that the Commission should take into consideration to ensure that a non-resident municipal advisor seeking to register as a municipal advisor can, in compliance with applicable foreign laws, provide the Commission with access to its books and records and can submit to inspection and examination by the Commission?
- Should the Commission require non-resident municipal advisors seeking to register as municipal advisors to certify to anything else on the execution page for non-resident municipal advisors?
- Should non-resident municipal advisors be required to provide any additional information or documents?
- Is the proposed self-certification broad enough in scope or too broad? If not, what additional factors should be included or excluded and why? Should the self-certification be required more or less frequently? If so, how often and why? Are there other alternatives the Commission should consider? If so, what alternatives and why?
- In connection with the proposed initial and annual review requirement for the self-certification, would municipal advisors undertake a meaningful review absent a minimum review standard?
- Should the Commission instead mandate a minimum level of review that must be performed of a municipal advisor's business? If so, what level of review would be

appropriate?

- Is there a minimum level of review that would be appropriate without imposing impracticable burdens or costs on municipal advisors?
- Should the self-certification requirement further specify the types of business activities that should be covered by the initial and annual review?
- Should a municipal advisor be required to disclose publicly, such as on Form MA, the nature of its review and its findings and conclusions?
- Should the Commission specify the types of review that should be performed? If so, what types of review would be appropriate for municipal advisors? Should the type of review differ depending on the type of municipal advisory activities in which the advisor engages and/or the size of the advisor? Please explain.
- As an alternative to the proposed self-certification requirement, should the Commission require an independent third party review of the municipal advisor as part of, or prior to, the advisor's application for registration and then annually thereafter? Should the Commission require that the municipal advisor name any such third party reviewer on the Form MA? Should the findings and conclusions of the third party reviewer be made publicly available?
- Is there any other party that a municipal advisor should be allowed to rely upon in order to satisfy an initial and annual review requirement? Please explain. Would an accountant or attorney be an appropriate third party reviewer?
- If the Commission were to permit or require third party reviews, how would the Commission encourage the quality of third party reviews? Should a third party be required to be independent? If so, should the Commission define "independence" for

this purpose? If so, how should “independence” be defined? Should the Commission require disclosure of affiliates related to third parties?

- Should the Commission undertake a review of all municipal advisors as part of the registration and examination process? If so, what should be the scope and frequency of the examination process? Should the Commission provide municipal advisors a choice between independent third party review and Commission review, or a combination thereof? In order to make the most efficient use of the Commission’s resources, should the Commission rely on an SRO or other third party to undertake such review?
- 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 the required access to a municipal advisor’s books and records and conduct onsite inspection or examination of the municipal advisor?

d. Information Requested in Form MA-I

The Commission is proposing to require natural person municipal advisors, which would include sole proprietors and certain individual employees of municipal advisory firms, to register on proposed Form MA-I. As a result, individual employees who meet the definition of a “municipal advisor” would be required to register independently, apart from the firm at which they are employed, on proposed Form MA-I.²³² Requirements for registration on proposed Form MA-I of individuals who are sole proprietors that meet the definition of “municipal advisor” are also discussed below.

²³² To date, in somewhat analogous registration contexts, the Commission has not required associated persons to register with the Commission. In the broker-dealer context, associated persons must register with FINRA. In the investment adviser context, associated persons of investment advisers generally must register with the states. For the reasons set forth below, in the context of municipal advisors, the Commission believes that registration of each natural person municipal advisor separately is the appropriate approach.

The Commission believes that the registration of natural person municipal advisors, including employees separately from their firms, would help the Commission better manage its regulatory and examination programs by assisting the Commission in identifying municipal advisors and better understanding their business structures. The required information also would assist the Commission in the preparation of its inspection and examination of municipal advisors, and in overseeing the municipal securities market and investigating instances of possible wrongdoing. In determining what information to propose to be disclosed, the Commission has also considered the broader public interest in availability of information about employees of municipal advisors to the public. The Commission believes that the required disclosures would provide municipal entities, obligated persons, investors, and other regulators with information that would inform them as to the relevant municipal advisory experience and history of such natural person municipal advisors. Moreover, a separate registration application form for natural person municipal advisors could enable municipal entities, investors, obligated persons, and regulators to obtain certain additional information regarding a natural person municipal advisor (as detailed below) directly from that individual, including the kind of information that would not be realistic or desirable to obtain through the firm's Form MA.²³³

For these reasons, the Commission is proposing to require natural person municipal advisors, including individual employees of firms, to register separately with the Commission, and is proposing new Form MA-I as the application form for such registration. As discussed above, a municipal advisory firm that registers by filing proposed Form MA must already provide

²³³ Section 975(c)(5) of the Dodd-Frank Act provides the Commission with authority to censure or place limitations on the activities or functions of any person associated with a municipal advisor or to suspend or bar any such person from being associated with a municipal advisor, but it appears Congress made a technical error in drafting this provision. To address any ambiguity in Section 975(c), the Commission intends to recommend a technical amendment to Section 975(c)(5) of the Dodd-Frank Act.

information on that form concerning the disciplinary history (over specified time spans) for each of its associated persons – a term that includes employees who are “engaged in the management, direction, supervision, or performance of any activities relating to the provision of advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities.”²³⁴ Thus, some information that could be valuable to municipal entities, obligated persons, investors, and regulators regarding individual employees who provide advice on behalf of a firm (and are natural person municipal advisors) would already be available through the municipal advisory firm’s Form MA. As detailed below, Form MA-I would, however, elicit additional information that would not be provided by the firm with which the natural person municipal advisor is employed.²³⁵ In addition, to obtain the same additional information from sole proprietors as obtained from natural person municipal advisors who are employees of firms, the Commission is proposing that sole proprietors, since they are also natural persons, be required to complete both Forms MA and MA-I. However, some information that a sole proprietor has already provided in his or her Form MA would not need to be provided a second time. Form MA-I would permit information required by a DRP to the form to be incorporated by reference, if the information has been previously disclosed on a DRP to his or her Form MA, ADV, BD, or U4, as applicable, or has been previously disclosed on his or her Form MA-T.²³⁶ Thus, the information

²³⁴ See Section 15B(e)(7) of the Exchange Act. 15 U.S.C. 78o-4(e)(7).

²³⁵ Under the proposal, however, to the extent that the required information regarding an employee’s disciplinary history has already been provided on Forms MA, MA-T, BD, ADV, or U4, the employee would be permitted to incorporate such information by reference in completing Form MA-I.

²³⁶ If the sole proprietor is also registered through the IARD system or CRD system, registered with the SEC as a municipal advisor on Form MA, or previously registered with the SEC on Form MA-T, or is an associated person of a municipal advisor that is registered with the SEC on Form MA or that previously registered with the SEC on Form MA-T, and the applicant or municipal advisor with which it is associated previously submitted a DRP (with Form ADV, BD, or U4) to the IARD or CRD, or submitted to the SEC disclosure on Form

required by Form MA-I, as proposed, would supplement, rather than duplicate, the information provided by a sole proprietor on Form MA.

The Commission notes that the information requested on proposed Form MA-I is similar to information requested on FINRA's Form U4.²³⁷ Form U4 is used, among other things, to register associated persons of broker-dealers with FINRA, and associated persons of state-registered investment advisers with the states. Some questions on Form U4, however, have been adapted for purposes of proposed Form MA-I to relate specifically to municipal advisors, or have been omitted as not necessary or appropriate in the municipal advisor context.

Request for Comment

The Commission requests comment generally on proposed Form MA-I and also requests comment on the following specific issues:

- What effects would a separate registration requirement have on natural persons and on firms from the standpoint of compliance? What would be the relative advantages and disadvantages for firms, municipal advisor employees, municipal entities, obligated persons, investors, and regulators, of requiring separate registration for natural person municipal advisors? How, if at all, does the moving of an employee from one firm to another bear on the issue of separate registration?
- Would the existence of a separate registration requirement and registration form for natural person municipal advisors cause confusion among municipal advisors such as to

MA-T or a DRP with Form MA, for the event that contains the information required by the comparable DRP to Form MA-I, such information may be incorporated by reference, to the extent applicable.

²³⁷ See Form U4, Uniform Application for Securities Industry Registration or Transfer, available at: <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf>.

outweigh its benefits? If the Commission were to only require registration of municipal advisory firms, would inclusion of information regarding the firm's employees on the firm's Form MA cause confusion for municipal entities, obligated persons, and investors?

- What, if any, legal ramifications may result for firms and/or for natural persons based on a registration regime that allows natural person municipal advisors that are employees of a municipal advisory firm to be registered by their firms as opposed to separate registration? What, if any, interpretive issues are raised with respect to the application of the statutory registration requirements?
- What would be the advantages and/or disadvantages of requiring a sole proprietor to complete two separate registration forms, and to keep both updated and to amend each form as the occasion arises? Should a separate form be adopted for the registration of sole proprietors?

Items 1 and 2: Identifying Information and Other Names

In addition to requesting basic identifying information about a natural person municipal advisor, and in the case of a natural person municipal advisor that is an employee²³⁸ and the firm with which he or she currently is associated,²³⁹ Item 1 of Form MA-I, as proposed, would require each such individual to disclose additional identifying information that would not be contained in his or her firm's Form MA, including:

²³⁸ This would include, for example, the individual's full legal name.

²³⁹ Such identifying information would include, if any, the CRD number assigned to the firm and any file number assigned to the firm by the Commission. The Commission believes that requiring individuals to provide these numbers would make it easier for municipal entities and investors to gather the information they need, would facilitate regulatory oversight and surveillance of municipal advisory activities, and would be valuable for investigative purposes.

- the individual's CRD number, if he or she has one;
- the individual's social security number;²⁴⁰
- the date of the individual's employment or contract with the firm;
- whether the individual has an independent contractor relationship with the firm;
- the firm's registration status;
- all the offices of the firm where the individual may be physically located and all the offices from which the individual will be supervised; and
- whether any of these offices are located in a private residence.

Item 2 would require a natural person municipal advisor to disclose all other names that he or she is using or has been known by since the age of 18, such as nicknames, aliases, and names before and after marriage.

The Commission believes that the information above would be useful to municipal entities and obligated persons in exploring the background, credentials, reliability, and trustworthiness of an individual in the course of making a decision whether to engage that natural person or his or her firm as a municipal advisor. The same information would be valuable to regulators in overseeing the market and investigating possible instances of wrongdoing.

Request for Comment

The Commission requests comment generally on Items 1 and 2 of proposed Form MA-I and also requests comment on the following specific issues:

- Do all these data elements serve the purposes of registration? Are all these facts helpful to municipal entities, obligated persons, and regulators in searching for information

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This information would not be made publicly available. This information is necessary in connection with the Commission's enforcement and examination functions pursuant to Section 15B(c) of the Exchange Act (15 U.S.C. 78o-4(c)).

about municipal advisors? If not, which should be eliminated and why?

- Is the additional identification information required of individuals registered as representatives of investment advisers and/or broker-dealers on FINRA's Form U4 a useful model for the disclosures that should be required of municipal advisors – i.e., are natural person municipal advisors distinguishable from representatives of investment advisers and/or broker-dealers in this regard? If so, how?
- Are there any additional data elements that would be useful to municipal entities, obligated persons, and regulators that should be required to be provided? If so, what are they?
- Are there other data elements that should not be made available to the public? If so, which should not be made available?
- Would a requirement to provide any of the information described raise any privacy issues, even if not made available to the public?

Item 3: Residential History

Form MA-I, as proposed, also would require a natural person municipal advisor to disclose each location where he or she has resided for the past five years, including the time period at each residence. Natural person municipal advisors would be required to report changes in residence (via an amendment) as they occur. In addition, the applicant must not leave any gaps greater than three months between addresses.

The Commission believes that a natural person municipal advisor's residential history, like the additional identifying information the proposed Form MA-I would seek, would be useful for interested parties in exploring the background, credentials, reliability, and trustworthiness of an individual and be valuable to regulators in overseeing the market and investigating possible

instances of wrongdoing. The Commission notes that the information proposed to be required regarding residential history is similar to the information requested on Form U4.²⁴¹

Request for Comments

The Commission requests comment generally on Item 3 of proposed Form MA-I and also requests comment on the following specific issues:

- Would a list of all the locations at which a natural person municipal advisor has resided for the past five years be necessary or useful in searching for information about municipal advisors to the extent that municipal advisors must be required to reveal them? If not, which should be eliminated?
- Are the disclosures concerning residential history required on FINRA's Form U4 a useful model for the disclosures that should be required of municipal advisors – i.e., are natural person municipal advisors distinguishable from individuals that are representatives of investment advisers and/or broker-dealers in this regard? If so, how?
- Would five years be an appropriate time span for which to require residential history? If not, what time span, if any, would be appropriate?

Item 4: Employment History

Form MA-I, as proposed, would require natural person municipal advisors to provide their complete employment history for the past ten years, including full and part-time employment, self-employment, military service, and homemaking. All statuses during the ten-year period, such as unemployed, full-time education, extended travel, and other similar circumstances would be required to be included. In addition, the applicant must not leave a gap longer than three months between entries. The information that the Commission proposes to be required is similar to the

²⁴¹ The Commission does not intend to make the information required by Item 3 publicly available.

information requested on Form U4,²⁴² and would help inform an understanding of an employee's business experience and provide useful information in preparing for regulatory examinations.

Request for Comments

The Commission requests comment generally on Item 4 of proposed Form MA-I and also requests comment on the following specific issues:

- Would requiring a natural person to provide his or her employment history serve a purpose essential enough to be included in the disclosures required of a natural person in registering as a municipal advisor?
- Is a list of all the places of employment and all the gaps in employment of a natural person municipal advisor over the past ten years necessary or useful for municipal entities, obligated persons, and regulators in searching for information about municipal advisors to the extent that municipal advisors must be required to reveal them? If not, should a less comprehensive employment history be required to be disclosed?
- Would ten years be an appropriate time span for which to require employment history? If not, what time span, if any, would be appropriate?
- If the employment history of a natural person municipal advisor is required for purposes of registration, should it be made available to the public? If so, why? If not, why not?
- To the extent that the employment history of a natural person municipal advisor must be disclosed on Form MA-I, should it be limited to employment relating to securities, or, more narrowly, to municipal securities or investment advice?

Item 5: Other Business

Form MA-I, as proposed, also would require a natural person municipal advisor to provide

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The Commission intends to make this information publicly available.

information about other business activities, if any, in which he or she is currently engaged – either as a proprietor, partner, officer, director, employee, trustee, agent or otherwise. The form would ask for the name of the other business, its address, whether it is municipal advisor-related, and, if not, the nature of the business in which it is engaged.

The natural person filing Form MA-I would be required to provide his or her position, title, or relationship with the other business, the start date of the relationship, the approximate number of hours per month the applicant devotes to the other business, and a brief description of his or her duties relating to the other business. The information sought in this section of the form is similar to the information sought by the equivalent section in Form U4, and would help the Commission understand a natural person municipal advisor's business activities and would help staff prepare for examinations.

Request for Comments

The Commission requests comment generally on Item 5 of proposed Form MA-I and also requests comment on the following specific issues:

- Does extensive information about a natural person municipal advisor's other current business activities, or any information at all, serve a purpose essential enough to be included in the disclosures required of a natural person in registering as a municipal advisor?
- Is information about a municipal advisor's other current business necessary or useful for municipal entities, obligated persons, and regulators searching for information about municipal advisors to the extent that municipal advisors must be required to reveal them?
- Are any additional points of information about a natural person municipal advisor's

other business activities relevant and, therefore, appropriate to require a natural person municipal advisor to disclose?

- Should required information about other business activities be limited to current activities? If not, over how long a time span should other business activities be reported?
- If the history of other business activities of a natural person municipal advisor is required for purposes of registration, should it be made available to the public?
- To the extent that the history of other business activities of a natural person municipal advisor must be disclosed, should it be limited to other business activities relating to securities, or, more narrowly, to municipal securities or investment advice?

Item 6: Criminal Action, Regulatory Action, and Civil Judicial History, Customer Complaint/Arbitration/Civil Litigation, Termination, and Financial Disclosure

Proposed Form MA-I would include sections that require a natural person municipal advisor to provide the same general types of information regarding his or her criminal, regulatory, and civil judicial history, if any, as provided by municipal advisory firms, including sole proprietors, in corresponding sections in Form MA.²⁴³ As in Form MA, certain responses would require disclosure of complete details of all events or proceedings on the DRPs attached to the form. However, a natural person completing Form MA-I would need to make certain additional disclosures, as specified below, and the DRPs would require details relating to these additional disclosures of the natural person's history.

²⁴³ See supra Section II.A.2.c. As previously discussed, a sole proprietor who has already filed a Form MA, and an employee whose employer has already filed a Form MA including information relating to that employee, would be permitted to incorporate by reference certain information in the Form MA into his or her Form MA-I, to the extent that providing the information in Form MA-I would duplicate the information already provided in the Form MA. See supra notes 235 and 236 and accompanying text.

The Commission believes that these additional disclosures, which are also required of individuals associated with broker-dealers and investment advisers on Form U4, would be appropriate to require of municipal advisors, both to aid municipal entities, obligated persons, and other members of the public in researching the background of municipal advisors, and to aid regulators in enhancing their oversight of municipal advisors.

Criminal Action Disclosure

With respect to felonies, Form MA-I, in contrast to the disclosures required by Item 9A of Form MA, would require disclosure of:

- any past conviction of, or plea of guilty or nolo contendere to, a felony by the natural person municipal advisor, rather than limiting the disclosure to the past ten years, as in a firm's or solo practitioner's Form MA.
- any charges of felony against the natural person municipal advisor in the past, rather than limiting disclosure to currently pending charges, as in a firm's or solo practitioner's Form MA.
- any convictions of, or plea of guilty or nolo contendere to, a felony by an organization based on activities that occurred when the natural person municipal advisor exercised control over the organization – a disclosure not required in Form MA.

Similarly, with respect to misdemeanors, in instances where Form MA would require only disclosures of convictions and pleas concerning a natural person municipal advisor looking back ten years, and require only disclosures of charges against the natural person that are currently pending, Form MA-I would require disclosure of such convictions, pleas, and charges that occurred at anytime in the individual's past. Misdemeanors, convictions, pleas, and charges of misdemeanor against an organization based on activities while the individual exercised control over it would also

be required to be disclosed.

These additional disclosures would be consistent with the disclosure requirements on Form U4. In addition, these disclosures would provide additional information with respect to natural person municipal advisors that would be useful to the Commission's regulatory and examination programs, and may be useful to municipal entities and obligated persons who are clients or prospective clients of the municipal advisor.

As would be required for firms with respect to proposed Form MA, the DRP for criminal disclosure on Form MA-I, as proposed, would similarly require a natural person municipal advisor to include certain details regarding events noted in the first section of the form. These additional disclosure details would include, among others: status of the event; details of its disposition; and the date of amended charges, if any. The DRP for Form MA-I would also provide an option and space for the individual to comment with a brief summary of the circumstances leading to the charge(s) as well as the current status or final disposition of the charge(s).

Request for Comment

The Commission requests comment generally on the criminal action disclosure requirements of proposed Form MA-I and also requests comment generally on the following specific issues:

- In addition to the questions posed above regarding the appropriateness of the criminal history disclosures proposed in Form MA,²⁴⁴ the Commission seeks comment on whether the broadened scope of these disclosures required of natural person municipal advisors in proposed Form MA-I would be warranted. If so, why? If not, why not? Would additional disclosure to those outlined above be appropriate? To the extent that additional disclosure regarding the criminal action history for a natural person municipal

²⁴⁴ See supra Section II.A.2.c.

advisor would be appropriate, please provide details regarding what those disclosures should require.

Regulatory Actions Relating to the Individual

With respect to regulatory actions, in addition to the disclosures required in Form MA, Form MA-I, similar to Form U4, would require a natural person municipal advisor to disclose whether the Commission or the CFTC has ever found the natural person to have:

- willfully violated, or been unable to comply with, any provision of the federal securities laws, the Commodity Exchange Act, and the rules thereunder, and any rule of the MSRB;
- willfully aided, abetted, commanded, induced, or procured the violation by any other person of these laws and rules; and
- failed reasonably to supervise another person subject to his or her supervision with a view to preventing violation of these laws and rules.

The disclosures that would be required by proposed Form MA-I with respect to findings and actions relating to the natural person municipal advisor by other federal regulatory agencies, state regulatory agencies, and foreign financial regulatory authorities, would be the same as disclosures required on Form MA. Proposed Form MA-I would also require a natural person municipal advisor to disclose whether he or she has ever been subject to a final order of a state securities commission or similar agency or office; state authority that supervises or examines banks, savings associations, or credit unions; state insurance commission; an appropriate federal banking agency; or the National Credit Union Administration that: bars the natural person municipal advisor from association with an entity regulated by such commission, agency, authority or office, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or constitutes a final order based on violations of laws or regulations that prohibit fraudulent,

manipulative, or deceptive conduct.

With respect to SRO actions, in addition to the disclosures required of a municipal advisory firm, including sole proprietors, regarding its individual associated persons on Form MA, Form MA-I would require a natural person municipal advisor to disclose any finding by an SRO that the natural person municipal advisor:

- willfully violated, or is unable to comply with, any provision of the federal securities laws, the Commodity Exchange Act and the rules thereunder, or the rules of the MSRB;
- willfully aided, abetted, counseled, commanded, induced, or procured the violation of any of these laws or rules; or
- failed reasonably to supervise another person subject to his or her supervision, with a view to preventing such violations.

Like Form MA, Form MA-I would require an natural person municipal advisor to disclose whether he or she has ever had an authorization to act as an attorney, accountant or federal contractor that was revoked or suspended. Also, as on Form MA, Form MA-I would also require an natural person municipal advisor to disclose whether he or she ever was notified, in writing, that he or she is currently the subject of any regulatory complaint or proceeding by a regulatory body relating to any occurrence of the kind that could trigger a disclosure requirement relating to regulatory history of the natural person municipal advisor with the Commission, the CFTC, other governmental regulators, or SROs as described above. Form MA-I would also require disclosure of whether the natural person municipal advisor was ever notified, in writing, that he or she is currently the subject of an investigation that could result in any occurrence of the kind that could trigger a disclosure requirement relating to the criminal or regulatory history of the natural person

municipal advisor as described above.²⁴⁵ Form MA would not require such disclosure.

The Commission believes that the additional disclosure items described above would be helpful to municipal entities and obligated persons as clients or prospective clients of municipal advisors. The information could also serve as the basis for granting or instituting proceedings to deny a registration, or for revoking a registration or imposing other sanctions by the Commission with respect to a natural person municipal advisor.²⁴⁶

The DRP for regulatory action disclosure in Form MA-I, as proposed, would require a natural person municipal advisor to include certain details regarding events noted in the main body of the form that are similar to the information that would be required in the corresponding DRP in a firm's Form MA, including: if requalification was a condition of any sanction reported, whether it was by exam, retraining, or other process; the length of time given to requalify; and whether the requalification condition was satisfied.

The additional disclosures required by the DRP would also include details of any monetary sanction imposed, including amount; portion levied against the natural person municipal advisor; payment plan; whether such plan was current; date paid; and whether the sanction was a civil or administrative penalty or fine, a monetary penalty other than a fine, disgorgement, or restitution.

Consistent with Form MA, Form MA-I would also include a DRP requiring a natural person municipal advisor to provide details of any investigation reported in the main body of the form, including the date the investigation was initiated, and indicate whether it was initiated by an SRO, a foreign financial regulatory authority (giving the specific jurisdiction), the Commission, or other federal agency. Space would be provided for the natural person municipal advisor to briefly describe the nature of the investigation, if known; whether it was pending or resolved; and details of

²⁴⁵ A related DRP would be required to disclose details of any pending investigation.

²⁴⁶ See supra note 218 (discussing grounds for revocation of a municipal advisor's registration).

any resolution. A space for optional comment would also be provided for the natural person municipal advisor to present a brief summary of the circumstances leading to the investigation, and its current status or final disposition and/or findings.

Request for Comment

The Commission requests comment generally on the regulatory action disclosure requirements of proposed Form MA-I, and also requests comment on the following specific issues:

- In addition to the questions posed above regarding the disclosures with respect to regulatory history proposed in Form MA,²⁴⁷ the Commission seeks comment on whether the broadened scope of the disclosures required of natural person municipal advisors in proposed Form MA-I would elicit information that would be valuable to the public, and in particular municipal entities or obligated persons. If so, in what way? Is there information proposed to be requested that would not be useful? If so, why? Is there additional information that should be requested with respect to regulatory actions relating to natural person municipal advisors? If so, what information and why?

Civil Judicial Action Disclosure

The disclosures that would be required by proposed Form MA-I with respect to certain matters relating to a natural person municipal advisor's civil judicial history would be the same as disclosures required on Form MA. Thus, a natural person municipal advisor would be required to disclose on Form MA-I whether he or she was ever:

- enjoined by a domestic or foreign court in connection with any investment-related or municipal advisor-related activity;

²⁴⁷ See supra Section II.A.2.c.

- found by a domestic or foreign court to be involved in a violation of any investment-related or municipal advisor-related statute or regulation; or
- had an investment-related or municipal advisor-related civil action brought against him or her dismissed, pursuant to a settlement agreement, by a state or foreign financial regulatory authority; or
- named in any such pending action.

A DRP would be required for affirmative responses to questions under this item.

Specifically, the DRP would require, among other things, information regarding by whom the court action was initiated; the name of the party initiating the proceeding; information about the relief sought; the date on which the action was filed and notice or process was served; the types of financial products involved; a description of the allegations relating to the civil action; the current status, including whether the action is on appeal and details relating to any such appeal; sanction details; and if the disposition resulted in a fine, disgorgement, restitution or monetary compensation, information relating thereto. The DRP would also provide the opportunity for an applicant to provide additional comment, including a summary of the circumstances leading to the action and current status. The Commission believes that it is appropriate to seek information from natural person municipal advisors regarding investment-related activities as well as municipal advisor-related activities due to the significant similarities that exist between the two advisory functions, and because such information could serve as a basis to institute proceedings to deny registration of a municipal advisor or to impose other sanctions on the municipal advisor's activities.

Request for Comment

The Commission requests comment generally on the civil action disclosure requirements of proposed Form MA-I and also requests comment on the following specific issues:

- Are these additional disclosure requirements for natural person municipal advisors regarding civil judicial history warranted?
- Would it be useful to municipal entities and obligated persons to require natural persons registering as municipal advisors to provide information regarding past investment-related activities as well as past municipal advisor-related activities? If so, why? If not, why not?

Customer Complaints/Arbitration/Civil Litigation

Form MA does not require a municipal advisory firm or a sole proprietor to disclose any customer complaints, arbitration matters, and civil litigation concerning natural person municipal advisors. Form MA-I, however, would require a natural person municipal advisor to disclose whether he or she has ever been:

- the subject of a complaint initiated by a consumer, whether written or oral, regarding investment-related or municipal advisor-related matters, which alleged that he or she was involved in fraud, false statements, omissions, theft, embezzlement, wrongful taking of property, bribery, forgery, counterfeiting, extortion, and dishonest, unfair or unethical practices; or
- the subject of an arbitration or civil litigation initiated by a consumer regarding investment-related or municipal advisor-related matters, which alleged that he or she was involved in fraud, false statements, omissions, theft, embezzlement, wrongful taking of property, bribery, forgery, counterfeiting, extortion, and dishonest, unfair or unethical practices.

In the case of a complaint, the natural person municipal advisor would be required to indicate whether the complaint is still pending or was settled. In the case of arbitration or civil

litigation, the natural person municipal advisor would be required to indicate whether the arbitration or litigation is still pending; resulted in an arbitration award or civil judgment against the natural person municipal advisor in any amount; or was settled.

A DRP would be required for affirmative responses to questions under this item. Specifically, the related DRP would require the municipal advisor to disclose the customer's name; the customer's state of residence and other states of residence; the employing firm of the municipal advisor when the activities occurred that led to the complaint, arbitration, CFTC reparation or civil litigation; and the allegations and brief summary of events related to the allegations, including the dates when they occurred; the product type; and the alleged compensatory damage amount. For customer complaints, arbitration, CFTC reparation, or civil litigation in which the municipal advisor is not a named party, the DRP would require disclosure of whether the complaint is oral or written, or whether it is an arbitration, CFTC reparation or civil litigation (and the arbitration or reparation forum, docket or case number, and the filing date); whether the complaint, arbitration, CFTC reparation or civil litigations is pending, and if not, the status. The DRP would require disclosure of the status date, and the settlement award amount, including the municipal advisor's contribution amount. If the matter involves an arbitration or CFTC reparation in which the municipal advisor is a named respondent, the DRP would require disclosure of the entity with which the claim was filed; the docket or case number; the date process was served; whether the arbitration or CFTC reparation is pending, and if not pending the form of disposition; the disposition date; and the amount of the monetary award, settlement or reparation (including the municipal advisor's contribution). If the matter involves a civil litigation, the DRP would require disclosure of the court in which the case was filed; the location of the court; the docket or case number; the date the complaint was served on or received by the municipal advisor; whether the litigation is still pending; if not still pending the

form of its disposition; the disposition date; the judgment, restitution or settlement amount, including the municipal advisor's contribution amount; whether the action is currently on appeal, and if so, the date the appeal was filed, the court in which the appeal was filed, the location of the court, and the docket or case number for the appeal. The DRP would also provide for optional additional comment, such as a summary of the circumstances leading to the complaint.

These disclosures, too, would mirror similar disclosures in Form U4, and would provide additional information about natural person municipal advisors that may be useful to municipal entities or obligated persons as clients or prospective clients. The information would also help the Commission prepare for and plan examinations.

Request for Comment

The Commission requests comment generally on the customer complaint/arbitration/civil litigation disclosure requirements of proposed Form MA-I and also requests comment on the following specific issues:

- Would these additional disclosure requirements for natural person municipal advisors provide information that would be useful in the context of natural person municipal advisors but that would not be useful in the context of firms? If so, to whom would the information be useful, and why?
- Would municipal entities and obligated persons find it useful for Form MA-I to require municipal advisors to disclose customer complaints, arbitration, and civil litigation with respect to investment-related matters, in addition to complaints, arbitration, and civil litigation with respect to municipal advisor-related matters? Is this information they would access and use if available? If so, how?
- Should Form MA also require similar disclosure with respect to associated persons of

municipal advisory firms? If so, which additional information would be useful and why?

Termination Disclosure

Unlike in Form MA, Form MA-I would require disclosure regarding the termination of a natural person municipal advisor's employment. Specifically, consistent with Form U4, Form MA-I would ask the natural person municipal advisor to indicate whether he or she ever voluntarily resigned, or was discharged or permitted to resign after allegations were made that accused him or her of:

- violating investment-related or municipal advisor-related statutes, regulations, rules, or industry standards of conduct;
- fraud or the wrongful taking of property; or
- failure to supervise in connection with investment-related or municipal advisor-related statutes, regulations, rules or industry standards of conduct.

An affirmative response to the disclosures described above would require the municipal advisor to disclose additional information on a related DRP. Specifically, the DRP would require the municipal advisor to disclose the name of the firm, the type of termination (whether discharged, permitted to resign, or voluntary resignation), the termination date, the allegations, and the product types. The DRP would also provide for optional additional comment, such as a summary of the circumstances leading to the termination. This disclosure would provide information that would be useful to the Commission in planning and preparing for inspections and examinations, and would be useful to the public generally (including municipal entities and obligated persons, as clients or prospective clients).

Request for Comment

The Commission requests comment generally on the termination disclosure requirements of proposed Form MA-I and also requests comment on the following specific issues:

- Would the requirement for the above-listed additional disclosures by natural person municipal advisors regarding their municipal advisory activities elicit information that would be useful to the public (including municipal entities and obligated persons, as clients or prospective clients) and that would be relevant in the context of natural person municipal advisors that is not relevant in the context of firms? If not, what additional information should be requested and why?
- Would requiring municipal advisors to disclose violations of investment-related statutes, regulations, rules, and industry standards, in addition to violations of municipal advisor-related statutes, regulations, rules, and industry standards on Form MA-I elicit information that would be useful to the public (including municipal entities and obligated persons, as clients or prospective clients)?

Financial Disclosures

Form MA-I also would require natural persons who are municipal advisors to make financial disclosures that are not required to be made by municipal advisory firms regarding their associated persons or by sole proprietors regarding themselves on Form MA. Specifically, the form would ask a natural person municipal advisor whether, within the past ten years:

- he or she has made a compromise with creditors, filed a bankruptcy petition, or been the subject of an involuntary bankruptcy petition;
- an organization controlled by the natural person municipal advisor has made a compromise with creditors, filed a bankruptcy petition, or been the subject of an

involuntary bankruptcy petition based upon events that occurred while he or she exercised control over it; or

- a broker or dealer controlled by the natural person municipal advisor has been the subject of an involuntary bankruptcy petition, had a trustee appointed, or had a direct payment procedure initiated under the Securities Investor Protection Act based upon events that occurred while he or she exercised control over it.

In addition, a natural person who is a municipal advisor would be required to disclose whether:

- a bonding company ever denied, paid out on, or revoked a bond for him or her; or
- the natural person municipal advisor has any unsatisfied judgments or liens against him or her.

An affirmative response to the disclosure items described above would require the municipal advisor to provide additional disclosure on a DRP. Specifically, the municipal advisor would be required to disclose the judgment or lien amount, the judgment or lien holder, the judgment or lien type (whether civil or tax), the date filed, the court in which the action was brought, the name of the court, the location of the court, the docket or case number (and whether the docket or case number is the municipal advisor's social security number, bank card number, or personal identification number), whether the judgment or lien is outstanding, and if the judgment or lien is not outstanding, the status date and how the matter was resolved. The DRP would also provide for optional comment, such as a brief summary of the circumstances leading to the action.

The Commission believes that the information that would be required, which is consistent with that required by Form U4, would be useful for its regulatory purposes, including planning and preparing for inspections and examinations, and to the public generally (including municipal entities

and obligated persons, as clients or prospective clients).

Request for Comment

The Commission requests comment generally on the financial disclosure requirements of proposed Form MA-I and also requests comment on the following specific issues:

- Would financial disclosure requirements be necessary, useful, or relevant in connection with natural person municipal advisors in a way that it would not be useful with respect to municipal advisors that are firms? If so, how? If not, why not?

Item 7: Execution and Self-Certification

With respect to execution of Form MA-I, the natural person municipal advisor who signs the form would be required to represent that the information and statements made in Form MA-I are true and correct. The municipal advisor also would be required to consent to service of any civil action or notice of any proceeding before the Commission or an SRO regarding its municipal advisory activities via registered or certified mail. The proposed requirements for execution of Form MA-I would be consistent with and serve the same purposes as the execution provisions of proposed Form MA, with modifications to reflect that Form MA-I would apply to municipal advisors that are natural persons rather than firms and that, unlike municipal advisory firms, natural person municipal advisors would not be subject to the books and records requirements of proposed rule 15Ba1-7.

A natural person municipal advisor would also be required to certify that he or she has: 1) sufficient qualifications, training, experience, and competence to effectively carry out his or her designated functions; 2) met, or within any applicable required timeframes will meet, such standards of training, experience, and competence, and such other qualifications, including testing, for a municipal advisor, required by the Commission, the MSRB or any other relevant SRO; and 3)

the necessary understanding of and ability to comply with, all applicable regulatory obligations. For these purposes, such applicable regulatory obligations are obligations under the federal securities laws and rules promulgated thereunder and applicable rules promulgated by the MSRB, or any other relevant SRO. Proposed rule 15Ba1-4(e) would require such certification at the time an initial application for registration as a municipal advisor is filed and annually thereafter.²⁴⁸

Request for Comment

The Commission requests comment generally on the execution requirements of proposed Form MA-I and also requests comment on the following specific issues:

- Should there be additional or alternative representations to those proposed for Item 7 of Form MA-I? If so, what representations and why?
- Would there be alternative methods to obtain consent to service of process or should such consent not be obtained?
- Is the proposed self-certification broad enough in scope or too broad? If not, what additional factors should be included or excluded and why? Should the self-certification be required more or less frequently? If so, how often and why? Are there other alternatives the Commission should consider? If so, what alternatives and why?
- Should the self-certification required of natural person municipal advisors include additional factors? If so, what would they be and why? Should the Commission require an independent third party review of the municipal advisor? What are examples of such a review? Should the Commission undertake a review of all municipal advisors as part

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See proposed rule 15Ba1-4(e). The proposed rule would require the annual self-certification to be filed by natural person municipal advisors, including sole proprietors, within 90 days of the end of the calendar year. General Instruction 13 would require that a natural person municipal advisor filing an annual self-certification on Form MA-I check the appropriate box to indicate as such and complete the certification included in Item 7.

of the registration and examination process? If so, what should be the scope and frequency of the examination process? Should the Commission provide municipal advisors a choice between independent third party review and Commission review, or a combination thereof?

3. Proposed Rule 15Ba1-3

a. Withdrawal from Municipal Advisor Registration

Pursuant to proposed rule 15Ba1-3, all municipal advisors, whether registered on Form MA or MA-I, would be required to file Form MA-W to withdraw from registration with the Commission as a municipal advisor.²⁴⁹ As would be the case with Forms MA and MA-I, Form MA-W would be required to be filed electronically with the Commission.²⁵⁰

A notice of withdrawal from registration would become effective on the 60th day after electronically filing the Form MA-W with the Commission, or within a longer time period if the municipal advisor consents, or the Commission by order determines as necessary or appropriate in the public interest, for the protection of investors, or within such shorter time as the Commission may determine.²⁵¹ Under the proposed rule, if a municipal advisor electronically filed a notice of withdrawal from registration with the Commission at any time subsequent to the date of issuance of a Commission order instituting proceedings pursuant to Section 15B(c) of the Exchange Act²⁵² to censure, place limitations on the activities, functions or operations of, or suspend or revoke the registration of the municipal advisor, or if the Commission institutes such a proceeding or a proceeding to impose terms and conditions upon the withdrawal, the notice of withdrawal would not

²⁴⁹ See proposed rule 15Ba1-3(a).

²⁵⁰ See proposed rule 15Ba1-3(b).

²⁵¹ See proposed rule 15Ba1-3(c).

²⁵² 15 U.S.C. 78q-4(c).

become effective except at the time and upon the terms and conditions as deemed by the Commission as necessary or appropriate in the public interest or for the protection of investors.

b. Form MA-W

Consistent with the requirements of withdrawal of a registration on Form ADV, Form MA-W would require a municipal advisor, whether a firm, sole proprietor, or associated person of a municipal advisor (that falls within the definition of a "municipal advisor") to provide identifying information keyed to the identifying information on, and the file number of, the municipal advisor's Form MA or Form MA-I. In the case of a firm, the municipal advisor would be required to provide on the form the name of an employee (or principal) of the firm who is authorized to receive information and respond to questions about the Form MA-W. Contact information for outside counsel for the firm would not suffice.

A municipal advisor filing to withdraw registration would be required to indicate on Form MA-W whether it has received any pre-paid fees for municipal advisory services that have not been delivered, including subscription fees for publications, and to specify the amount. In addition, the withdrawing registrant would be required to indicate how much money, if any, it has borrowed from clients that it has not repaid. The municipal advisor that is filing to withdraw its registration also would be required to indicate whether there were any unsatisfied liens or judgments against it. If the filer responded affirmatively that it owed money or had any liens or judgments against it, it would be required to disclose on a schedule attached to Form MA-W, Schedule W2, the nature and amount of its assets and liabilities and its net worth on the last day of the month prior to the filing of the form.

The Commission believes that requiring such information from a municipal advisor that is withdrawing its registration is appropriate for the protection of investors and of those who do business with municipal advisors because it would put them on notice that the municipal advisor

would no longer be registered and, therefore, would not be able to engage in municipal advisory activities without violating federal securities laws. Such information would also alert clients and prospective clients as to the financial stability of the municipal advisor. In addition, the information would help investigative and enforcement efforts on the part of regulators. The Commission notes that an investment adviser that withdraws from registration must supply similar information on its Form ADV-W.²⁵³

Because proposed rule 15Ba1-7(b) under the Exchange Act requires a municipal advisor withdrawing from registration to nonetheless preserve its books and records, a filer of Form MA-W would be required to list the name and address of each person who has, or will have, custody or possession of its books and records and the location at which such books and records will be kept. A withdrawing municipal advisor would be required to identify, in an additional schedule attached to Form MA-W, Schedule W1, each person to which it has assigned any of its contracts. The Commission believes that such a requirement – which also exists for investment advisers – is important for the protection of participants in the municipal securities markets.

The signatory to the Form MA-W would be required to certify, under penalty of perjury, that the information and statements made in the form, including any exhibits or other information provided, are true. If the form is being filed on behalf of a municipal advisory firm,²⁵⁴ the signature would constitute such certification by both the firm and the signatory. Similarly, the signatory (and the municipal advisory firm, if the municipal advisor is a firm) would be required to certify that the advisor's books and records will be preserved and available for inspection as required by law, and to authorize any person having custody or possession of these books and records to make them

²⁵³ See 17 CFR 279.2.

²⁵⁴ In the case of a firm, the signatory's certification includes a statement that he or she has signed on behalf of the firm and that he or she has the authority to do so.

available to authorized regulatory representatives.

The certification would include a statement that all information previously submitted on the municipal advisor's most recent Form MA, Form MA-I, or both, as applicable, was accurate and complete as of the date of the signing of the Form MA-W. It would also include an understanding by the signatory that if any information contained in items on the Form MA-W is different from the information contained on the most recent Form MA, MA-I, or both, as applicable, the information on the Form MA-W would replace the corresponding entry on the municipal advisor's Form MA or MA-I available through the Commission's electronic system.

The Commission believes that the certification requirement should serve as an effective means to assure that the information supplied in Form MA-W is correct.

Request for Comment

The Commission requests comment generally on proposed Form MA-W and also requests comment on the following specific issues:

- Form MA-W would have to be filed electronically for purposes of withdrawing from registration with the Commission. Should the proposed rule include an option for the form to be filed in paper rather than electronically? If so, please explain under what circumstances it would be appropriate to allow paper filings of the form.
- How much identifying information should be required of the municipal advisor filing to withdraw its registration? Is the information required in the proposed form too much or too little?
- What are the relative benefits and disadvantages of requiring the contact person for a withdrawal of registration to be an employee or principal of the firm that is

withdrawing? Considering these factors, should a firm be permitted to name outside counsel as the contact?

- Do the proposed disclosures require more, or less, information than necessary from municipal advisors that are withdrawing from registration? To the extent additional disclosures should be required, please provide specific examples of the types of additional disclosures that would be valuable, to whom they would be valuable, and why.

4. Proposed Rule 15Ba1-4: Amendment to Application for Registration and Self-Certification

Proposed rule 15Ba1-4 sets forth the timeframes within which a municipal advisor must amend its Forms MA and MA-I. Proposed rule 15Ba1-4(a)(1) would require that a municipal advisor amend its Form MA at least annually, within 90 days of the end of the applicant's fiscal year in the case of applicants that are firms, or within 90 days of the end of the calendar year in the case of sole proprietors. In addition, proposed rule 15Ba1-4(a)(2) would require that a municipal advisor amend its Form MA more frequently than annually if required by the instructions to Form MA.²⁵⁵

Consistent with the requirement of Form ADV, proposed rule 15Ba1-4(a) would require a firm to amend its Form MA promptly if information provided in response to Item 1 (Identifying Information), 2 (Form of Organization), or 9 (Disclosure Information) becomes inaccurate in any way; or if information provided in response to Items 3 (Succession), 7 (Participation or Interest of Applicant, or of Associated Persons of Applicant, in Municipal Advisory Client Transactions), or 8 (Control Persons) becomes materially inaccurate.²⁵⁶ Proposed rule 15Ba1-4(b) would require that a

²⁵⁵ See proposed rule 15Ba1-4(a)(2). See also General Instruction 8.

²⁵⁶ See proposed rule 15Ba1-4(a). See also General Instruction 8.

natural person municipal advisor promptly amend its Form MA-I if any information provided previously becomes inaccurate.²⁵⁷ This requirement for natural person municipal advisors would be consistent with the requirement for updating Form U4.

A non-resident municipal advisory firm would be required to file an amendment to Form MA 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 the required access to its books and records or impacts the Commission's ability to inspect to examine the municipal advisor onsite.²⁵⁸ The amendment should include a revised opinion of counsel describing how, as a matter of law, the municipal advisor will continue to meet its obligations to provide the Commission with the required access to the municipal advisor'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 II.a.2.c. above, if a registered non-resident municipal advisory firm 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 municipal advisor's registration.

The Commission is not proposing to require natural person municipal advisors to annually update their Forms MA-I, as it is proposing to require municipal advisors registered on Form MA to do. In the case of firms, changes commonly occur over the course of a year, and a wide range of changes is possible – e.g., changes in control persons and personnel, number of employees, nature of services provided, types of clients, and compensation arrangements, among others, as well as new disclosures that may be necessary for all of the firm's associated persons, rather than just one natural person. Accordingly, the Commission believes it is appropriate to require a firm to confirm through an annual update that its registration is up-to-date. With respect to natural person

²⁵⁷ See proposed rule 15Ba1-4(b). See also General Instruction 9.

²⁵⁸ See General Instruction 8.

municipal advisors, however, because an amendment to Form MA-I would be promptly required whenever information previously provided becomes inaccurate, the Commission believes that the gains to be had by requiring the extra confirmation of an annual update are outweighed by the burden such a requirement would impose on natural person municipal advisors that are employees of municipal advisory firms.

All amendments to Form MA and Form MA-I would be required to be filed electronically with the Commission.²⁵⁹ In addition, amendments to Form MA and Form MA-I would be “reports” for purposes of Sections 15B(c), 17(a), 18(a), 32(a) (15 U.S.C. 78oF(b), 78q(a), 78r(a), 78ff(a)) and other applicable provisions of the Exchange Act.²⁶⁰

These proposed rules are 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.²⁶¹ The Commission believes that such amendments are important for obtaining updated information on each municipal advisor so that the Commission would be able to assess whether each municipal advisor 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 a municipal advisor, and better inform the MSRB’s regulation of municipal advisors. In addition, the Commission believes it is important for municipal entities and obligated persons, as well as the public generally, to have access to current information regarding advisors registered with the Commission.

²⁵⁹ See proposed rule 15Ba1-4(c).

²⁶⁰ See proposed rule 15Ba1-4(d). As a consequence, it would be unlawful for a municipal advisor to willfully make or cause to be made, a false or misleading statement of a material fact or omit to state a material fact in an amendment to Form MA or Form MA-I.

²⁶¹ See e.g., rules 6a-2 and 15b3-1 under the Exchange Act. 17 CFR 240.6a-2 and 240.15b3-1. See also 17 CFR 249.1001 (Form SIP, application for registration as a securities information processor or to amend such an application or registration).

Request for Comment

The Commission requests comment generally on the proposed requirement for amendments to Forms MA and MA-I, and also requests comment on the following specific issues:

- Should the events triggering amendment of Form MA be reduced or expanded? If so, which events should be added or removed and why?
- Is there any information that would be required by Form MA-I that should not trigger an amendment if it becomes inaccurate? If so, which information and why? Should the deadline by which a natural person municipal advisor must file an amendment to Form MA-I upon the occurrence of a material change be different from the deadline by which a firm must file an amendment to a Form MA? If so, what should be the deadline, and why?
- Should the requirements for amending or updating Forms MA and MA-I be the same? If so, why? If not, why not?

5. Proposed Rule 15Ba1-5: General Procedures for Serving Non-Residents and Form MA-NR

The Commission is proposing rule 15Ba1-5 to set forth the general procedures for serving non-residents under Form MA-NR. Proposed rule 15Ba1-5 would require that non-resident municipal advisors and non-resident general partners and managing agents²⁶² of municipal advisors must furnish the Commission with a written irrevocable consent and power of attorney on Form

²⁶² Proposed rule 15Ba1-1(c) defines a “managing agent” as “any person, including a trustee, who directs or manages, or who participates in directing or managing, the affairs of any unincorporated organization or association other than a partnership.” This definition is consistent with the definition of a “managing agent” as used in rule 15b1-5 under the Exchange Act relating to consent to service of process to be furnished by non-resident brokers or dealers and by non-resident general partners or managing agents of brokers or dealers. See 17 CFR 240.15b1-5. See also 17 CFR 275.0-2 (discussing general procedures for serving non-resident investment advisers in connection with Form ADV).

MA-NR to appoint an agent in the United States, other than a Commission member, official, or employee, upon whom may be served any process, pleadings, or other papers in any action brought against the non-resident municipal advisor, general partner or managing agent that arises out of or relates to or concerns the municipal advisory activities of the municipal advisor.

This proposed requirement is designed to allow the Commission and others to provide service of process to a non-resident municipal advisor, general partner or managing agent to enforce the provisions of new Exchange Act Section 15B. Proposed rule 15Ba1-5 also would require that non-resident municipal advisors, general partners and managing agents update the information on the Form MA-NR if it becomes inaccurate. Further, the proposed rule would require that the non-resident municipal advisor, general partner or managing agent appoint a successor agent and file an updated Form MA-NR if the non-resident municipal advisor, general partner or managing agent discharges its agent or if the agent becomes unwilling or unable to accept service on behalf of the municipal advisor, general partner or managing agent. Finally, proposed rule 15Ba1-1(h) would define the term "non-resident," to mean: "(i) [i]n the case of an individual, one who resides in or has his principal office and place of business in any place not in the United States; (ii) [i]n the case of a corporation, one incorporated in or having its principal office and place of business in any place not in the United States; (iii) [i]n the case of a partnership or other unincorporated organization or association, one having its principal office and place of business in any place not in the United States." Pursuant to proposed General Instruction 2, and consistent with the proposed rule, every non-resident municipal advisor and every non-resident general partner and managing agent of a municipal advisor, whether or not the municipal advisor is resident in the United States, must file Form MA-NR in connection with the municipal advisor's initial application.²⁶³

²⁶³

See General Instruction 2. Failure to file Form MA-NR promptly may delay SEC consideration of the initial application. Additionally, a municipal advisor or general partner

Request for Comments

The Commission requests comment generally on the proposed general procedures for serving non-residents and proposed Form MA-NR, and also requests comment on the following specific issues:

- Is the Commission's proposed rule regarding service of process on non-residents appropriate and sufficiently clear? If not, why not and what would be a better alternative?
- Are there any factors that the Commission should take into consideration to ensure effective service of process on a non-resident municipal advisor or a non-resident general partner or managing agent?
- Should the Commission require non-resident municipal advisors and non-resident managing agents and general partners to certify to anything else on Form MA-NR?

6. Proposed Rule 15Ba1-6: Registration of Successor to Municipal Advisor

Proposed rule 15Ba1-6 would govern the registration of a successor to a registered municipal advisor. This proposed rule is substantially similar to rule 15b1-3 under the Exchange Act, which governs the registration of a successor to a registered broker-dealer.²⁶⁴

Succession by Application

Specifically, proposed rule 15Ba1-6(a) provides that in the event that a municipal advisor succeeds to and continues the business of a municipal advisor registered pursuant to Exchange Act Section 15B(a), the registration of the predecessor shall be deemed to remain effective as the

or managing agent of an SEC-registered municipal advisor who becomes a non-resident after the initial application has been submitted must file Form MA-NR within 30 days. Id.

²⁶⁴

See 17 CFR 240.15b1-3. See also Registration of Successors to Broker-Dealers and Investment Advisers, Exchange Act Release No. 31661 (December 28, 1992), 58 FR 7 (January 4, 1993) (providing interpretive guidance regarding amendments to rule 15b1-3).

registration of the successor if the successor, within 30 days after such succession, files an application for registration on Form MA, and the predecessor files a notice of withdrawal from registration with the Commission on Form MA-W.

This proposed rule further provides that the registration of the predecessor municipal advisor shall cease to be effective 45 days after the application for registration on Form MA is filed by the successor municipal advisor.²⁶⁵ In other words, the 45-day period would not begin to run until a complete Form MA has been filed by the successor with the Commission. This 45-day period is consistent with Exchange Act Section 15B(a)(2), pursuant to which the Commission has 45 days to grant a registration or institute proceedings to determine if a registration should be denied.²⁶⁶

Succession by Amendment

Proposed rule 15Ba1-6(b) further provides that notwithstanding rule 15Ba1-6(a), if a municipal advisor succeeds to and continues the business of a registered predecessor municipal advisor, 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 municipal advisor on Form MA 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 that are specified in proposed rule 15Ba1-6(b) (change in the date or state of incorporation, change in form of organization, and change in composition of a partnership), the predecessor must cease operating as a municipal advisor. The Commission believes that it is appropriate to allow a successor to file an amendment to the predecessor's Form MA in these types of successions because such successions do not typically result in a change of control of the municipal advisor.

²⁶⁵ See proposed rule 15Ba1-6(a).

²⁶⁶ See 15 U.S.C. 78o-4(a)(2).

Scope and Applicability of Proposed Rule 15Ba1-6

The purpose of proposed rule 15Ba1-6 is to enable a successor municipal advisor to operate without an interruption of business by relying for a limited period of time on the registration of the predecessor municipal advisor until the successor's own registration becomes effective. The proposed rule is intended to facilitate the legitimate transfer of business between two or more municipal advisors and to be used only where there is a direct and substantial business nexus between the predecessor and the successor municipal advisor. The proposed rule is not designed to allow a registered municipal advisor 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 15Ba1-6 unless it is acquiring or assuming substantially all of the assets and liabilities of the predecessor's municipal advisor business, or there has been no practical change of control.²⁶⁷

The Commission would not apply proposed rule 15Ba1-6 to a reorganization that involves only registered municipal advisors. In those situations, the registered municipal advisors need not rely on the proposed 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 municipal advisory activities. Otherwise, confusion may result as to the identities and registration statuses of the parties.

Request for Comments

The Commission requests comment generally on the proposed requirement for registration of a successor to a municipal advisor and also requests comment on the following specific issues:

²⁶⁷ See Instruction 1 to Form MA.

- Is the Commission's proposed successor rule sufficiently clear? If not, why not and what would be a better alternative?
- Are the 30-day and 45-day timeframes in the proposed successor rule too short or too long? If so, 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 MA for registration?
- Are there any downsides to allowing a successor to rely on its predecessor's registration by filing an amendment to the predecessor's Form MA?

B. Approval or Denial of Registration

Exchange Act Section 15B(a)(2) provides that within forty-five days of the filing of an application to register as a municipal advisor,²⁶⁸ the Commission must either: (a) by order grant registration, or (b) 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 and shall be concluded within one hundred twenty days of the date of the filing of the application for registration. At the conclusion of such proceedings, the Commission, by order, shall grant or deny such registration. The Commission may extend the time for the conclusion of such proceedings for up to ninety 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.

In accordance with Exchange Act Section 15B(a)(2), the Commission shall grant the registration of a municipal advisor if the Commission finds that the requirements of Section 15B of

²⁶⁸ The statute allows for a longer period if the applicant consents. See 15 U.S.C. 78o-4(a)(2).

the Exchange Act are satisfied.²⁶⁹ The Commission shall deny the registration of a municipal advisor if the Commission does not make any such finding, or if it finds that if the applicant were registered, its registration would be subject to suspension or revocation under Section 15B(c) of the Exchange Act.²⁷⁰

The information currently required by temporary Form MA-T is not reviewed by the Commission prior to registration, although the Commission retains full authority to review such information and examine any registered municipal advisor at any time. The Commission intends that the permanent registration process would entail a review of each Form MA and Form MA-I filed. In approving or denying an application for registration as a municipal advisor, the Commission would review the information provided on Form MA or Form MA-I as applicable. For example, the Commission may perform cross checks of applicants through the use of the applicant's other registration numbers, such as its CRD or other SEC registration numbers, to the extent available. Also, the Commission may review the disclosures required by Item 9 of Form MA and Item 6 of Form MA-I discussed above, including the disciplinary history of an applicant. In order to form a more complete and informed basis on which to determine whether to grant, institute proceedings to deny, or revoke a municipal advisor's registration, the Commission is also proposing to adopt a requirement that a municipal advisor file with the Commission an annual self-certification relating to its ability to meet its regulatory obligations.

The benefit of the proposed municipal advisor registration process is that it would allow the Commission and staff to ask questions and, as needed, to require amendments, before approving an application for registration. The procedural process for reviewing applications for registration as a municipal advisor would be substantially similar to the procedural process for reviewing

²⁶⁹ See 15 U.S.C. 78o-4(a)(2).

²⁷⁰ See *id.*

applications of other registrants with the Commission (e.g., SIPs, broker-dealers, national securities exchanges, registered securities associations, clearing agencies, and investment advisers).²⁷¹

C. Proposed Rule 15Ba1-7: Books and Records to be Made and Maintained by Municipal Advisors

Section 17(a)(1) under the Exchange Act provides, in pertinent part, that all registered municipal advisors other than natural persons (i.e., municipal advisory firms, including sole proprietors) shall make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.²⁷² The Commission is proposing rule 15Ba1-7 under the Exchange Act to specify books and records requirements applicable to municipal advisors.²⁷³ Proposed rule 15Ba1-7's requirements are discussed below.

Records to be Made by Municipal Advisors

Proposed rule 15Ba1-7(a) would require municipal advisory firms to make and keep true, accurate, and current, certain books and records relating to its municipal advisory activities. These proposed books and records requirements are based generally on Exchange Act rules 17a-3 and 17a-4, and Investment Advisers Act rule 204-2, which set forth books and records requirements with respect to broker-dealers and investment advisers, respectively, with appropriate revisions to reflect the activities of municipal advisors.²⁷⁴

Proposed rule 15Ba1-7(a) would require municipal advisory firms to make and keep current

²⁷¹ See 15 U.S.C. §§ 78k-1(b)(3), 78o(b), 78s(a), and 80b-3(c).

²⁷² See Exchange Act Section 17(a)(1). 15 U.S.C. 78q(a)(1).

²⁷³ In addition, Section 15B(b)(2)(G) provides that the rules of the MSRB shall "prescribe records to be made and kept by . . . municipal advisors and the periods for which such records shall be preserved." 15 U.S.C. 78o-4(b)(2)(G).

²⁷⁴ See 17 CFR 240.17a-3 and 17a-4, and 17 CFR 275.204-2.

originals or copies of all communications received, and originals or copies of all communications sent, by such municipal advisor (including inter-office memoranda and communications) relating to municipal advisory activities, regardless of the format of the communications.²⁷⁵ Municipal advisory firms would also have to keep all check books, bank statements, cancelled checks and cash reconciliations; a copy of each version of the municipal advisor's policies and procedures, if any, in effect at any time within the last five years; and a copy of any document created by the municipal advisor that was material to making a recommendation to a municipal advisory client or that memorializes the basis for that recommendation. A municipal advisory firm would also be required to keep copies of all written agreements entered into by the municipal advisor with any municipal entity, employee of a municipal entity or an obligated person or otherwise relating to the business of the municipal advisor. A municipal advisory firm would also be required to keep a record of the names of persons who are, or have been in the past five years, associated persons of the municipal advisor; names, titles and addresses of persons associated with the municipal advisor; municipal entities or obligated persons with whom the municipal advisor has engaged in municipal advisory activities in the past five years; the names and business addresses of persons to whom the municipal advisor agrees to provide payment to solicit municipal entities on its behalf; and the names and business addresses of persons that agree to provide payment to the municipal advisor to make solicitations on their behalf. The purpose of these rules is to assist the Commission in its inspection and examination function. Based on the Commission's experience in conducting examinations of broker-dealers and investment advisers, the Commission believes that requiring municipal advisory firms to comply with these rules would facilitate the Commission's inspections and examinations of

²⁷⁵ Materials posted on a municipal advisor's website relating to municipal advisory activities would be written communications sent by the municipal advisor for purposes of this provision.

municipal advisors.

Proposed rule 15Ba1-7(b)(1) would require municipal advisory firms to maintain and preserve all books and records required to be made under this proposed rule for a period of not less than five years, the first two years in an easily accessible place. Corporate governance documents, such as articles of incorporation and stock certificate books of the municipal advisor and including those of any predecessor, would be required to be maintained in the principal office of the municipal advisor and preserved for three years after termination of the business or withdrawal from registration as a municipal advisor.

Proposed rule 15Ba1-7(d) is modeled on rule 204-2 under the Investment Advisers Act,²⁷⁶ and permits, and sets forth the requirements for, electronic storage of the records required to be maintained by this proposed rule. Also, proposed rule 15Ba1-7(e) provides that any book or record made, kept, maintained and preserved in compliance with rules 17a-3 and 17a-4 of the Exchange Act, rules of the MSRB, or rule 204-2 under the Investment Advisers Act, which is substantially the same as a book or record required to be made, kept, maintained and preserved under rule 15Ba1-7, would satisfy these proposed record-keeping requirements.²⁷⁷ Subparagraph (e) of proposed rule 15Ba1-7 is designed to minimize the record-keeping burden for municipal advisory firms that are otherwise subject to similar record-keeping requirements.

Record-keeping After a Municipal Advisor Ceases to do Business

Proposed rule 15Ba1-7(c) would require a municipal advisory firm, if it ceases doing business as a municipal advisor, to arrange for and be responsible for the continued preservation of the books and records required by the rule for the remainder of the period required by the rule, and would require the municipal advisor to notify the Commission of where such books and records will

²⁷⁶ See 17 CFR 275.204-2.

²⁷⁷ See proposed rule 15Ba1-7(e).

be maintained. This proposed requirement is necessary for the Commission to perform effective inspections and examinations of municipal advisory firms.

Requirements for Non-Residents

Proposed rule 15Ba1-7(f), which is modeled on rule 204-2(j) under the Investment Advisers Act,²⁷⁸ sets forth the books and records requirements for non-resident municipal advisory firms, including requirements for making, keeping current, maintaining, and preserving copies of books and records required to be made, kept current, maintained, and preserved under any rule or regulation adopted under the Exchange Act, as well as the requirements for providing notice to the Commission regarding the location of such books and records.²⁷⁹ Specifically, proposed rule 15Ba1-7(f) would require non-resident municipal advisors, other than natural persons, including non-resident sole proprietors (i.e., non-resident municipal advisor firms) to maintain all such books and records in the United States,²⁸⁰ and provide notice to the Commission of such location within 30 days after the proposed rule becomes effective (in the case of municipal advisory firms that are already registered or in the process of applying for registration when, and if, the rule becomes effective), or when filing an application for registration (in the case of municipal advisory firms that have not yet applied for registration when, and if, the rule becomes effective).²⁸¹ A non-resident municipal advisory firm would not be required to keep such books and records in the United States if the municipal advisor files with the Commission an undertaking to furnish the Commission, upon demand, copies of any or all of such books and records at the municipal advisor's expense to the

²⁷⁸ 17 CFR 275.204-2(j).

²⁷⁹ See proposed rule 15Ba1-7(f).

²⁸⁰ See proposed rule 15Ba1-7(f)(2).

²⁸¹ See id.

Commission's principal or regional office (as specified by the Commission),²⁸² provided the municipal advisor furnishes the requested books and records within 14 days of the Commission's written demand to the offices of the Commission specified in the written demand.²⁸³

The proposed requirements for non-resident municipal advisory firms are designed to ensure that the Commission has access to the books and records of municipal advisors located outside of the United States to enable it to perform effective examinations and inspections. The proposed requirements would also serve to mitigate the time and cost burdens the Commission may otherwise face in attempting to gain access to books and records located outside of the United States, for example in the case of any jurisdictional dispute relating to such access.

Request for Comments

The Commission requests comment generally on the proposed books and records requirements and also requests comment on the following specific issues:

- What types of documents and data should be retained by municipal advisory firms pursuant to the proposed rules? What burdens or costs would the retention of such information entail?
- Is it appropriate to base the books and records requirements for municipal advisory firms on the books and records requirements for broker-dealers and investment advisers? Are there books and records requirements for broker-dealers and investment advisers not included in proposed rule 15Ba1-7 that should be included? Please provide examples of any such requirements.

²⁸² See proposed rule 15Ba1-7(f)(3)(i). The proposed rule sets forth the form of undertaking the municipal advisor would be required to file. See *id.*

²⁸³ See proposed Rule 15Ba1-7(f)(3)(ii). The rule would require that any written demand would be forwarded by the Commission to the municipal advisor by registered mail at the municipal advisor's last address of record filed with the Commission. See *id.*

- Should the proposed periods for maintaining and preserving books and records for municipal advisory firms be lengthened or shortened? If so, by how much and why?
- Should the Commission impose other requirements that might be necessary or useful in protecting the records of a municipal advisory firm upon the failure of such entity?
- What documents and data typically are kept by municipal advisory firms? In what format? How long are such records currently maintained by municipal advisors?
- What are the technological or administrative burdens of maintaining the information specified in the proposed rules?
- Is there an industry standard format for information and records regarding municipal advisory firms? Are there different standard formats depending on the type of municipal advisor? Please answer with specificity.
- Should the Commission require records retained under this section to be retained electronically or furnished to the Commission electronically? If so, should any particular electronic format be mandated?
- Are the proposed requirements for non-resident municipal advisory firms overly burdensome? Are they sufficient to ensure that the Commission would have adequate access to the municipal advisor's books and records in a timely manner?
- Should the proposed books and records requirements include a requirement that municipal advisory firms must keep all bills or statements (or copies thereof), paid or unpaid, relating to the business of the municipal advisor? Would such a requirement be overly burdensome? If so, how should such a requirement be modified to make the information provided useful for examination, enforcement, or any other purpose? Please provide suggested alternatives for any such books and records requirement.

III. GENERAL REQUEST FOR COMMENT

The Commission is requesting comments from all members of the public. The Commission particularly requests comment from the point of view of persons who must register as municipal advisors, municipal entities, obligated persons, investors, and other regulators. The Commission seeks comments on all aspects of the proposed rules and forms. The Commission will carefully consider the comments that it receives. In addition, the Commission seeks comment on the following:

- Should the Commission clarify or modify any of the definitions included in the proposed rules? If so, which definitions and what specific modifications would be appropriate or necessary?
- Are the proposed rules sufficiently clear? Is additional guidance from the Commission necessary?
- Are there additional disclosures that would be useful to require on Forms MA and MA-1?
- Are the burdens of any of the requirements in the proposed rule greater than the benefits that would be attained by such requirement?
- Exchange Act rule 15b1-4 provides that the registration of a broker or dealer shall be deemed to be the registration of any executor, administrator, guardian, conservator, assignee for the benefit of creditors, receiver, trustee in insolvency or bankruptcy, or other fiduciary, appointed or qualified by order, judgment, or decree of a court of competent jurisdiction to continue the business of such broker or dealer, provided that the fiduciary files with the Commission, within 30 days after entering upon the performance of his duties, a statement setting forth as to such fiduciary substantially the

information required by Form BD.²⁸⁴ Should rules relating to the registration of municipal advisors similarly include a process through which an executor, administrator, guardian, conservator, assignee for the benefit of creditors, receiver, trustee in insolvency or bankruptcy, or other fiduciary, appointed or qualified by order, judgment, or decree of a court of competent jurisdiction could continue the business of a municipal advisor?

- Form ADV²⁸⁵ and related rules under the Investment Advisers Act require investment advisers registered with the Commission to provide new and prospective clients with a brochure and brochure supplements written in plain English and to send an updated brochure or a summary of material changes to existing clients at least annually. These brochures are intended to provide advisory clients with clearly written, meaningful, current disclosure of the business practices, conflicts of interest and background of the investment adviser and its advisory personnel.²⁸⁶ Would such a brochure delivery requirement be necessary or useful to municipal entities and obligated persons? If so, what information would it be helpful to include in such brochures? If the Commission were to adopt a brochure delivery requirement, should it be in substantially the same form as the brochure delivery requirement relating to investment advisers, including with respect to content, amendments to the content, and time periods for delivery? What aspects of the brochure delivery requirement for investment advisers would it be appropriate to apply to municipal advisors and what aspects of the brochure delivery

²⁸⁴ See 15 U.S.C. 240.15b1-4.

²⁸⁵ See 17 CFR 279.1.

²⁸⁶ See Investment Advisers Act Release No. IA-3060 (July 28, 2010), 75 FR 49234 (August 12, 2010).

requirement for investments advisers would it not be appropriate to apply to municipal advisers? Is there a category of municipal advisers that should be excluded from any such brochure delivery requirement, if the Commission were to adopt such a requirement? If so, how should such a category be described and what would be the reason for the exclusion? If such an exclusion were created, how would the Commission ensure that the clients of excluded advisers received adequate disclosures and protection? Is there a category of clients as to whom the brochure delivery requirement should not, or need not, apply? If so, how should such a category be described and what would be the reason for the exclusion? What would be the costs and benefits of any such brochure delivery requirement to municipal advisers? What would be the costs and benefits of any such brochure delivery requirement to the clients of municipal advisers?

The Commission seeks comments generally concerning the requirement for a municipal advisor to supply information in Forms MA and MA-I concerning the general types of municipal advisory activities in which it engages. In particular, would it be confusing or otherwise difficult for a municipal advisor to provide this information? Are there considerations relating to the business of municipal advisers, or of some types of municipal advisers, that the Commission may not have taken into account in connection with the proposed information disclosure requirements of Forms MA and MA-I?

In addition, the Commission seeks comments on the proposals as a whole, including their interaction with the other provisions of the Dodd-Frank Act. The Commission seeks comments on whether the proposals would help achieve the broader goals of increasing transparency and accountability in the municipal securities markets.

The Commission requests comment generally on whether its proposed actions to govern the

municipal advisor registration process are necessary or appropriate. If commenters do not believe one or all such actions are necessary and appropriate, why not? What would be the preferred action?

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 975 of the Dodd-Frank Act governing municipal advisors.

IV. PAPERWORK REDUCTION ACT

Certain provisions of the Dodd-Frank Act and the rules and forms the Commission is proposing thereunder relating to the permanent registration of municipal advisors would impose new “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“Paperwork Reduction Act” or “PRA”).²⁸⁷

The Commission is submitting these collections of information to the Office of Management and Budget (“OMB”) for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The proposed titles for these collections of information are “Form MA: Application for Municipal Advisor Registration”; “Form MA-I: Application for Municipal Advisor Registration for Natural Persons”; “Rule 15Ba1-4: Amendments to Application for Registration and Self-Certification”; “Form MA-W: Notice of Withdrawal from Registration as a Municipal Advisor”; “Form MA-NR: Designation of U.S. Agent for Service of Process”; and “Rule 15Ba1-7: Books and Records to be Maintained by Municipal Advisors.”

²⁸⁷ 44 U.S.C. 3501 et seq.

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. Section 15B of the Exchange Act, as amended by the Dodd-Frank Act, requires municipal advisors (as defined in Section 15B(e)(4) of the Exchange Act²⁸⁸) to register with the Commission.²⁸⁹ As a transitional step to the implementation of a permanent registration program, the Commission adopted, on an interim final basis, Rule 15Ba2-6T, which permitted municipal advisors to temporarily satisfy the registration requirement by filing Form MA-T, effective October 1, 2010. The interim final temporary rule provides that, unless rescinded, a municipal advisor's temporary registration by means of Form MA-T will expire on the earlier of (1) the date that the municipal advisor's registration is approved or disapproved by the Commission pursuant to a final rule establishing a permanent registration regime; (2) the date on which the municipal advisor's temporary registration is rescinded by the Commission; or (3) December 31, 2011.²⁹⁰ Pursuant to the Dodd-Frank Act, the Commission is proposing new rules that would establish a permanent municipal advisor registration regime and would impose certain record-keeping requirements on municipal advisors.

A. Summary of Collection of Information

Section 15B(a)(2) of the Exchange Act, as amended by the Dodd-Frank Act, provides that a municipal advisor may be registered by filing with the Commission an application for registration in such form and containing such information and documents concerning the municipal advisor and any persons associated with the municipal advisor as the Commission, by rule, may prescribe as

²⁸⁸ See 15 U.S.C. 78o-4(e)(4). See also *supra* Section II.A.1.

²⁸⁹ See 15 U.S.C. 78o-4(a).

²⁹⁰ See 17 CFR 240.15Ba2-6T(e). The OMB approved the collection of information for Form MA-T and Rule 15Ba2-6T ("Temporary Registration of Municipal Advisors – Form MA-T") (OMB Control No. 3235-0659) on an emergency basis for six months.

necessary or appropriate in the public interest or for the protection of investors.²⁹¹

Under the proposed rules, the permanent registration regime for municipal advisors would be more comprehensive than the temporary one. The proposed regime would require more detailed disclosures, and entail a review of a respondent's registration form. Under proposed rule 15Ba1-2(a), a municipal advisory firm would be required to apply for registration with the Commission by completing and electronically filing Form MA. Under proposed rule 15Ba1-2(b), a natural person municipal advisor would be required to apply for registration with the Commission by completing and electronically filing Form MA-I. A sole proprietor would have to complete both Form MA and Form MA-I. The Commission anticipates developing an online filing system, where a municipal advisor would be able to file a completed Form MA and/or MA-I and the information filed would be publicly available. In addition, under proposed rule 15Ba1-7, registered municipal advisors other than natural persons (i.e., municipal advisory firms, including sole proprietors) would be required to maintain books and records relating to their municipal advisory activities.

Under the proposed permanent registration regime, municipal advisors would include sole proprietorships, individual employees of municipal advisors, and firms of varying sizes. In addition, municipal advisors would include firms that engage in municipal advisory activities as part of a broader array of financial services serving many types of clients, and may have many associated persons. Thus, the paperwork burden would reflect these differences in size and types of other financial services in which the municipal advisors engage.

Pursuant to proposed rule 15Ba1-4(a)(1), a municipal advisory firm that registers on Form MA would have to amend its Form MA at least annually, within 90 days of the end of the applicant's fiscal year in the case of applicants that are firms, or within 90 days of the end of the

²⁹¹ See 15 U.S.C. 78o-4(a)(2).

calendar year in the case of sole proprietors. Proposed rule 15Ba1-4(a)(2) would require a municipal advisory firm to amend its Form MA more frequently than annually as required by the General Instructions. Pursuant to proposed rule 15Ba1-4(b), a natural person municipal advisor who registers on Form MA-I would have to amend his or her Form MA-I whenever any information previously provided in Form MA-I becomes inaccurate. Pursuant to proposed rule 15Ba1-4(e), a registered municipal advisor would have to complete the self-certification on Form MA or Form MA-I, as applicable, both at the time the municipal advisor initially files its application for registration, and also on an ongoing annual basis. Municipal advisors registered on Form MA would have to complete the Form MA self-certification within 90 days of the end of a municipal advisor's fiscal year, or for municipal advisors that are sole proprietors, within 90 days of the end of the calendar year. Municipal advisors registered on Form MA-I would have to complete the Form MA-I self-certification within 90 days of the end of the calendar year.

Pursuant to proposed rule 15Ba1-3, all municipal advisors, whether registered on Form MA or MA-I, would be required to file Form MA-W to withdraw from registration with the Commission as a municipal advisor. As would be the case with Form MA and MA-I, Form MA-W would be required to be filed electronically with the Commission.

Proposed rule 15Ba1-5 sets forth the general procedures for serving non-residents on Form MA-NR. Pursuant to the instructions to Form MA-NR, and consistent with proposed rule 15Ba1-5, non-resident municipal advisors other than natural persons, but including sole proprietors ("non-resident municipal advisory firms"), and non-resident general partners and non-resident managing agents of municipal advisors must file Form MA-NR to furnish the Commission with a written irrevocable consent and power of attorney to appoint an agent in the United States, other than a Commission member, official, or employee, upon whom may be served any process, pleadings, or

other papers in an action brought against the non-resident municipal advisory firm, non-resident general partner or non-resident managing agent that arises out of or relates to the municipal advisory activities of the municipal advisor. In addition, proposed rule 15Ba1-5(d) would require each non-resident municipal advisory firm to provide an opinion of counsel that the advisory firm can, as a matter of law, provide the Commission with prompt access to the advisory firm's books and records and that the advisory firm can, as a matter of law, submit to onsite inspection and examination by the Commission.

Proposed rule 15Ba1-7 would require all registered municipal advisors other than natural persons (i.e., municipal advisory firms, including sole proprietors) to maintain books and records relating to their municipal advisory activities. Generally, proposed rule 15Ba1-7 would require such books and records to be maintained and preserved for a period of not less than five years, the first two years in an easily accessible place.

B. Proposed Use of Information

The proposed requirement that a municipal advisor must register with the Commission on Forms MA and MA-I to continue to engage in municipal advisory activities would help ensure that the Commission has information to effectively oversee respondents and their activities in the municipal securities market. In particular, the information provided in Forms MA and MA-I would be used to determine whether to grant the applicant's application for registration, institute proceedings to determine whether registration should be denied, and place limitations on the applicant's activities as a municipal advisor. The information would also be used to focus on-site examinations and aid in risk-based examination targeting. It would enable the Commission to obtain an accurate estimate of the number of municipal advisors, by size and by municipal advisory activity; analyze data regarding the various types of municipal advisory activities in which advisors

engage; and evaluate the disciplinary history of all advisors and associated persons, including all regulatory, civil, and criminal proceedings. The proposed registration requirement would also help to ensure that the Commission can make such information transparent and easily accessible to the investing public, including municipal entities and obligated persons who engage municipal advisors, investors who may purchase securities from offerings in which municipal advisors participated, and other regulators.

The proposed requirement that a municipal advisory firm must make and keep books and records, including written communications and records of associated persons, would help to ensure that records exist of the respondent's primary municipal advisory activities and of its associated persons, and could potentially be requested by Commission staff during an examination to evaluate the municipal advisory firm's compliance with the proposed rules. In particular, the proposed requirement that a municipal advisory firm must keep a record of the initial or annual review, as applicable, conducted by the municipal advisory firm of such municipal advisory firm's business in connection with its self-certification on Form MA, would help ensure, among other things, that the municipal advisory firm and every natural person associated with it has met certain standards of training, experience, and competence required by the Commission, the MSRB, or any other relevant SROs.

The proposed requirement that a non-resident municipal advisor, or a non-resident general partner or non-resident managing agent of a municipal advisor, file Form MA-NR in connection with the municipal advisor's initial application would help minimize legal or logistical obstacles that the Commission may encounter when attempting to effect service, to conserve Commission resources, and to avoid potential conflicts of law. The proposed requirement that a non-resident municipal advisory firm provide an opinion of counsel on Form MA would help ensure that such

non-resident municipal advisory firm could provide access to its books and records and submit to onsite inspection and examination by the Commission.

C. Respondents

The Commission estimates that the proposed "collections of information" would initially apply to approximately 1,000 municipal advisory firms, including sole proprietors. This estimate is based partly on the number of municipal advisors that have registered with the Commission under rule 15Ba2-6T. As of October 2010, there were approximately 800 total unique electronic registrations where Form MA-T was completed and not withdrawn. The Commission believes that this number of Form MA-T registrants would likely increase, because numerous applicants that would be required to register may have missed the October 1, 2010 deadline for a variety of reasons, such as concluding, based on their interpretation of the Dodd-Frank Act, that they were not required to register as municipal advisors. For the PRA analysis of the interim final temporary rule, Commission staff estimated that approximately 1,000 applicants would be required to complete Form MA-T.²⁹² Commission staff believes that this remains an appropriate estimate for the total number of municipal advisory firms that would be required to register on Form MA under the proposed permanent registration regime.²⁹³

²⁹² See Temporary Registration Rule Release, supra note 63, at 54473.

²⁹³ The Commission notes that a person that solicits a municipal entity or obligated person on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser that controls, is controlled by, or is under common control with the person undertaking such solicitation, may voluntarily apply to register as a municipal advisor. See supra Section II.A.2.a. Based on investment adviser registration data, Commission staff estimates that out of approximately 12,000 investment advisers currently registered with the Commission, only 385, or approximately 3%, (1) have municipal clients; (2) use firms or persons to solicit advisory clients on the adviser's behalf; and (3) compensate persons for client referrals. The Commission expects that of these 385 investment advisers, a significantly smaller subset would have the specific circumstances where voluntary municipal advisor registration would be applicable, i.e., they use affiliates that exclusively solicit municipal entities for them (or other affiliates), and not for third parties. For purposes

The proposed "collections of information" would also apply to natural person municipal advisors. For purposes of estimating the paperwork burden, the Commission notes that the number of Form MA-I applicants may be divided into three main categories: (1) individuals who are currently also registered as investment advisers, broker-dealers, or both, and who are employed at investment advisory firms, broker-dealer firms, or banks; (2) individuals who are employed at financial advisor firms that are not registered as broker-dealers or investment advisers; and (3) individual solicitors who are employed at third-party marketing and solicitor firms. To calculate the total number of likely Form MA-I applicants, the Commission estimates the number of respondents in each of these categories.

First, the Commission estimates the number of individuals who are currently registered as investment advisers, broker-dealers, or both, and would register on Form MA-I. To calculate this estimate, the Commission compares the proportion of FINRA Form U4 filers (i.e., individuals who are registered representatives of investment advisers and/or broker-dealers) to the sum of all investment advisers registered on Form ADV and all broker-dealers registered on Form BD. FINRA estimates that as of October 2010, 637,000 individuals had registered as representatives of broker-dealers and/or investment advisers on Form U4.²⁹⁴ The Commission estimates that as of October 2010, 11,888 investment advisers had registered on Form ADV, while as of March 2010, 5,163 broker-dealers had registered on Form BD. The proportion of Form U4 registrants to the sum of Form ADV and Form BD registrants is approximately 37.36 to 1.²⁹⁵ According to Form MA-T

of this analysis, the Commission's estimate of the number of potential voluntary municipal advisor applicants is included as part of the total estimate of 1,000 applicants noted above.

²⁹⁴ See October 2010 "Registered Reps" in "FINRA Statistics," available at <http://www.finra.org/Newsroom/Statistics>.

²⁹⁵ $637,000$ (estimated number of Form U4 registrants) / ($11,888$ (estimated number of Form ADV registrants) + $5,163$ (estimated number of Form BD registrants)) = 37.36.

data collected to date, the Commission estimates that approximately 450 of 1,000 MA-T registrants would be investment adviser and/or broker-dealer firms. Thus, the Commission estimates that approximately 16,800 individuals who are registered as investment advisers, broker-dealers, or both, would be required to register on Form MA-I.²⁹⁶

Second, the Commission estimates the number of individuals who are employed at financial advisor firms and would register on Form MA-I. Commission staff understands from discussions with industry and market participants that it is reasonable to estimate that there is an average of approximately 10 professional employees per financial advisor firm. According to Form MA-T data collected to date, the Commission estimates that approximately 450 of 1,000 MA-T registrants would be financial advisor firms. Thus, the Commission estimates that approximately 4,500 individuals who are employed at financial advisor firms would be required to register on Form MA-I.²⁹⁷

Third, the Commission estimates the number of individual solicitors who would register on Form MA-I. Commission staff examined the data of all MA-T registrants as of October 2010, and estimates that approximately 100 out of 1,000 registrants are exclusively focused on third-party marketing and solicitation. For purposes of this PRA, the Commission assumes that there are five individual solicitors who would register on Form MA-I for every solicitor firm that would register on Form MA.²⁹⁸ Thus, the Commission estimates that approximately 500 individual solicitors

²⁹⁶ 450 (total number of investment adviser and broker-dealer firms registered as municipal advisors) x 37.36 (proportion of Form U4 registrants to all Form ADV and Form BD registrants) = 16,812.

²⁹⁷ 450 (total number of independent financial advisor firms registered as municipal advisors) x 10 (estimated average number of professional employees per independent financial advisor firm) = 4,500.

²⁹⁸ See Letter from Donna DiMaria, President, Third Party Marketers Association, dated August 27, 2009, available at <http://www.sec.gov/comments/s7-18-09/s71809-36.pdf> (commenting on the Commission's proposal to adopt a rule addressing "pay to play")

would be required to register on Form MA-I.²⁹⁹

The Commission estimates that the total number of Form MA-I applicants would be approximately 21,800 natural persons.³⁰⁰ The Commission recognizes that, based on a number of factors, the actual total number of respondents may differ from this estimate. For example, the current estimate does not include Form MA-I applicants who might be employed at banks, but are not registered as either investment advisers or broker-dealers. Thus, the actual total number of respondents could be higher. Under the proposed rules, sole proprietors would be required to complete both Form MA and Form MA-I. The respondent estimates presented here likely include some overlap, but the actual total number of respondents could be slightly lower depending on the overall percentage of sole proprietors among all municipal advisory firms.

To estimate the average annual number of new Form MA applicants, the Commission relies on investment adviser registration data, which indicates that new investment adviser applicants comprise, on average, approximately 10.4% of the total number of registered investment

practices by investment advisers and estimating that the typical solicitor firm consists of 2 to 5 professionals).

²⁹⁹ 100 (estimated number of solicitor firms) x 5 (estimated number of Form MA-I applicants per solicitor firm) = 500. The Commission notes that a person that solicits a municipal entity or obligated person on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser that controls, is controlled by, or is under common control with the person undertaking such solicitation, may voluntarily apply to register as a municipal advisor. See *supra* Section II.A.2.a. Based on investment adviser registration data, Commission staff expects that only a small number of registered investment advisers that are natural persons would have the specific circumstances where voluntary municipal advisor registration would be applicable. See *supra* note 293. For purposes of this analysis, the Commission's estimate of the number of potential voluntary natural person municipal advisor applicants is included as part of the total estimate of 500 individual solicitors noted above.

³⁰⁰ 16,800 (estimated number of individual investment advisers and/or broker-dealers) + 4,500 (estimated number of individuals who are employed at financial advisor firms) + 500 (estimated number of individuals who are employed at solicitation firms) = 21,800.

advisers.³⁰¹ The Commission expects the proportion of new municipal advisory firm applicants to all municipal advisory firm applicants may be similar. Accordingly, the Commission estimates that the average number of new Form MA applicants per year would be 100.³⁰² To estimate the average annual number of new Form MA-I applicants, the Commission relies on FINRA registration data, which indicates that new Form U4 applicants that are new to the industry comprise, on average, approximately 8.39% of the total number of Form U4 applicants.³⁰³ The Commission expects the proportion of new natural person municipal advisor registrants to all natural person municipal advisor registrants may be similar. Accordingly, the Commission estimates that the average number of new Form MA-I applicants per year would be 1,800.³⁰⁴

D. Total Initial and Annual Reporting and Record-Keeping Burdens

The estimated burdens on respondents to complete and submit Forms MA, MA-I, MA-W, and MA-NR,³⁰⁵ amend Forms MA and MA-I, consult with outside counsel, and maintain books and records related to municipal advisory activities, are described below.

1. Form MA

Form MA, which is to be completed by municipal advisory firms (including sole proprietors) registering under the proposed permanent registration regime, would require more

³⁰¹ According to the Commission's Division of Investment Management, as of October 2010, there were 11,888 investment advisers registered with the Commission. From 2002 to 2009, there was an average of 1,237 new investment adviser registrations per year. $(1,237 / 11,888) = 10.4\%$.

³⁰² $1,000$ (all Form MA applicants) $\times 10.4\% = 104$ new Form MA applicants per year.

³⁰³ According to FINRA, as of October 2010, there were approximately 637,000 individuals registered on Form U4. See *supra* note 295. FINRA has notified the Commission that from October 2008 to the present, there was an average of 53,474 Form U4 registrants that were new to the industry per year. $(53,474 / 637,000) = 8.39\%$.

³⁰⁴ $21,800$ (all Form MA-I applicants) $\times 8.39\% = 1,829$ new Form MA-I applicants per year.

³⁰⁵ See *infra* Sections IV.D.4 and IV.D.5 (discussing the number of respondents relating to filing Form MA-W and Form MA-NR, respectively).

comprehensive disclosure in addition to the information already collected and submitted on Form MA-T. As discussed in detail above, municipal advisory firms that would be required to register with the Commission by filing Form MA would have to provide, among other things:

1. identifying information;
2. information regarding the municipal advisor's form of organization;
3. whether the advisor is succeeding to the business of a registered municipal advisor;
4. information about the municipal advisor's business and business structure;
5. information regarding the municipal advisor's other business activities;
6. financial industry affiliations of associated persons of the municipal advisor;
7. the municipal advisor's interest in municipal advisory client transactions;
8. information related to control persons of the municipal advisor;
9. disclosures relating to regulatory, civil, and criminal disciplinary history;³⁰⁶
10. information regarding whether the municipal advisor is a "small business;" and
11. a self-certification, filed on an initial and annual basis, regarding the municipal advisor's qualifications as a municipal advisor and its ability to comply with its obligations under the federal securities laws.

The Commission has previously estimated that, in the case of Form ADV – a similar form to Form MA, which must be completed for the registration of investment advisers with the Commission – the average time necessary to complete the form is approximately 36.24 hours.³⁰⁷ Form ADV, however, is significantly longer than Form MA and contains sections that are not

³⁰⁶ See supra Section II.A.2.c.

³⁰⁷ See Release No. IA-3060, supra note 286, at 49256. Additionally, the Commission notes that the average time necessary to complete Part IA of Form ADV is approximately 4.32 hours. See Form ADV, Part 1A (Paper Version), at 1 (under "OMB Approval," estimated average burden hours per response is 4.32 hours).

required for Form MA registration, such as Part 2A, which requires the applicant to create narrative brochures containing information about the advisory firm. Thus, the Commission expects the hourly burden for Form MA to be considerably less than 36.24 hours.

In contrast, the Commission previously estimated that the average amount of time for a municipal advisor to complete Form MA-T, regardless of advisor size, is approximately 2.5 hours.³⁰⁸ This estimate for completion of Form MA-T includes all of the time necessary to research, evaluate, and gather all of the information that is requested in the form and all of the time necessary to complete and submit the form.³⁰⁹

The Commission believes that the paperwork burden of completing Form MA would be greater than the amount of time required to complete Form MA-T, because Form MA is longer and more comprehensive than Form MA-T. Nevertheless, the Commission believes that the estimated time to complete Form MA-T, rather than Form ADV, is the more appropriate basis to estimate the time to complete Form MA. Accordingly, the Commission estimates that the average amount of time for a municipal advisory firm to complete Form MA would be 3.5 hours. This estimate would apply to all municipal advisory firms, because even those that had already completed Form MA-T under the temporary registration regime must register anew.

In addition, pursuant to proposed rule 15Ba1-4(e)(1), a municipal advisory firm would be required at the time it initially files Form MA to conduct an initial review of its business and certify that, among other things, it and every natural person associated with the municipal advisory firm

³⁰⁸ See Temporary Registration Rule Release, supra note 63, at 54473.

³⁰⁹ The Commission notes that some municipal advisors that would be required to register under the proposed permanent registration regime would also be registered with the Commission as broker-dealers and/or investment advisers. The Commission believes that these persons could require less time to research and complete the proposed permanent registration forms to the extent information contained in those other registration(s) could be incorporated by reference, avoiding the need to repeat the information on Form MA. See supra note 220, and accompanying text.

meet standards required by the Commission, the MSRB, or any other relevant SRO to engage in municipal advisory activities. To estimate the initial burden for this self-certification, the Commission examined burden estimates for Form N-CSR (“Certified Shareholder Report of Registered Management Investment Companies”) and Form N-Q (“Quarterly Schedule of Portfolio Holdings of Registered Management Investment Company”), which include similar self-certification requirements.³¹⁰ Based on its prior burden estimates, Commission staff estimates that the initial burden to comply with the Form MA self-certification requirement would be, on average, approximately 3.0 hours per applicant. Thus, the total average initial burden for Form MA would be 6.5 hours per applicant.³¹¹

The Commission recognizes that depending on the specific circumstances of the municipal advisory firm, the initial burden to complete Form MA may vary from respondent to respondent. For example, as discussed above, a non-resident municipal advisor would be required to attach a legal opinion to its Non-Resident Municipal Advisor Execution Page to Form MA.³¹²

As discussed above, Commission staff estimates that approximately 1,000 municipal advisory firms would be required to fill out Form MA. Thus, the Commission estimates that the total initial paperwork burden for completion and submission of Form MA would be 6,500 hours.³¹³ The Commission notes that respondents may have potential one-time burdens associated with Form MA. For example, respondents may need to develop internal controls associated with procedures

³¹⁰ See Exchange Act Release No. 34-47262 (January 27, 2003), 68 FR 5348 (February 3, 2003); Exchange Act Release No. 34-49333 (February 27, 2004), 69 FR 11244 (March 9, 2004).

³¹¹ 3.5 hours (average time required to complete Form MA) + 3.0 hours (average time required to complete self-certification) = 6.5 hours per applicant.

³¹² See *supra* Section II.A.2.b. For a discussion of the estimated burden for a non-resident municipal advisor to provide opinion of counsel, see *infra* Section IV.D.5.

³¹³ 1,000 (persons required to submit Form MA) x 6.5 hours (average estimated time required to complete Form MA and initial self-certification) = 6,500 hours.

for obtaining the information required by Form MA, and they would need to familiarize themselves with the proposed rules and the form. For purposes of this analysis, these potential one-time burdens are included in the estimates noted above.

The Commission estimates that the average number of new Form MA applicants per year would be 100,³¹⁴ and the annual paperwork burden for new completions and submissions of Form MA would be 650 hours.³¹⁵ The Commission notes that respondents may have potential recurring burdens associated with Form MA, such as systemic ongoing monitoring and maintenance of the information required by the form. For the purposes of this analysis, these potential recurring burdens are included in the estimates with respect to amendments to Form MA.³¹⁶

The collection of information made pursuant to Form MA would not be confidential and would be made publicly available. Some information, such as social security numbers, would be kept confidential to the extent permitted by law.

2. Form MA-I

Form MA-I, which is to be completed by natural persons (including sole proprietors) registering under the proposed permanent registration regime, would require more comprehensive disclosure compared to the information already collected and submitted on Form MA-T. As discussed above, natural person municipal advisors required to register with the Commission by filing Form MA-I would be required to provide, among other things:

1. identifying information;
2. residential history for the five years preceding filing of the application;

³¹⁴ See supra Section IV.C.

³¹⁵ 100 (new Form MA applicants per year) x 6.5 hours (average estimated time required to complete Form MA and initial self-certification) = 650 hours.

³¹⁶ See infra Section IV.D.3.

3. employment history for the ten years preceding filing of the application;
4. any other businesses in which the advisor is currently engaged;
5. disclosures relating to regulatory, civil, and criminal disciplinary history; and
6. a self-certification, filed on an initial and annual basis, indicating, among other things, that the municipal advisor has met or will meet qualification standards required by the Commission, the MSRB, or any other relevant SRO for municipal advisors.

Moreover, Form MA-I would require disclosure forms for reporting disciplinary proceedings, including criminal, regulatory, and civil judicial actions.

To estimate the average amount of time required to complete Form MA-I, the Commission compares the average amount of time required for an applicant to complete Form MA-T. As described above, the Commission previously estimated that the average amount of time for a municipal advisor to complete Form MA-T would be approximately 2.5 hours.³¹⁷ This estimate includes all of the time necessary to research, evaluate, and gather all of the information that is requested in Form MA-T and all of the time necessary to complete and submit the form. The Commission believes that the paperwork burden of completing Form MA-I would not be significantly greater than the amount of time required to complete Form MA-T, because some of the information required for Form MA-I would have already been gathered for completing Form MA-T. The Commission anticipates that the most burdensome portion of the form would be the disclosure of the advisor's disciplinary history, but the Commission believes that this burden should only be substantial for a small number of applicants. Overall, the Commission estimates that the average amount of time for a natural person municipal advisor to complete Form MA-I would be

³¹⁷ See supra note 308, and accompanying text.

3.0 hours.³¹⁸ This estimate would apply to all natural person municipal advisors, because even those who had already completed Form MA-T under the temporary registration regime must register anew.

The Commission estimates that approximately 21,800 natural person municipal advisors would be required to register on Form MA-I.³¹⁹ Thus, the Commission estimates that the total paperwork burden for completion and submission of Form MA-I would be 65,400 hours.³²⁰ The Commission notes that respondents may have potential one-time burdens associated with Form MA-I. For example, respondents may need to locate information not previously required for other registrations, but required by Form MA-I, and they would need to familiarize themselves with the proposed rules and the form. For purposes of this analysis, these potential one-time burdens are included in the estimates noted above.

The Commission estimates that the average number of new Form MA-I applicants per year would be 1,800,³²¹ and the annual paperwork burden for new completions and submissions of Form MA-I would be 5,400 hours.³²² The Commission notes that respondents may have potential

³¹⁸ The Commission notes that pursuant to proposed rule 15Ba1-4(e)(1), a natural person municipal advisor would also be required at the time he or she initially files Form MA-I to certify that, among other things, he or she meets standards required by the Commission, the MSRB, or any other self-regulatory organization to engage in municipal advisory activities. For purposes of this analysis, the Commission believes that the initial burden for a natural person to complete Form MA-I self-certification would be minimal, because it would not require the more burdensome initial review of a municipal advisory firm. Thus, the Commission includes the average amount of time for initial self-certification as part of its estimate of the average amount of time for a natural person municipal advisor to initially complete Form MA-I.

³¹⁹ See supra Section IV.C.

³²⁰ 21,800 (persons required to submit Form MA-I) x 3.0 hours (average estimated time required to complete Form MA-I and initial self-certification) = 65,400 hours.

³²¹ See supra Section IV.C.

³²² 1,800 (new Form MA-I registrants per year) x 3.0 hours (average estimated time required to complete Form MA-I and initial self-certification) = 5,400 hours.

recurring burdens associated with Form MA-I, such as tracking ongoing updates to the information required by the form. For the purposes of this analysis, these potential recurring burdens are included in the estimates with respect to amendments to Form MA-I.³²³

The collection of information made pursuant to Form MA-I would not be confidential and would be made publicly available. Some information, such as social security numbers, would be kept confidential to the extent permitted by law.

3. Amendments to Form MA and Form MA-I

Under proposed rule 15Ba1-4, once a municipal advisor is registered on Form MA, the municipal advisor would be required to electronically amend Form MA at least annually, within 90 days of the end of the advisor's fiscal year, if a firm, or within 90 days of the end of the calendar year, if a sole proprietor; and more frequently, as set forth in the General Instructions to Form MA, as applicable. A natural person municipal advisor registered on Form MA-I would be required to electronically amend Form MA-I whenever the information previously provided in Form MA-I becomes inaccurate.

The Commission notes that in addition to preparing amendments for Form MA and/or Form MA-I as described above, a respondent would also be required to certify annually that, among other things, it meets qualification standards required by the Commission, the MSRB, or any other relevant SRO to engage in municipal advisory activities. For purposes of this analysis, the Commission includes the annual self-certification as part of the amendment requirements, and the Commission addresses their associated burdens together below.

The Commission estimates that the average time necessary to prepare an annual amendment for Form MA would be approximately 1.5 hours because only certain parts of Form MA would

³²³ See infra Section IV.D.3.

need to be completed for amendments. The Commission recognizes that depending on the extent of the amendments, the burden to complete the annual amendment may vary greatly from respondent to respondent, and that some would require significantly more time than 1.5 hours to submit annual amendments while others would require significantly less time than 1.5 hours. For example, as discussed above, a non-resident municipal advisory firm would be required to file an amendment to Form MA promptly and include a revised opinion of counsel after any changes in the legal or regulatory framework that would impact its ability or the manner in which it provides the Commission with the required access to its books and records or impacts the Commission's ability to inspect to examine the municipal advisory firm onsite.³²⁴

In addition, pursuant to proposed rule 15Ba1-4(e)(2), a municipal advisory firm would be required to conduct an annual review of its business and certify that, among other things, it and every natural person associated with the municipal advisory firm has met, or will meet, qualification standards required by the Commission, the MSRB, or any other relevant SRO to engage in municipal advisory activities. To estimate the annual burden, the Commission examined burden estimates for Form N-CSR and Form N-Q.³²⁵ Based on its prior burden estimates, Commission staff estimates that the annual burden to comply with the Form MA self-certification requirement would be, on average, approximately one hour per respondent. Therefore, the total average annual burden for Form MA amendments would be 2.5 hours per respondent.³²⁶

To estimate the average amount of time necessary to prepare an additional updating amendment for Form MA (i.e., any additional amendment other than the required annual

³²⁴ See supra Section II.A.4. For a discussion of the estimated burden for a non-resident municipal advisor to provide opinion of counsel, see infra Section IV.D.5.

³²⁵ See supra note 310.

³²⁶ 1.5 hours (average time required to amend Form MA) + 1.0 hour (average time required to complete annual self-certification) = 2.5 hours per respondent.

amendment), the Commission relies on its estimate for the amount of time required to prepare an interim updating amendment for Form ADV. The Commission estimated that an updating amendment for Form ADV would require 0.5 hours per amendment, because interim amendments typically only amend one or two items in Form ADV and thus should not require as much time to prepare as an annual amendment.³²⁷ For the purposes of this PRA analysis, the Commission believes that the amount of time to complete an updating amendment for Form MA would also be 0.5 hours.

Under proposed rule 15Ba1-4(a)(1), all 1,000 municipal advisory firms registered on Form MA would be required to amend their Form MA once every fiscal or calendar year, as applicable. It is also possible that some of these 1,000 municipal advisory firms would have to submit more than one amendment. To estimate the average number of amendments in addition to the annual amendment, the Commission relies on its prior estimate for the average number of additional amendments for Form ADV. The Commission estimated that, on average, each adviser filing Form ADV would likely amend its form two times during the year – one annual amendment, and one interim updating amendment.³²⁸ For the purposes of this PRA analysis, the Commission believes that the same estimate of two Form MA amendments per year on average – one annual amendment and one interim updating amendment – would be appropriate, although the Commission recognizes that the actual number of amendments per advisor might be higher or lower, depending on how frequently respondents must amend Form MA for material changes. The total estimated burden for updates to Form MA per year, including compliance with the annual self-certification requirement, would be 3,000 hours.³²⁹

³²⁷ See Release No. IA-3060, supra note 286, at 49257.

³²⁸ Id.

³²⁹ 1,000 (persons required to amend Form MA) x 2.5 (average estimated time to amend Form

To estimate the average amount of time necessary to prepare an updating amendment for Form MA-I (i.e., a required amendment whenever any information previously provided becomes inaccurate), the Commission relies on its estimate for the amount of time required to prepare an interim updating amendment for Form ADV. As noted above, the Commission estimated that an updating amendment for Form ADV would require 0.5 hours per amendment, because interim amendments typically only amend one or two items in Form ADV and thus should not require as much time to prepare as an annual amendment.³³⁰ For the purposes of this PRA analysis, the Commission believes that the amount of time to complete an updating amendment for Form MA-I would also be 0.5 hours.

The Commission estimates that the time required to complete the Form MA-I annual self-certification requirement would be approximately five minutes, or 0.1 hours. The Commission believes that, given the short time required to read and review the self-certification statement and sign the section, this estimate is appropriate.

To estimate the average number of Form MA-I amendments per respondent per year, the Commission relies on FINRA Form U4 registration data. FINRA estimates that from October 2008 to the present, there was an average of 1,088,637 Form U4 amendment filings per year, regardless of the information updated. For purposes of estimating the paperwork burden, the Commission believes that the proportion of Form U4 amendment filings compared to all Form U4 registrants may be similar to the proportion of Form MA-I amendments compared to all Form MA-I respondents. Thus, the Commission estimates that the average number of amendments that a Form

MA and complete self-certification annually) x 1.0 (number of annual amendments per year) + 1,000 (persons required to amend Form MA) x 0.5 (average estimated time to prepare an interim updating amendment for Form MA) x 1.0 (number of interim updating amendments per year) = 3,000 hours per year.

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See supra note 327.

MA-I respondent would submit would be 1.7 per year.³³¹ The Commission recognizes, however, that because Form U4 is significantly longer than Form MA-I and contains sections that are not required for Form MA-I registration, the actual number of Form MA-I amendments per applicant may be less than 1.7 per year.³³² The total burden for these Form MA-I amendments per year would be 18,500 hours.³³³

The Commission estimates that the annual burden attributable to the requirement to certify on Form MA-I would equal approximately 2,200 hours.³³⁴ The total burden associated with updates to Form MA-I, including compliance with the annual self-certification requirement, would be approximately 20,700 hours.³³⁵

The collection of information made pursuant to amendments to Forms MA and MA-I would not be confidential and would be made publicly available. Some information, such as social security numbers, would be kept confidential to the extent permitted by law.

4. Withdrawal from Municipal Advisor Registration

Pursuant to proposed rule 15Ba1-3, municipal advisors that withdraw from municipal advisor registration with the Commission would be required to electronically file Form MA-W. The Commission has previously estimated that, in the case of Form ADV-W – a similar form to

³³¹ (1,088,637 / 637,000) (proportion of Form U4 amendment filings to all Form U4 registrants) = 1.7.

³³² Information requested in Form U4 that is not requested in Form MA-I include fingerprint information, SRO registration requests, jurisdictions for broker-dealer agent and/or investment adviser representative registration requests, and FINRA examination requests.

³³³ 21,800 (persons required to amend Form MA-I during any given year) x 0.5 (average estimated time to prepare any updating amendment for Form MA-I) x 1.7 (average number of amendments per year) = 18,530 hours per year.

³³⁴ 21,800 (persons required to complete annual self-certification on Form MA-I) x 0.1 (average estimated time to complete self-certification) = 2,180 hours per year.

³³⁵ 18,530 + 2,180 = 20,710 hours per year.

Form MA-W – the average time necessary to complete the form is approximately 0.5 hours.³³⁶

Based on this prior estimate, the Commission estimates that the average time necessary to complete Form MA-W would be approximately 0.5 hours.

To estimate the annual number of withdrawals for Form MA registrants, the Commission relies on investment adviser registration data, which indicates that annually, investment adviser withdrawals comprise, on average, approximately 6.4% of the total number of registered investment advisers.³³⁷ The Commission expects the proportion of Form MA withdrawals compared to all Form MA registrants would be similar. Thus, the average number of withdrawals from Form MA registration per year would be 60,³³⁸ and the total burden would be approximately 30 hours.³³⁹

Meanwhile, to estimate the number of Form MA-I withdrawals per year, the Commission relies on FINRA Form U4 registration data. FINRA estimates that from October 2008 to the present, there was an average of 79,722 individuals per year who fully terminated FINRA registration and had not returned to the industry. For purposes of establishing the paperwork burden, the Commission believes that the proportion of individuals who fully terminated FINRA registration compared to all Form U4 registrants may be similar to the proportion of Form MA-I withdrawals compared to all Form MA-I registrants. Thus, the average number of withdrawals from Form MA-I registration per year would be 2,700,³⁴⁰ and the total burden would be 1,350

³³⁶ See Form ADV-W (Paper Version), at 1 (under “OMB Approval,” estimated average burden hours per response is 0.5 hours).

³³⁷ As of October 2010, there were 11,888 investment advisers registered with the Commission. From 2002 to 2009, there was an average of 760 investment adviser withdrawals per year. $(760 / 11,888) = 6.4\%$.

³³⁸ $1,000$ (all Form MA applicants) $\times 6.4\% = 64$ Form MA withdrawals per year.

³³⁹ 60 (estimated number of persons withdrawing from Form MA registration each year) $\times 0.5$ hours (average estimated time to complete Form MA-W) = 30 hours per year.

³⁴⁰ $21,800$ (all Form MA-I applicants) $\times (79,722 / 637,000)$ (proportion of individuals who fully terminated FINRA registration to all Form U4 registrants) = 2,728.

hours.³⁴¹

The collection of information made pursuant to Form MA-W would not be confidential and would be made publicly available.

5. Non-Resident Municipal Advisors

As discussed above, proposed rule 15Ba1-5 sets forth the general procedures for serving non-resident municipal advisors, non-resident general partners and non-resident managing agents. A non-resident municipal advisor, or a non-resident general partner or non-resident managing agent of a municipal advisor must, among other things, furnish to the Commission a written irrevocable consent and power of attorney on Form MA-NR to appoint an agent in the United States, other than a Commission member, official, or employee, upon whom may be served any process, pleadings, or other papers in any action brought against the non-resident municipal advisor, non-resident general partner, or non-resident managing agent.³⁴² In addition, proposed rule 15Ba1-5(d) would require each non-resident municipal advisory firm to provide an opinion of counsel that the non-resident municipal advisory firm can, as a matter of law, provide the Commission with access to the advisory firm's books and records and that the advisory firm can, as a matter of law, submit to onsite inspection and examination by the Commission.

The Commission has previously estimated that, in the case of Form ADV-NR – a form with a similar purpose to Form MA-NR – the average time necessary to complete the form is approximately one hour.³⁴³ The Commission estimates that, because of the additional time required

³⁴¹ 2,700 (estimated number of persons withdrawing from Form MA-I registration each year) x 0.5 hours (average estimated time to complete Form MA-W) = 1,350 hours per year.

³⁴² See supra Section II.A.5, and accompanying text (discussing proposed rule 15Ba1-5 and Form MA-NR).

³⁴³ See Form ADV-NR (Paper Version), at 1 (under "OMB Approval," estimated average burden hours per response is 1 hour). The Commission notes that for Form ADV-NR, the non-resident general partner or non-resident managing agent must appoint each of the

to find and designate an agent, the process to complete Form MA-NR would take longer, or approximately 1.5 hours on average. The burden associated with this process would primarily involve the designation and authorization of a United States person as agent for service of process.

To estimate the average time necessary to provide an opinion of counsel, Commission staff relies on its burden estimates for Form 20-F, a form submitted by certain foreign private issuers, which has a similar opinion of counsel requirement to proposed rule 15Ba1-5(d). The Commission estimates that this additional burden would add approximately three hours and \$900 in outside legal costs per respondent.³⁴⁴

The Commission notes that proposed Form MA-NR would have one additional type of respondent (*i.e.*, non-resident municipal advisory firms) compared to the types of respondents that must file Form ADV-NR. Thus, to estimate the total number of Form MA-NR respondents, Commission staff has combined two different estimates – one for the number of non-resident general partners or non-resident managing agents, and another for the number of non-resident municipal advisory firms. To estimate the number of non-resident general partners or non-resident managing agents that would have to file Form MA-NR, the Commission relies on investment adviser registration data, which indicates that the percentage of Form MA-NR filings to total

Secretary of the Commission, and the Secretary of State, or equivalent officer, of the state in which the investment adviser 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 agents to receive service. In contrast, Form MA-NR would require the respondent to find and designate a United States person (and not currently the Secretary of the Commission) to be an agent, which the Commission expects would require additional time.

³⁴⁴ See Exchange Act Release No. 49616 (April 26, 2004); 69 FR 24016 (April 30, 2004). The \$900 figure is based on an hourly cost estimate of \$400 on average for an outside attorney, which is based on Commission staff conversations with law firms that regularly assist regulated financial firms with compliance matters. Based on previous burden estimates, the Commission estimates that outside counsel would take, on average, 2.25 hours to assist in preparation of the opinion of counsel, for an average cost of \$900 per respondent.

number of investment adviser applicants is 1.64%.³⁴⁵ The Commission expects the proportion of non-resident general partners or non-resident managing agents compared to all Form MA applicants would be similar. Based on this estimate, the Commission anticipates that there would be 16 non-resident general partner or non-resident managing agent applicants on Form MA-NR.³⁴⁶

To estimate the number of non-resident municipal advisory firms that would have to file Form MA-NR, the Commission relies on Form MA-T registrant data, which indicate that as of October 2010, two of 800 Form MA-T registrants had non-U.S.-based addresses. The Commission expects that the proportion of non-resident municipal advisory firms compared to all Form MA applicants would be similar. Based on this estimate, the Commission anticipates that three respondents would be non-resident municipal advisory firms that would be required to complete Form MA-NR.³⁴⁷ Thus, the total number of Form MA-NR filers would be approximately 20, and the total initial burden for completion of Form MA-NR would be 30 hours.³⁴⁸

The three non-resident municipal advisory firms that would be required to complete Form MA-NR would be the respondents required to provide an opinion of counsel. The total initial burden for providing an opinion of counsel would be approximately 9 hours.³⁴⁹ Thus, the total initial burden for non-resident municipal advisors to complete Form MA-NR and provide an

³⁴⁵ The Commission's Division of Investment Management indicates that 195 Form ADV-NRs have been filed since January 1, 2003. The proportion of filed forms to the total number of investment adviser registrants is $195 / 11,888 = 1.64\%$.

³⁴⁶ $1,000$ (all Form MA applicants) $\times 1.64\% = 16$ Form MA-NR filers that are non-resident general partners or non-resident managing agents.

³⁴⁷ $1,000$ (all Form MA applicants) $\times (2 / 800)$ (proportion of non-U.S.-based Form MA-T registrants compared to all Form MA-T registrants) = 2.5 Form MA-NR filers that are non-resident municipal advisors.

³⁴⁸ 20 (persons expected to file Form MA-NR for the first time) $\times 1.5$ hours (average estimated time to complete Form MA-NR) = 30 hours.

³⁴⁹ 3 (non-resident municipal advisory firms expected to provide opinion of counsel) $\times 3.0$ hours (average estimated time to provide an opinion of counsel) = 9 hours.

opinion of counsel would be 39 hours. The Commission estimates that the total initial cost for all non-resident municipal advisory firms to hire outside counsel as part of providing an opinion of counsel would be approximately \$2,700.³⁵⁰

The Commission notes that filers may have potential one-time burdens associated with Form MA-NR. For example, filers may need to locate information required by Form MA-NR, or they may need to familiarize themselves with the proposed rules and the form. For purposes of this analysis, these potential one-time burdens are included in the estimates noted above.

To estimate the ongoing annual number of new Form MA-NR filers that are non-resident general partners or non-resident managing agents, the Commission relies on investment adviser registration data, which indicate that yearly filings of Form ADV-NR comprise, on average, approximately 0.09% of the total number of registered investment advisers.³⁵¹ The Commission expects the proportion of Form MA-NR filers that are non-resident general partners or non-resident managing agents compared to all Form MA applicants would be similar. Based on the above estimate, the Commission anticipates that only one municipal advisor respondent per year would have a non-resident general partner or non-resident managing agent that would be required to complete Form MA-NR.³⁵² This estimate includes the ongoing annual number of new Form MA-NR filers that are non-resident municipal advisors, because the small initial number of non-resident municipal advisors suggests that, at most, there would be only one new non-resident municipal

³⁵⁰ 3 (non-resident municipal advisory firms expected to provide opinion of counsel) x \$900 (average estimated cost to hire outside counsel for providing an opinion of counsel) = \$2,700.

³⁵¹ As of October 2010, there were 11,888 investment advisers registered with the Commission. For the years 2003-2004 and 2007-2010, there was an average of 11 new Form ADV-NR filings per year. $(11 / 11,888) = 0.09\%$.

³⁵² 1,000 (all Form MA applicants) x 0.09% = 0.9 Form MA-NR filers per year; this number was rounded up to 1.

advisor every several years. Thus, the total burden per year for completion of Form MA-NR would be approximately two hours.³⁵³ For the purposes of this analysis, the Commission assumes that the one new non-resident municipal advisor per year would not be a natural person, and would thus be required to provide opinion of counsel. The total burden per year for providing opinion of counsel would be approximately three hours.³⁵⁴ The Commission estimates that the ongoing annual cost for non-resident municipal advisors to hire outside counsel as part of providing opinion of counsel would be approximately \$900.³⁵⁵

The Commission notes that filers may have potential recurring burdens associated with Form MA-NR, such as monitoring and maintaining the information required by the form. For the purposes of this analysis, these potential recurring burdens are included in the estimates noted above.

Proposed rule 15Ba1-5 also would require that non-resident municipal advisors, general partners and managing agents update the information on Form MA-NR if it becomes inaccurate. Commission staff believes that the burdens associated with these updates are accounted for in the above estimates because, given the small number of Form MA-NR filers, the burden for Form MA-NR updates would likely be negligible.

The collection of information made pursuant to Form MA-NR would not be confidential and would be made publicly available.

³⁵³ 1 (persons expected to file Form MA-NR each year) x 1.5 (average estimated time to complete Form MA-NR) = 1.5 hours per year.

³⁵⁴ 1 (municipal advisory firms expected to provide an opinion of counsel) x 3.0 (average estimated time to provide opinion of counsel) = 3.0 hours per year.

³⁵⁵ 1 (persons expected to file Form MA-NR each year) x \$900 (average estimated cost to hire outside counsel for providing opinion of counsel) = \$900.

6. Outside Counsel

The Commission believes that some municipal advisory firms would seek outside counsel to help them comply with the requirements of the proposed rules, and complete Form MA.³⁵⁶ The Commission believes that it is unlikely that natural person municipal advisors would obtain and consult counsel for purposes of completing Form MA-I. For PRA purposes, the Commission assumes that all 1,000 municipal advisory firms registering on Form MA would, on average, consult outside counsel for one hour to help them comply with the requirements. The Commission believes that the estimate of the number of municipal advisory firms that would consult outside counsel is likely to be lower than 1,000 because some municipal advisory firms, especially those that are sole proprietors, would choose not to seek outside counsel. The Commission also recognizes that some municipal advisory firms would hire outside counsel for more than one hour and others may hire outside counsel for less than one hour. On balance, the Commission believes that its estimate that, on average, each municipal advisory firm would hire outside counsel for one hour is appropriate. The Commission estimates that the total cost for all municipal advisory firms to hire outside counsel to review their compliance with the requirements of the proposed rules and forms would be approximately \$400,000.³⁵⁷

7. Maintenance of Books and Records

As described in detail above, all municipal advisory firms would be required to maintain

³⁵⁶ The collection of information relating to outside counsel will be included as part of the collection of information "Form MA: Application for Municipal Advisor Registration."

³⁵⁷ 1,000 (estimated number of municipal advisory firms that would hire outside counsel) x 1 hour (average estimated time spent by outside counsel to help municipal advisory firms comply with the rule) x \$400 (hourly rate for an attorney, outside counsel) = \$400,000. The hourly cost estimate of \$400 on average for an attorney is based on Commission staff conversations with law firms that regularly assist regulated financial firms with compliance matters.

books and records relating to their municipal advisory activities.³⁵⁸ These proposed book and records requirements are based generally on Exchange Act rules 17a-3 and 17a-4, and Investment Advisers Act rule 204-2, which set forth books and records requirements with respect to broker-dealers and investment advisers, respectively.³⁵⁹ In addition, proposed rule 15Ba1-7 would require all municipal advisory firms to keep a record of the initial and annual review, as applicable, conducted by the municipal advisory firm of such municipal advisory firm's business in connection with its self-certification on Form MA.³⁶⁰

To estimate the annual books and records burden for municipal advisory firms, the Commission examined the current annual burdens and number of respondents to rules 17a-3 and 17a-4 of the Exchange Act ("Rule 17a-3; Records to be Made by Certain Exchange Members, Brokers and Dealers" and "Rule 17a-4; Records to be Preserved by Certain Exchange Members, Brokers and Dealers"),³⁶¹ and rule 204-2 of the Investment Advisers Act ("Books and Records To Be Maintained by Investment Advisers").³⁶² The most recently approved annual aggregate burden for broker-dealer compliance with rule 17a-3 is currently 2,835 hours based on an estimate of 105 respondents, or 27 hours per respondent,³⁶³ while the most recently approved annual aggregate burden for broker-dealer compliance with rule 17a-4 is currently 1,752,600 hours based on an

³⁵⁸ See supra Section II.C. (discussing the books and records requirements under proposed rule 15Ba1-7).

³⁵⁹ See 17 CFR 240.17a-3 and 17a-4, and 17 CFR 275.204-2.

³⁶⁰ See supra Section II.C. (discussing the books and records requirements under proposed rule 15Ba1-7).

³⁶¹ See Collections of Information for Rules 17a-3 and 17a-4 (OMB Control Nos. 3235-0508 and 3235-0279), Office of Information and Regulatory Affairs, Office of Management and Budget, available at <http://www.reginfo.gov/public/do/PRAMain>.

³⁶² See Collection of Information for Rule 204-2 of the Investment Advisers Act (OMB Control No. 3235-0278), Office of Information and Regulatory Affairs, Office of Management and Budget, available at <http://www.reginfo.gov/public/do/PRAMain>.

³⁶³ 2,835 hours / 105 respondents = 27 hours per respondent.

estimate of 6,900 respondents, or 254 hours per respondent.³⁶⁴ The most recently approved annual aggregate burden for rule 204-2 is currently 2,106,046 hours based on an estimate of 11,607 registered advisers, or 181 hours per registered adviser.³⁶⁵

The Commission anticipates that, given the relatively smaller size of municipal advisory firms compared to investment adviser and broker-dealer firms and the fewer books and records requirements imposed by proposed rule 15Ba1-7 than by rules 17a-3 or 17a-4, or by rule 204-2, the hourly burden per registered municipal advisory firm would likely be lower than the hourly burden estimates per broker-dealer and per investment adviser. For the purposes of this analysis, the Commission estimates that the annual books and records burden on average for a municipal advisory firm to comply with the proposed books and records requirements would be similar to that of an investment adviser, or 181 hours. The Commission staff recognizes that the proposed books and records requirements would likely impose initial burdens on respondents in connection with necessary updates to their record-keeping systems, such as systems development or modifications. For the purposes of this analysis, these initial burdens are included in the estimate of 181 burden hours per respondent per year. Thus, the total compliance burden is about 181,000 hours per year.³⁶⁶

Based on discussions with industry participants and the Commission's prior experience with broker-dealers and investment advisers, the Commission believes that the ongoing books and records obligations under the proposed rule would be handled internally because compliance with these obligations is consistent with the type of work that a market participant would typically handle

³⁶⁴ 1,752,600 hours / 6,900 respondents = 254 per respondent.

³⁶⁵ 2,106,046 hours / 11,607 registered advisers = 181 hours per adviser.

³⁶⁶ 1,000 (estimated number municipal advisors) x 181 hours (estimated time spent by municipal advisors to ensure annual compliance with the books and records requirement) = 181,000 hours.

internally. The Commission does not believe that a municipal advisory firm would have any recurring external costs associated with books and records obligations.

The Commission staff would use the collection of information for maintenance of books and records in its examinations and oversight program, and the information would be generally kept confidential to the extent permitted by law.

8. Total Burden

Under the proposed rules and forms, the total initial one-time burden for all respondents would be approximately 71,939 hours,³⁶⁷ while the total ongoing annual burden for all respondents would be approximately 212,135 hours.³⁶⁸ The total initial outside cost for all respondents would be \$402,700,³⁶⁹ while the total ongoing outside cost for all respondents would be \$900 per year.³⁷⁰

The Commission seeks comment on the reporting and record-keeping collection of information burdens associated with the proposed rules and forms. In particular:

- How many municipal advisors would incur collection of information burdens if the proposed rules and forms were adopted by the Commission?
- Would there be additional or alternative burdens associated with the collection of information under the proposed rules and forms?

³⁶⁷ 6,500 hours (initial burden for Form MA applicants) + 65,400 hours (initial burden for Form MA-I applicants) + 39 hours (initial burden for Form MA-NR filers) = 71,939 hours.

³⁶⁸ 650 hours (annual burden for new Form MA applicants) + 5,400 hours (annual burden for new Form MA-I applicants) + 3,000 hours (annual burden for Form MA amendments) + 20,700 hours (annual burden for Form MA-I amendments) + 30 hours (annual burden for Form MA withdrawal) + 1,350 hours (annual burden for Form MA-I withdrawal) + 5 hours (annual burden for Form MA-NR filers) + 181,000 hours (annual burden for books and records requirement) = 212,135 hours.

³⁶⁹ \$2,700 (estimated initial cost to hire outside counsel for providing opinion of counsel) + \$400,000 (initial cost for review by outside counsel) = \$402,700.

³⁷⁰ \$900 = estimated ongoing cost to hire outside counsel for providing opinion of counsel.

- How much work would it take for municipal advisory firms with existing books and records to comply with the books and records requirements of the proposed rules?
- Would municipal advisory firms generally perform the work internally or outsource the work?

E. Collections of Information are Mandatory

The collections of information would be mandatory.

F. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comment to:

- evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;
- evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information;
- enhance the quality, utility, and clarity of the information to be collected; and
- minimize the burden of collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503; and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-45-10. OMB is required to make a

decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication of this release. 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. S7-45-10, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213.

V. ECONOMIC ANALYSIS

As discussed above, the Dodd-Frank Act added provisions to the Exchange Act that, among other things, require municipal advisors to register with the Commission and authorize the Commission to impose certain record-keeping requirements on municipal advisors.³⁷¹ In enacting Section 975 of the Dodd-Frank Act, Congress established a mandatory registration regime for municipal advisors but left the form and content of such registration within the discretion of the Commission.³⁷² In determining the form and content of such registration, the Commission may require “such information and documents” as it considers “necessary or appropriate in the public interest or for the protection of investors.”³⁷³ Congress also granted the Commission exemptive authority to exclude certain persons from the definition of municipal advisor.³⁷⁴

The Commission is proposing new rules and forms that, if adopted, would provide for a permanent registration regime for municipal advisors. The proposed rules and forms would include the submission of Form MA by municipal advisory firms (including sole proprietors) seeking registration, the submission of Form MA-I by natural person municipal advisors (including sole

³⁷¹ See 15 U.S.C. 78o-4.

³⁷² See 15 U.S.C. 78o-4(a)(2).

³⁷³ See *id.*

³⁷⁴ See 15 U.S.C. 78o-4(a)(4).

proprietors) seeking registration, the completion of a self-certification as to the municipal advisors' qualifications and ability to comply with applicable regulatory obligations, and the submission of Form MA-W by municipal advisors seeking to withdraw from registration. The Commission is also proposing rule 15Ba1-5, which would require certain non-resident persons to submit Form MA-NR in certain circumstances, relating to consent to service of process, and would require non-resident municipal advisory firms to provide an opinion of counsel that the non-resident municipal advisory firms can provide the Commission with access to their books and records and submit to onsite inspection and examination by the Commission. In addition, proposed rule 15Ba1-7 would require certain books and records to be maintained by municipal advisory firms in connection with their municipal advisory activities.³⁷⁵

The Commission is sensitive to the costs and benefits imposed by its rules. The discussion below focuses on the costs and benefits of the decisions made by the Commission to fulfill the mandates of the Dodd-Frank Act within its permitted discretion, rather than the costs and benefits of the mandates of the Dodd-Frank Act itself. However, to the extent that the Commission's discretion is exercised to realize the benefits intended by the Dodd-Frank Act or to impose the costs associated with the Dodd-Frank Act, the two types of benefits and costs are not entirely separable. Accordingly, the PRA hourly burden estimates made in accordance with the requirements of the PRA, and their corresponding dollar cost estimates, are included in full below, although a portion of the cost to register is attributable to the requirements of the Dodd-Frank Act and not to the specific rules proposed by the Commission.

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in

³⁷⁵ See supra Section II.C (discussing the books and records requirements under proposed rule 15Ba1-7).

the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition and capital formation.³⁷⁶ In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.³⁷⁷ Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.³⁷⁸ The Commission's consideration of these matters is set forth below. In considering these matters, the Commission is mindful of the industry background described above in Sections I.A.1.a and I.A.1.b. The Commission requests comment on those Sections I.A.1.a and I.A.1.b in connection with comments requested below.

A. Proposed Rule 15Ba1-1: Definition of "Municipal Advisor" and Related Terms

Proposed rule 15Ba1-1(d) would clarify that the exclusion from the definition of "municipal advisor" for a broker, dealer or municipal securities dealer serving as an underwriter shall not apply when such persons are acting in a capacity other than as underwriters on behalf of a municipal entity or obligated person.³⁷⁹ The proposed rule also would clarify that the exclusion from the definition of "municipal advisor" for a Commission-registered investment adviser and its associated persons applies only to advice that "would subject such adviser or person associated with such adviser to the Investment Advisers Act of 1940."³⁸⁰ The proposed rule also would interpret the exclusion from the definition of "municipal advisor" for any registered commodity trading advisors and their associated persons to apply only to such persons when they are providing advice related to

³⁷⁶ See 15 U.S.C. 78c(f).

³⁷⁷ See 15 U.S.C. 78w(a)(2).

³⁷⁸ See *id.*

³⁷⁹ See proposed rule 15Ba1-1(d)(2)(i). See also *supra* notes 105-106, and accompanying text.

³⁸⁰ See proposed rule 15Ba1-1(d)(2)(ii). See also *supra* notes 114-117, and accompanying text.

swaps on behalf of a municipal entity or obligated person.³⁸¹ In addition, the proposed rule provides that the definition of “municipal advisor” shall not include attorneys offering legal advice or providing services that are of a traditional legal nature,³⁸² or engineers providing engineering advice.³⁸³

As discussed above, the Commission is proposing to exclude from the definition of “municipal advisor” accountants preparing financial statements, auditing financial statements, or issuing letters for underwriters for, or on behalf of, a municipal entity or obligated person.³⁸⁴ The Commission is also proposing to exclude “providers of municipal bond insurance, letters of credit, or other liquidity facilities” from the definition of “obligated persons.”³⁸⁵ Excluding such persons from the definition of “obligated persons” would, among other things, help reduce market confusion because the exclusion would further uniformity among rules relating to the definition of “obligated person” in the municipal securities market.³⁸⁶

These proposed interpretations and exclusions would mean that certain persons who are currently regulated (such as broker-dealers serving as underwriters or investment advisers providing advice which would subject them to the Investment Advisers Act) or that are governed by other professional codes of conduct (such as attorneys providing traditional legal services) would not be required to register as municipal advisors.

The Dodd-Frank Act includes distinct groups of professionals within its definition of “municipal advisor” that offer different services and compete in distinct markets. The three

³⁸¹ See proposed rule 15Ba1-1(d)(2)(iii). See also *supra* notes 121-122, and accompanying text.

³⁸² See proposed rule 15Ba1-1(d)(2)(iv). See also *supra* note 132, and accompanying text.

³⁸³ See proposed rule 15Ba1-1(d)(2)(v). See also *supra* note 133-138, and accompanying text.

³⁸⁴ See proposed rule 15Ba1-1(d)(2)(vi). See also *supra* note 124-131, and accompanying text.

³⁸⁵ See proposed rule 15Ba1-1(i). See also *supra* note 90, and accompanying text.

³⁸⁶ See *supra* note 88, and accompanying text.

principal types of municipal advisors are: (1) financial advisors, including, but not limited to, broker-dealers already registered with the Commission, that provide advice to municipal entities with respect to their issuance of municipal securities and their use of municipal financial products (“financial advisors” or “municipal financial advisors”); (2) investment advisers that advise municipal pension funds and other municipal entities on the investment of funds held by or on behalf of municipal entities (subject to certain exclusions from the definition of a “municipal advisor”) (“municipal investment advisers”); and (3) third-party marketers and solicitors (“solicitors”). As discussed above in Sections I.A.1.a and I.A.1.b, these different types of municipal advisors operate in different markets. These markets have distinct competitive structures. Within each of these markets, different participants are subject to different regulatory regimes. For purposes of this Economic Analysis, the Commission uses the above-defined terms to describe these distinct types of professionals separately, while using the term “municipal advisors” to describe all municipal advisors generally.

The Commission believes that the proposed interpretations and exemptions contained in proposed rule 15Ba1-1(d) would not impose a burden on competition and would have minimal, if any, impact on the promotion of efficiency and capital formation except to the extent that they reduce market confusion with respect to which persons would be required to register as municipal advisors under the proposed permanent registration regime. Finally, the Commission believes that the direct costs for respondents to read and apply the definitions in proposed rule 15Ba1-1(d) would be minimal.

B. Registration System

The Commission is proposing rules to create a permanent registration regime that would consist of the following forms: Form MA, Form MA-I, and Form MA-W. Municipal advisors

would complete these forms to register with the Commission, to amend information previously reported to the Commission, to report the succession of registration of a municipal advisor, and to withdraw from registration. Under proposed rule 15Ba1-4, amendments to Form MA must be filed annually and in the event of certain material changes to the information previously provided, and to Form MA-I whenever the information previously provided becomes inaccurate. Municipal advisors would also be required to provide, on both an initial and annual basis, a self-certification as to their qualifications as municipal advisors and ability to comply with applicable regulatory obligations.

1. Benefits

The proposed permanent registration regime is designed to allow the Commission and other regulators to oversee the conduct of municipal financial advisors, municipal investment advisers, and solicitors in the municipal securities market, as contemplated by the Dodd-Frank Act. Forms MA and MA-I have been designed to provide information that the Commission believes would be helpful for municipal entities to have in a standard format, because it would lower the costs of information gathering for municipal entities³⁸⁷ in comparing municipal advisors. The Commission believes that a municipal advisor's knowledge of the Commission's authority to examine the municipal advisor and its authority to sanction the municipal advisor for false and misleading statements is likely to result in increased reliability of the information submitted by municipal advisors under the proposed permanent registration regime.

The proposed forms would require municipal advisors to provide information about their disciplinary histories and potential conflicts of interest (and information that may be useful in assessing potential conflicts of interest).³⁸⁸ Municipal entities and obligated persons would have

³⁸⁷ For the purposes of this Economic Analysis, references to municipal entities include obligated persons where the context requires.

³⁸⁸ See supra Sections II.A.2.c and II.A.2.d.

ready access to this information and thus would be in a position to become more fully informed about more municipal financial advisor candidates at lower cost when choosing those who would provide advice to them. Research has shown that most municipal entities do not utilize a formalized selection process when they choose their municipal financial advisors³⁸⁹ and, therefore, might not have disciplinary information about the advisors they hire. To the extent that municipal entities or obligated persons consider such information important in the selection of municipal advisors, the proposed permanent registration regime may reduce municipal entities' or obligated persons' reliance on municipal advisors that have been the subject of disciplinary actions, or whose activities or affiliations create or have the potential to create conflicts of interest. In addition, municipal advisors, knowing that conflicts of interest must be disclosed, may be more likely to avoid associations that could be perceived as creating conflicts of interest, or would more likely avoid recommending financial intermediaries or investments for which conflicts of interest might be present.

While much of this information is already publicly available with respect to municipal financial advisors that are already registered with the Commission as broker-dealers, disclosure of potential conflicts of interest specific to their municipal financial advisory role could be valuable to potential municipal clients. Many municipal financial advisors that are not registered as broker-dealers would make this sort of information publicly available for the first time.

Similar benefits would be expected to accrue from the public disclosure of the disciplinary history and potential conflicts of interest of municipal investment advisers not registered with the Commission. Congress determined that investment advisers to municipal entities that are already

³⁸⁹ According to Mark D. Robbins and Bill Simonsen, 2003, Financial Advisor Independence and the Choice of Municipal Bond Sale Type, *Municipal Finance Journal* 24: 42 ("Robbins and Simonsen"), an RFP had been used only 22.6% of the time by governments in selecting the financial advisor for their last bond sale. See also Allen & Dudney, supra note 11.

registered with the Commission as investment advisers would not be required to register again as municipal advisors, to the extent the advice provided would subject the investment adviser to the Investment Advisers Act. Many, if not most, of the investment advisers that would be required to register as municipal advisors may be registered as investment advisers under state laws, and any incremental benefit in requiring disciplinary and conflict disclosure would vary from state to state, depending on how that disciplinary and conflict disclosure is required by or applied to different state legal regimes. Nevertheless, the availability of important information in a uniform, standardized format may prove beneficial by reducing the cost of collecting information and comparing it across municipal investment advisers.³⁹⁰

Solicitors are a group of municipal advisors about whom relatively little is known, and the benefits of registering this group may prove to be substantial, to the extent that disciplinary records and conflicts of interest are revealed.³⁹¹

Public disclosure of the disciplinary history of municipal advisors, and their associated persons, would make this information available not only to regulators, but also to all interested persons.³⁹² This disclosure would benefit municipal entities and the general public. Even if the municipal entity does not otherwise seek to obtain this disciplinary information as part of its

³⁹⁰ Unless registered with the Commission as municipal advisors, state-registered investment advisers that advise municipal entities would not be subject to “pay-to-play” rules, as contemplated in the Commission’s recent releases. See Political Contributions Final Rule, supra note 31 and IA-3110, supra note 104 (proposing rules implementing amendments to the Investment Advisers Act, and, among other things, modifying the Commission’s “pay-to-play” rule).

³⁹¹ The Commission’s recent proposed amendments to the “pay-to-play” rules for investment advisers contemplate that, if adopted, certain solicitors for municipal investment advisers would be registered as municipal advisors and potentially subject to “pay-to-play” rules. See IA-3110, supra note 104, at 69-70. Other solicitors for municipal investment advisers may voluntarily register as municipal advisors in order to continue in the business of soliciting on behalf of municipal investment advisers. See supra Section II.A.2.a.

³⁹² See supra Sections II.A.2.c and II.A.2.d.

selection process, the information would be available to interested persons (e.g., the press and concerned citizens) who might directly or indirectly influence the selection of the municipal advisor.

In addition, such public disclosure may deter municipal advisors that have disclosable disciplinary events from entering the market. Thus, this proposed requirement (as well as the ability to regulate municipal advisors going forward) could help discourage entities with disclosable disciplinary histories from entering the pool of potential municipal advisors and reduce the potential for corruption in the municipal market.

To the extent that municipal entities or obligated persons have been deterred from engaging a municipal advisor because they were not familiar with the municipal advisor population and were unsure whether they could identify a trustworthy advisor (including fear of hiring someone tainted with conflicts or violations too expensive to uncover), the proposed permanent registration regime might increase the use of municipal advisors generally. As such, there could be an increased likelihood of using a municipal advisor when a municipal entity or obligated person makes issuance or investment decisions.

With respect to the issuance of municipal securities, this increased likelihood of using a municipal financial advisor could in turn reduce issuance costs and may produce savings. One empirical study suggests that the use of municipal financial advisors is associated with better borrowing terms, lower reoffering yields and narrower underwriter gross spreads,³⁹³ particularly where the advisors are of a higher quality.³⁹⁴ The small average size of publicly offered municipal issues, as compared, for example, to publicly offered corporate issues,³⁹⁵ makes municipal securities

³⁹³ See generally Vijayakumar and Daniels, supra note 7.

³⁹⁴ See generally Allen & Dudney, supra note 11.

³⁹⁵ See Testimony of Christopher M. Ryon, Principal and Senior Municipal Bond Portfolio

issuers particularly sensitive to issuance costs. This sensitivity may create a demand for advisors that can successfully negotiate to lower these costs. Municipal financial advisors that provide advice with respect to the issuance of municipal securities and are continually active in the municipal securities market may help to reduce the information asymmetry gap between municipal entities and underwriters, swap dealers, bond insurers, letter of credit providers and other financial intermediaries.³⁹⁶ Thus, municipal issuers and obligated persons should benefit from having municipal financial advisors compete in a more informationally efficient market that may result from the proposed permanent registration regime. In addition, reducing the cost of identifying a high-quality municipal financial advisor may be expected to increase the use of such advisors, who may be in a position to obtain better financing terms for their municipal entity clients and, indirectly, for taxpayers, than those that could be negotiated by lesser-quality municipal financial advisors. Higher-quality municipal financial advisors have been shown to be associated with more efficient capital formation (*i.e.*, lower interest costs).³⁹⁷

With the readily available information on municipal advisor disciplinary histories and conflicts of interest, municipal entities would be able to more easily set objective criteria for the municipal advisors hired by decision-making officials. The ease of setting such criteria and verifying compliance with such criteria might reduce the likelihood that municipal advisors are hired because of their political or personal connections to decision-making officials, rather than because of their qualifications.

Manager, the Vanguard Group, before the Senate Committee on Banking, Housing, and Urban Affairs, June 17, 2004, at 4, available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=2474c4c6-d0ed-4a44-a9c8-6376484a4cde.

³⁹⁶ See generally Vijayakumar and Daniels, *supra* note 7.

³⁹⁷ See generally Allen & Dudney, *supra* note 11, at 412.

The collection of this information pursuant to the proposed permanent registration regime, and the fact that, if adopted, the information would be available directly to regulators, would also facilitate enforcement against municipal advisors by allowing the available information to be used for identifying trends and risky firms and natural persons, among other uses. If such information were requested directly from applicants as contemplated in the proposed permanent registration regime, regulators would not have to rely on other sources to obtain this disciplinary history information.

The combined effect of increasing the likelihood of using municipal advisors and improving the average quality of the municipal advisor selection pool (as described above) may improve allocative efficiency, since municipal entities may benefit from better advice in their consideration of issuance or investment alternatives. Such improvements in allocative efficiency may also promote more efficient capital formation. In addition, the improvement in disclosure about, and average quality of, municipal advisors, and the more frequent use of municipal advisors by municipal entities or obligated persons, may also increase competition among municipal advisors of all types – municipal financial advisors, municipal investment advisers, and solicitors. As noted above, however, the benefits in the case of municipal investment advisers would be limited, to the extent that the same or similar information is publicly available under an applicable state law regime.

2. Costs

The establishment of a permanent registration regime would impose costs on persons registering as municipal advisors on Form MA and/or Form MA-I. In particular, the Commission anticipates the following one-time costs for the proposed rules:

- The Commission believes that the total initial labor cost for all municipal advisory firms to complete Form MA would be approximately \$1,105,000,³⁹⁸ while the total initial labor cost for all natural person municipal advisors to complete Form MA-I would be approximately \$11,118,000.³⁹⁹
- If adopted, municipal advisors would incur one-time costs in familiarizing themselves with the proposed rules and the relevant proposed forms. The Commission notes, however, that such a familiarization period is an inevitable necessity for any newly-introduced registration regime. As noted in the PRA section above, the paperwork burden of gathering information for the purpose of completing Forms MA and MA-I would be reduced because some of the information required by Form MA and Form MA-I would have already been gathered for Form MA-T. For municipal advisors that are either municipal financial advisors or municipal investment advisers, to the extent that the disclosures that would be required on Form MA or Form MA-I have been disclosed on Form ADV, BD or U4, the employees would be permitted to incorporate

³⁹⁸ 6,500 hours (total estimated hourly burden under the proposed rules for all municipal advisors to complete a Form MA) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$1,105,000. The Commission expects that Form MA completion would most likely be performed equally by compliance managers and compliance clerks. Dividing the hourly rate evenly between a compliance manager of \$273 per hour and a compliance clerk of \$67 per hour results in a cost per hour of \$170. $(\$273 \times 0.5) + (\$67 \times 0.5) = \$170$. The \$273 per hour figure for a Compliance Manager and the \$67 per hour figure for a Compliance Clerk are from the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2010, as 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.

³⁹⁹ 65,400 hours (total estimated hourly burden under the proposed rules for all municipal advisors to complete a Form MA-I) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$11,118,000. See id. The Commission recognizes that instead of using a Compliance Manager or Compliance Clerk, most Form MA-I registrants would fill out the form themselves. The Commission believes, however, that the average compliance rate used to calculate the labor cost for Form MA would be a reasonable proxy for the compliance rate used to calculate the labor cost for Form MA-I.

such information by reference in completing Form MA or Form MA-I, further reducing the costs to complete the form. The one-time costs for familiarizing themselves with the proposed rules and the relevant proposed forms would likely be higher for municipal financial advisors or solicitors that are not broker-dealers or investment advisers, because they may need to gather information required by Form MA and Form MA-I for the first time. For the purposes of this analysis, this one-time cost is included in the cost estimates noted above.

- If adopted, municipal advisors might incur one-time costs in establishing new internal controls such as procedures for obtaining the information required by Form MA and Form MA-I, as applicable. The Commission believes that these costs would be limited for municipal advisors that are financial advisors or investment advisers and are currently regulated with respect to their other activities or have voluntarily adopted such practices. These costs would be higher for municipal financial advisors or solicitors that are not broker-dealers or investment advisers, are not otherwise regulated, or have not voluntarily adopted such practices.⁴⁰⁰ For the purposes of this analysis, this one-time cost is included in the cost estimates noted above.

The Commission also anticipates the following recurring costs for compliance with the proposed permanent registration regime, which would likely be similar across all municipal advisor types – municipal financial advisors, municipal investment advisers, and solicitors:

⁴⁰⁰ Some unregulated groups that engage in municipal advisory activities have formed professional associations that have implemented their own voluntary best practices with respect to conflicts of interest, educational standards, and other disclosure of note to their clients. See, e.g., National Association of Independent Public Finance Advisors, www.naipfa.com.

- The Commission believes that the ongoing annual labor cost for new municipal advisory firms to complete Form MA would be approximately \$110,500,⁴⁰¹ while the ongoing annual labor cost for new natural person municipal advisors to complete Form MA-I would be approximately \$918,000.⁴⁰²
- The Commission believes that the ongoing annual labor cost for all municipal advisory firms to amend Form MA and complete the annual self-certification would be approximately \$510,000,⁴⁰³ while the ongoing annual labor cost for all natural person municipal advisors to amend Form MA-I and complete the annual self-certification would be approximately \$3,519,000.⁴⁰⁴
- The Commission believes that the ongoing annual labor cost for all municipal advisory firms to complete Form MA-W to withdraw from Form MA registration would be approximately \$5,100,⁴⁰⁵ while the ongoing annual labor cost for all natural person

⁴⁰¹ 650 hours (total estimated hourly burden under the proposed rules for new municipal advisors to complete a Form MA) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$110,500. See supra note 398 for the calculation of the combined hourly rate.

⁴⁰² 5,400 hours (total estimated hourly burden under the proposed rules for new municipal advisors to complete a Form MA-I) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$918,000. See supra note 399 for the calculation of the combined hourly rate.

⁴⁰³ 3,000 hours (total estimated hourly burden under the proposed rules for all municipal advisors to amend a Form MA and complete annual self-certification) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$510,000. See supra note 398 for the calculation of the combined hourly rate.

⁴⁰⁴ 20,700 hours (total estimated hourly burden under the proposed rules for all municipal advisors to amend a Form MA-I and complete annual self-certification) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$3,519,000. See supra note 399 for the calculation of the combined hourly rate.

⁴⁰⁵ 30 hours (total estimated hourly burden under the proposed rules for all municipal advisors to withdraw from Form MA registration) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$5,100. See supra note 398 for the calculation of the combined hourly rate.

municipal advisors to complete Form MA-W to withdraw from Form MA-I registration would be approximately \$229,500.⁴⁰⁶

- If adopted, municipal advisors would incur recurring costs for monitoring and/or maintaining the information required by the registration forms and providing updates to the registration forms. For the purposes of this analysis, this recurring cost is included in the cost estimates noted above.

In addition to the direct, out-of-pocket costs estimated for PRA purposes, the Commission considered the economic costs of the proposed permanent registration regime. The Commission recognizes that the cost of becoming subject to registration for the first time may lead some municipal advisors that are not particularly active to leave the business, to the extent they presume that the additional costs associated with registration would negatively impact potential revenues to such a degree that the best economic choice for them would be to suspend operating their business or, at least, the municipal advisory portion of their business. Moreover, if the proposed permanent registration regime is adopted, municipal entities may also incur costs from decisions based on the incorrect perception that registration as a municipal advisor is a stamp of quality.

Furthermore, as noted above, the additional costs associated with registration may impact those municipal advisors that are not already registered as either investment advisers or broker-dealers to a greater degree than they would impact municipal advisors that have previously registered under another regulatory regime. To the extent that municipal advisors that have not previously registered under another regime provide greater positive value to their advisees,⁴⁰⁷ their

⁴⁰⁶ 1,350 hours (total estimated hourly burden under the proposed rules for all municipal advisors to withdraw from Form MA-I registration) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$229,500. See supra note 399 for the calculation of the combined hourly rate.

⁴⁰⁷ See, e.g., Robbins and Simonsen, supra note 389, at 55 (finding that financial advisors that

disproportionate exit from the market, compared to municipal advisors that have previously registered under another regulatory regime, would negatively impact the value of advice provided to municipal entities. In the case of solicitors for investment advisers to municipal pension funds, however, few are currently registered as either broker-dealers or investment advisers. The registration requirement under the proposed permanent registration regime may cause some of these solicitors to exit the market to avoid the cost and scrutiny that would accompany registration. To the extent that the solicitors that would exit this market would disproportionately include those that provide less value to municipal entities, their exit from the market would be a benefit that may mitigate these costs.

Because the existing markets for all three municipal advisor types – municipal financial advisors, municipal investment advisers, and solicitors – appear to be competitive, exits from such markets are not expected to lead to market concentration levels at which economic inefficiency (monopoly profits for the few surviving municipal advisors) would result. Moreover, given the content of the proposed forms, those municipal advisors that may exit such markets may include disproportionately more municipal advisors with disciplinary records or other negative histories.

The Commission further recognizes that some state-registered investment advisers that manage municipal pension investments may have the incentive to exit these investments to avoid federal registration under the proposed permanent registration regime. These investment advisers may perceive the costs of the required federal registration, in addition to one or more state registrations, to outweigh the benefits of managing such municipal pension investments.

The Commission believes that few of these initial and recurring costs, if any, would be passed on to municipal entities or obligated persons in the form of higher fees. To the extent that

are not broker-dealers are more likely to recommend a competitive sale, which generally results in lower borrowing costs for the issuer).

costs are passed on, the financial advisor and solicitor markets may be impacted to a greater degree than the investment adviser market, which would be more likely to keep fees relatively fixed for investment adviser services.

The Commission has considered the effects on competition, efficiency and capital formation of the proposed rule regarding the proposed permanent registration regime as a whole, as noted above.

C. Non-Resident Municipal Advisors

The Commission is proposing rule 15Ba1-5 to set forth the general procedures for serving non-residents on Form MA and Form MA-NR. Pursuant to the instructions to Form MA-NR, and consistent with proposed rule 15Ba1-5, non-resident municipal advisory firms, non-resident general partners and non-resident managing agents of municipal advisors must file Form MA-NR to furnish the Commission with a written irrevocable consent and power of attorney to appoint an agent in the United States, other than a Commission member, official, or employee, upon whom may be served any process, pleadings, or other papers in any action brought against the non-resident municipal advisory firm, non-resident general partner or non-resident managing agent. Proposed rule 15Ba1-5(e) would also require each non-resident municipal advisory firm to provide an opinion of counsel that the non-resident municipal advisory firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite and inspection and examination by the Commission.

1. Benefits

The proposed requirement that a non-resident municipal advisor or a non-resident general partner or non-resident managing agent of a municipal advisor file Form MA-NR in connection with the municipal advisor's initial application would help minimize any legal or logistical obstacles that the Commission may encounter when attempting to effect service, to conserve

Commission resources, and to avoid potential conflicts of law. The proposed requirement that a non-resident municipal advisory firm must obtain an opinion of counsel that the municipal advisory firm can provide access to books and records and can be subject to onsite inspection and examination would allow the Commission to better evaluate a municipal advisory firm's ability to meet the requirements of registration and ongoing supervision. These benefits would be the same across all municipal advisor types – municipal financial advisors, municipal investment advisers, and solicitors. In addition, the requirements to file Form MA-NR and provide an opinion of counsel are expected to have minimal, if any, effect on competition, efficiency and capital formation.

2. Costs

The filing of proposed Form MA-NR and the obtaining of an opinion of counsel would impose compliance burdens on municipal advisors. In particular, the Commission anticipates the following one-time costs:

- The Commission believes that the initial labor cost for non-resident municipal advisory firms, non-resident general partners or non-resident managing agents to complete the Form MA-NR would be approximately \$5,100.⁴⁰⁸
- The Commission believes that the initial labor cost for non-resident municipal advisory firms to obtain an opinion of counsel that the municipal advisor can provide access to books and records and can be subject to onsite inspection and examination would be approximately \$3,200.⁴⁰⁹

⁴⁰⁸ 30 hours (estimated initial hourly burden under the proposed rules for all respondents to complete a Form MA-NR) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$5,100. See supra note 398 for the calculation of the combined hourly rate.

⁴⁰⁹ 9 hours (estimated initial hourly burden under the proposed rules for all respondents to obtain opinion of counsel) x \$354 (hourly rate for an internal attorney) = \$3,186. The \$354 per hour figure for an Attorney is from the SIFMA publication titled Management &

- If adopted, non-resident municipal advisory firms and non-resident general partners and non-resident managing agents of municipal advisors may incur one-time costs in establishing new internal controls such as procedures for obtaining the information required by Form MA-NR. For the purposes of this analysis, this one-time cost is included in the cost estimate noted above.

The Commission also anticipates the following recurring costs:

- The Commission believes that the ongoing annual labor cost for non-resident advisory firms, non-resident general partners or non-resident managing agents to complete the Form MA-NR would be approximately \$340.⁴¹⁰
- The Commission believes that the ongoing annual labor cost for non-resident municipal advisory firms to obtain opinion of counsel that the municipal advisory firm can provide prompt access to books and records and can be subject to onsite inspection and examination would be approximately \$1,100.⁴¹¹
- If adopted, non-resident municipal advisory firms or non-resident general partners and non-resident managing agents of municipal advisors would incur recurring costs for monitoring and maintaining the information required by Form MA-NR. This cost would

Professional Earnings in the Securities Industry 2010, as 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.

⁴¹⁰ 2 hours (estimated ongoing annual hourly burden under the proposed rules for respondents to complete a Form MA-NR) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$340. See supra note 398 for the calculation of the combined hourly rate.

⁴¹¹ 3 hours (estimated ongoing annual hourly burden under the proposed rules for all respondents to obtain opinion of counsel) x \$354 (hourly rate for an internal attorney) = \$1,062. The \$354 per hour figure for an Attorney is from the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2010, as 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.

likely be similar across all municipal advisor types – municipal financial advisors, municipal investment advisers, and solicitors. For the purposes of this analysis, this recurring cost is included in the cost estimate noted above.

D. Record-Keeping

Proposed rule 15Ba1-7 sets forth requirements relating to the maintenance and retention of certain records relating to the business of municipal advisors and the forms required for the proposed permanent registration regime. The proposed rule would require, among other things, that municipal advisory firms maintain and preserve all books and records required to be made under the proposed rule for a period of not less than five years, the first two years in an easily accessible place.⁴¹² Record-keeping requirements are a familiar and important element of the Commission's approach to investment adviser and broker-dealer regulation, and are designed to maintain the efficiency and effectiveness of the Commission's inspection program for regulated entities, which facilitates the Commission's review for their compliance with statutory mandates and with the Commission's rules.

1. Benefits

The proposed rule would assist the Commission in evaluating a municipal advisory firm's compliance with Section 15B of the Exchange Act⁴¹³ and rules and regulations promulgated thereunder. Regulators would benefit from standardized record-keeping practices for municipal advisory firms because they would be able to perform more efficient, targeted inspections and examinations, and have an increased likelihood of identifying improper conduct at earlier stages in the inspection or examination. In addition, municipal advisory firms should benefit from standardized record-keeping practices by having their operations interrupted for shorter time periods

⁴¹² See supra Section II.C.

⁴¹³ See 15 U.S.C. 78o-4.

in response to inspections or examinations than if their record-keeping practices were not standardized. Both regulators and municipal advisory firms should benefit from standardized record-keeping requirements to the extent that uniform records would identify for regulators and municipal advisory firms the records that municipal advisory firms should have on hand.

The record-keeping practices proposed in rule 15Ba1-7 would also help regulators perform their supervisory functions in an effective manner. To the extent that more effective supervision results in greater market integrity, municipal entities may make better use of municipal advisory firms in a way that should positively affect their capital formation activities.

2. Costs

The books and records requirements of proposed rule 15Ba1-7 would impose compliance burdens on municipal advisory firms. In particular, the Commission anticipates the following one-time costs:

- If adopted, municipal advisory firms may incur one-time costs in establishing the new internal controls and systems necessary to comply with the record-keeping requirements of the proposed rule. The Commission believes that for municipal advisory firms that are municipal financial advisors or municipal investment advisers and are currently regulated with respect to their other activities, these costs would be limited because the proposed rule allows some records to be maintained in compliance with those other rules.⁴¹⁴ The Commission believes that these costs would also be limited for municipal advisory firms that have voluntarily adopted similar record-keeping practices.

Commission staff anticipates that these costs may be higher for solicitors and for

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See supra Section II.C.

municipal advisory firms that are not otherwise regulated or have not voluntarily adopted similar record-keeping practices.

The Commission also anticipates the following recurring costs:

- The Commission believes that the ongoing annual labor cost for all municipal advisory firms to comply with the proposed requirement would be approximately \$9,050,000.⁴¹⁵
- If adopted, municipal advisory firms would also incur recurring costs related to the maintenance of books and records and the storage of such books and records, as required by the proposed rule. For the purposes of this analysis, these recurring costs are included in the cost estimate noted above.
- If adopted, municipal advisory firms would also need to provide applicable training to ensure compliance with the proposed record-keeping requirements. For the purposes of this analysis, this recurring cost is included in the cost estimate noted above.

The Commission does not believe that currently-operating municipal advisory firms would be subject to significant additional record-keeping costs as a result of the proposed rule because such municipal advisory firms already maintain books and records as part of their day-to-day operations. The proposed rule, however, provides specific parameters relating to the retention and maintenance of certain books and records and the proposed requirements may be more extensive than current market practices. Moreover, the Commission recognizes that these costs may impact those municipal advisory firms that are not already registered as either investment advisers or broker-dealers to a greater degree than they would impact municipal advisory firms that have

⁴¹⁵ 181,000 hours (total estimated hourly burden under the proposed rules for all municipal advisory firms to annually comply with the books and records requirement) x \$50 (hourly rate for a General Clerk) = \$9,050,000. The \$50 per hour figure for a General Clerk is from the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2010, as 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.

previously registered under another regulatory regime. Based on discussions with industry participants, however, Commission staff believes that some unregistered municipal advisory firms may already keep business records similar to those required by the Commission's proposal. The proposed record-keeping requirements would reinforce improvements in disclosure about, and the average quality of, municipal advisors.

The Commission has considered the effects on competition, efficiency and capital formation of the proposed rule regarding initial and ongoing record-keeping in the context of the proposed permanent registration regime as a whole, as noted above.

E. Request for Comment on Economic Analysis

The Commission seeks estimates of the costs and benefits identified in this Economic Analysis section, as well as any costs and benefits not already discussed, which may result from the adoption of the proposed rules and forms. In connection with the comments requested below, the Commission requests comment on its understanding of the municipal advisor markets reflected in Sections I.A.1.a and I.A.1.b above. The Commission also requests comment on the potential costs and benefits of alternatives suggested by commenters. The Commission specifically requests comments with respect to the following:

- Would the availability of disciplinary information and conflict of interest information, along with the other information required by Form MA and Form MA-I, assist municipal entities or obligated persons in making hiring decisions with respect to municipal advisors?

The Commission solicits comments on the costs associated with the registration-related rules and new forms. The Commission specifically requests comment on the following:

- Would additional benefits accrue if the Commission required different or additional information on the proposed forms and, if so, what would these requirements entail?
- Are there additional costs or benefits related to registration that the Commission should consider? In particular, are there any outside costs associated with Form MA-NR that the Commission has not identified and should consider?

The Commission solicits comments on the costs and benefits related to the proposed record-keeping requirements. The Commission specifically requests comment on the following:

- Would additional benefits accrue if the Commission imposed different or additional record-keeping requirements and, if so, what would these requirements entail?
- The Commission specifically requests comments on the initial and ongoing costs associated with establishing and maintaining the record-keeping systems and related policies and procedures, including whether municipal advisory firms that are otherwise currently regulated would incur different record-keeping costs.
- Are there additional costs or benefits related to record-keeping that the Commission should consider? If so, please explain.

The Commission generally requests comment on the competitive or anticompetitive effects, as well as efficiency and capital formation effects, of the proposed rules and forms on any market participants if the proposals are adopted as proposed. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposed rules and forms.

VI. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or

“SBREFA,”⁴¹⁶ the Commission must advise OMB as to whether the proposed regulation constitutes a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is “major,” its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of the proposed rules and forms 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.

VII. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) in accordance with Section 603(a) of the Regulatory Flexibility Act (RFA).⁴¹⁷ This IRFA relates to proposed rules 240.15Ba1-1 through 240.15Ba1-7 under the Exchange Act, which sets forth the requirements for municipal advisors to register with the Commission and the books and records that registered municipal advisory firms must make and keep.

Section 15B, as amended by the Dodd-Frank Act, generally is intended to strengthen oversight of the municipal securities markets and broaden current municipal securities market protections to cover, among other things, previously unregulated market participants. The proposed rules and forms are designed to meet this mandate by requiring each municipal advisor, whether a firm or a natural person, to provide basic identifying information about itself, a description of its

⁴¹⁶ 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).

⁴¹⁷ See 5 U.S.C. 603(a).

activities, and facts regarding its disciplinary history, if any.

A. Reasons and Objectives for the Proposed Rules

Sections I and II of this Release describe the reasons for and objectives of the proposed rules and forms. Many market professionals are involved in issuing municipal securities and advising municipal entities and obligated persons with respect to municipal financial products. Historically, however, municipal advisors have been largely unregulated. Consistent with the requirements of the Dodd-Frank Act, the Commission is proposing new rules and forms that, if adopted, would establish a permanent registration regime for municipal advisors. The Commission believes that the information disclosed pursuant to the proposed rules and forms would provide significant value to the Commission in its oversight of municipal advisors and their activities in the municipal securities markets. The information provided pursuant to these proposed rules and forms would also aid municipal entities, obligated persons, and others in choosing municipal advisors, engaging in transactions with municipal advisors, or participating in transactions in municipal securities issued in offerings in which a municipal advisor provided municipal advisory services.

B. Legal Basis

Pursuant to the Exchange Act, and particularly Sections 15B, 17, and 36 (15 U.S.C. 78o-4, 78q, and 78mm, respectively), the Commission is proposing to adopt §§ 240.15Ba1-1 through 240.15Ba1-7, Form MA, Form MA-I, Form MA-W, and Form MA-NR.

C. Small Entities Subject to the Proposed Rules

Under section 601(3) of the RFA, the term “small business” is defined as having “the same meaning as the term ‘small business concern’ under section 3 of the Small Business Act, unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal

Register.”⁴¹⁸ The Commission’s rules do not define “small business” or “small organization” for purposes of municipal advisors. The SBA defines small business, for purposes of entities that provide financial investments and related activities, as a business that had annual receipts of less than \$7 million during the preceding fiscal year and is not affiliated with any person that is not a small business or small organization.⁴¹⁹ Therefore, the Commission is using the SBA’s definition of small businesses to define municipal advisors that are small entities for purposes of the RFA.

In developing the proposed rules and forms, the Commission has considered their potential impact on the small entities that would be subject to the proposed rules and would be required to complete the proposed forms. All municipal advisors must register with the Commission, including small entities, and would be subject to the proposed rules.

Based on the number of municipal advisors who have already registered with the Commission by completing Form MA-T, the Commission estimates that approximately 1,000 municipal advisory firms, including sole proprietors, would be required to complete Form MA.⁴²⁰ In connection with the promulgation of rule 15Ba2-6T, industry sources were unable to provide an estimate, based on the definitions discussed above, of how many of these municipal advisory firms would be small businesses or small organizations.⁴²¹ However, for purposes of this IRFA, the Commission believes that the proportion of small municipal advisory firms subject to the proposed rules compared to all Form MA applicants subject to the proposed rules may be similar to the proportion of small registered broker-dealers compared to all registered broker-dealers. The

⁴¹⁸ 5 U.S.C. 601(3).

⁴¹⁹ See 13 CFR 121.201.

⁴²⁰ See *supra* Section IV.C.

⁴²¹ Proposed Form MA, Item 10, would ask municipal advisors to indicate whether they meet the definition of “small business” or “small organization.” As a result, if adopted, in the future the Commission would have information on which to base estimates of the number of small municipal advisors subject to its rules.

Commission has previously estimated that approximately 17% of all broker-dealers are “small” for the purposes of the RFA.⁴²² Thus, the Commission estimates that approximately 170 municipal advisory firms that would be required to register with the Commission by filing Form MA would be small entities subject to the proposed rules.⁴²³

The Commission estimates that approximately 21,800 natural persons must complete Form MA-I.⁴²⁴ Of these Form MA-I applicants, only those that are sole proprietors and meet the annual receipts threshold would be considered small entities subject to the proposed rules.⁴²⁵ Because all sole proprietors would be required to complete Form MA in addition to Form MA-I, the Commission believes that sole proprietors that would be small entities subject to the proposed rules, *i.e.*, that are under the “small entities” annual receipts thresholds, are already counted among the estimate of 170 small entities calculated above. Thus, for the purposes of this IRFA, the Commission does not believe that it would be necessary to further estimate the number of small entities among Form MA-I applicants, because such an estimate would result in the double-counting of respondents. The Commission estimates that a total of 170 municipal advisors would be small entities subject to the proposed rules.

The Commission requests comment on its estimate of how many municipal advisors would

⁴²² See Securities Exchange Act Release No. 61908 (April 14, 2010), 75 FR 21456, 21483 (April 23, 2010). The Commission received no comments on its estimate of the percentage of all broker-dealers that are considered “small” for RFA purposes.

⁴²³ $1,000$ (estimated number of municipal advisors subject to the Rule) \times $.17$ (estimated percentage of municipal advisors that are small entities) = 170 small entity municipal advisors.

⁴²⁴ See *supra* Section IV.C.

⁴²⁵ Individuals who are not sole proprietors, *i.e.*, employees of municipal advisors, and must register on Form MA-I would not fall within the definitions of “small business” or “small organization,” because only those businesses and organizations that are “independently owned” may qualify as small entities pursuant to the definitions contained in the RFA. See 5 U.S.C. 601(4) and 15 U.S.C. 632(a)(1).

be small entities for purposes of the IRFA. Specifically, the Commission seeks comment on whether there are alternative ways to estimate the number of municipal advisors that are small entities. Is the proportion of small registered municipal advisors to all registered municipal advisors for purposes of the IRFA similar to the proportion of small registered broker-dealers to all registered broker-dealers?

D. Reporting, Record-keeping, and Other Compliance Requirements

The proposed rules and forms would impose certain reporting and record-keeping requirements on small municipal advisors. For example, under the proposed rules, municipal advisors would be required to complete the information disclosure requirements on Forms MA and MA-I, as applicable. Moreover, municipal advisory firms would be required to maintain books and records relating to their municipal advisory activities in which they engage.

As discussed above, under the proposed rules, municipal advisors are required by statute to register with the Commission. The Commission is proposing a permanent registration regime for municipal advisors that would require completion of Form MA and/or Form MA-I, as applicable.

The Commission estimates that the initial cost per applicant to complete Form MA and the initial self-certification would be approximately \$1,110,⁴²⁶ and the initial reporting cost per applicant to complete Form MA-I and the initial self-certification would be approximately \$510.⁴²⁷

The Commission also estimates that the ongoing annual cost per applicant to amend Form MA and

⁴²⁶ 6.5 hours (total estimated hourly burden under the proposed rules for one municipal advisor to complete a Form MA and complete initial self-certification) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$1,110. See *supra* note 398 for the calculation of the combined hourly rate.

⁴²⁷ 3.0 hours (total estimated hourly burden under the proposed rules for one municipal advisor to complete a Form MA-I and complete initial self-certification) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$510. See *supra* note 399 for the calculation of the combined hourly rate.

complete self-certification would be approximately \$510,⁴²⁸ and the ongoing annual cost per applicant to amend Form MA-I and complete self-certification would be approximately \$160.⁴²⁹

Municipal advisors would also incur costs when they need to withdraw their registration. The Commission estimates that the cost per registrant to complete Form MA-W would be approximately \$85.⁴³⁰ In addition, non-resident municipal advisors and non-resident general partners and managing agents of municipal advisors would incur costs to file Form MA-NR. The Commission estimates that the cost per filer to complete Form MA-NR would be approximately \$255.⁴³¹ Non-resident municipal advisory firms would also incur costs to obtain an opinion of counsel. The Commission estimates that the cost per non-resident municipal advisory firm to obtain an opinion of counsel, including the cost to hire outside counsel, would be approximately \$1,960.⁴³²

⁴²⁸ 2.5 hours (estimated time to prepare one annual amendment and complete annual self-certification for Form MA) x 1.0 (number of annual amendments per year) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) + 0.5 hours (estimated time to prepare one interim updating amendment per year for Form MA) x 1.0 (average number of interim updating amendments per year) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$510. See supra note 398 for the calculation of the combined hourly rate.

⁴²⁹ 0.5 hours (estimated time to complete amended Form MA-I) x 1.7 (average number of amendments per year) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$145; 0.1 hours (estimated time to complete annual self-certification on Form MA-I) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$17; \$145 + \$17 = \$162. See supra note 399 for the calculation of the combined hourly rate.

⁴³⁰ 0.5 hours (estimated time to complete Form MA-W) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$85. See supra note 398 for the calculation of the combined hourly rate.

⁴³¹ 1.5 hours (estimated time to complete Form MA-NR) x \$170 (combined hourly rate for a Compliance Manager and Compliance Clerk) = \$255. See supra note 398 for the calculation of the combined hourly rate.

⁴³² 3.0 hours (estimated time to obtain opinion of counsel) x \$354 (hourly rate for an internal attorney) = \$1,062. See supra note 411 regarding the hourly rate. \$900 = estimated cost to hire outside counsel. See supra note 344 for an explanation of the outside counsel cost estimate. \$1,062 + \$900 = \$1,962.

The Commission also believes that some municipal advisory firms would incur costs associated with hiring outside counsel to determine the need to file and to comply with the requirements of the proposed rules and forms. The Commission estimates that the total cost per municipal advisory firm to hire outside counsel would be approximately \$400.⁴³³

Based on discussions with various industry participants and the Commission's prior experience with broker-dealers and investment advisers, the Commission estimates that the average cost per municipal advisory firm to comply with the proposed requirement to maintain annual books and records would be approximately \$9,050.⁴³⁴ The Commission requests comment on these estimates.

The Commission believes that these compliance burdens would not disproportionately affect small entities. The Commission notes that the proposed rules and forms strike the appropriate balance between minimizing the burden on small municipal advisors and allowing the Commission to meet its mandate under Section 15B of the Exchange Act to establish a permanent registration regime for municipal advisors. Moreover, the Commission believes that completing and submitting Forms MA and MA-I electronically should not be unduly burdensome or costly for municipal advisors, including small municipal advisors.

E. Duplicative, Overlapping, or Conflicting Federal Rules

As discussed in Section I.B, a temporary registration procedure was developed as a transitional step toward the implementation of a permanent registration regime for municipal advisors. Rule 15Ba2-6T provides that, unless rescinded, a municipal advisor's temporary

⁴³³ 1 hour (estimated time spent by outside counsel to help municipal advisor comply with rule) x \$400 (hourly rate for an attorney) = \$400. See supra note 357 for the calculation of the hourly rate.

⁴³⁴ 181 hours (estimated time spent by municipal advisors to ensure annual compliance with the books and records requirement) x \$50 (hourly rate for a General Clerk) = \$9,050. See supra note 415 for the calculation of the hourly rate.

registration by means of Form MA-T will expire on the earlier of (1) the date that the municipal advisor's registration is approved or disapproved by the Commission pursuant to a final rule rescinded by the Commission or (2) December 31, 2011.⁴³⁵

The Commission is proposing rules and forms to establish a permanent municipal advisors registration regime. Under the permanent registration regime, all municipal advisors, including those who had previously registered on Form MA-T, would be required to register anew on Form MA and/or on Form MA-I. Thus, the Commission believes that current rules do not generally duplicate, overlap, or conflict with the proposed rules.

The Commission recognizes, however, that some of the information that respondents would collect for purposes of the proposed record-keeping rules and the relevant proposed registration forms would overlap with information previously collected for other registration regimes or record-keeping rules. As acknowledged above, the Commission recognizes that persons who have registered on Form MA-T under the temporary registration regime or that have completed a Form BD, ADV or U4, could require less time to research and complete the proposed permanent registration forms to the extent information contained in those other forms can be incorporated by reference or used to assist in completing information on Forms MA or MA-I. Persons who are Commission-registered investment advisers or broker-dealers may also require less time to comply with the proposed rule 15Ba1-7 books and records requirements, to the extent that the proposed books and records requirements overlap with those required to be kept and maintained in accordance with investment adviser and/or broker-dealer books and records requirements.

⁴³⁵ See 17 CFR 240.15Ba2-6T(e).

F. Significant Alternatives

Pursuant to Section 3(a) of the RFA,⁴³⁶ 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 proposed rules for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the proposed rules, or any part of the proposed rules, for small entities.

The Commission believes that the proposed rules and forms strike the appropriate balance between minimizing the burden on small municipal advisors and allowing the Commission to meet its mandate under Section 15B of the Exchange Act to establish a registration regime for municipal advisors. The Commission does not believe that establishing different compliance or reporting standards is necessary because the information requested in Forms MA and MA-I would be accessible to municipal advisors regardless of whether the municipal advisor is a small entity. Moreover, the Commission believes that completing and submitting Forms MA and MA-I electronically should not be unduly burdensome or costly for municipal advisors, including small municipal advisors. In developing the proposed rules and forms, the Commission considered requiring additional information from municipal advisors and using different submission mechanisms. The Commission decided that the information in the proposed forms and the submission requirements would be simple, straightforward, and take into account the resources available to all municipal advisors, including small municipal advisors. The Commission believes that it is inconsistent with the goals of a uniform registration system to use performance standards rather than design standards. Further, the Commission believes that it would be inconsistent with

⁴³⁶ 5 U.S.C. 603(c).

the purposes of the Exchange Act to exempt small entities from compliance with the proposed rules.

G. General Request for Comment

The Commission is soliciting comments regarding its analysis. The Commission requests comment on the number of small entities that would be subject to the proposed rules and forms and whether the proposed rules and forms would have any effects that have not been discussed. The Commission requests that commenters describe the nature of any effects on small entities subject to the rule and provide empirical data to support the nature and extent of such effects. The Commission also requests comment on the compliance burdens and how they would affect small entities. Does the proposed permanent registration regime create an undue burden on small entities? Are there any additional compliance burdens that would affect small entities in particular, compared to larger entities?

VIII. STATUTORY BASIS AND TEXT OF PROPOSED AMENDMENTS

Pursuant to the Exchange Act, and particularly Sections 15B, 17, and 36 (15 U.S.C. 78o-4, 78q, and 78mm, respectively), the Commission is proposing to adopt §§ 240.15Ba1-1 through 240.15Ba1-7, Form MA, Form MA-I, Form MA-W, and Form MA-NR.

List of Subjects in 17 CFR Parts 240 and 249

Reporting and record-keeping requirement, Municipal advisors, Registration requirements.

Text of Proposed Rules and Forms

For the reasons set out above, 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 general 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, 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.; 18 U.S.C. 1350; and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

Sections 240.15Ba1-1 through 240.15Ba1-7 are also issued under Pub. L. No. 111-203, § 975, 124 Stat. 1376, 1915-1923 (2010).

* * * * *

2. Section 240.15Ba1-1 through 240.15Ba1-7 are added to read as follows:

Sec.

* * * * *

240.15Ba1-1 Definitions.

240.15Ba1-2 Application for municipal advisor registration.

240.15Ba1-3 Withdrawal from municipal advisor registration.

240.15Ba1-4 Amendments to application for registration and self-certification.

240.15Ba1-5 Consent to service of process to be furnished by non-resident municipal advisors, general partners and managing agents; legal opinion to be furnished by non-resident municipal advisors.

240.15Ba1-6 Registration of successor to municipal advisor.

240.15Ba1-7 Books and records to be maintained by municipal advisor.

§ 240.15Ba1-1 Definitions.

As used in the rules and regulations prescribed by the Commission pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4):

(a) Guaranteed investment contract has the same meaning as in Section 15B(e)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(2)).

(b) The term investment strategies, as defined in Section 15B(e)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(3)), includes plans, programs or pools of assets that invest funds held by or on behalf of a municipal entity.

(c) Managing agent means any person, including a trustee, who directs or manages, or who participates in directing or managing, the affairs of any unincorporated organization or association other than a partnership.

(d)(1) Municipal Advisor has the same meaning as in Section 15B(e)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(4)).

(2) The term Municipal Advisor shall not include:

(i) A broker, dealer, or municipal securities dealer serving as an underwriter (as that term is defined in Section 2(a)(11) of the Securities Act of 1933 (15 U.S.C. 77b(a)(11))) on behalf of a municipal entity or obligated person, unless the broker, dealer or municipal securities dealer engages in municipal advisory activities while acting in a capacity other than as an underwriter on behalf of a municipal entity or obligated person.

(ii) An investment adviser registered under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) or a person associated with such registered investment adviser, unless the registered investment adviser or person associated with the investment adviser engages in municipal advisory activities other than providing investment advice that would subject such adviser or person associated with such adviser to the Investment Advisers Act of 1940.

(iii) Any commodity trading advisor registered under the Commodity Exchange Act or persons associated with a commodity trading advisor, unless the registered commodity trading

advisor or persons associated with the registered commodity trading advisor engages in municipal advisory activities other than advice related to swaps (as defined in Section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)) and Section 3(a)(69) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(69)), including any rules and regulations thereunder).

(iv) Any attorney, unless the attorney engages in municipal advisory activities other than the offer of legal advice or the provision of services that are of a traditional legal nature to a client of the attorney that is a municipal entity or obligated person.

(v) Any engineer, unless the engineer engages in municipal advisory activities other than providing engineering advice.

(vi) Any accountant, unless the accountant engages in municipal advisory activities other than preparing financial statements, auditing financial statements, or issuing letters for underwriters for, or on behalf of, a municipal entity or obligated person.

(e) Municipal advisory activities means providing advice to or on behalf of a municipal entity (as defined in Section 15B(e)(8) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(8)) or obligated person (as defined in Section 15B(e)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(10))) with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or solicitation of a municipal entity or obligated person.

(f) Municipal derivatives means any swap (as defined in Section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)) and Section 3(a)(69) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(69)), including any rules and regulations thereunder) or security-based swap (as defined in Section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)),

including any rules and regulations thereunder) to which a municipal entity is a counterparty, or to which an obligated person, acting in its capacity as an obligated person, is a counterparty.

(g) Municipal financial product has the same meaning as in Section 15B(e)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(5)).

(h) Non-resident means:

(1) In the case of an individual, one who resides in or has his principal office and place of business in any place not in the United States;

(2) In the case of a corporation, one incorporated in or having its principal office and place of business in any place not in the United States; and

(3) In the case of a partnership or other unincorporated organization or association, one having its principal office and place of business in any place not in the United States.

(i) The term obligated person, as defined in Section 15B(e)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(e)(10)), shall not include providers of municipal bond insurance, letters of credit, or other liquidity facilities.

(j) Principal office and place of business means the executive office of the municipal advisor from which the officers, partners, or managers of the municipal advisor direct, control, and coordinate the activities of the municipal advisor.

§ 240.15Ba1-2 Application for municipal advisor registration.

(a) Form MA. A person, other than a natural person, including a sole proprietor, applying for registration with the Commission as a municipal advisor pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4) must complete Form MA (17 CFR 249.1300) in accordance with the instructions in such Form and file such Form electronically with the Commission.

(b) Form MA-I. A natural person (including a sole proprietor) applying for registration with the Commission as a municipal advisor pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4) must complete Form MA-I (17 CFR 249.1310) in accordance with the instructions in the Form and file such Form electronically with the Commission.

(c) When filed. Each Form MA (17 CFR 249.1300) and Form MA-I (17 CFR 249.1310) shall be considered filed with the Commission upon acceptance by the [applicable electronic system]. Filings required to be made on a day that the [applicable electronic system] is closed shall be considered timely filed with the Commission if filed electronically no later than the following business day.

(d) Form MA and Form MA-I are reports. Each Form MA (17 CFR 249.1300) and Form MA-I (17 CFR 249.1310) required to be filed under this section shall constitute a “report” within the meaning of Sections 15B(c), 17(a), 18(a), 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(c), 78q(a), 78r(a), 78ff(a)) and other applicable provisions of the Exchange Act.

§ 240.15Ba1-3 Withdrawal from municipal advisor registration.

(a) Form MA-W. Notice of withdrawal from registration as a municipal advisor shall be filed on Form MA-W (17 CFR 249.1320) in accordance with the instructions to the Form.

(b) Electronic filing. Any notice of withdrawal on Form MA-W (17 CFR 249.1320) must be filed electronically.

(c) Effective date. A notice of withdrawal from registration shall become effective for all matters on the 60th day after the filing thereof, within such longer period of time as to which such municipal advisor 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. If a notice of withdrawal from registration is filed at any

time subsequent to the date of the issuance of a Commission order instituting proceedings pursuant to Section 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(c)) to censure, place limitations on the activities, functions or operations of, or suspend or revoke the registration of, such municipal advisor, or if prior to the effective date of the notice of withdrawal pursuant to this paragraph (c), the Commission institutes such a proceeding or a proceeding to impose terms or conditions upon such withdrawal, the notice of withdrawal shall not become effective pursuant to this paragraph (c) 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.

(d) Form MA-W is a report. Each Form MA-W (17 CFR 249.1320) required to be filed under this section shall constitute a “report” within the meaning of Sections 15B(c), 17(a), 18(a), 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(c), 78q(a), 78r(a), 78ff(a)) and other applicable provisions of the Exchange Act.

§ 240.15Ba1-4 Amendments to application for registration and self-certification.

(a) When amendment is required – Form MA. A registered municipal advisor shall promptly amend the information contained in its Form MA (17 CFR 249.1300):

(1) At least annually, within 90 days of the end of a municipal advisor’s fiscal year, or of the end of the calendar year for municipal advisors that are sole proprietors; and

(2) More frequently, if required by the General Instructions to Form MA (17 CFR 249.1300), as applicable.

(b) When amendment is required – Form MA-I. A registered municipal advisor shall promptly amend the information contained in its Form MA-I (17 CFR 249.1310) by filing an amended Form MA-I whenever the information contained in the Form MA-I becomes inaccurate for any reason.

(c) Electronic filing of amendments. A registered municipal advisor shall file all amendments to Form MA (17 CFR 249.1300) and Form MA-I (17 CFR 249.1310) electronically.

(d) Amendments to Form MA and Form MA-I are reports. Each amendment required to be filed under this section shall constitute a "report" within the meaning of Sections 15B(c), 17(a), 18(a), 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(c), 78q(a), 78r(a), 78ff(a)) and other applicable provisions of the Exchange Act.

(e) Self-certification. A registered municipal advisor shall complete the self-certification contained in Form MA (17 CFR 249.1300) or Form MA-I (17 CFR 249.1310), as applicable:

(1) At the time the municipal advisor initially files its application for registration as a municipal advisor on Form MA (17 CFR 249.1300) or Form MA-I (17 CFR 249.1310), as applicable; and

(2) In the case of a municipal advisor registered on Form MA (17 CFR 249.1300), annually, within 90 days of the end of a municipal advisor's fiscal year, or of the end of the calendar year for municipal advisors that are sole proprietors; and in the case of a municipal advisor registered on Form MA-I (17 CFR 249.1310), annually within 90 days of the end of the calendar year.

§ 240.15Ba1-5 Consent to service of process to be furnished by non-resident municipal advisors, general partners and managing agents; legal opinion to be furnished by non-resident municipal advisors.

(a) Each non-resident municipal advisor, and each non-resident general partner or managing agent of a municipal advisor, applying for registration pursuant to Section 15B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(a)) shall, at the time of filing of the municipal advisor's application on Form MA (17 CFR 249.1300) or MA-I (17 CFR 249.1310), furnish to the

Commission a written irrevocable consent and power of attorney on Form MA-NR (17 CFR 249.1330) to appoint an agent in the United States, other than a Commission member, official, or employee, upon whom may be served any process, pleadings, or other papers in any action brought against the non-resident municipal advisor, or non-resident general partner or non-resident managing agent of a municipal advisor, to enforce this Title.

(b) Any change to the name or address of each non-resident municipal advisor's, general partner's or managing agent's agent for service of process shall be communicated promptly to the Commission through amendment of the Form MA-NR (17 CFR 249.1330).

(c) Each non-resident municipal advisor, general partner and managing agent must promptly appoint a successor agent for service of process and file an amended Form MA-NR (17 CFR 249.1330) if the non-resident municipal advisor, general partner or managing agent discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on behalf of the non-resident municipal advisor, general partner or managing agent.

(d) Each non-resident municipal advisor, other than a natural person, including non-resident sole proprietors, applying for registration pursuant to this section shall provide an opinion of counsel on Form MA (17 CFR 249.1300) that the municipal advisor can, as a matter of law, provide the Commission with access to the books and records of such municipal advisor as required by law and that the municipal advisor can, as a matter of law, submit to onsite inspection and examination by the Commission.

§ 240.15Ba1-6 Registration of successor to municipal advisor.

(a) In the event that a municipal advisor succeeds to and continues the business of a municipal advisor registered pursuant to Section 15B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(a)), the registration of the predecessor shall be deemed to remain effective as the

registration of the successor if the successor, within 30 days after such succession, files an application for registration on Form MA (17 CFR 249.1300), and the predecessor files a notice of withdrawal from registration on Form MA-W (17 CFR 249.1320); provided, however, that the registration of the predecessor municipal advisor will cease to be effective as the registration of the successor municipal advisor 45 days after the application for registration on Form MA is filed by such successor.

(b) Notwithstanding paragraph (a) of this section, if a municipal advisor succeeds to and continues the business of a registered predecessor municipal advisor, 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 municipal advisor on Form MA (17 CFR 249.1300) to reflect these changes. This amendment shall be deemed an application for registration filed by the predecessor and adopted by the successor.

§ 240.15Ba1-7 Books and records to be maintained by municipal advisors.

(a) Every person, other than a natural person, including sole proprietors, registered or required to be registered under Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4) shall make and keep true, accurate, and current the following books and records relating to its municipal advisory activities:

(1) Originals or copies of all written communications received, and originals or copies of all written communications sent, by such municipal advisor (including inter-office memoranda and communications) relating to municipal advisory activities, regardless of the format of such communications;

(2) All check books, bank statements, cancelled checks and cash reconciliations of the

municipal advisor;

(3) A copy of each version of the municipal advisor's policies and procedures, if any, that are in effect or at any time within the last five years were in effect;

(4) A copy of any document created by the municipal advisor that was material to making a recommendation to a municipal entity or obligated person or that memorializes the basis for that recommendation;

(5) All written agreements (or copies thereof) entered into by the municipal advisor with any municipal entity, employee of a municipal entity, or an obligated person or otherwise relating to the business of such municipal advisor as such;

(6) A record of the names of persons who are currently, or within the past five years were, associated with the municipal advisor; and

(7) Books and records containing a list or other record of:

(i) The names, titles, and business and residence addresses of all persons associated with the municipal advisor;

(ii) All municipal entities or obligated persons with which the municipal advisor is engaging or has engaged in municipal advisory activities in the past five years;

(iii) The name and business address of each person to whom the municipal advisor provides or agrees to provide, directly or indirectly, payment to solicit a municipal entity, an employee of a municipal entity, or an obligated person on its behalf; and

(iv) The name and business address of each person that provides or agrees to provide, directly or indirectly, payment to the municipal advisor to solicit a municipal entity, an employee of a municipal entity or an obligated person on its behalf.

(8) A record of the initial or annual review, as applicable, conducted by the municipal

advisor of such municipal advisor's business in connection with its self-certification on Form MA (17 CFR 249.1300).

(b)(1) All books and records required to be made under this section shall be maintained and preserved for a period of not less than five years, the first two years in an easily accessible place.

(2) Partnership articles and any amendments thereto, articles of incorporation, charters, minute books, and stock certificate books of the municipal advisor and of any predecessor shall be maintained in the principal office of the municipal advisor and preserved until at least three years after termination of the business or withdrawal from registration as a municipal advisor.

(c) A municipal advisor subject to paragraph (a) of this section, before ceasing to conduct or discontinuing business as a municipal advisor, shall arrange for and be responsible for the preservation of the books and records required to be maintained and preserved under this section for the remainder of the period specified in this section, and shall notify the Commission in writing, at its principal office, Washington, DC, of the exact address where such books and records will be maintained during such period.

(d) Electronic storage permitted.

(1) General. The records required to be maintained and preserved pursuant to this part may be maintained and preserved for the required time on:

(i) Electronic storage media, including any digital storage medium or system that meets the terms of this section; or

(ii) Paper documents.

(2) General requirements. The municipal advisor must:

(i) Arrange and index the records in a way that permits easy location, access, and retrieval of any particular record;

(ii) Provide promptly any of the following that the Commission (by its examiners or other representatives) may request:

(A) A legible, true, and complete copy of the record in the medium and format in which it is stored;

(B) A legible, true, and complete printout of the record; and

(C) Means to access, view, and print the records; and

(iii) Separately store, for the time required for preservation of the record, a duplicate copy of the record on any medium allowed by this section.

(3) Special requirements for electronic storage media. In the case of records on electronic storage media, the municipal advisor must establish and maintain procedures:

(i) to maintain and preserve the records, so as to reasonably safeguard them from loss, alteration, or destruction;

(ii) to limit access to the records to properly authorized personnel and the Commission (including its examiners and other representatives); and

(iii) to reasonably ensure that any reproduction of a non-electronic record on electronic storage media is complete, true, and legible when retrieved.

(e)(1) Any book or other record made, kept, maintained, and preserved in compliance with §§ 240.17a-3 and 240.17a-4 of this chapter, rules of the Municipal Securities Rulemaking Board, or § 275.204-2 under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1), which is substantially the same as a book or other record required to be made, kept, maintained and preserved under this section, shall satisfy the requirements of this section.

(2) A record made and kept pursuant to any provision of paragraph (a) of this section that contains all the information required under any other provision of paragraph (a) of this section,

need not be maintained in duplicate in order to meet the requirements of the other provisions of paragraph (a) of this section.

(f)(1) Except as provided in paragraph (f)(3) of this section, each non-resident municipal advisor, other than a natural person, including sole proprietors, registered or applying for registration pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4) shall keep, maintain, and preserve, at a place within the United States designated in a notice from such municipal advisor as provided in paragraph (f)(2) of this section, true, correct, complete, and current copies of books and records which such municipal advisor is required to make, keep current, maintain or preserve pursuant to any provisions of any rule or regulation of the Commission adopted under the Securities Exchange Act of 1934.

(2) Except as provided in paragraph (f)(3) of this section, each non-resident municipal advisor subject to paragraph (f)(1) of this section shall furnish to the Commission a written notice specifying the address of the place within the United States where the copies of the books and records required to be kept and preserved by such municipal advisor pursuant to paragraph (f)(1) of this section are located. Each non-resident municipal advisor registered or applying for registration when this paragraph becomes effective shall file such notice within 30 days after this paragraph becomes effective. Each non-resident municipal advisor that files an application for registration after this paragraph becomes effective shall file such notice with such application for registration.

(3) Notwithstanding the provisions of paragraphs (f)(1) and (2) of this section, a non-resident municipal advisor need not keep or preserve within the United States copies of the books and records referred to in paragraphs (f)(1) and (2) of this section, if:

(i) Such non-resident municipal advisor files with the Commission, at the time or within the period provided by paragraph (f)(2) of this section, a written undertaking, in a form acceptable

to the Commission and signed by a duly authorized person, to furnish to the Commission, upon demand, at the Commission's principal office in Washington, DC, or at any Regional Office of the Commission designated in such demand, true, correct, complete, and current copies of any or all of the books and records which such municipal advisor is required to make, keep current, maintain, or preserve pursuant to any provision of any rule or regulation of the Commission adopted under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), or any part of such books and records that may be specified in such demand. Such undertaking shall be in substantially the following form:

The undersigned hereby undertakes to furnish at its own expense to the Securities and Exchange Commission at the Commission's principal office in Washington, DC or at any Regional Office of the Commission specified in a demand for copies of books and records made by or on behalf of the Commission, true, correct, complete, and current copies of any or all, or any part, of the books and records that the undersigned is required to make, keep current, or preserve pursuant to any provision of any rule or regulation of the Securities and Exchange Commission under the Securities Exchange Act of 1934. This undertaking shall be suspended during any period when the undersigned is making, keeping current, and preserving copies of all of said books and records at a place within the United States in compliance with 17 CFR 240.15Ba1-7(f)(1). This undertaking shall be binding upon the undersigned and the heirs, successors and assigns of the undersigned, and the written irrevocable consents and powers of attorney of the undersigned, its general partners, and managing agents filed with the Securities and Exchange Commission shall extend to and cover any action to enforce the same.

and

(ii) Such non-resident municipal advisor furnishes to the Commission, at such municipal advisor's own expense 14 days after written demand therefor forwarded to such municipal advisor

by registered mail at such municipal advisor's last address of record filed with the Commission and signed by the Secretary of the Commission or such person as the Commission may authorize to act in its behalf, true, correct, complete, and current copies of any or all books and records which such municipal advisor is required to make, keep current, or preserve pursuant to any provision of any rule or regulation of the Commission adopted under the Securities and Exchange Act of 1934, or any part of such books and records that may be specified in said written demand. Such copies shall be furnished to the Commission at the Commission's principal office in Washington, DC, or at any Regional Office of the Commission which may be specified in said written demand.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for part 249 is amended by adding the following citation 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.

* * * * *

Sections 249.1300, 1310, 1320 and 1330 are also issued under Pub. L. No. 111-203, § 975, 124 Stat. 1376, 1915-1923 (2010).

* * * * *

4. Subpart N is amended by removing § 249.1300T and adding §§ 249.1300, 249.1310, 249.1320, and 249.1330 to read as follows:

Subpart N – Forms for Registration of Municipal Advisors

Sec.

249.1300 Form MA, for registration as a municipal advisor, and for amendments to registration

249.1310 Form MA-I, for registration as a municipal advisor, and for amendments to registration

249.1320 Form MA-W, for withdrawal from registration as a municipal advisor

249.1330 Form MA-NR, for appointment of agent for service of process by non-resident municipal advisor, and non-resident general partner and non-resident managing agent of a municipal advisor

§ 249.1300 Form MA, for registration as a municipal advisor, and for amendments to registration

The form shall be used for registration as municipal advisors by persons other than natural persons, and by sole proprietors, and for amendments to registrations pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4).

§ 249.1310 Form MA-I, for registration as a municipal advisor, and for amendments to registration

The form shall be used for registration as municipal advisors by natural persons, and for amendments to registrations, pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4).

§ 249.1320 Form MA-W, for withdrawal from registration as a municipal advisor

The form shall be used for filing a notice of withdrawal from registration as a municipal advisor pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4).

§ 249.1330 Form MA-NR, for appointment of agent for service of process by non-resident municipal advisor, and non-resident general partner and non-resident managing agent of a municipal advisor

The form shall be used for appointment of agent for service of process by a non-resident general partner and non-resident managing agent of a municipal advisor pursuant to Section 15B of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4).

[Note: The following Forms will not appear in the Code of Federal Regulations.]

By the Commission.



Elizabeth M. Murphy
Secretary

Date: December 20, 2010

FORM MA

APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION ANNUAL UPDATE OF MUNICIPAL ADVISOR REGISTRATION AMENDMENT OF A PRIOR APPLICATION FOR REGISTRATION

PART 1

This form must be completed by *municipal advisors* that are organized entities, including sole proprietors (referred to herein as "*municipal advisory firms*"). Natural persons applying for registration as a *municipal advisor*, including sole proprietors, must complete Form MA-I.

WARNING: Complete this form truthfully. False statements or omissions may result in denial of application, revocation of registration, or criminal prosecution. Form MA must be amended promptly upon the occurrence of certain material events, and updated at least annually, within 90 days of the end of the *municipal advisor's* fiscal year, or, if a sole proprietor, the *municipal advisor's* calendar year. See General Instruction 8. All italicized terms are defined or described in the Glossary to this Form.

Check the appropriate box:

This is an:

- Initial application to register as a *municipal advisor* with the SEC.
- Annual update of *municipal advisor's* Form MA, for fiscal year ended _____, or, if a sole proprietor, for calendar year _____.
If no changes are made in this *annual update* to information provided in the *municipal advisor's* most recent Form MA, check here:
- Amendment (other than *annual update*) to any part of the *municipal advisor's* most recent Form MA.

Item 1 Identifying Information

- A. Full legal name of the firm. (If the applicant is a sole proprietor, provide last, first, and middle names.)

If full legal name has changed since the *municipal advisor's* most recent Form MA, check here and provide the previous full legal name.

- B. Name under which *municipal advisor-related* business is primarily conducted, if different from Item 1-A.

If name under which *municipal advisor-related* business is primarily conducted has changed since the *municipal advisor's* most recent Form MA, check here and provide the previous name under which the *municipal advisor-related* business was primarily conducted.

List on Section 1-B of Schedule D any additional names under which *municipal advisor-related* business is conducted.

- C. IRS employer identification number. If the applicant is a sole proprietor and has no employer identification number, provide the applicant's social security number.

- D. Registrations

Was the applicant previously registered on Form MA-T as a *municipal advisor*?

- Yes File No. _____
- No

Is the applicant registered as or with any of the following?

Check all that apply. An applicant firm that does not have a CRD number, or other specified number, should enter nothing in the space provided. Such applicant should NOT provide the CRD number, or other specified number, of any of its officers, employees, or affiliates.

- Municipal Advisor* SEC File No.: _____
- Municipal Securities Dealer* SEC File No.: _____
- Broker-Dealer* SEC File No.: _____ CRD No.: _____
- Investment Adviser*
 - SEC-Registered* SEC File No.: _____ CRD No.: _____
 - State Registered* CRD No.: _____
- Government Securities Broker-Dealer* SEC File No.: _____ Bank Identifier _____
- Other SEC Registration (Specify)* _____ SEC File No.: _____
- Another federal or state regulator (Specify)* _____ Registration No.: _____

If more space is needed, list any additional registrations in Section 1-D of Schedule D.

E. *Principal Office and Place of Business*

Do not use a P.O. Box.

Address:

(number and street)

(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box:

List on Section 1-E of Schedule D any office(s) at which municipal advisor-related business is conducted other than applicant's principal office and place of business listed above.

Telephone number at this location: _____

(area code) (telephone number)

Fax number (if any) at this location: _____

(area code) (fax number)

Mailing address:

Complete this item only if mailing address is different from principal office and place of business address in Item 1-E:

(number and street)

(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box:

- F. Does the applicant have one or more websites? Yes No

If "yes," list all website addresses on Section 1-F of Schedule D.

- G. If the applicant has a *Chief Compliance Officer*, provide his or her name and contact information:

(name)

(other title(s), if any)

(area code) (telephone number) (area code) (fax number)

(number and street)

(city) (state/country) (zip+4/postal code)

@
(E-mail address of *Chief Compliance Officer*)

- H. Contact Person: If a *person* other than the *Chief Compliance Officer* is authorized to receive information and respond to questions about this Form, provide the name and contact information for that *person*:

(name)

(title)

(area code) (telephone number) (area code) (fax number)

(number and street)

(city) (state/country) (zip+4/postal code)

@
(E-mail address of contact person)

- I. Does the applicant maintain, or intend to maintain, some or all of the books and records required to be kept under *MSRB* rules and *SEC* rules at a location other than the *principal office and place of business* address listed in Item 1-E? Yes No

If "yes," complete Section 1-I of Schedule D.

- J. Is the applicant registered with a *foreign financial regulatory authority*?
Answer "no" even if affiliated with a business that is registered with a *foreign financial regulatory authority*.

Yes No

If "yes," complete Section 1-J of Schedule D.

- K. Is the applicant affiliated with any other business entities?

Yes No

If "yes," provide the names of these affiliates and any applicable registrations in Section I-K of Schedule D.

Item 2 Form of Organization

A. Applicant's form of organization:

If this is an annual update or amendment, and the applicant's form of organization has changed, see Instruction 8 of the General Instructions.

- Corporation Sole Proprietorship Limited Liability Partnership (LLP)
 Partnership Limited Liability Company (LLC) Limited Partnership (LP)
 Other (specify): _____

B. Month of applicant's annual fiscal year end: _____

C. The state in the U.S. or the jurisdiction outside the U.S. under which the applicant is organized:

If the applicant is a corporation or limited liability company, indicate the state or jurisdiction where the applicant is incorporated. If the applicant is a partnership, indicate the name of the state or jurisdiction under the laws of which the partnership was formed. If applicant is a sole proprietor, indicate the state or jurisdiction in which applicant resides.

If this is not an initial application for registration, and the applicant's information has changed since the applicant's most recent Form MA, see General Instruction 8.

D. Date of organization: _____

E. Is the applicant a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934?

Yes No

*If "yes", provide applicant's CIK number: _____
(A CIK, or Central Index Key number, is assigned by the SEC to every public reporting company.)*

Item 3 Successions

Is the applicant, at the time of this filing, succeeding to the business of a registered *municipal advisor*?

If this succession was previously reported on Form MA, do not report the succession again. Instead, check "No." See Instruction 1 of the General Instructions to this Form.

Yes
 Date of Succession: _____
 (mm/dd/yyyy)

No

If "yes," complete Section 3 of Schedule D.

Item 4 Information About Applicant's Business

Note: Instruction 2 of the General Instructions to this Form provides guidance for newly-formed municipal advisors completing this Item 4.

Employees

If the applicant is organized as a sole proprietorship, include the sole proprietor as an employee.

- A. Approximate number of *employees* of applicant. Include full- and part-time *employees*, but do not include clerical workers: _____
- B. Approximately how many of these *employees* engage in *municipal advisory activities*? (Include *employees* who perform other functions in addition to engaging in *municipal advisory activities*.) _____
- C. Approximately how many of the *employees* who are included in the response to part B are registered representatives of a broker-dealer? _____
- Approximately how many are registered representatives of an investment adviser? _____
- D. Approximately how many firms and other *persons* who are not employed by the applicant and who are not otherwise *associated persons* of the applicant *solicit clients* on the applicant's behalf? (Count a firm only once; do not count each of the firm's *employees* that *solicits* on the applicant's behalf.) _____

If the number entered includes firms, please list the names of these firms on Section 4D of Schedule D.

- E. Does the applicant have any *employees* that also do business independently on the applicant's behalf as affiliates of the applicant?
 Yes No

If yes, list the names of these employees on Section 4E of Schedule D.

Clients

- F. Approximately how many *clients* did the applicant serve in the context of its *municipal advisory activities* during its most-recently completed fiscal year? _____

The applicant has the following types of *clients*:
 (Check all that apply.)

- (1) *Municipal entities*
- (2) Non-profit organizations (e.g., 501(c)(3) organizations) who are *obligated persons*
- (3) Corporations or other businesses not listed above who are *obligated persons*
- (4) Other: _____
- (5) Not applicable - applicant engages only in *solicitation*; does not serve *clients* in the context of its *municipal advisory activities*.

- G. Approximately how many *municipal entities* and *obligated persons* were *solicited* by the applicant on behalf of a third-party during its most-recently completed fiscal year? (If the applicant *solicits its clients* in addition to serving them in the context of its *municipal advisory activities*, these *clients* should be counted in the response to this Part G even if counted in Part F.) _____

The applicant *solicits* the following types of *persons*:
 (Check all that apply.)

- (1) Public pension funds
- (2) 529 Plans
- (3) Local government investment pools
- (4) State government investment pools
- (5) Hospitals
- (6) Colleges
- (7) Other: _____
- (8) Not applicable – applicant only serves *clients*; does not engage in *solicitation* in the context of its *municipal advisory activities*.

Compensation Arrangements

H. Applicant is compensated for its advice to or on behalf of *municipal entities* or *obligated persons* with respect to *municipal financial products* or the issuance of municipal securities by:
(Check all that apply.)

- (1) Hourly charges
- (2) Fixed fees (not contingent on the issuance of municipal securities)
- (3) *Contingent fees*
- (4) Subscription fees (for a newsletter or other publications)
- (5) Other (specify): _____
- (6) Not applicable – applicant engages only in *solicitation*; does not serve *clients* in the context of its *municipal advisory activities*.

I. Applicant is compensated for its *solicitation* activities by:
(Check all that apply.)

- (1) Hourly charges
- (2) Fixed fees (not contingent on the success of *solicitations*)
- (3) *Contingent fees*
- (4) Subscription fees (for a newsletter or other publications)
- (5) Other (specify): _____
- (6) Not applicable; applicant only serves *clients*; does not engage in *solicitation* as part of its *municipal advisory activities*.

J. Does the applicant receive compensation, in the context of its *municipal advisory activities*, from anyone other than *clients*?

- Yes No

If yes, please explain:

Applicant's Business Relating to Municipal Securities

K. Applicant is engaged in the following types of activities:
(Check all that apply.)

- (1) Advice concerning the issuance of municipal securities (including, without limitation, advice concerning the structure, timing, terms and other similar matters, such as the preparation of feasibility studies, tax rate studies, appraisals and similar documents, related to an offering of municipal securities)

- (2) Advice concerning the investment of the proceeds of municipal securities (including, without limitation, advice concerning the structure, timing, terms and other similar matters concerning such investments)
- (3) Advice concerning municipal escrow investments (including, without limitation, advice concerning their structure, timing, terms and other similar matters)
- (4) Advice concerning the investment of other funds of a *municipal entity* (including, without limitation, advice concerning the structure, timing, terms and other similar matters concerning such investments)
- (5) Advice concerning *guaranteed investment contracts* (including, without limitation, advice concerning their structure, timing, terms and other similar matters)
- (6) Advice concerning the use of *municipal derivatives* (including, without limitation, advice concerning their structure, timing, terms and other similar matters)
- (7) *Solicitation* of investment advisory business from a *municipal entity* or *obligated person* (including, without limitation, municipal pension plans) on behalf of an unaffiliated broker, dealer, *municipal advisor* or *investment adviser* (e.g., third party marketers, placement agents, solicitors, and finders)
- (8) *Solicitation* of business other than investment advisory business from a *municipal entity* or *obligated person* on behalf of an unaffiliated *person* or firm (e.g., third party marketers, placement agents, solicitors, and finders)
- (9) Advice or recommendations concerning the selection of other *municipal advisors* or underwriters with respect to *municipal financial products* or the issuance of municipal securities
- (10) Brokerage of municipal escrow investments
- (11) Other (specify): _____

Item 5 Other Business Activities

A. Applicant is actively engaged in business in or as a:

(Check all that apply.)

- (1) Broker-dealer, municipal securities dealer or government securities broker or dealer
- (2) Registered representative of a broker-dealer
- (3) Commodity pool operator (whether registered or exempt from registration)
- (4) Commodity trading advisor (whether registered or exempt from registration)
- (5) Futures commission merchant
- (6) Major swap participant
- (7) Major security-based swap participant
- (8) Swap dealer or security-based swap dealer
- (9) Trust company
- (10) Real estate broker, dealer, or agent
- (11) Insurance company, broker, or agent
- (12) Banking or thrift institution (including a separately identifiable department or division of a bank)
- (13) *Investment adviser* (including financial planners)
- (14) Lawyer or law firm (Jurisdiction(s) where licensed: _____)
- (15) Accountant or accounting firm (Jurisdiction(s) where licensed: _____)
- (16) Engineering firm
- (17) Other financial product advisor (specify): _____

B. Is applicant actively engaged in any other business not listed in Part A of this Item (other than engaging in *municipal advisory activities*)? Yes No

If yes, is this other business applicant's primary business? Yes No

Also, if "yes", describe this other business on Section 5-B of Schedule D.

Item 6 Financial Industry Affiliations of *Associated Persons*

"Associated Person" herein refers to a person who is an associated person of a municipal advisor. Note that "associated person" includes employees and persons with control over the municipal advisor that do not themselves engage in municipal advisory activities, but does not include employees that are solely clerical or administrative.

Applicant has one or more *associated persons* that is a:
(Check all that apply.)

- (1) Broker-dealer, municipal securities dealer, or government securities broker or dealer
- (2) Investment company (including mutual funds)
- (3) *Investment adviser* (including financial planners)
- (4) Swap dealer
- (5) Security-based swap dealer
- (6) Major swap participant
- (7) Major security-based swap participant
- (8) Commodity pool operator (whether registered or exempt from registration)
- (9) Commodity trading advisor (whether registered or exempt from registration)
- (10) Futures commission merchant
- (11) Banking or thrift institution
- (12) Trust company
- (13) Accountant or accounting firm
- (14) Lawyer or law firm
- (15) Insurance company or agency
- (16) Pension consultant
- (17) Real estate broker or dealer
- (18) Sponsor or syndicator of limited partnerships
- (19) Engineer or engineering firm
- (20) Other *municipal advisor*

Applicant must list on Section 6 of Schedule D all *associated persons*, including foreign affiliates, that are broker-dealers, municipal securities dealers, or government securities brokers or dealers, or *investment advisers*, *municipal advisors*, registered swap dealers, banking or thrift institutions, or trust companies.

Item 7 Participation or Interest of Applicant, or of *Associated Persons* of Applicant, in *Municipal Advisory Client Transactions*

Proprietary Interest in Municipal Advisory Client Transactions

A. Does applicant or any *associated person*:

- (1) buy securities or other investment or derivative products for itself from *clients* that it serves or *persons* that it has *solicited* or intends to *solicit* in the context of its *municipal advisory activities*, or sell securities it owns to such *clients*? Yes No
- (2) buy or sell for itself securities (other than shares of mutual funds) or other investment or derivative products that the applicant also recommends to such *clients*? Yes No
- (3) enter into derivatives contracts with such *clients*? Yes No

- (4) recommend securities or other investment or derivative products to such *clients* in which applicant or any *associated person* has some other proprietary (ownership) interest (other than those mentioned in Items 7-A(1), (2) or (3) above)?

Yes No

Sales Interest in Client Transactions

- B. Does applicant or any *associated person*:

- (1) recommend purchases of securities or derivatives to *clients* that are served by the applicant or *associated person*, or *persons* that the applicant or *associated person* has *solicited* or intends to *solicit* in the context of its *municipal advisory activities*, for which the applicant or any *associated person* serves as underwriter, general or managing partner, or purchaser representative?

Yes No

- (2) recommend purchases or sales of securities or derivatives to such *clients* in which applicant or any *associated person* has any other sales interest (other than the receipt of sales commissions as a broker or registered representative of a broker-dealer)?

Yes No

Investment or Brokerage Discretion

- C. Does applicant or any *associated person* have *discretionary authority* to determine the:

- (1) securities or other investment or derivative products to be bought or sold for the account of a *client* that it serves or *person* that it has *solicited* or intends to *solicit* in the context of its *municipal advisory activities*?

Yes No

- (2) amount of securities or other investment or derivative products to be bought or sold for the account of such a *client*?

Yes No

- (3) broker or dealer to be used for a purchase or sale of securities or other investment or derivative products for the account of such a *client*?

Yes No

If "yes," are any of the brokers or dealers *associated persons*?

Yes No

- (4) commission rates or other fees to be paid to a broker or dealer for such a *client's* securities transactions or transactions in other investment or derivative products?

Yes No

- D. Does applicant or any *associated person* recommend brokers, dealers or *investment advisers* to *clients* that it serves or *persons* that it has *solicited* or intends to *solicit* in the context of its *municipal advisory activities*?

Yes No

If "yes," are any of the brokers, dealers, or *investment advisers* *associated persons*?

Yes No

In responding to Items 7-E and 7-F below, consider all cash and non-cash compensation that the applicant or an associated person gave or received from any person in exchange for referrals of such clients, including any bonus that is based, at least in part, on the number or amount of such referrals.

E. Does the applicant or any *associated person*, directly or indirectly, compensate any *person* for referrals of *clients* in connection with *municipal advisory activities*? Yes No

F. Does the applicant or any *associated person*, directly or indirectly, receive compensation from any *person* for referrals of *clients* in connection with *municipal advisory activities*? Yes No

Item 8 Control Persons

In this Item, identify every *person* that, directly or indirectly, *controls* the applicant, or that the applicant directly or indirectly *controls*.

If this is an initial application, the applicant must complete Schedule A and Schedule B. Schedule A asks for information about direct owners and executive officers. Schedule B asks for information about indirect owners. If this is an amendment updating information reported on either the Schedule A or Schedule B (or both) filed with the applicant's initial application, the applicant must also complete Schedule C.

Does any *person* not named in Item 1-A or Schedules A, B, or C, directly or indirectly, *control* the applicant's management or policies? Yes No

If yes, complete Section 8-A of Schedule D.

If any person in Schedules A, B, or C, or in Section 8-A of Schedule D is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934, complete Section 8-B of Schedule D.

Item 9 Disclosure Information

In this Item, provide information about the applicant's disciplinary history and the disciplinary history of all associated persons of the applicant.

This information is used to determine whether to approve an application for registration, to decide whether to revoke registration, or to place limitations on the applicant's activities as a municipal advisor, and to identify potential problem areas on which to focus during on-site examinations. One event may result in the requirement to answer "yes" to more than one of the questions below.

If the answer is "yes" to any question in this Item 9, the applicant must complete the appropriate Disclosure Reporting Page ("DRP") – Criminal, Regulatory, etc. – found at the back of this application, as indicated below.

Criminal Action Disclosure

If the answer is "yes" to any question below in Part A or B below, complete a Criminal Action DRP.

Check all that apply:

A. In the past ten years, has the applicant or any *associated person*:

(1) been convicted of any *felony*, or pled guilty or nolo contendere ("no contest") to any *charge* of a *felony*, in a domestic, foreign, or military court? Yes No

(2) been *charged* with any *felony*? Yes No

The response to Item 9-A(2) may be limited to charges that are currently pending.

B. In the past ten years, has the applicant or any *associated person*:

- (1) been convicted of any *misdemeanor*, or pled guilty or nolo contendere ("no contest"), in a domestic, foreign, or military court to any *charge of a misdemeanor* in a case involving: *municipal advisor-related* business, 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? Yes No

The response to the following question may be limited to charges that are currently pending:

- (2) been *charged* with a *misdemeanor* listed in Item 9-B(1)? Yes No

Regulatory Action Disclosure

If the answer is "yes" to any question in Parts C-G below, complete a Regulatory Action DRP.

Check all that apply:

C. Has the *SEC* or the *CFTC* ever:

- (1) *found* the applicant or any *associated person* to have made a false statement or omission? Yes No
- (2) *found* the applicant or any *associated person* to have been *involved* in a violation of any *SEC* or *CFTC* regulation or statute? Yes No
- (3) *found* the applicant or any *associated person* to have been a cause of the denial, suspension, revocation, or restriction of the authorization of a *municipal advisor-related* or an *investment-related* business to operate? Yes No
- (4) entered an *order* against the applicant or any *associated person* in connection with *municipal advisor-related* or *investment-related* activity? Yes No
- (5) imposed a civil money penalty on the applicant or any *associated person*, or *ordered* the applicant or any *associated person* to cease and desist from any activity? Yes No

D. Has any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority*:

- (1) ever *found* the applicant or any *associated person* to have made a false statement or omission, or been dishonest, unfair, or unethical? Yes No
- (2) ever *found* the applicant or any *associated person* to have been *involved* in a violation of *municipal advisor-related* or *investment-related* regulations or statutes? Yes No
- (3) ever *found* the applicant or any *associated person* to have been the cause of a denial, suspension, revocation, or restriction of the authorization of a *municipal advisor-related* or an *investment-related* business to operate? Yes No
- (4) ever entered an *order* against the applicant or any *associated person* in connection with a *municipal advisor-related* or *investment-related* activity? Yes No

- (5) ever denied, suspended, or revoked the registration or license of the applicant or that of any *associated person*, or otherwise prevented the applicant or any *associated person* of the applicant, by *order*, from associating with a *municipal advisor-related* or *investment-related* business or restricted the activities of the applicant or any *associated person*? Yes No

E. Has any *self-regulatory organization* or commodities exchange ever:

- (1) *found* the applicant or any *associated person* to have made a false statement or omission? Yes No
- (2) *found* the applicant or any *associated person* 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*)? Yes No
- (3) *found* the applicant or any *associated person* to have been the cause of a denial, suspension, revocation or restriction of the authorization of a *municipal advisor-related* or an *investment-related* business to operate? Yes No
- (4) disciplined the applicant or any *associated person* by expelling or suspending the applicant or the *associated person* from membership, barring or suspending the applicant or the *associated person* from association with other members, or by otherwise restricting the activities of the applicant or the *associated person*? Yes No

F. Has the applicant or any *associated person* ever had an authorization to act as an attorney, accountant, or federal contractor revoked or suspended? Yes No

G. Is the applicant or any *associated person* currently the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of Item 9-C, 9-D, or 9-E.? Yes No

Civil Judicial Disclosure

If the answer is "yes" to a question below, complete a Civil Judicial Action DRP.

Check all that apply:

- H. (1) Has any domestic or foreign court:
- (a) ever *enjoined* the applicant or any *associated person* in connection with any *municipal advisor-related* or *investment-related* activity? Yes No
- (b) ever *found* that the applicant or any *associated person* was *involved* in a violation of *municipal advisor-related* or *investment-related* statutes or regulations? Yes No
- (c) ever dismissed, pursuant to a settlement agreement, a *municipal advisor-related* or *investment-related* civil action brought against the applicant or any *associated person* by a state or *foreign financial regulatory authority*? Yes No
- (2) Is the applicant or any *associated person* now the subject of any civil *proceeding* that could result in a "yes" answer to any part of Item 9-H(1)? Yes No

Item 10 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, the *SEC* needs to determine whether you meet the Small Business Administration's definition of "small business" for purposes of entities that provide investment and related activities. Accordingly, answer "yes" or "no," as appropriate, to Item 10-A below:

- A. Did the applicant have annual receipts of less than \$7 million during its most recent fiscal year (or during the time the applicant has been in business, if it has not completed its first fiscal year in business)?
 Yes No
- B. Is the applicant affiliated with any business or organization that had annual receipts of \$7 million or more during its most recent fiscal year (or during the time it has been in business, if it has not completed its first fiscal year in business)?
 Yes No

FORM MA

SCHEDULE A

Direct Owners and Executive Officers

1. Complete Schedule A only if submitting an initial application. Schedule A asks for information about the applicant's 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*, director and any other individuals with similar status or functions;
 - (b) if applicant is organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of the applicant's voting securities, unless applicant is 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 the applicant's 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 the applicant is organized as a partnership, all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of the applicant's capital;
- (d) in the case of a trust, a *person* that directly owns 5% or more of a class of the applicant's voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of the applicant's capital, the trust and each trustee; and
- (e) if the applicant is 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 the applicant's capital, and (ii) if managed by elected managers, all elected managers.

Does applicant have any indirect owners to be reported on Schedule B? Yes No

4. In the DE/FE/NP 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 "NP" if the owner or executive officer is a natural person.
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 MA, 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 (Natural Persons: Last Name, First Name, Middle Name)	DE/FE/NP	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		Yes/No	PR	

FORM MA

SCHEDULE C

Amendments to Schedules A and B

- 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.
- In the Type of Amendment column, indicate "A" (addition), "D" (deletion), or "C" (change in information about the same person).
- Ownership codes are:

NA - less than 5%	C - 25% but less than 50%	G - Other (general partner, trustee, or elected member)
A - 5% but less than 10%	D - 50% but less than 75%	
B - 10% but less than 25%	E - 75% or more	
- List below all changes to Schedule A (Direct Owners and Executive Officers):

FULL LEGAL NAME (Natural Persons: Last Name, First Name, Middle Name)	DE/ FE/ NP	Type of Amend- ment	Title or Status	Date Title or Status Acquired		Ownership Code	Control Person		CRD No. (If None: S.S. No. and Date or Birth, IRS Tax No., or Employer ID No.)
				MM	YYYY		Yes/No	PR	

List below all changes to Schedule B (Indirect Owners):

FULL LEGAL NAME (Natural persons: Last Name, First Name, Middle Name)	DE/ FE/ NP	Type of Amend- ment	Entity in Which Interest is Owned	Status	Date Title or Status Acquired		Ownership Code	Control Person		CRD No. (If None: S.S. No. and Date or Birth, IRS Tax No., or Employer ID No.)
					MM	YYYY		Yes/No	PR	

FORM MA
SCHEDULE D

Certain items in Part 1 of Form MA 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 Names under which *Municipal Advisor-Related Business* is Conducted

List the applicant's other business names and the jurisdictions in which they are used. A separate Schedule D must be completed for each business name.

Check only one box: Add Delete Amend

Name _____ Jurisdictions _____

SECTION 1-D Additional Registrations of the Applicant

Indicate any additional federal or state registration, and the relevant registration number. A separate Schedule D must be completed for each such registration.

Name _____ Registration No. _____

SECTION 1-E Additional Offices at which the Applicant's *Municipal Advisor-Related Business* is Conducted

Provide the location of any additional offices at which the applicant's *municipal advisor-related* business is conducted other than applicant's *principal office and place of business*. A separate Schedule D must be completed for each such office. List only the largest five (in terms of numbers of *employees*).

Check only one box: Add Delete Amend

(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) (fax number)

SECTION 1-F Website Addresses

List the applicant's website addresses. A separate Schedule D must be completed for each website address.

Check only one box: Add Delete Amend

Website Address: _____

SECTION 1-I Location of Books and Records

Complete the following information for each location at which the applicant keeps books and records, other than its *principal office and place of business*. A separate Schedule D must be completed 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) (fax number) _____

This is (check one): one of applicant's branch offices or affiliates.
 a third-party unaffiliated recordkeeper.
 other.

Briefly describe the books and records kept at this location.

SECTION 1-J Registration with Foreign Financial Regulatory Authorities

List the name, in English, of each *foreign financial regulatory authority* and country with which the applicant is registered. A separate Schedule D must be completed for each *foreign financial regulatory authority* with whom the applicant is registered.

Check only one box: Add Delete Amend

English Name of *Foreign Financial Regulatory Authority* _____

Name of Country _____

SECTION 1-K Business Affiliates of the Applicant

Provide the name of any business affiliate of the applicant and any federal or state registration of such affiliate and the registration number. A separate Schedule D must be completed for each such affiliate.

Name of Affiliate _____ Registration No. _____

SECTION 3 Successions

Complete the following information if succeeding to the business of a currently-registered *municipal advisor*. If the applicant acquired more than one *municipal advisory firm* in the succession being reported on this Form MA, a separate Schedule D must be completed for each acquired firm. See Instruction 1 of the General Instructions to this Form.

Name of Acquired *Municipal Advisory Firm* _____

- Municipal Advisor* SEC File No.: [MA]- _____
- Municipal Securities Dealer* SEC File No.: _____
- Broker-Dealer* SEC File No.: _____ CRD No.: _____
- Investment Adviser*
 - SEC-Registered SEC File No.: _____ CRD No.: _____
 - State Registered CRD No. _____
- Government Securities Broker-Dealer* SEC File No.: _____ Bank Identifier _____
- Other SEC Registration (Specify)* _____ SEC File No. or CIK: _____
- Another federal or state regulator (Specify)* _____ Registration No.: _____

SECTION 4-D Firms that Solicit Municipal Advisor Clients on the Applicant's Behalf

Provide the name, address, and phone number of any firm that is not otherwise an *associated person* of the applicant that *solicits municipal advisor clients* on the applicant's behalf. A separate Schedule D must be completed for each such firm.

Name of Firm _____

(number and street)

(city) (state/country) (zip+4/postal code)

(area code) (telephone number) (area code) (fax number)

SECTION 5-B Description of Primary Business (when primary business is not business as *municipal advisor*)

Describe the applicant's primary business (not the applicant's *municipal advisor-related* business):

SECTION 6 Financial Industry Affiliations

The following information must be completed for each *associated person* that is a *municipal advisor*, broker-dealer, municipal securities dealer, government securities broker or dealer, *investment adviser*, registered swap dealer, banking or thrift institution, or trust company, foreign or domestic. A separate Schedule D must be completed for each listed *associated person*.

Check only one box: Add Delete Amend

Legal Name of *Associated Person*: _____

Primary Business Name of *Associated Person*: _____

Associated person is a (check all that apply):

- Broker-Dealer, Municipal Securities Dealer, or Government Securities Broker or Dealer
 - Government Securities Broker or Dealer
 - Swap Dealer Pension Consultant
 - Banking or Thrift Institution Trust Company
 - Investment Company (including mutual funds) *Investment Adviser* (including financial planners)
 - Security-Based Swap Dealer Major Swap Participant Major Security-Based Swap Participant
 - Futures Commission Merchant Commodity Pool Operator (whether registered or exempt from registration)
 - Commodity Trading Advisor (whether registered or exempt from registration) Accountant or Accounting Firm
 - Sponsor or Syndicator of Limited Partnerships Lawyer or Law Firm
 - Engineer or Engineering Firm
 - Other *Municipal Advisor*
1. Does the applicant *control* or is it *controlled* by the *associated person*? Yes No
 2. Are the applicant and the *associated person* under common *control*? Yes No
 3. (a) Is the *associated person* registered with a *foreign financial regulatory authority*? Yes No
(b) If the answer to 3(a) is "yes", list the name, in English, of each *foreign financial regulatory authority* and country with which the *associated person* is registered.

SECTION 8 Control Persons

A separate Schedule D must be completed for each *control person* not named in Item 1-A. or Schedules A, B, or C that directly or indirectly *controls* the applicant's management or policies.

Check only one box: Add Delete Amend

If *control person* is a firm or organization:

Name _____

Municipal Advisor
Effective Date _____ mm/dd/yyyy
SEC File No.: _____
Termination Date _____ mm/dd/yyyy

Municipal Securities Dealer
Effective Date _____ mm/dd/yyyy
SEC File No.: _____
Termination Date _____ mm/dd/yyyy

Broker-Dealer
Effective Date _____ mm/dd/yyyy
SEC File No.: _____ CRD No.: _____
Termination Date _____ mm/dd/yyyy

Investment Adviser
 SEC-Registered
Effective Date _____ mm/dd/yyyy
SEC File No.: _____ CRD No.: _____
Termination Date _____ mm/dd/yyyy

State Registered
Effective Date _____ mm/dd/yyyy
CRD No. _____
Termination Date _____ mm/dd/yyyy

Government Securities Broker-Dealer
Effective Date _____ mm/dd/yyyy
SEC File No.: _____ Bank Identifier _____
Termination Date _____ mm/dd/yyyy

Other SEC Registration (Specify) _____
Effective Date _____ mm/dd/yyyy
SEC File No. or CIK: _____
Termination Date _____ mm/dd/yyyy

Another federal or state regulator (Specify) _____
Effective Date _____ mm/dd/yyyy
Registration No.: _____
Termination Date _____ mm/dd/yyyy

Business Address:

_____ (number and street)

_____ (city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box:

If *control person* is a natural person:

Name (Last, First, Middle) _____

CRD Number (if any) _____ Effective Date _____ Termination Date _____
mm/dd/yyyy mm/dd/yyyy

Business Address:

_____ (number and street)

_____ (city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box:

Briefly describe the nature of the *control*:

B. If any *person* named in Schedules A, B, or C or in Section 8-A of this Schedule D is a public reporting company under Section 12 or 15(d) of the Securities Exchange Act of 1934, provide the information below. A separate Schedule D must be completed 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): _____

MISCELLANEOUS

The space below may be used to explain a response to an Item or to provide any other information.

CRIMINAL ACTION DISCLOSURE REPORTING PAGE (MA)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP MA) is an INITIAL *OR* AMENDED response used to report details for affirmative responses to Items 9-A or 9-B of Form MA.

Check item(s) being responded to: 9-A(1) 9-A(2) 9-B(1) 9-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. Use this DRP to report all *charges* arising out of the same event. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. One event may result in more than one affirmative answer to the items listed above.

PART I

Check all that apply:

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are) the:

- Applicant
- Applicant and one or more *associated persons*
- One or more of applicant's *associated persons*

If this DRP is being filed for the applicant, and it is an amendment that seeks to remove a DRP concerning the applicant from the record, the reason the DRP should be removed is:

- The applicant is registered or applying for registration and the event or *proceeding* was resolved in the applicant's favor.
- The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: a firm a natural person
The *associated person* is: registered with the SEC not registered with the SEC

Full name of the *associated person* (including, for natural persons, last, first and middle names):

If the *associated person* has a CRD number, provide that number. _____

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

- The *associated person(s)* is no longer associated with the advisor.
- The event or *proceeding* was resolved in the *associated person's* favor.
- The event or *proceeding* occurred more than ten years ago.
- The DRP was filed in error. Explain the circumstances:

B. If the *municipal advisor* or *associated person* is registered through the IARD system or CRD system, or if the *municipal advisor* previously registered with the SEC on Form MA-T, has the *municipal advisor* or *associated person* previously submitted a DRP (with Form ADV, BD, or U4) to the IARD or CRD, or has the *municipal advisor* filed disclosure on Form MA-T, for the event that contains the information required by this DRP? Yes No

If the answer is "Yes," no other information on this DRP must be provided.

NOTE: The completion of this form does not relieve the *municipal advisor* or *associated person* of its obligation to update its IARD or CRD records.

PART II

If *charge(s)* were brought against a firm or organization over which the applicant or an *associated person* exercised control:

Enter the firm or organization's name _____

Was the firm or organization engaged in a *municipal advisor-related* business? Yes No

What was the relationship of the applicant with the firm or organization? (In the case of an *associated person*, include any position or title with the firm or organization.)

2. Formal *charge(s)* were brought in: (include the name of Federal, Military, State or Foreign Court, Location of Court - City or County and State or Country, and Docket/Case number).

Name of court: _____

Location: _____

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 *municipal advisor-related* or *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.

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. (The response must fit within the space provided.)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (MA)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP MA) is an INITIAL **OR** AMENDED response used to report details for affirmative responses to Items 9-C, 9-D, 9-E, 9-F or 9-G of Form MA.

Check item(s) being responded to: 9-C(1) 9-C(2) 9-C(3) 9-C(4) 9-C(5)
 9-D(1) 9-D(2) 9-D(3) 9-D(4) 9-D(5)
 9-E(1) 9-E(2) 9-E(3) 9-E(4)
 9-F 9-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 9-C, 9-D, 9-E, 9-F or 9-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) the:

- Applicant (the *municipal advisory firm*)
- Applicant and one or more of the applicant's *associated person(s)*
- One or more of applicant's *associated person(s)*

If this DRP is being filed for the applicant, and it is an amendment that seeks to remove a DRP concerning the applicant from the record, the reason the DRP should be removed is:

- The applicant is registered or applying for registration and the event or *proceeding* was resolved in the applicant's favor.
- The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: a firm a natural person
The *associated person* is: registered with the SEC not registered with the SEC

Full name of the *associated person* (including, for natural persons, last, first and middle names):

If the *associated person* has a CRD number, provide that number. _____

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

- The *associated person(s)* is no longer associated with the advisor.
- The event or *proceeding* was resolved in the *associated person's* favor.
- The DRP was filed in error. Explain the circumstances:

C. If the *municipal advisor* or *associated person* is registered through the IARD system or CRD system, or if the *municipal advisor* previously registered with the SEC on Form MA-T, has the *municipal advisor* or *associated person* previously submitted a DRP (with Form ADV, BD, or U4) to the IARD or CRD, or has the *municipal advisor* filed disclosure on Form MA-T, for the event that contains the information required by this DRP? Yes No

If the answer is "Yes," no other information on this DRP must be provided.

NOTE: The completion of this form does not relieve the *municipal advisor* or *associated person* of its obligation to update its IARD or CRD records.

PART II

Regulatory Action was initiated by:

- SEC Other Federal Authority State SRO Foreign Authority

(Full name of regulator, foreign financial regulatory authority, federal authority, state or SRO)

2. Principal Sanction (check appropriate item):

- | | | |
|--|---------------------------------------|--------------------------------------|
| <input type="checkbox"/> Civil and Administrative Penalty(ies)/Fine(s) | <input type="checkbox"/> Disgorgement | <input type="checkbox"/> Restitution |
| <input type="checkbox"/> Bar | <input type="checkbox"/> Expulsion | <input type="checkbox"/> Revocation |
| <input type="checkbox"/> Cease and Desist | <input type="checkbox"/> Injunction | <input type="checkbox"/> Suspension |
| <input type="checkbox"/> Censure | <input type="checkbox"/> Prohibition | <input type="checkbox"/> Undertaking |
| <input type="checkbox"/> Denial | <input type="checkbox"/> Reprimand | <input type="checkbox"/> Other _____ |

Other Sanctions:

3. Date Initiated (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

4. Docket/Case Number: _____

Associated person's Employing Firm when activity occurred which led to the regulatory action (if applicable):

6. Principal Product Type (check appropriate item):

- | | | |
|--|--|---|
| <input type="checkbox"/> Annuity(ies) - Fixed | <input type="checkbox"/> Derivative(s) | <input type="checkbox"/> Investment Contract(s) |
| <input type="checkbox"/> Annuity(ies) - Variable | <input type="checkbox"/> Direct Investment(s) - DPP & LP Interest(s) | <input type="checkbox"/> Money Market Fund(s) |
| <input type="checkbox"/> CD(s) | <input type="checkbox"/> Equity - OTC | <input type="checkbox"/> Mutual Fund(s) |
| <input type="checkbox"/> Commodity Option(s) | <input type="checkbox"/> Equity Listed (Common & Preferred Stock) | <input type="checkbox"/> No Product |
| <input type="checkbox"/> Debt - Asset Backed | <input type="checkbox"/> Futures - Commodity | <input type="checkbox"/> Options |
| <input type="checkbox"/> Debt - Corporate | <input type="checkbox"/> Futures - Financial | <input type="checkbox"/> Penny Stock(s) |
| <input type="checkbox"/> Debt - Government | <input type="checkbox"/> Index Option(s) | <input type="checkbox"/> Unit Investment Trust(s) |
| <input type="checkbox"/> Debt - Municipal | <input type="checkbox"/> Insurance | <input type="checkbox"/> Other _____ |

Other Product Types:

7. Describe the allegations related to this regulatory action. (The response must fit within the space provided.)

8. Current status? Pending On Appeal Final

9. If on appeal, to whom the regulatory action was appealed (*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):

- | | | |
|--|--|--------------------------------------|
| <input type="checkbox"/> Acceptance, Waiver & Consent (AWC) | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Vacated |
| <input type="checkbox"/> Consent | <input type="checkbox"/> Order | <input type="checkbox"/> Withdrawn |
| <input type="checkbox"/> Decision | <input type="checkbox"/> Settled | <input type="checkbox"/> Other _____ |
| <input type="checkbox"/> Decision & Order of Offer of Settlement | <input type="checkbox"/> Stipulation and Consent | |

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)?

- | | | | | | |
|--|--|---|--|------------------------------|-------------------------------------|
| <input type="checkbox"/> Monetary/Fine
Amount: \$ _____ | <input type="checkbox"/> Revocation/Expulsion/Denial | <input type="checkbox"/> Disgorgement/Restitution | <input type="checkbox"/> Cease and Desist/Injunction | <input type="checkbox"/> Bar | <input type="checkbox"/> Suspension |
| <input type="checkbox"/> Censure | | | | | |

B. Other Sanctions *Ordered*:

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 the applicant or an *associated person*, date paid and if any portion of penalty was waived:

13. Provide a brief summary of details related to the action status and (or) disposition and include relevant terms, conditions and dates.

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (MA)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP MA) is an INITIAL *OR* AMENDED response used to report details for affirmative responses to Item 9-H. of Form MA.

Check item(s) being responded to: 9-H(1)(a) 9-H(1)(b) 9-H(1)(c) 9-H(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.

One event may result in more than one affirmative answer to Item 9-H. 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) the:

- Applicant (the *municipal advisory firm*)
- Applicant and one or more of the applicant's *associated person(s)*
- One or more of applicant's *associated person(s)*

If this DRP is being filed for the applicant, and it is an amendment that seeks to remove a DRP concerning the applicant from the record, the reason the DRP should be removed is:

- The applicant is registered or applying for registration and the event or *proceeding* was resolved in the applicant's favor.
- The DRP was filed in error.

If this DRP is being filed for an *associated person*:

- This *associated person* is: a firm a natural person
The *associated person* is: registered with the *SEC* not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

If the *associated person* has a *CRD* number, provide that number. _____

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

- The *associated person(s)* is no longer associated with the advisor.
- The event or *proceeding* was resolved in the *associated person's* favor.
- The DRP was filed in error. Explain the circumstances:

D. If the *municipal advisor* or *associated person* is registered through the *IARD* system or *CRD* system, or if the *municipal advisor* previously registered with the *SEC* on Form MA-T, has the *municipal advisor* or *associated person* previously submitted a DRP (with Form ADV, BD, or U4) to the *IARD* or *CRD*, or has the *municipal advisor* filed disclosure on Form MA-T, for the event that contains the information required by this DRP? Yes No

If the answer is "Yes," no other information on this DRP must be provided.

NOTE: The completion of this form does not relieve the *municipal advisor* or *associated person* of its obligation to update its *IARD* *CRD* records.

PART II

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 Disgorgement Money Damages (Private/Civil Complaint) Restraining Order
 Civil Penalty(ies)/Fine(s) Injunction Restitution 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):

- | | | |
|--|--|---|
| <input type="checkbox"/> Annuity(ies) - Fixed | <input type="checkbox"/> Derivative(s) | <input type="checkbox"/> Investment Contract(s) |
| <input type="checkbox"/> Annuity(ies) - Variable | <input type="checkbox"/> Direct Investment(s) - DPP & LP Interest(s) | <input type="checkbox"/> Money Market Fund(s) |
| <input type="checkbox"/> CD(s) | <input type="checkbox"/> Equity - OTC | <input type="checkbox"/> Mutual Fund(s) |
| <input type="checkbox"/> Commodity Option(s) | <input type="checkbox"/> Equity Listed (Common & Preferred Stock) | <input type="checkbox"/> No Product |
| <input type="checkbox"/> Debt - Asset Backed | <input type="checkbox"/> Futures - Commodity | <input type="checkbox"/> Options |
| <input type="checkbox"/> Debt - Corporate | <input type="checkbox"/> Futures - Financial | <input type="checkbox"/> Penny Stock(s) |
| <input type="checkbox"/> Debt - Government | <input type="checkbox"/> Index Option(s) | <input type="checkbox"/> Unit Investment Trust(s) |
| <input type="checkbox"/> Debt - Municipal | <input type="checkbox"/> Insurance | <input type="checkbox"/> Other _____ |

Other Product Types:

5. Formal Action was brought in (include the name of the Federal, State or Foreign Court, Location of Court - City or County and State or Country, and Docket/Case Number):

6. *Associated person's* Employing Firm when activity occurred which led to the civil judicial action (if applicable):

7. Describe the allegations related to this civil action (the response must fit within the space provided):

8. Current status? Pending On Appeal Final

9. If on appeal, court to which the action was appealed (provide name of the 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 Amount: \$ _____ Revocation/Expulsion/Denial Disgorgement/Restitution
 Censure Cease and Desist/Injunction Bar Suspension

B. Other Sanctions *Ordered*:

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 the applicant or an *associated person*, 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.

Form MA
APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION

DOMESTIC MUNICIPAL ADVISOR EXECUTION PAGE

You must complete the following execution page to Form MA. This execution page must be signed and attached to your initial application for *SEC* registration and all amendments to registration.

Appointment of Agent for Service of Process

By signing this Form MA, you, the undersigned advisor, 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*, as your agents to receive service, and agree that such *persons* may be served any process, pleadings, subpoenas, or other papers in (a) any *investigation* or administrative *proceeding* conducted by the *Commission* that relates to the applicant or about which the applicant may have information; and (b) any civil suit or action brought against the applicant or to which the applicant has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, where the *investigation, proceeding* or cause of action arises out of or relates to or concerns *municipal advisory activities* of the *municipal advisor*. The applicant stipulates and agrees that any such civil suit or action or administrative *proceeding* may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

Signature

I, the undersigned, sign this Form MA on behalf of, and with the authority of, the *municipal advisor*. The *municipal advisor* 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 Form MA, including exhibits and any other information submitted, are true and correct, and that I am signing this Form MA as a free and voluntary act.

I certify that the advisor'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 regulatory representatives.

Signature: _____ Date: _____

Printed Name: _____ Title: _____

Advisor *CRD* Number: _____

Self-Certification

I, the undersigned, sign this self-certification on behalf of and with the authority of the *municipal advisor*.

The *municipal advisor* and I both certify that the *municipal advisor* and every natural person associated with it has met, or within any applicable required timeframes will meet, such standards of training, experience, and competence, and such other qualifications, including testing, for a *municipal advisor* and natural persons associated with it, required by the *Commission*, the *MSRB* or any other relevant self-regulatory organization.

The *municipal advisor* and I certify that the *municipal advisor* has conducted an initial or annual review, as applicable, of the *municipal advisor's* business and has reasonably determined that the municipal advisor: 1) can carry out the activities described in the items that are checked in Item 4.K (Applicant's Business Relating to Municipal Securities) of this form; 2) can comply with all applicable regulatory obligations; and 3) has met such regulatory obligations during the last year (or such shorter period if this is an initial application for registration). For these purposes, such applicable regulatory obligations are obligations under the federal securities laws and rules promulgated thereunder and applicable rules promulgated by the *MSRB*, or any other relevant self-regulatory organization. The *municipal advisor* has documented this review process and will maintain all documents relating to such review in accordance with rule 15Ba1-7(a)(8) under the Exchange Act.

Signature: _____

Date: _____

Printed Name: _____

Title: _____

Advisor CRD Number: _____

Form MA
APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION

NON-RESIDENT MUNICIPAL ADVISOR EXECUTION

You must complete the following execution page to Form MA. You must also complete Form MA-NR. This execution page must be signed and attached to your initial application for *SEC* registration and all amendments to registration.

Non-Resident Municipal Advisor Undertaking Regarding Books and Records

By signing this Form MA, you 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 by law. 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 MA on behalf of, and with the authority of, the *non-resident municipal advisor*. The *municipal advisor* 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 Form MA, including exhibits and any other information submitted, are true and correct, and that I am signing this Form MA as a free and voluntary act.

I certify that the *municipal advisor'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 regulatory representatives. Further, attached as an exhibit to this Form MA is an opinion of counsel that the municipal advisor can, as a matter of law, provide the Commission with access to the books and records of such municipal advisor, as required by law, and that the municipal advisor can, as a matter of law, submit to onsite inspection and examination by the Commission.

Signature: _____

Date: _____

Printed Name: _____

Title: _____

Advisor *CRD* Number: _____

Self-Certification

I, the undersigned, sign this self-certification on behalf of and with the authority of the *municipal advisor*.

The *municipal advisor* and I both certify that the *municipal advisor* and every natural person associated with it has met, or within any applicable required timeframes will meet, such standards of training, experience, and competence, and such other qualifications, including testing, for a *municipal advisor* and natural persons associated with it, required by the *Commission*, the *MSRB* or any other relevant self-regulatory organization.

The *municipal advisor* and I certify that the *municipal advisor* has conducted an initial or annual review, as applicable, of the *municipal advisor*'s business and has reasonably determined that the municipal advisor: 1) can carry out the activities described in the items that are checked in Item 4.K (Applicant's Business Relating to Municipal Securities) of this form; 2) can comply with all applicable regulatory obligations; and 3) has met such regulatory obligations during the last year (or such shorter period if this is an initial application for registration). For these purposes, such applicable regulatory obligations are obligations under the federal securities laws and rules promulgated thereunder and applicable rules promulgated by the *MSRB*, or any other relevant self-regulatory organization. The *municipal advisor* has documented this review process and will maintain all documents relating to such review in accordance with rule 15Ba1-7(a)(8) under the Exchange Act.

Signature: _____

Date: _____

Printed Name: _____

Title: _____

Advisor *CRD* Number: _____

FORM MA-I

APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION FOR NATURAL PERSONS

PART 1

This form must be completed by all *municipal advisors* who are natural persons, including *employees* of *municipal advisors* that are organized entities (referred to herein as "*municipal advisory firms*") and sole proprietors (together, "*natural person municipal advisors*"). A *municipal advisory firm* applying for registration as a *municipal advisor* must complete Form MA. A sole proprietor must complete both Form MA and this Form MA-I.

WARNING: Complete this form truthfully. False statements or omissions may result in denial of application, revocation of registration, or criminal prosecution. Form MA-I must be amended whenever any information previously provided becomes inaccurate. See *General Instruction 9*. All *italicized* terms are defined or described in the Glossary to this Form.

Check the appropriate box:

This is an:

- Initial application to register as a *municipal advisor* with the SEC.
- Amendment to the *municipal advisor's* most recent Form MA-I.
- Municipal advisor's* annual self-certification.

Item 1 Identifying Information

Note: If this is an amendment to change identifying information regarding the applicant in part A below, check this box

A. The Applicant

Full Legal Name:

First: _____ Middle: _____ Last: _____ Suffix: _____

Individual CRD No.: _____ SSN: _____

B. The Applicant's Municipal Advisory Firm

Name of *municipal advisory firm* with which applicant is employed:

Most recent date employment with this *municipal advisory firm* commenced (MM/DD/YYYY): _____

Does the applicant have an independent contractor relationship with the above-named firm? Yes No

Municipal Advisory Firm's Registration Information:

Check all that apply:

- Municipal Advisor* SEC File No.: _____
- Municipal Securities Dealer SEC File No.: _____
- Broker-Dealer SEC File No.: _____ CRD No.: _____
- Investment Adviser*
 - SEC-Registered SEC File No.: _____ CRD No.: _____
 - State Registered CRD No. _____
- Government Securities Broker-Dealer SEC File No.: _____ Bank Identifier _____

Other SEC Registration (Specify) _____ SEC File No. or CIK: _____

Enter the following information for each office of the *municipal advisory firm* where the *natural person municipal advisor* will be physically located, and supervised from, as applicable:

Office

Located At Supervised From
Start Date: _____ End Date: _____
Street Address 1: _____
Street Address 2: _____
City: _____ State: _____ Country: _____ Postal Code: _____

Private Residence Check Box: If the Office of Employment address is a private residence, check this box.

Item 2 Other Names

Enter the following information for all other names that you have used or are using, or by which you are known or have been known, other than your legal name, since the age of 18. This space should include, for example, nicknames, aliases, and names used before or after marriage.

First Name: _____ Middle Name: _____ Last Name: _____ Suffix: _____

Item 3 Residential History

Starting with the current address, enter the following information for all residential addresses for the past 5 years. Leave no gaps greater than three months between addresses. Report changes in an amendment as they occur.

Current Address:
From (MM/YYYY): _____ To (MM/YYYY): _____
Street Address 1: _____
Street Address 2: _____
City: _____ State: _____ Country: _____ Postal Code: _____

Prior Address:
From (MM/YYYY): _____ To (MM/YYYY): _____
Street Address 1: _____
Street Address 2: _____
City: _____ State: _____ Country: _____ Postal Code: _____

Item 4 Employment History

Provide complete employment history for the past 10 years. Include the *municipal advisory firm* noted in Item 1. Enter the following information for each employer. Account for all time, leaving no gaps longer than three months, including full and part-time employment, self-employment, military service, and homemaking. Also include statuses such as unemployed, full-time education, extended travel, or other similar statuses.

Report changes in an amendment as they occur.

Current Employer:

From (MM/YYYY): _____ To (MM/YYYY): _____
Name of *Municipal Advisory Firm* or Company: _____
City: _____ State: _____ Country: _____
Municipal Advisor-Related Business? Yes No
Investment-Related Business? Yes No
Position Held: _____

Prior to the Above:

From (MM/YYYY): _____ To (MM/YYYY): _____

Name of *Municipal Advisory Firm* or Company: _____

City: _____ State: _____ Country: _____

Municipal Advisor-Related Business? Yes No

Investment-Related Business? Yes No

Position Held: _____

Item 5 Other Business

Are you currently engaged in any other business either as a proprietor, partner, officer, director, *employee*, trustee, agent or otherwise? Yes No

If yes, please enter the following details for each other business below:

Other Business:

Start Date (MM/YYYY): _____

Name of Business: _____

Street Address 1: _____

Street Address 2: _____

City: _____ State: _____ Country: _____

Municipal Advisor-Related Business? Yes No

Investment-Related Business? Yes No

Nature of Business: _____

Position/Title/Relationship: _____

Approximate No. of Hours / Month: _____

Description of Duties: _____

Item 6 Disclosure Questions

IF THE ANSWER TO ANY OF THE FOLLOWING QUESTIONS IS "YES," COMPLETE DETAILS OF ALL EVENTS OR *PROCEEDINGS* ON THE APPROPRIATE DISCLOSURE REPORTING PAGES IN PART II.

Refer to the Glossary for definitions or descriptions of italicized terms.

	YES	NO
CRIMINAL ACTION DISCLOSURE		
Item 6A.		
(1) Have you ever:		
(a) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to any <i>felony</i> ?	<input type="checkbox"/>	<input type="checkbox"/>
(b) been <i>charged</i> with any <i>felony</i> ?	<input type="checkbox"/>	<input type="checkbox"/>
(2) Based upon activities that occurred while you exercised <i>control</i> over it, has an organization ever:		
(a) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic or foreign court to any <i>felony</i> ?	<input type="checkbox"/>	<input type="checkbox"/>
(b) been <i>charged</i> with any <i>felony</i> ?	<input type="checkbox"/>	<input type="checkbox"/>

Item 6B.

(1) Have you ever:

(a) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to a *misdemeanor* involving: *municipal advisory activities* or a *municipal advisor-related* or *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?

(b) been *charged* with a *misdemeanor* specified in 6B(1)(a)?

(2) Based upon activities that occurred while you exercised *control* over it, has an organization ever:

(a) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic or foreign court to a *misdemeanor* specified in 6B(1)(a)?

(b) been *charged* with a *misdemeanor* specified in 6B(1)(a)?

REGULATORY ACTION DISCLOSURE **YES** **NO**

Item 6C.

Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:

(1) *found* you to have made a false statement or omission?

(2) *found* you to have been *involved* in a violation of its regulations or statutes?

(3) *found* you to have been the cause of a denial, suspension, revocation, or restriction of the authorization of a *municipal advisor-related* business or *investment-related* business to operate?

(4) entered an *order* against you in connection with *municipal advisor-related* or *investment-related* activity?

(5) imposed a civil money penalty on you, or *ordered* you to cease and desist from any activity?

(6) *found* you to have willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board, or *found* you to have been unable to comply with any provision of such Act, rule or regulation?

(7) *found* you to have willfully aided, abetted, counseled, commanded, induced, or procured the violation by any *person* of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board?

(8) *found* you to have failed reasonably to supervise another *person* subject to your supervision, with a view to preventing the violation of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board?

Item 6D.

(1) Has any other federal regulatory agency or any state regulatory agency or *foreign financial regulatory authority* ever:

- (a) *found* you to have made a false statement or omission or been dishonest, unfair or unethical?
- (b) *found* you to have been *involved* in a violation of *municipal advisor-related* or *investment-related* regulation(s) or statute(s)?
- (c) *found* you to have been a cause of the denial, suspension, revocation, or restriction of the authorization of a *municipal advisor-related* or *investment-related* business to operate?
- (d) entered an *order* against you in connection with a *municipal advisor-related* or *investment-related* activity?
- (e) denied, suspended, or revoked your registration or license or otherwise, by *order*, prevented you from associating with a *municipal advisor-related* or *investment-related* business or restricted your activities?

(2) Have you been subject to any final *order* of a state securities commission (or any agency or office performing like functions), state authority that supervises or examines banks, savings associations, or credit unions, state insurance commission (or any agency or office performing like functions), an appropriate *federal banking agency*, or the National Credit Union Administration, that:

- (a) bars you from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or
- (b) constitutes a final *order* based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct?

6E.

Has any *self-regulatory organization* ever:

- (1) *found* you to have made a false statement or omission?
- (2) *found* you 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 U.S. Securities and Exchange Commission)?
- (3) *found* you to have been the cause of a denial, suspension, revocation, or restriction of the authorization of a *municipal advisor-related* or *investment-related* business to operate?
- (4) disciplined you by expelling or suspending you from membership, barring or suspending your association with its members, or restricting your activities?
- (5) *found* you to have willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board, or *found* you to have been unable to comply with any provision of such Act, rule or regulation?
- (6) *found* you to have willfully aided, abetted, counseled, commanded, induced, or procured the violation by any *person* of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board?

(7) *found* you to have failed reasonably to supervise another *person* subject to your supervision, with a view to preventing the violation of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, the Commodity Exchange Act, or any rule or regulation under any of such Acts, or any of the rules of the Municipal Securities Rulemaking Board?

6F.
Have you ever had an authorization to act as an attorney, accountant or federal contractor that was revoked or suspended?

6G.
Have you been notified, in writing, that you are now the subject of any:

- (1) regulatory complaint or *proceeding* that could result in a "yes" answer to any part of 6C, D or E? (If "yes," complete the Regulatory Action Disclosure Reporting Page.)
- (2) *investigation* that could result in a "yes" answer to any part of 6A, B, C, D or E? (If "yes," complete the Investigation Disclosure Reporting Page.)

CIVIL JUDICIAL ACTION DISCLOSURE **YES** **NO**

- 6H.
- (1) Has any domestic or foreign court ever:
 - (a) *enjoined* you in connection with any *municipal advisor-related* or *investment-related* activity?
 - (b) *found* that you were *involved* in a violation of any *municipal advisor-related* or *investment-related* statute(s) or regulation(s)?
 - (c) dismissed, pursuant to a settlement agreement, a *municipal advisor-related* or *investment-related* civil action brought against you by a state or *foreign financial regulatory authority*?
 - (2) Are you named in any pending *municipal advisor-related* or *investment-related* civil action that could result in a "yes" answer to any part of 6H(1)?

CUSTOMER COMPLAINT/ARBITRATION/CIVIL LITIGATION DISCLOSURE **YES** **NO**

- 6I.
- (1) Have you ever been the subject of a *municipal advisor-related* or *investment-related*, consumer-initiated (written or oral) complaint which alleged that you were *involved* in fraud, false statements, omissions, theft, embezzlement, wrongful taking of property, bribery, forgery, counterfeiting, extortion, and dishonest, unfair or unethical practices, and which:
 - (a) is still pending, or;
 - (b) was settled?
 - (2) Have you ever been the subject of a *municipal advisor-related* or *investment-related*, consumer-initiated arbitration or civil litigation which alleged that you were *involved* in fraud, false statements, omissions, theft, embezzlement, wrongful taking of property, bribery, forgery, counterfeiting, extortion, and dishonest, unfair or unethical practices, and which:
 - (a) is still pending, or;

- (b) resulted in an arbitration award or civil judgment against you, regardless of amount, or;
- (c) was settled?

TERMINATION DISCLOSURE

YES NO

6J. Have you ever voluntarily *resigned*, been discharged or permitted to *resign* after allegations were made that accused you of:

- (1) violating *municipal advisor-related* or *investment-related* statutes, regulations, rules, or industry standards of conduct?
- (2) fraud or the wrongful taking of property?
- (3) failure to supervise in connection with *municipal advisor-related* or *investment-related* statutes, regulations, rules or industry standards of conduct?

FINANCIAL DISCLOSURE

YES NO

6K.

Within the past 10 years:

- (1) have you made a compromise with creditors, filed a bankruptcy petition or been the subject of an involuntary bankruptcy petition?
- (2) based upon events that occurred while you exercised *control* over it, has an organization made a compromise with creditors, filed a bankruptcy petition or been the subject of an involuntary bankruptcy petition?
- (3) based upon events that occurred while you exercised *control* over it, has a broker or dealer been the subject of an involuntary bankruptcy petition, or had a trustee appointed, or had a direct payment procedure initiated under the Securities Investor Protection Act?

6L.

Has a bonding company ever denied, paid out on, or revoked a bond for you?

6M.

Do you have any unsatisfied judgments or liens against you?

Item 7 Signature and Self-Certification

Signature

The *municipal advisor* consents that service of any civil action brought by, or notice of any *proceeding* before, the Securities and Exchange Commission or any *self-regulatory organization* in connection with the *municipal advisor's municipal advisory activities* may be given by registered or certified mail or confirmed telegram to the *municipal advisor's* address given in Item 1. To the extent that the *municipal advisor* is a *non-resident municipal advisor*, the *municipal advisor* must also complete Form MA-NR.

I, the undersigned, certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this Form MA-I, including exhibits and any other information submitted, are true and correct, and that I am signing this Form MA-I Execution Page as a free and voluntary act.

Date: _____

Full Legal Name of *Municipal Advisor*: _____

By: _____
(signature)

Title: _____

Self-Certification

I, the undersigned, certify that:

I have 1) sufficient qualifications, training, experience, and competence to effectively carry out my designated functions; 2) met, or within any applicable required timeframes will meet, such standards of training, experience, and competence, and such other qualifications, including testing, for a municipal advisor, required by the *Commission*, the *MSRB* or any other relevant self-regulatory organization; and 3) the necessary understanding of, and ability to comply with, all applicable regulatory obligations. For these purposes, such applicable regulatory obligations are obligations under the federal securities laws and rules promulgated thereunder and applicable rules promulgated by the *MSRB*, or any other relevant self-regulatory organization.

Date: _____

Full Legal Name of *Municipal Advisor*: _____

By: _____
(signature)

Title: _____

Warning: Intentional misstatements or omissions of fact constitute Federal criminal violations. See, 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

PART 2: DISCLOSURE REPORTING PAGES (DRPs)

CRIMINAL ACTION DISCLOSURE

This Disclosure Form is an INITIAL or AMENDED response to report details for affirmative response(s) to *Question(s) 6A and 6B* on Form MA-I;

Check the question(s) you are responding to, regardless of whether you are answering the question(s) "yes" or amending the answer(s) to "no":

- 6A(1)(a) 6A(1)(b) 6A(2)(a) 6A(2)(b)
 6B(1)(a) 6B(1)(b) 6B(2)(a) 6B(2)(b)

Use this Disclosure Form to report all *charges* arising out of the same event. One event may result in more than one affirmative answer to the above items. Multiple counts of the same *charge* arising out of the same event should be reported on the same Disclosure Form. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate Disclosure Forms.

Applicable court documents (*i.e.*, criminal complaint, information or indictment as well as judgment of conviction or sentencing documents) must be provided electronically if not previously submitted.

If the applicant is also registered through the *IARD* system or *CRD* system, registered with the *SEC* as a *municipal advisor* on Form MA, or previously registered with the *SEC* on Form MA-T, or is an *associated person of a municipal advisor* that is registered with the *SEC* on Form MA or that previously registered with the *SEC* on Form MA-T, has the applicant or *municipal advisor* with which it is associated previously submitted a *DRP* (with Form ADV, BD, or U4) to the *IARD* or *CRD*, or submitted to the *SEC* disclosure on Form MA-T or a *DRP* with a Form MA, for the event that contains the information required by this *DRP*? Yes No

If the answer is "Yes," no other information on this *DRP* must be provided.

NOTE: The completion of this form does not relieve the applicant or any municipal advisor with which it is associated of its obligation to update its Form MA or its IARD or CRD records.

1. If *charge(s)* were brought against an organization over which you exercise(d) *control*:

- A. Organization Name: _____
B. *Municipal Advisor-Related* or *Investment-Related* business? Yes No
C. Position, title or relationship: _____

2. Formal action was brought in:

- Federal Court
 State Court
 Foreign Court
 Military Court
 Other: _____

- A. Name of Court: _____
B. Location of Court (City or County and State or Country): _____
C. Docket/Case#: _____

3. Event Status:

- A. Current status of the Event? Pending On Appeal Final
B. Event Status Date (complete unless status is pending) (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

4. Event and Disposition Disclosure Detail (Use this for both organizational and individual *charges*):

- A. Date First Charged (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

CRIMINAL ACTION DISCLOSURE (CONT.)

B. Event and Disposition Detail:

Charge Details (complete every space for each charge)

Formal Charge/Description: _____

No. of Counts: _____

Felony or Misdemeanor: Felony Misdemeanor

Plea for each Charge: _____

Disposition of Charge:

- | | | |
|--|---|---|
| <input type="checkbox"/> Acquitted | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Pre-trial intervention |
| <input type="checkbox"/> Amended | <input type="checkbox"/> Found not guilty | <input type="checkbox"/> Reduced |
| <input type="checkbox"/> Convicted | <input type="checkbox"/> Pled guilty | <input type="checkbox"/> Other (requires explanation) |
| <input type="checkbox"/> Deferred Adjudication | <input type="checkbox"/> Pled not guilty | |

Explanation: _____

Date of Amended Charge, if applicable: _____

If original charge was amended or reduced, specify new charge (i.e., list amended charge or reduced charge):

No. of Counts (for amended or reduced charge): _____

Specify if amended or reduced charge is a Felony or Misdemeanor: Felony Misdemeanor

Plea for each amended or reduced Charge: _____

Disposition of amended or reduced Charge:

- | | | |
|--|---|---|
| <input type="checkbox"/> Acquitted | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Pre-trial intervention |
| <input type="checkbox"/> Amended | <input type="checkbox"/> Found not guilty | <input type="checkbox"/> Reduced |
| <input type="checkbox"/> Convicted | <input type="checkbox"/> Pled guilty | <input type="checkbox"/> Other (requires explanation) |
| <input type="checkbox"/> Deferred Adjudication | <input type="checkbox"/> Pled not guilty | |

Explanation: _____

Charge Details (complete every space for each charge)

Formal Charge/Description: _____

No. of Counts: _____

Felony or Misdemeanor: Felony Misdemeanor

Plea for each Charge: _____

Disposition of Charge:

- | | | |
|--|---|---|
| <input type="checkbox"/> Acquitted | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Pre-trial intervention |
| <input type="checkbox"/> Amended | <input type="checkbox"/> Found not guilty | <input type="checkbox"/> Reduced |
| <input type="checkbox"/> Convicted | <input type="checkbox"/> Pled guilty | <input type="checkbox"/> Other (requires explanation) |
| <input type="checkbox"/> Deferred Adjudication | <input type="checkbox"/> Pled not guilty | |

Explanation: _____

Date of Amended Charge, if applicable: _____

If original charge was amended or reduced, specify new charge (i.e., list amended charge or reduced charge):

No. of Counts (for amended or reduced charge): _____

Specify if amended or reduced charge is a Felony or Misdemeanor: Felony Misdemeanor

Plea for each amended or reduced Charge: _____

CRIMINAL ACTION DISCLOSURE (CONT.)

Disposition of amended or reduced *Charge*:

- | | | |
|--|--|---|
| <input type="checkbox"/> Acquitted | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Pre-trial intervention |
| <input type="checkbox"/> Amended | <input type="checkbox"/> <i>Found</i> not guilty | <input type="checkbox"/> Reduced |
| <input type="checkbox"/> Convicted | <input type="checkbox"/> Pled guilty | <input type="checkbox"/> Other (requires explanation) |
| <input type="checkbox"/> Deferred Adjudication | <input type="checkbox"/> Pled not guilty | |

Explanation:

Charge Details (complete every space for each charge)

Formal *Charge*/Description:

No. of Counts: _____

Felony or *Misdemeanor*: *Felony* *Misdemeanor*

Plea for each *Charge*: _____

Disposition of *Charge*:

- | | | |
|--|--|---|
| <input type="checkbox"/> Acquitted | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Pre-trial intervention |
| <input type="checkbox"/> Amended | <input type="checkbox"/> <i>Found</i> not guilty | <input type="checkbox"/> Reduced |
| <input type="checkbox"/> Convicted | <input type="checkbox"/> Pled guilty | <input type="checkbox"/> Other (requires explanation) |
| <input type="checkbox"/> Deferred Adjudication | <input type="checkbox"/> Pled not guilty | |

Explanation:

Date of Amended *Charge*, if applicable: _____

If original *charge* was amended or reduced, specify new *charge* (i.e., list amended *charge* or reduced *charge*):

No. of Counts (for amended or reduced *charge*): _____

Specify if amended or reduced *charge* is a *Felony* or *Misdemeanor*: *Felony* *Misdemeanor*

Plea for each amended or reduced *Charge*: _____

Disposition of amended or reduced *Charge*:

- | | | |
|--|--|---|
| <input type="checkbox"/> Acquitted | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Pre-trial intervention |
| <input type="checkbox"/> Amended | <input type="checkbox"/> <i>Found</i> not guilty | <input type="checkbox"/> Reduced |
| <input type="checkbox"/> Convicted | <input type="checkbox"/> Pled guilty | <input type="checkbox"/> Other (requires explanation) |
| <input type="checkbox"/> Deferred Adjudication | <input type="checkbox"/> Pled not guilty | |

Explanation:

C. Date of Disposition (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

D. Sentence/Penalty; Duration (if suspension, probation, etc): Start Date of Penalty: (MM/DD/YYYY); End date of Penalty: (MM/DD/YYYY); If Monetary penalty/fine - Amount paid; Date monetary/penalty fine paid: (MM/DD/YYYY) if not exact, provide explanation.

5. Comment (Optional). You may use this space to provide a brief summary of the circumstances leading to the *charge(s)* as well as the current status or final disposition. Your information must fit within the space provided.

REGULATORY ACTION DISCLOSURE

This Disclosure Form is an **INITIAL** or **AMENDED** response to report details for affirmative response(s) to *Question(s) 6C, 6D, 6E, 6F and 6G(1)* on Form MA-I;

Check the question(s) you are responding to, regardless of whether you are answering the question(s) "yes" or amending the answer(s) to "no":

- | | | | |
|--------------------------------|-----------------------------------|--------------------------------|--------------------------------|
| <input type="checkbox"/> 6C(1) | <input type="checkbox"/> 6D(1)(a) | <input type="checkbox"/> 6E(1) | <input type="checkbox"/> 6F |
| <input type="checkbox"/> 6C(2) | <input type="checkbox"/> 6D(1)(b) | <input type="checkbox"/> 6E(2) | |
| <input type="checkbox"/> 6C(3) | <input type="checkbox"/> 6D(1)(c) | <input type="checkbox"/> 6E(3) | <input type="checkbox"/> 6G(1) |
| <input type="checkbox"/> 6C(4) | <input type="checkbox"/> 6D(1)(d) | <input type="checkbox"/> 6E(4) | |
| <input type="checkbox"/> 6C(5) | <input type="checkbox"/> 6D(1)(e) | <input type="checkbox"/> 6E(5) | |
| <input type="checkbox"/> 6C(6) | <input type="checkbox"/> 6D(2)(a) | <input type="checkbox"/> 6E(6) | |
| <input type="checkbox"/> 6C(7) | <input type="checkbox"/> 6D(2)(b) | <input type="checkbox"/> 6E(7) | |
| <input type="checkbox"/> 6C(8) | | | |

One matter may result in more than one affirmative answer to the above items. Use a single Disclosure Form to report details to the same event. If an event gives rise to actions by more than one regulator, provide details to each action on a separate Disclosure Form.

If the applicant is also registered through the *IARD* system or *CRD* system, registered with the *SEC* as a *municipal advisor* on Form MA, or previously registered with the *SEC* on Form MA-T, or is an *associated person of a municipal advisor* that is registered with the *SEC* on Form MA or that previously registered with the *SEC* on Form MA-T, has the applicant or *municipal advisor* with which it is associated previously submitted a *DRP* (with Form ADV, BD, or U4) to the *IARD* or *CRD*, or submitted to the *SEC* disclosure on Form MA-T or a *DRP* with a Form MA, for the event that contains the information required by this *DRP*? Yes No
 If the answer is "Yes," no other information on this *DRP* must be provided.

NOTE: The completion of this form does not relieve the applicant or any municipal advisor with which it is associated of its obligation to update its Form MA or its IARD or CRD records.

1. Regulatory Action initiated by:

A. (Select appropriate item):

- | | | | | | |
|---|---|---------------------------------------|-------------------------------------|--------------------------------------|---|
| <input type="checkbox"/> <i>SEC</i> | <input type="checkbox"/> Other Federal Agency | <input type="checkbox"/> Jurisdiction | <input type="checkbox"/> <i>SRO</i> | <input type="checkbox"/> <i>CFTC</i> | <input type="checkbox"/> Foreign Financial Regulatory Authority |
| <input type="checkbox"/> Federal Banking Agency | <input type="checkbox"/> National Credit Union Administration | <input type="checkbox"/> Other: _____ | | | |

B. Full name of regulator (if other than the *SEC*) that initiated the action: _____

2. Sanctions Sought (select all that apply):

- | | | |
|---|---|---------------------------------------|
| <input type="checkbox"/> Bar | <input type="checkbox"/> Cease and Desist | <input type="checkbox"/> Censure |
| <input type="checkbox"/> Civil and Administrative | <input type="checkbox"/> Denial | <input type="checkbox"/> Disgorgement |

Penalty(ies)/Fines(s)

- | | | |
|--------------------------------------|--|--------------------------------------|
| <input type="checkbox"/> Expulsion | <input type="checkbox"/> Monetary Penalty other than Fines | <input type="checkbox"/> Prohibition |
| <input type="checkbox"/> Reprimand | <input type="checkbox"/> Requalification | <input type="checkbox"/> Rescission |
| <input type="checkbox"/> Restitution | <input type="checkbox"/> Revocation | <input type="checkbox"/> Suspension |
| <input type="checkbox"/> Undertaking | <input type="checkbox"/> Other: _____ | |

3. Date Initiated (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

4. Docket/Case#: _____

5. Employing *Municipal Advisory Firm* when activity occurred which led to the regulatory action: _____

REGULATORY ACTION DISCLOSURE (CONT.)

6. Product Type(s): (select all that apply)

- | | | |
|--|---|--|
| <input type="checkbox"/> No Product | <input type="checkbox"/> Derivative | <input type="checkbox"/> Mutual Fund |
| <input type="checkbox"/> Annuity-Charitable | <input type="checkbox"/> Direct Investment-DPP & LP Interest | <input type="checkbox"/> Oil & Gas |
| <input type="checkbox"/> Annuity-Fixed | <input type="checkbox"/> Equipment Leasing | <input type="checkbox"/> Options |
| <input type="checkbox"/> Annuity-Variable | <input type="checkbox"/> Equity Listed (Common & Preferred Stock) | <input type="checkbox"/> Penny Stock |
| <input type="checkbox"/> Banking Product (other than CD) | <input type="checkbox"/> Equity-OTC | <input type="checkbox"/> Prime Bank Instrument |
| <input type="checkbox"/> CD | <input type="checkbox"/> Futures Commodity | <input type="checkbox"/> Promissory Note |
| <input type="checkbox"/> Commodity Option | <input type="checkbox"/> Futures-Financial | <input type="checkbox"/> Real Estate Security |
| <input type="checkbox"/> Debt-Asset Backed | <input type="checkbox"/> Index Option | <input type="checkbox"/> Security Futures |
| <input type="checkbox"/> Debt-Corporate | <input type="checkbox"/> Insurance | <input type="checkbox"/> Unit Investment Trust |
| <input type="checkbox"/> Debt-Government | <input type="checkbox"/> Investment Contract | <input type="checkbox"/> Viatical Settlement |
| <input type="checkbox"/> Debt-Municipal | <input type="checkbox"/> Money Market Fund | <input type="checkbox"/> Other: _____ |

7. Describe the allegations related to this regulatory action:

8. Current Status? Pending On Appeal Final

9. If pending, are there any limitations or restrictions currently in effect? Yes No
If the answer is "yes," provide details:

10. If on appeal:

A. Action appealed to:

- SEC SRO CFTC Federal Court State Agency State Court or Commission

Other: _____

B. Date appeal filed (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

C. Are there any limitations or restrictions currently in effect while on appeal? Yes No

If the answer is "yes," provide details:

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.

11. Resolution Detail:

A. How was matter resolved? (select appropriate item):

- | | | |
|--|--|-----------------------------------|
| <input type="checkbox"/> Acceptance Waiver & Consent (AWC) | <input type="checkbox"/> Consent | <input type="checkbox"/> Decision |
| <input type="checkbox"/> Decision & Order of Offer of Settlement | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Order |
| <input type="checkbox"/> Settled | <input type="checkbox"/> Stipulation and Consent | <input type="checkbox"/> Vacated |
| <input type="checkbox"/> Vacated Nunc Pro Tunc / ab initio | <input type="checkbox"/> Withdrawn | |
| <input type="checkbox"/> Other: _____ | | |

B. Resolution Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

REGULATORY ACTION DISCLOSURE (CONT.)

12. Does the *order* constitute a final *order* based on violations of any laws or regulations that prohibit fraudulent, or deceptive conduct?

Yes No

13. Sanction Detail:

A. Were any of the following sanctions *ordered*? (Select all appropriate items):

- | | | |
|--|--|--|
| <input type="checkbox"/> Bar (Permanent) | <input type="checkbox"/> Bar (Temporary / Time Limited) | <input type="checkbox"/> Cease and Desist |
| <input type="checkbox"/> Censure | <input type="checkbox"/> Civil and Administrative Penalty(ies)/Fine(s) | <input type="checkbox"/> Denial |
| <input type="checkbox"/> Disgorgement | <input type="checkbox"/> Expulsion | <input type="checkbox"/> Letter of Reprimand |
| <input type="checkbox"/> Monetary Penalty Other than Fines | <input type="checkbox"/> Prohibition | <input type="checkbox"/> Requalification |
| <input type="checkbox"/> Rescission | <input type="checkbox"/> Restitution | <input type="checkbox"/> Revocation |
| <input type="checkbox"/> Suspension | <input type="checkbox"/> Undertaking | |

B. Other sanctions *ordered*: _____

C. If suspended or barred, provide:

Sanction Type: Bar (Permanent) Bar (Temporary / Time Limited) Suspension

Registration Capacities affected (e.g., General Securities Principal, Financial Operations Principal, All Capacities, etc.):

Duration (length of time): _____ Exact Explanation
If not exact, provide explanation:

Start Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

End Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

Sanction Details

Sanction Type: Bar (Permanent) Bar (Temporary / Time Limited) Suspension

Registration Capacities affected (e.g., General Securities Principal, Financial Operations Principal, All Capacities, etc.):

Duration (length of time): _____ Exact Explanation
If not exact, provide explanation:

Start Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

End Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

REGULATORY ACTION DISCLOSURE (CONT.)

Sanction Details

Sanction Type: Bar (Permanent) Bar (Temporary / Time Limited) Suspension

Registration Capacities affected (e.g., General Securities Principal, Financial Operations Principal, All Capacities, etc.):

B. Duration (length of time): _____ Exact Explanation
If not exact, provide explanation:

Start Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

End Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

D. If requalification by exam/retraining was a condition of the sanction, provide:

Requalification Details

Requalification Type: Requalification by Exam Re-Training Other
Length of time given to requalify/retrain: _____
Type of Exam required: _____
Has condition been satisfied? Yes No
Explanation:

Requalification Details

Requalification Type: Requalification by Exam Re-Training Other
Length of time given to requalify/retrain: _____
Type of Exam required: _____
Has condition been satisfied? Yes No
Explanation:

Requalification Details

Requalification Type: Requalification by Exam Re-Training Other
Length of time given to requalify/retrain: _____
Type of Exam required: _____
Has condition been satisfied? Yes No
Explanation:

REGULATORY ACTION DISCLOSURE (CONT.)

E. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide:

Monetary Sanction Details

Monetary Related Sanction Type: Civil and Administrative Penalty(ies)/Fine(s) Disgorgement
 Monetary Penalty other than Fines Restitution

Total Amount: \$ _____
Portion levied against you: \$ _____
Payment Plan:

Is Payment Plan Current? Yes No
Date Paid by You (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

Was any portion of penalty waived? Yes No
If yes, amount: \$ _____

Monetary Sanction Details

Monetary Related Sanction Type: Civil and Administrative Penalty(ies)/Fine(s) Disgorgement
 Monetary Penalty other than Fines Restitution

Total Amount: \$ _____
Portion levied against you: \$ _____
Payment Plan:

Is Payment Plan Current? Yes No
Date Paid by You (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

Was any portion of penalty waived? Yes No
If yes, amount: \$ _____

Monetary Sanction Details

Monetary Related Sanction Type: Civil and Administrative Penalty(ies)/Fine(s) Disgorgement
 Monetary Penalty other than Fines Restitution

Total Amount: \$ _____
Portion levied against you: \$ _____
Payment Plan:

Is Payment Plan Current? Yes No
Date Paid by You (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

Was any portion of penalty waived? Yes No
If yes, amount: \$ _____

14. Comment (Optional). You may use this space to provide a brief summary of the circumstances leading to the action as well as the current status or disposition and/or finding(s).

INVESTIGATION DISCLOSURE

This Disclosure Form is an **INITIAL** or **AMENDED** response to report details for affirmative response(s) to *Question(s) 6G(2)* on Form MA-I;

Check the question(s) you are responding to, regardless of whether you are answering the question(s) "yes" or amending the answer(s) to "no":

6G(2)

Complete this Disclosure Form only if you are answering "yes" to Item 6G(2). If you answered "yes" to Item 6G(1), complete the Regulatory Action Disclosure Form. If you have been notified that the *investigation* has been concluded without formal action, complete items 4 and 5 of this Disclosure Form to update. One event may result in more than one *investigation*. If more than one authority is *investigating* you, use a separate Disclosure Form to provide details.

If the applicant is also registered through the *IARD* system or *CRD* system, registered with the *SEC* as a *municipal advisor* on Form MA, or previously registered with the *SEC* on Form MA-T, or is an *associated person of a municipal advisor* that is registered with the *SEC* on Form MA or that previously registered with the *SEC* on Form MA-T, has the applicant or *municipal advisor* with which it is associated previously submitted a *DRP* (with Form ADV, BD, or U4) to the *IARD* or *CRD*, or submitted to the *SEC* disclosure on Form MA-T or a *DRP* with a Form MA, for the event that contains the information required by this *DRP*? Yes No
If the answer is "Yes," no other information on this *DRP* must be provided.

NOTE: The completion of this form does not relieve the applicant or any municipal advisor with which it is associated of its obligation to update its Form MA or its IARD or CRD records.

1. *Investigation* initiated by:

A. Notice Received From (select appropriate item):

- SRO* *Foreign* *Jurisdiction* *SEC* *Other Federal Agency*
- Financial*
- Regulatory Authority*

Other: _____

B. Full name of regulator (if other than the *SEC*) that initiated the *investigation*: _____

2. Notice Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

3. Describe briefly the nature of the *investigation*, if known:

4. Is *investigation* pending? Yes No

If no, complete item 5. If yes, skip to item 6.

5. Resolution Details:

A. Date Closed/Resolved (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

B. How was *investigation* resolved? (select appropriate item):

- Closed Without Further Action Closed - Regulatory Action Initiated Other: _____

6. Comment (Optional). You may use this space to provide a brief summary of the circumstances leading to the *investigation*, as well as the current status or final disposition and/or finding(s).

CIVIL JUDICIAL ACTION DISCLOSURE

This Disclosure Form is an **INITIAL** or **AMENDED** response to report details for affirmative response(s) to **Question(s) 6H** on Form MA-I;

Check the question(s) you are responding to, regardless of whether you are answering the question(s) "yes" or amending the answer(s) to "no":

6H(1)(a) **6H(1)(b)** **6H(1)(c)** **6H(2)**

One event may result in more than one affirmative answer to the above items. Use only one Disclosure Form to report details related to the same event. Unrelated civil judicial actions must be reported on separate Disclosure Forms.

If the applicant is also registered through the *IARD* system or *CRD* system, registered with the *SEC* as a *municipal advisor* on Form MA, or previously registered with the *SEC* on Form MA-T, or is an *associated person of a municipal advisor* that is registered with the *SEC* on Form MA or that previously registered with the *SEC* on Form MA-T, has the applicant or *municipal advisor* with which it is associated previously submitted a *DRP* (with Form ADV, BD, or U4) to the *IARD* or *CRD*, or submitted to the *SEC* disclosure on Form MA-T or a *DRP* with a Form MA, for the event that contains the information required by this *DRP*? Yes No

If the answer is "Yes," no other information on this *DRP* must be provided.

NOTE: The completion of this form does not relieve the applicant or any municipal advisor with which it is associated of its obligation to update its Form MA or its IARD or CRD records.

1. Court Action initiated by:

A. (Select appropriate item):

- SEC*
- Other Federal Agency
- Jurisdiction
- Foreign Financial Regulatory Authority*
- Municipal Advisory Firm*
- Private Plaintiff

B. Name of party initiating the *proceeding*: _____

2. Relief Sought: (select all that apply):

- Cease and Desist Injunction Restraining Order Civil and Administrative Penalty(ies)/Fine(s)
- Monetary Penalty other than Fines Other: _____
- Disgorgement Restitution

3. A. Filing Date of Court Action (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

B. Date notice/process was served (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

CIVIL JUDICIAL ACTION DISCLOSURE (CONT.)

4. Product Type(s): (select all that apply)

- | | | |
|--|---|--|
| <input type="checkbox"/> No Product | <input type="checkbox"/> Derivative | <input type="checkbox"/> Mutual Fund |
| <input type="checkbox"/> Annuity-Charitable | <input type="checkbox"/> Direct Investment-DPP & LP Interest | <input type="checkbox"/> Oil & Gas |
| <input type="checkbox"/> Annuity-Fixed | <input type="checkbox"/> Equipment Leasing | <input type="checkbox"/> Options |
| <input type="checkbox"/> Annuity-Variable | <input type="checkbox"/> Equity Listed (Common & Preferred Stock) | <input type="checkbox"/> Penny Stock |
| <input type="checkbox"/> Banking Product (other than CD) | <input type="checkbox"/> Equity-OTC | <input type="checkbox"/> Prime Bank Instrument |
| <input type="checkbox"/> CD | <input type="checkbox"/> Futures Commodity | <input type="checkbox"/> Promissory Note |
| <input type="checkbox"/> Commodity Option | <input type="checkbox"/> Futures-Financial | <input type="checkbox"/> Real Estate Security |
| <input type="checkbox"/> Debt-Asset Backed | <input type="checkbox"/> Index Option | <input type="checkbox"/> Security Futures |
| <input type="checkbox"/> Debt-Corporate | <input type="checkbox"/> Insurance | <input type="checkbox"/> Unit Investment Trust |
| <input type="checkbox"/> Debt-Government | <input type="checkbox"/> Investment Contract | <input type="checkbox"/> Viatical Settlement |
| <input type="checkbox"/> Debt-Municipal | <input type="checkbox"/> Money Market Fund | <input type="checkbox"/> Other: _____ |

5. Formal Action was brought in:

- Federal Court
- State Court
- Foreign Court
- Military Court
- Other: _____

- A. Name of Court: _____
- B. Location of Court (City or County and State or Country): _____
- C. Docket/Case#: _____

6. Employing *Municipal Advisory Firm* when activity occurred which led to the civil judicial action: _____

7. Describe the allegations related to this civil action. (Your information must fit within the space provided.):

8. Current Status?

- Pending
- On Appeal
- Final

9. If pending and any limitations or restrictions are currently in effect, provide details:

10. If on appeal:

- A. Action appealed to (provide name of court): _____
 - B. Location of Court (City or County and State or Country): _____
 - C. Docket/Case#: _____
 - D. Date appeal filed (MM/DD/YYYY): _____ Exact Explanation
- If not exact, provide explanation:

E. Appeal details (including status):

F. If on appeal and any limitations or restrictions are currently in effect, provide details:

CIVIL JUDICIAL ACTION DISCLOSURE (CONT.)

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

11. Resolution Detail:

A. How was matter resolved? (Select appropriate item)

- Consent
- Judgment Rendered
- Settled
- Vacated
- Vacated Nunc Pro Tunc / ab initio
- Dismissed
- Withdrawn
- Other: _____

B. Resolution Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

12. Sanction Detail:

A. Were any of the following Sanctions *Ordered* or Relief Granted? (Select all that apply)

- Civil and Administrative Injunction Cease and Desist
- Penalty(ies)/Fine(s)
- Monetary Penalty other than fines Disgorgement Restitution

B. Other Sanctions: _____

C. If *enjoined*, provide:

Injunction Details

Registration Capacities Affected (e.g., General Securities Principal, Financial Operations Principal, All Capacities, etc.):

Duration (length of time): _____ Exact Explanation

If not exact, provide explanation:

Start Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

End Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

Injunction Details

Registration Capacities Affected (e.g., General Securities Principal, Financial Operations Principal, All Capacities, etc.):

Duration (length of time): _____ Exact Explanation

If not exact, provide explanation:

Start Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

End Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

CIVIL JUDICIAL ACTION DISCLOSURE (CONT.)

Injunction Details

Registration Capacities Affected (e.g., General Securities Principal, Financial Operations Principal, All Capacities, etc.):

Duration (length of time): _____ Exact Explanation
If not exact, provide explanation:

Start Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

End Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

D. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide:

Monetary Related Sanction Details

Monetary Related Sanction Type:

- Monetary Fine
- Disgorgement
- Restitution
- Other (requires explanation)

Explanation:

Total Amount: \$ _____
Portion levied against you: \$ _____
Date Paid by You (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

Was any portion of penalty waived? Yes No
If yes, amount: \$ _____

Monetary Related Sanction Details

Monetary Related Sanction Type:

- Monetary Fine
- Disgorgement
- Restitution
- Other (requires explanation)

Explanation:

Total Amount: \$ _____
Portion levied against you: \$ _____
Date Paid by You (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

Was any portion of penalty waived? Yes No
If yes, amount: \$ _____

CIVIL JUDICIAL ACTION DISCLOSURE (CONT.)

Monetary Related Sanction Details

Monetary Related Sanction Type:

- Monetary Fine
- Disgorgement
- Restitution
- Other (requires explanation)

Explanation:

Total Amount: \$ _____

Portion levied against you: \$ _____

Date Paid by You (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

Was any portion of penalty waived? Yes No

If yes, amount: \$ _____

13. Comment (Optional). You may use this space to provide a brief summary of the circumstances leading to the action, as well as the current status or disposition and/or finding(s).

CUSTOMER COMPLAINT / ARBITRATION / CIVIL LITIGATION DISCLOSURE

This Disclosure Form is an **INITIAL** or **AMENDED** response to report details for affirmative response(s) to **Question(s) 6I** on Form MA-I;

Check the question(s) you are responding to, regardless of whether you are answering the question(s) "yes" or amending the answer(s) to "no":

- 6I(1)(a)** **6I(2)(a)** **6I(2)(c)**
 6I(1)(b) **6I(2)(b)**

One matter may result in more than one affirmative answer to the above items. Use a single Disclosure Form to report details relating to a particular matter (*i.e.*, a customer complaint/arbitration/*CFTC* reparation/civil litigation). Use a separate Disclosure Form for each matter.

If the applicant is also registered through the *IARD* system or *CRD* system, registered with the *SEC* as a *municipal advisor* on Form MA, or previously registered with the *SEC* on Form MA-T, or is an *associated person of a municipal advisor* that is registered with the *SEC* on Form MA or that previously registered with the *SEC* on Form MA-T, has the applicant or *municipal advisor* with which it is associated previously submitted a *DRP* (with Form ADV, BD, or U4) to the *IARD* or *CRD*, or submitted to the *SEC* disclosure on Form MA-T or a *DRP* with a Form MA, for the event that contains the information required by this *DRP*? Yes No

If the answer is "Yes," no other information on this *DRP* must be provided.

NOTE: The completion of this form does not relieve the applicant or any municipal advisor with which it is associated of its obligation to update its Form MA or its IARD or CRD records.

Disclosure Instructions:

- Complete items 1-6 for all matters (*i.e.*, customer complaints, arbitrations/*CFTC* reparations and civil litigation in which you are not named as a party, as well as arbitrations/*CFTC* reparations and civil litigation in which you are named as a party).
- If the matter *involves* a customer complaint, or an arbitration/*CFTC* reparation or civil litigation in which you are not named as a party, complete items 7-11 as appropriate.
- If a customer complaint has evolved into an arbitration/*CFTC* reparation or civil litigation, amend the existing Disclosure Form by completing items 9 and 10.
- If the matter *involves* an arbitration/*CFTC* reparation in which you are a named party, complete items 12-16, as appropriate. If the matter *involves* a civil litigation in which you are a named party, complete items 17-23.
- Item 24 is an optional space and applies to all event types (*i.e.*, customer complaint, arbitration/*CFTC* reparation, civil litigation).

Complete items 1-6 for all matters (*i.e.*, customer complaints, arbitrations/*CFTC* reparations, civil litigation).

1. Customer Name(s): _____

2. A. Customer(s) State of Residence (select "not on list" when the customer's residence is a foreign address): _____

B. Other state(s) of residence/detail:

3. Employing *Municipal Advisory Firm* when activities occurred which led to the customer complaint, arbitration, *CFTC* reparation or civil litigation:

4. Allegation(s) and a brief summary of events related to the allegation(s) including dates when activities leading to the allegation(s) occurred:

CUSTOMER COMPLAINT / ARBITRATION / CIVIL LITIGATION DISCLOSURE (CONT.)

5. Product Type(s): (select all that apply)

- | | | |
|--|---|--|
| <input type="checkbox"/> No Product | <input type="checkbox"/> Derivative | <input type="checkbox"/> Mutual Fund |
| <input type="checkbox"/> Annuity-Charitable | <input type="checkbox"/> Direct Investment-DPP & LP Interest | <input type="checkbox"/> Oil & Gas |
| <input type="checkbox"/> Annuity-Fixed | <input type="checkbox"/> Equipment Leasing | <input type="checkbox"/> Options |
| <input type="checkbox"/> Annuity-Variable | <input type="checkbox"/> Equity Listed (Common & Preferred Stock) | <input type="checkbox"/> Penny Stock |
| <input type="checkbox"/> Banking Product (other than CD) | <input type="checkbox"/> Equity-OTC | <input type="checkbox"/> Prime Bank Instrument |
| <input type="checkbox"/> CD | <input type="checkbox"/> Futures Commodity | <input type="checkbox"/> Promissory Note |
| <input type="checkbox"/> Commodity Option | <input type="checkbox"/> Futures-Financial | <input type="checkbox"/> Real Estate Security |
| <input type="checkbox"/> Debt-Asset Backed | <input type="checkbox"/> Index Option | <input type="checkbox"/> Security Futures |
| <input type="checkbox"/> Debt-Corporate | <input type="checkbox"/> Insurance | <input type="checkbox"/> Unit Investment Trust |
| <input type="checkbox"/> Debt-Government | <input type="checkbox"/> Investment Contract | <input type="checkbox"/> Viatical Settlement |
| <input type="checkbox"/> Debt-Municipal | <input type="checkbox"/> Money Market Fund | <input type="checkbox"/> Other: _____ |

6. Alleged Compensatory Damage Amount: \$ _____

- Exact
 Explanation:

If the matter involves a customer complaint, arbitration/CFTC reparation or civil litigation in which you are not named as a party, complete items 7-11 as appropriate. [Note: Report in Items 12-16, or 17-23, as appropriate, only arbitrations/CFTC reparations or civil litigation in which you are named as a party.]

7. A. Is this an oral complaint? Yes No
B. Is this a written complaint? Yes No
C. Is this an arbitration/CFTC reparation or civil litigation? Yes No

If yes, provide:

- i. Arbitration/reparation forum or court name and location: _____
ii. Docket/Case#: _____
iii. Filing date of arbitration/CFTC reparation or civil litigation (MM/DD/YYYY): _____

D. Date received by/served on firm (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

8. Is the complaint, arbitration/CFTC reparation or civil litigation pending? Yes No

If "No," complete item 9.

9. If the complaint, arbitration/CFTC reparation or civil litigation is not pending, provide status:

- Closed/No Action Withdrawn Denied Settled
 Arbitration Award/Monetary Judgment (for claimants/plaintiffs)
 Arbitration Award/Monetary Judgment (for respondents/defendants)
 Evolved into Arbitration/CFTC reparation (you are a named party)
 Evolved into Civil litigation (you are a named party)

If status is arbitration/CFTC reparation in which you are not a named party, provide details in item 7C.

If status is arbitration/CFTC reparation in which you are a named party, complete items 12-16.

If status is civil litigation in which you are a named party, complete items 17-23.

CUSTOMER COMPLAINT / ARBITRATION / CIVIL LITIGATION DISCLOSURE (CONT.)

10. Status Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

11. Settlement/Award/Monetary Judgment:

A. Settlement/Award/Monetary Judgment amount: \$ _____

B. Your Contribution Amount: \$ _____

If the matter involves an arbitration or CFTC reparation in which you are a named respondent, complete items 12-16, as appropriate.

12. A. Arbitration/CFTC reparation claim filed with (FINRA, AAA, CFTC, etc.): _____

B. Docket/Case#: _____

C. Date notice/process was served (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

13. Is arbitration/ CFTC reparation pending? Yes No

If "No," complete item 14.

14. If the arbitration/CFTC reparation is not pending, what was the disposition?

Award to Applicant Award to Customer Denied Dismissed

(Agent/Representative)

Judgment (other than No Action Settled Withdrawn

monetary)

Other: _____

15. Disposition Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

16. Monetary Compensation Details (award, settlement, reparation amount):

A. Total Amount: \$ _____

B. Your Contribution Amount: \$ _____

If the matter involves a civil litigation in which you are a defendant, complete items 17-23.

17. Court in which case was filed:

Federal Court State Court Foreign Court Military Court Other: _____

A. Name of Court: _____

B. Location of Court (City or County and State or Country): _____

C. Docket/Case#: _____

18. Date received by/served on firm (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

19. Is the civil litigation pending? Yes No

If "No," complete item 20.

20. If the civil litigation is not pending, what was the disposition?

Denied Dismissed Judgment (other than monetary)

Monetary Judgment to Applicant (Agent/Representative) Monetary Judgment to Customer

No Action Settled Withdrawn

Other: _____

CUSTOMER COMPLAINT / ARBITRATION / CIVIL LITIGATION DISCLOSURE (CONT.)

21. Disposition Date (MM/DD/YYYY): _____ Exact Explanation
If not exact, provide explanation:

22. Monetary Compensation Details (judgment, restitution, settlement amount):

A. Total Amount: \$ _____

B. Your Contribution Amount: \$ _____

23. If action is currently on appeal:

A. Enter date appeal filed (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

B. Court appeal filed in:

Federal Court State Court Foreign Court Military Court Other: _____

A. Name of Court: _____

B. Location of Court (City or County and State or Country): _____

C. Docket/Case#: _____

24. Comment (Optional). You may use this space to provide a brief summary of the circumstances leading to the customer complaint, arbitration/*CFTC* reparation and/or civil litigation as well as the current status or final disposition(s). Your information must fit within the space provided.

TERMINATION DISCLOSURE

This Disclosure Form is an **INITIAL** or **AMENDED** response to report details for affirmative response(s) to *Question(s) 6J* on Form MA-I;

Check the question(s) you are responding to, regardless of whether you are answering the question(s) "yes" or amending the answer(s) to "no":

6J(1)

6J(2)

6J(3)

One event may result in more than one affirmative answer to the above items. Use only one Disclosure Form to report details to the same termination. Use a separate Disclosure Form for each termination reported.

If the applicant is also registered through the *IARD* system or *CRD* system, registered with the *SEC* as a *municipal advisor* on Form MA, or previously registered with the *SEC* on Form MA-T, or is an *associated person of a municipal advisor* that is registered with the *SEC* on Form MA or that previously registered with the *SEC* on Form MA-T, has the applicant or *municipal advisor* with which it is associated previously submitted a *DRP* (with Form ADV, BD, or U4) to the *IARD* or *CRD*, or submitted to the *SEC* disclosure on Form MA-T or a *DRP* with a Form MA, for the event that contains the information required by this *DRP*? Yes No
If the answer is "Yes," no other information on this *DRP* must be provided.

NOTE: The completion of this form does not relieve the applicant or any municipal advisor with which it is associated of its obligation to update its Form MA or its IARD or CRD records.

1. *Municipal Advisory Firm Name*: _____

2. Termination Type:

Discharged Permitted to *Resign* Voluntary *Resignation*

3. Termination Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

4. Allegation(s):

5. Product Type(s): (select all that apply)

- | | | |
|--|---|--|
| <input type="checkbox"/> No Product | <input type="checkbox"/> Derivative | <input type="checkbox"/> Mutual Fund |
| <input type="checkbox"/> Annuity-Charitable | <input type="checkbox"/> Direct Investment-DPP & LP Interest | <input type="checkbox"/> Oil & Gas |
| <input type="checkbox"/> Annuity-Fixed | <input type="checkbox"/> Equipment Leasing | <input type="checkbox"/> Options |
| <input type="checkbox"/> Annuity-Variable | <input type="checkbox"/> Equity Listed (Common & Preferred Stock) | <input type="checkbox"/> Penny Stock |
| <input type="checkbox"/> Banking Product (other than CD) | <input type="checkbox"/> Equity-OTC | <input type="checkbox"/> Prime Bank Instrument |
| <input type="checkbox"/> CD | <input type="checkbox"/> Futures Commodity | <input type="checkbox"/> Promissory Note |
| <input type="checkbox"/> Commodity Option | <input type="checkbox"/> Futures-Financial | <input type="checkbox"/> Real Estate Security |
| <input type="checkbox"/> Debt-Asset Backed | <input type="checkbox"/> Index Option | <input type="checkbox"/> Security Futures |
| <input type="checkbox"/> Debt-Corporate | <input type="checkbox"/> Insurance | <input type="checkbox"/> Unit Investment Trust |
| <input type="checkbox"/> Debt-Government | <input type="checkbox"/> Investment Contract | <input type="checkbox"/> Viatical Settlement |
| <input type="checkbox"/> Debt-Municipal | <input type="checkbox"/> Money Market Fund | <input type="checkbox"/> Other: _____ |

6. Comment (Optional). You may use this space to provide a brief summary of the circumstances leading to the termination. Your information must fit within the space provided.

JUDGMENT / LIEN DISCLOSURE

This Disclosure Form is an INITIAL or AMENDED response to report details for affirmative response(s) to Question(s) 6M on Form MA-I;

Check the question(s) you are responding to, regardless of whether you are answering the question "yes" or amending the answer(s) to "no":

6M

If multiple, unrelated events result in the same affirmative answer, details must be provided on separate Disclosure Forms.

If the applicant is also registered through the IARD system or CRD system, registered with the SEC as a municipal advisor on Form MA, or previously registered with the SEC on Form MA-T, or is an associated person of a municipal advisor that is registered with the SEC on Form MA or that previously registered with the SEC on Form MA-T, has the applicant or municipal advisor with which it is associated previously submitted a DRP (with Form ADV, BD, or U4) to the IARD or CRD, or submitted to the SEC disclosure on Form MA-T or a DRP with a Form MA, for the event that contains the information required by this DRP? Yes No
If the answer is "Yes," no other information on this DRP must be provided.

NOTE: The completion of this form does not relieve the applicant or any municipal advisor with which it is associated of its obligation to update its Form MA or its IARD or CRD records.

1. Judgment/Lien Amount:\$ _____

2. Judgment/Lien Holder: _____

3. Judgment/Lien Type: Civil Tax

4. Date Filed (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

5. Court action brought in: Federal Court State Court Foreign Court Other: _____

A. Name of Court: _____

B. Location of Court (City or County and State or Country): _____

C. Docket/Case#: _____

Check this box if the Docket/Case# is your SSN, a Bank Card number, or a Personal Identification Number.

6. Is Judgment/Lien outstanding? Yes No

If "No," complete item 7. If "Yes," skip to item 8.

7. If Judgment/Lien is not outstanding, provide:

A. Status Date (MM/DD/YYYY): _____ Exact Explanation

If not exact, provide explanation:

B. How was matter resolved? (select appropriate item): Discharged Released Removed Satisfied

6. Comment (Optional). You may use this space to provide a brief summary of the circumstances leading to the action as well as the current status or final disposition. Your information must fit within the space provided.

FORM MA-NR DESIGNATION OF U.S. AGENT FOR SERVICE OF PROCESS	Applicant Name: _____ Municipal Advisor Name: _____ Date: _____ Advisor SEC No.: _____	Official Use

Use Form MA-NR to identify an agent for service of process for *non-resident municipal advisors* and *non-resident* general partners and *managing agents of municipal advisors*.

- Instructions:
1. The power of attorney, consent, stipulation and agreement shall be signed by the applicant and its authorized agent for service of process in the United States.
 2. The name of each *person* who signs this Form MA-NR shall be typed or printed beneath such *person's* signature.
 3. Any *person* who occupies more than one of the specified positions shall indicate each capacity in which such *person* signs Form MA-NR.
 4. If any name is signed pursuant to a board resolution, a copy of the resolution shall be filed as an attachment to the applicant's Form MA-NR.
 5. If any name is signed pursuant to a power of attorney, a copy of the power of attorney shall be filed as an attachment to the applicant's Form MA-NR.

A. Name of United States *person* applicant designates and appoints as agent for service of process

B. Address of United States *person* applicant designates and appoints as agent for service of process

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

(a) any *investigation* or administrative *proceeding* conducted by the *Commission* that relates to the applicant or about which the applicant may have information; and

(b) any civil suit or action brought against the applicant or to which the applicant has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, where the *investigation, proceeding* or cause of action arises out of or relates to or concerns *municipal advisory activities* of the *municipal advisor*. The applicant stipulates and agrees that any such civil suit or action or administrative *proceeding* may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made. Such person cannot be a *Commission* member, official, or employee.

The applicant certifies that it has duly caused this power of attorney, consent, stipulation and agreement to be signed on its behalf by the undersigned, thereunto duly authorized,

In the City of:	In the Country of:
Applicant Name:	Date:
Signature:	Print Name and Title:

Notary Public Signature and Information:

Subscribed and sworn to me this ___ day of _____, _____

My Commission expires _____ County of _____ State of _____

This statement has been signed by the following *persons* in the capacities and on the dates indicated.

1.	Signature:
	Print Name and Title:
	Date:
2.	Signature:
	Print Name and Title:
	Date:
3.	Signature:
	Print Name and Title:
	Date:

FORM MA-W
NOTICE OF WITHDRAWAL FROM REGISTRATION AS A MUNICIPAL ADVISOR

Form MA-W

A municipal advisor must complete this Form MA-W to withdraw its municipal advisor registration with the SEC. Form MA-W must be filed by both municipal advisors that are organized entities (including sole proprietors, and each hereinafter a "municipal advisory firm"); and natural persons that are municipal advisors (including sole proprietors, and each hereinafter a "natural person municipal advisor").

WARNING: Complete this form truthfully. False statements or omissions may result in administrative or civil action or criminal prosecution. All *italicized* terms are defined or described in the Glossary to this Form.

Item 1 Identifying Information

A. Full Legal Name:

The name entered here must be the same as the name entered on the registrant's most recent Form MA or Form MA-I. Do not report a name change on this Form MA-W.

B. Registrant's Municipal Advisor Registration Number: _____

Item 2 Contact Person (for Municipal Advisory Firms)

The registrant's contact person must be a principal or employee (not outside counsel) of the municipal advisor authorized to receive information and respond to questions about this Form MA-W.

Name, title, and contact information:

(name) (title)

(number and street)

(city) (state) (country) (zip+4/postal code)

(area code) (telephone number)

@

(E-mail address)

Item 3 Money Owed to Clients

Has the registrant:

A. Received any pre-paid municipal advisory fees for municipal advisory activities, including subscription fees for publications, that have not been delivered: Yes No

If "yes," what is the amount owed for these pre-paid services (including subscriptions)? \$ _____ .00

B. Borrowed any money from clients that has not been repaid?

If "yes," what is the amount owed for these borrowed funds? \$ _____ .00

Item 4 Advisory Contract Assignments

Has the registrant assigned any municipal advisory contracts to another *person* that engages in *municipal advisory activities*? Yes No

If yes, list on Section 4 of Schedule W1 each provider to whom the registrant has assigned any such municipal advisory contracts and provide the requested information.

Item 5 Judgments and Liens

Are there any unsatisfied judgments or liens against the registrant? Yes No

Item 6 Books and Records

NOTE: Rule 15Ba1-7(b) under the Exchange Act requires a municipal advisor to preserve its books and records after the municipal advisor ceases to conduct or discontinues business as a municipal advisor.

Provide in Schedule W1 the name and address of each *person* who has or will have custody or possession of the *municipal advisor's* books and records; and each location at which any of such books and records are or will be kept.

Item 7 Statement of Financial Condition

If registrant answered "yes" to Item 3 or Item 5, complete Schedule W2, disclosing the nature and amount of the registrant's assets and liabilities and net worth as of the last day of the month prior to the filing of this Form MA-W.

Execution

For a *Natural Person Municipal Advisor* other than a sole proprietor:

I, the undersigned, certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this Form MA-W, including exhibits and any other information submitted, are true and complete. I understand that if any information contained in this Form MA-W is different from the information contained on a Form MA-I, the information on this Form MA-W will replace the corresponding entry on the Form MA-I.

Signature: _____ Date: _____
Printed Name: _____ Title: _____

For a *Sole Proprietor*:

I, the undersigned, certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this Form MA-W, including exhibits and any other information submitted, are true and complete. I further certify that the books and records of my *municipal advisor-related* business will be preserved and available for inspection as required by law, and that all information submitted on my most recent Form MA and Form MA-I is accurate and complete as of this date. I understand that if any information contained in this Form MA-W is different from the information contained on my Form MA and Form MA-I, the information on this Form MA-W will replace the corresponding entry on my Form MA and Form MA-I. Finally, I authorize any *person* having custody or possession of these books and records to make them available to authorized regulatory representatives.

Signature: _____ Date: _____
Printed Name: _____ Title: _____

For a *Municipal Advisory Firm*:

I, the undersigned, have signed this Form MA-W on behalf of, and with the authority of, the *municipal advisor* withdrawing its registration. The advisor 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 Form MA-W, including exhibits and any other information submitted, are true and complete. I further certify that the *municipal advisor's* books and records will be preserved and available for inspection as required by law, and that all information submitted on the *municipal advisor's* most recent Form MA is accurate and complete as of this date. The *municipal advisor* and I understand that if any information contained in this Form MA-W is different from the information contained on Form MA, the information on this Form MA-W will replace the corresponding entry on the *municipal advisor's* Form MA. Finally, I authorize any *person* having custody or possession of these books and records to make them available to authorized regulatory representatives.

Signature: _____ Date: _____
Printed Name: _____ Title: _____

FORM MA-W
Schedule W1

Certain items in Form MA-W may require additional information on this Schedule W1. Use this Schedule W1 to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

SECTION 4 Advisory Contract Assignments

Check here if this section is being completed:

Complete the following information for each *person* to whom the registrant has assigned any advisory contract. Complete a separate Schedule W1 for each *person* to whom the registrant has assigned an advisory contract.

Name and business address of the *person* to whom advisory contracts were assigned:

(name)

(number and street)

(city) (state) (country) (zip+4/postal code)

(area code) (telephone number)

If this address is a private residence, check this box:

SECTION 6 Books and Records

Person with Custody

Complete the following information for the *person* that has or will have custody or possession of the books and records kept at the location described in this Section 6 of this Schedule. A separate Schedule W1 must be completed for each *person* that has or will have custody of any of the registrant's books and records. If the *person* listed below has or will have custody of any of the registrant's books and records at any other location, a separate Schedule W1 must be completed listing this *person* and each other location where the *person* has custody of the registrant's books and records.

(name)

(number and street)

(city) (state) (country) (zip+4/postal code)

(area code) (telephone number)

If this address is a private residence, check this box:

Location:

Complete the following information for the location where the books and records of which the *person* listed in this Section 6 of this Schedule has or will have custody or possession. A separate Schedule W1 must be completed for each location at which the registrant's records are or will be kept. If any other *person* has or will have custody or possession of any of the books and records at the location described below, a separate Schedule W1 must be completed listing this location and each other *person* that has or will have custody of the registrant's books and records.

(name)

(number and street)

(city) (state) (country) (zip+4/postal code)

(area code) (telephone number)

If this address is a private residence, check this box:

Briefly describe the books and records kept at this location. _____

FORM MA-W
Schedule W2

If the registrant answered "yes" to Items 3 or 5 of Form MA-W, complete this Schedule W2. This balance sheet must be prepared in accordance with generally accepted accounting principles, but need not be audited.

SECTION 7 STATEMENT OF FINANCIAL CONDITION

I. Assets

Current Assets

Cash _____
Securities at Market _____
Non-Marketable Securities _____
Other Current Assets _____
Total Current Assets \$ _____

Fixed Assets

Total Fixed Assets \$ _____

TOTAL ASSETS \$ _____

II. Liabilities & Shareholders' Equity

Current Liabilities

Prepaid Advisory Fees _____
Short-Term Loans from *Clients* _____
Other Short-Term Loans _____
Other Current Liabilities _____
Total Current Liabilities \$ _____

Fixed Liabilities

Long-Term Debt Owed to *Clients* _____
Other Long-Term Debt _____
Other Long-Term Liabilities _____
Total Fixed Liabilities \$ _____

Shareholders' Equity

Total Shareholders' Equity (or Deficit) \$ _____

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY \$ _____

**FORM MA, FORM MA-I, FORM MA-NR, FORM MA-W
APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION
APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION FOR NATURAL
PERSONS
DESIGNATION OF U.S. AGENT FOR SERVICE OF PROCESS
WITHDRAWAL OF MUNICIPAL ADVISOR REGISTRATION**

General Instructions

Read these general instructions carefully before filing Form MA, Form MA-I, Form MA-NR, or Form MA-W. Specific instructions for Forms MA and MA-I are available after these general instructions. Failure to follow instructions or properly complete the form may result in the application being delayed or rejected.

Italicized terms are defined or described in the Glossary of Terms.

1. Where can an applicant obtain more information on Form MA, Form MA-I, Form MA-NR, Form MA-W, and electronic filing?

The *Commission* provides information about its rules with respect to *municipal advisors* and the Exchange Act on its website at: <<http://www.sec.gov/info/municipal.shtml>>.

2. Who should file these forms?

A partnership, corporation, trust, limited liability company, limited liability partnership, sole proprietorship, or other organized entity (other than a natural person) must use Form MA to register with the *Commission* and to amend a previously submitted Form MA.

A natural *person* doing business in his or her own name as a sole proprietor must use both Form MA and Form MA-I to register with the *Commission* and to amend a previously submitted Form MA and Form MA-I.

Every natural *person*, including any *employee* of a *municipal advisor*, who engages in *municipal advisory activities*, must use Form MA-I to register with the *Commission* and to amend a previously submitted Form MA-I.

A person that makes a direct or indirect communication with a *municipal entity* or *obligated person* on behalf of a broker, dealer, municipal securities dealer, *municipal advisor*, or *investment adviser* that *controls*, is *controlled* by, or is under common *control* with the person undertaking such communication, where the communication is for the purpose of obtaining or retaining an engagement by a *municipal entity* or *obligated person* of a broker, dealer, municipal securities dealer, or *municipal advisor* for or in connection with *municipal financial products*, the issuance of municipal securities, or of an *investment adviser* to provide investment advisory services to or on behalf of a *municipal entity*, may voluntarily file these forms and apply to register as a *municipal advisor*. By registering as a *municipal advisor*, such persons must

comply with all federal securities laws and rules or regulations promulgated thereunder relating to registered *municipal advisors*, including the obligation to comply with *MSRB* rules (such as *MSRB* pay-to-play rules) that apply to *municipal advisors*.

Every (i) *non-resident municipal advisor*; and (ii) *non-resident* general partner and *non-resident managing agent* of a *municipal advisor*, whether or not the *municipal advisor* is a resident of the United States; must file Form MA-NR in connection with the *municipal advisor's* initial application for registration. An *SEC*-registered *municipal advisor*, or general partner or *managing agent* of an *SEC*-registered *municipal advisor*, who becomes a *non-resident* after the *municipal advisor's* initial application has been submitted, must file Form MA-NR within 30 days of becoming a *non-resident*. **Failure to file Form MA-NR promptly may delay *SEC* consideration of the initial application.**

A *municipal advisor* no longer required to register must file Form MA-W to withdraw its registration.

3. How is Form MA organized?

Form MA asks a number of questions about the *municipal advisor*, the *municipal advisor's* business practices, the *persons* who own and *control* the *municipal advisor*, and the *persons* who engage in *municipal advisory activities* on behalf of the *municipal advisor*. All items must be completed.

Form MA also contains several supplemental schedules.

Schedule A asks for information about the *municipal advisor's* direct owners and executive officers.

Schedule B asks for information about the *municipal advisor's* indirect owners.

Schedule C is used to amend information on either Schedule A or Schedule B.

Schedule D asks for additional information on certain items and provides space for explanations.

Criminal Disclosure Reporting Pages, Regulatory Action Disclosure Reporting Pages, and Civil Judicial Action Disclosure Reporting Pages are schedules that ask for details about disciplinary events *involving* the *municipal advisor* and the *municipal advisor's associated persons*.

4. How is Form MA-I organized?

Form MA-I asks a number of questions about a *natural person municipal advisor* (including a sole proprietor), including the residential history and employment history of the *municipal advisor*, and other business in which the *municipal advisor* is engaged. All items must be completed.

Form MA-I also contains several supplemental schedules with respect to disciplinary events involving the *municipal advisor*. These supplemental schedules include Criminal Action Disclosure, Regulatory Action Disclosure, *Investigation* Disclosure, Civil Judicial Action Disclosure, Customer Complaint/Arbitration/Civil Litigation Disclosure, Termination Disclosure, and Judgment/Lien Disclosure.

5. Where does an applicant sign the Form MA?

The *municipal advisor* must sign the appropriate Execution Page – either the:

- Domestic Municipal Advisor Execution Page, if the *municipal advisory firm* (including a sole proprietor) is a resident of the United States (a sole proprietor would also need to sign the Form MA-I, as discussed below); or
- Non-Resident Municipal Advisor Execution Page, if the *municipal advisory firm* (including a sole proprietor) is not a resident of the United States. *Non-Resident municipal advisors* must also file Form MA-NR as specified in Instruction 2 above.

6. Where does an applicant sign the Form MA-I?

The *municipal advisor* must sign Item 7 of the Form MA-I.

7. Who must sign the Form MA or MA-I?

The individual who signs the form depends upon the *municipal advisor's* form of organization:

- For a sole proprietorship, the sole proprietor.
- For a partnership, a general partner.
- For a corporation, an authorized principal officer.
- For all others, an authorized individual who participates in managing or directing the *municipal advisor's* affairs; or in the case of a natural person, the natural person filing the form on his or her own behalf.

For purposes of this electronic form, the signature is a typed name.

8. When does Form MA (for municipal advisory firms, including sole proprietors) need to be updated?

Every *municipal advisor* must amend Form MA each year by filing an *annual update* within 90 days after the end of its fiscal year (calendar year for sole proprietors). Responses to all items must be updated when submitting the *annual update*.

In addition to the *annual update*, a *municipal advisor* must amend Form MA by filing additional amendments (other than *annual updates*) promptly if a material event has occurred that changes

the information provided in Form MA. For purposes of Form MA, a material event will be deemed to have occurred if:

- information provided in response to Items 1 (Identifying Information); 2 (Form of Organization); or 9 (Disclosure Information) becomes inaccurate in any way; or
- information provided in response to Items 3 (Successions); 7 (Participation or Interest of Applicant or *Associated Persons* of Applicant in *Municipal Advisory Client* Transactions); or 8 (*Control Persons*) becomes materially inaccurate.

A non-resident *municipal advisor* shall file an amendment promptly to Form MA to provide an updated opinion counsel after any changes in the legal or regulatory framework that would impact the ability of the *municipal advisor* to provide the *Commission* with the access to its books and records, as required by law, or would impact the *Commission's* ability to inspect and examine the *municipal advisor* onsite.

Note: If submitting an amendment (other than an *annual update*), a *municipal advisor* is not required to update the responses to Items 4 (Information About Applicant's Business), 5 (Other Business Activities), 6 (Financial Industry Affiliations of *Associated Persons*), or 10 (Small Businesses) even if the responses to those items have become inaccurate.

Failure to update Form MA, as required by this instruction, is a violation of *SEC* rule 15Ba1-4 and could lead to the revocation of registration.

9. When does Form MA-I (for natural person municipal advisors) need to be updated?

Every *natural person municipal advisor* (including sole proprietors) must promptly amend Form MA-I whenever any information previously provided on Form MA-I becomes inaccurate.

10. How does an applicant file these forms?

An applicant must complete and file the forms electronically.

11. How does an applicant get started filing electronically?

[Instructions to come on how to file electronically]

12. How does an applicant make the required self-certification?

Municipal advisors applying for registration on both Form MA and Form MA-I must certify as to their training, experience, and competence and their ability to comply with federal securities laws. *Municipal advisors* filing on Form MA must complete the self-certification included on the execution page to Form MA. *Municipal advisors* filing on Form MA-I must complete the self-certification included in Item 7.

13. When must an applicant make the required self-certification?

All *municipal advisors* must complete the required certification at the time of filing an initial application for registration as a *municipal advisor*, and annually thereafter. *Municipal advisory firms* must complete their annual certification at the time of their annual amendment as described in Instruction 8 above. *Natural person municipal advisors* must check the appropriate box on Form MA-I to indicate filing of an annual self-certification and complete the certification included in Item 7 of Form MA-I within 90 days after the end of the calendar year.

14. How does a non-resident municipal advisor file its opinion of counsel?

A *non-resident municipal advisor* must attach as Exhibit A to its execution page an opinion of counsel that the *municipal advisor* can, as a matter of law, provide the *Commission* with access to the books and records of such *municipal advisor*, as required by law, and that the *municipal advisor* can, as a matter of law, submit to onsite inspection and examination by the *Commission*.

Federal Information Law and Requirements

Section 15B(a) of the Securities Exchange Act [15 U.S.C. § 78o-4(a)] authorizes the *SEC* to collect the information required by Form MA and Form MA-I. The *SEC* collects the information for regulatory purposes. Filing Form MA and/or Form MA-I is mandatory for *municipal advisors* who are required to register with the *SEC*. The *SEC* maintains the information submitted on these forms and, unless otherwise specified, makes it publicly available. The *SEC* will not accept forms that do not include the required information.

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 Exchange Act authorizes the *SEC* to collect the information on Form MA and Form MA-I from applicants. See 15 U.S.C. § 78o-4. Filing of the form is mandatory.

The main purpose of these forms is to enable the *SEC* to register *municipal advisors*. Every applicant for registration with the *SEC* as a *municipal advisor* must file the applicable form. See 17 C.F.R. § 240.15Ba1-2. By accepting Form MA and/or Form MA-I, however, the *SEC* does not make a finding that it has been completed or submitted correctly. Form MA must be filed annually by every *municipal advisory firm*, no later than 90 days after the end of its fiscal year (calendar year for sole proprietors). Form MA also must be filed promptly during the year to reflect changes as described in these instructions. Form MA-I must be filed by every *natural person municipal advisor* (including sole proprietors). Form MA-I also must be filed promptly whenever any information previously provided becomes inaccurate. The *SEC* maintains the information on the forms and, unless otherwise specified, makes it publicly available through the *SEC* website.

Anyone may send the *SEC* comments on the accuracy of the burden estimate on page 1 of the forms, 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.

.....
Intentional misstatements or omissions of fact constitute federal criminal violations.

See 18 U.S.C. 1001 and 15 U.S.C. 78ff(a)
.....

FORM MA

APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION

These instructions explain how to complete certain items in Form MA.

1. Item 3: Successions

Succession of a Registered *Municipal Advisor*. If the applicant has (i) taken over the business of another *municipal advisor* or (ii) changed its 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 Exchange Act. There are different ways to fulfill these obligations. The *municipal advisor* may rely on the registration provisions discussed in the General Instructions, or may be able to rely on special registration provisions for "successors" to registered *municipal advisors*, which may ease the transition to the successor *municipal advisor's* registration.

If the *municipal advisor* has taken over another *municipal advisor*, follow the instructions below under: "Succession by Application." If the *municipal advisor* has changed its structure or legal status, follow the instruction below under "Succession by Amendment."

- a. **Succession by Application.** If the applicant is not registered with the *SEC* as a *municipal advisor*, and is acquiring or assuming substantially all of the assets and liabilities of the advisory business of a registered *municipal advisor*, file a new application for registration on Form MA. The applicant will receive new registration numbers. The applicant must file the new application within 30 calendar days after the succession. On the application, make sure to check "yes" to Item 3, enter the date of the succession in Item 3, and complete Section 3 of Schedule D.

Until the *SEC* declares the new registration effective, the *municipal advisor* may rely on the registration of the acquired *municipal advisor*, but only if the acquired *municipal advisor* is no longer engaged in *municipal advisory activities*. Once the new registration is effective, a Form MA-W must be filed with the *SEC* to withdraw the registration of the acquired *municipal advisor*.

- b. **Succession by Amendment.** If a new *municipal advisor* is 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, the applicant may amend the registration of the registered *municipal advisor* to reflect these changes rather than file a new application. The applicant will keep the same registration number, and should not file a Form MA-W. On the amendment, make sure to check "yes" to Item 3, enter the date of the succession in Item 3, and complete Section 3 of Schedule D. The amendment must be submitted within 30 calendar days after the change or reorganization.

2. Item 4: Information About Applicant's Business

Newly-Formed *Municipal Advisors*: Several questions in Item 4 that ask about *municipal advisory activities* assume that the *municipal advisor* has been in existence for some time. Responses to these questions should reflect the applicant's current *municipal advisory activities* (i.e., at the time of filing of the Form MA or MA-I), with the following exceptions:

- Base responses to Item 4.H., I. and J. on the types of compensation the applicant expects to accept; and
- Base responses to Item 4.K. on the types of *municipal advisory activities* in which the applicant expects to engage during the next year.

3. Additional Information

Complete Schedule D if any response to an item in Form MA requires further explanation or if the applicant wishes to provide additional information.

FORM MA-I

APPLICATION FOR MUNICIPAL ADVISOR REGISTRATION FOR NATURAL PERSONS

These instructions explain how to complete certain items in Form MA-I.

1. Item 1: Identifying Information

If the applicant has an assigned *CRD* number, enter it.

Enter the applicant's social security number.

Enter the address of every office at which the applicant will be physically located, and from which the applicant will be supervised.

2. Item 2: Other Names

Enter all other names that the applicant has used or is using, or by which the applicant is known or has been known, other than the legal name, since the age of 18. For example, include nicknames, aliases, and names used before or after marriage.

3. Item 3: Residential History

Provide residential addresses for the past 5 years. Leave no gaps greater than 3 months between addresses. Post office boxes are not acceptable.

4. Item 4: Employment History

Provide employment history for the past 10 years. Leave no gaps greater than 3 months between entries. All entries must include beginning and end dates of employment. Account for full-time and part-time employment, self-employment, military service, and homemaking. Include unemployment, full-time education, extended travel, and other similar statuses.

5. Item 5: Other Business

Provide information regarding any other business in which the applicant is currently engaged, including:

Name and address of the other business.

Nature of the other business, including whether it is *municipal advisor-related*.

Position, title, or relationship with the other business, including duties.

The start date of the relationship with the other business.

The approximate number of hours per month devoted to the other business.

6. Item 6: Disclosure Questions

Note that an affirmative answer to certain disclosure questions may make an individual subject to a statutory disqualification as defined in Section 3(a)(39) and Section 15B(c) of the Securities Exchange Act of 1934.

7. Item 7: Signature

Signature is effected by typing a name in the designated signature field. By typing a name in this field, the signatory acknowledges and represents that the entry constitutes in every way, use, or aspect, his or her legally binding signature. Submit the signed form electronically with the *Commission*.

GLOSSARY OF TERMS

1. **Annual Update:** Within 90 calendar days after the *municipal advisor's* fiscal year end (calendar year for sole proprietors), the *municipal advisor* must file an "annual update," which is an amendment to the *municipal advisor's* Form MA that updates the responses to any item for which the information is no longer accurate.
2. **Associated Person or Associated Person of a Municipal Advisor:** Any partner, officer, director, or branch manager of a *municipal advisor* (or any *person* occupying a similar status or performing similar functions); any other *employee* of such *municipal advisor* who is engaged in the management, direction, supervision, or performance of any *municipal advisory activities* relating to the provision of advice to or on behalf of a *municipal entity* or *obligated person* with respect to *municipal financial products* or the issuance of municipal securities (other than *employees* who are solely clerical or administrative); and any *person* directly or indirectly *controlling, controlled by, or under common control* with such *municipal advisor*.
3. **Charged:** Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal *charge*).
4. **CFTC:** Commodity Futures Trading Commission.
5. **Chief Compliance Officer:** The officer in charge of the *municipal advisor's* compliance issues.
6. **Client or Municipal Advisory Client:** Any of the *municipal advisor's clients*. This term includes *clients* from which the *municipal advisor* receives no compensation. If the *municipal advisor* also engages in activities that are not *municipal advisory activities*, this term does not include such *clients*.
7. **Contingent Fees:** Any fee or payment for services provided where the fee is payable upon a condition to be satisfied.
8. **Control:** The power, directly or indirectly, to direct the management or policies of a *person*, whether through ownership of securities, by contract, or otherwise.
 - Each of the *municipal advisor's* officers, partners, or directors exercising executive responsibility (or *persons* having similar status or functions) is presumed to *control* the *municipal advisor*.
 - A *person* is presumed to *control* a corporation if the *person*: (i) directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or (ii) has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities.

- A *person* is presumed to *control* a partnership if the *person* has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership.
 - A *person* is presumed to *control* a limited liability company (“LLC”) if the *person*: (i) directly or indirectly has the right to vote 25 percent or more of a class of the interests of the LLC; (ii) has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or (iii) is an elected manager of the LLC.
 - A *person* is presumed to *control* a trust if the *person* is a trustee or *managing agent* of the trust.
9. **CRD:** The Web Central Registration Depository (“*CRD*”) system operated by *FINRA* for the registration of broker-dealers and broker-dealer representatives.
 10. **Discretionary Authority:** The *municipal advisor* has *discretionary authority* or manages assets on a discretionary basis if it has the authority to decide which securities to purchase and sell for a *client*. The *municipal advisor* also has *discretionary authority* if it has the authority to decide which *investment advisers* to retain on behalf of a *client*.
 11. **Employee:** This term includes an independent contractor who engages in *municipal advisory activities* on the *municipal advisor’s* behalf.
 12. **Enjoined:** This term includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining *order*.
 13. **Federal Banking Agency:** This term includes any *Federal banking agency* as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).
 14. **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. This term also includes a general court martial.
 15. **FINRA:** Financial Industry Regulatory Authority.
 16. **Foreign Financial Regulatory Authority:** This term includes (i) a foreign securities regulatory authority; (ii) 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 *municipal advisor-related* activities; and (iii) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above.
 17. **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.

- 18. Guaranteed Investment Contract:** This term includes any investment that has specified withdrawal or reinvestment provisions and a specifically negotiated or bid interest rate, and also includes any agreement to supply investments on 2 or more future dates, such as a forward supply contract.
- 19. IARD:** The Investment Adviser Registration Depository (“IARD”) system operated by *FINRA* for the registration of *investment advisers* and investment adviser representatives.
- 20. Investigation:** This term includes: (a) grand jury investigations; (b) *SEC* investigations after the “Wells” notice has been given; (c) *FINRA* investigations after the “Wells” notice has been given or after a *person* associated with a member, as defined by The *FINRA* By-Laws, has been advised by the staff that it intends to recommend formal disciplinary action; (d) *NYSE* Regulation investigations after the “Wells” notice has been given or after a *person* over whom *NYSE* Regulation has jurisdiction, as defined in the applicable rules, has been advised by *NYSE* Regulation that it intends to recommend formal disciplinary action; (e) formal investigations by other *SROs*; or (f) actions or procedures designated as investigations by other federal, state, or local jurisdictions. The term *investigation* does not include subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, “blue sheet” requests or other trading questionnaires, or examinations.
- 21. Investment Adviser:** As defined in Section 202(a)(11) of the Investment Advisers Act of 1940.
- 22. 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).
- 23. Investment Strategies:** The term includes plans, programs, or pools of assets that invest funds held by or on behalf of a *municipal entity*.
- 24. Involved:** Engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with, or failing reasonably to supervise another in an act.
- 25. Managing Agent:** Any *person*, including a trustee, who directs or manages, or who participates in directing or managing, the affairs of any unincorporated organization or association other than a partnership.
- 26. 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.)

27. Misdemeanor: For jurisdictions that do not differentiate between a *felony* and a *misdemeanor*, a *misdemeanor* is an offense punishable by a sentence of less than one year imprisonment and/or a fine of less than \$1,000. This term also includes a special court martial.

28. MSRB or Board: Municipal Securities Rulemaking Board.

29. Municipal Advisor: This term means a *person* (who is not a *municipal entity* or an *employee* of a *municipal entity*) that (i) provides advice to or on behalf of a *municipal entity* or *obligated person* with respect to *municipal financial products* or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or (ii) undertakes a *solicitation of a municipal entity or obligated person*. This term does not include:

A broker, dealer, or municipal securities dealer serving as an underwriter (as that term is defined in Section 2(a)(11) of the Securities Act of 1933) on behalf of a *municipal entity* or *obligated person*, unless the broker, dealer or municipal securities dealer engages in *municipal advisory activities* while acting in a capacity other than as an underwriter on behalf of a *municipal entity or obligated person*;

An *investment adviser* registered under the Investment Advisers Act of 1940 or a *person* associated with such registered *investment adviser* unless the registered *investment adviser* or a *person* associated with the *investment adviser* engages in *municipal advisory activities* other than providing investment advice that would subject such adviser or *person* associated with such adviser to the Investment Advisers Act of 1940;

Any commodity trading advisor registered under the Commodity Exchange Act or *persons* associated with a commodity trading advisor, unless the registered commodity trading advisor or *persons* associated with the registered commodity trading advisor engages in *municipal advisory activities* other than advice related to swaps;

Any attorney, unless the attorney engages in *municipal advisory activities* other than the offer of legal advice or the provision of services that are of a traditional legal nature;

Any engineer, unless the engineer engages in *municipal advisory activities* other than providing engineering advice; and

Any accountant, unless the accountant engages in *municipal advisory activities* other than preparing financial statements, auditing financial statements, or issuing letters for underwriters for, or on behalf of, a *municipal entity or obligated person*.

30. Municipal Advisor-Related: Conduct that pertains to *municipal advisory activities* (including, but not limited to, acting as, or being an *associated person* of, a *municipal advisor*).

31. Municipal Advisory Activities: Providing advice to or on behalf of a *municipal entity* or *obligated person* with respect to *municipal financial products* or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar

matters concerning such financial products or issues; or *solicitation of a municipal entity or obligated person*.

- 32. Municipal Advisory Firm:** Any organized entity that is a *municipal advisor*, including sole proprietors. A sole proprietor that is a *municipal advisor* is also a *natural person municipal advisor*.
- 33. Municipal Derivatives:** Any swap (as defined in Section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), including any rules and regulations thereunder) or security-based swap (as defined in Section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)), including any rules and regulations thereunder) to which a *municipal entity or obligated person* is a counterparty.
- 34. Municipal Entity:** Any State, political subdivision of a State, or municipal corporate instrumentality of a State, including (i) any agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality; (ii) any plan, program, or pool of assets sponsored or established by the State, political subdivision, or municipal corporate instrumentality or any agency, authority, or instrumentality thereof; and (iii) any other issuer of municipal securities.
- 35. Municipal Financial Products:** *Municipal derivatives, guaranteed investment contracts, and investment strategies.*
- 36. Natural Person Municipal Advisor:** Any natural person that is a *municipal advisor*, including sole proprietors. A sole proprietor that is a *municipal advisor*, is also a *municipal advisory firm*.
- 37. Non-Resident:** (i) in the case of an individual, one who resides in or has his *principal office and place of business* in any place not in the United States; (ii) in the case of a corporation, one incorporated in or that has its *principal office and place of business* in any place not in the United States; and (iii) in the case of a partnership or other unincorporated organization or association, one having its *principal office and place of business* in any place not in the United States.
- 38. NYSE:** New York Stock Exchange.
- 39. Obligated Persons:** Any *person*, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such *person*, committed by contract or other arrangement to support payment of all or part of the obligations of the municipal securities to be sold in an offering of municipal securities. This term does not include providers of municipal bond insurance, letters of credit, or other liquidity facilities.
- 40. Order:** A written directive issued pursuant to statutory authority and procedures, including an *order* of denial, exemption, suspension, or revocation. Unless included in an *order*, this term does not include special stipulations, undertakings, or agreements relating to payments, limitations on activity or other restrictions.

41. **Person:** An individual, sole proprietorship, or a firm. A firm includes any partnership, corporation, trust, limited liability company ("LLC"), limited liability partnership ("LLP"), or other organization.
42. **Principal Place of Business or Principal Office and Place of Business:** The executive office of the *municipal advisor* from which the officers, partners, or managers of the *municipal advisor* direct, control, and coordinate the activities of the *municipal advisor*.
43. **Proceeding:** This term includes a formal administrative or civil action initiated by a governmental agency, *self-regulatory organization* or *foreign financial regulatory authority*; a *felony* criminal indictment or information (or equivalent formal *charge*); or a *misdemeanor* criminal information (or equivalent formal *charge*). This term does not include other civil litigation, *investigations*, arrests or similar *charges* effected in the absence of a formal criminal indictment or information (or equivalent formal *charge*).
44. **Resign:** relates to separation from employment with any employer, is not restricted to *municipal advisory-related* or *investment-related* employments, and would include any termination in which allegations are a proximate cause of separation, even if the individual initiated the separation.
45. **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*, *MSRB* and *NYSE* are *self-regulatory organizations*.
46. **SEC or Commission:** Securities and Exchange Commission.
47. **Solicitation or Solicitation of a Municipal Entity or Obligated Person:** A direct or indirect communication with a *municipal entity* or *obligated person* made by a *person*, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, *municipal advisor*, or *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 a broker, dealer, municipal securities dealer, or *municipal advisor* for or in connection with *municipal financial products*, the issuance of municipal securities, or of an *investment adviser* to provide investment advisory services to or on behalf of a *municipal entity* or *obligated person*.
48. **Supervised Person:** Any of the *municipal advisor's* officers, partners, directors (or other *persons* occupying a similar status or performing similar functions), or *employees*, or any other *person* who engages in *municipal advisory activities* on the *municipal advisor's* behalf and is subject to the *municipal advisor's* supervision or control.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63586 / December 21, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-14170

In the Matter of

**Caibs International, Inc. (n/k/a Caibs
International Holding, Inc.),
Caliber Learning Network, Inc. (n/k/a
CLN, Inc.),
Cartoon Acquisition, Inc.,
Cel Communications, Inc.,
Cellular Telephone Enterprises, Inc., and
Centrum Industries, 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 Caibs International, Inc. (n/k/a Caibs International Holding, Inc.), Caliber Learning Network, Inc. (n/k/a CLN, Inc.), Cartoon Acquisition, Inc., Cel Communications, Inc., Cellular Telephone Enterprises, Inc., and Centrum Industries, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Caibs International, Inc. (n/k/a Caibs International Holding, Inc.) (CIK No. 1317832) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Caibs 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 January 31, 2006, which reported a net loss of \$1,825 from the time of inception on February 2, 2005.

2. Caliber Learning Network, Inc. (n/k/a CLN, Inc.) (CIK No. 1057187) is a forfeited Maryland corporation located in Baltimore, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Caliber is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2001, which reported a net loss of \$9 million for the prior three months. On June 15, 2001, Caliber filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Maryland, and the case was terminated on July 29, 2008. As of December 20, 2010, the company's common stock (symbol "CLBRQ") was traded on the over-the-counter markets.

3. Cartoon Acquisition, Inc. (CIK No. 1265869) is a void Delaware corporation located in Wyoming, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cartoon Acquisition 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, 2005, which reported a net loss of \$26,027 for the prior nine months.

4. Cel Communications, Inc. (CIK No. 355271) is a New York corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cel Communications is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1994, which reported a net loss of \$791,000 for the prior three months. As of December 20, 2010, the company's common stock (symbol "CELC") was traded on the over-the-counter markets.

5. Cellular Telephone Enterprises, Inc. (CIK No. 862885) is a delinquent Delaware corporation located in Bellerose, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cellular Telephone 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, 1996, which reported a net loss of \$43,580 for the prior three months. On August 5, 1994, Cellular Telephone filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of New York, which was converted to Chapter 7, and the case was terminated on January 16, 2007.

6. Centrum Industries, Inc. (CIK No. 351127) is a void Delaware corporation located in Corry, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Centrum is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2000, which reported a net loss of \$966,000 for the prior three months. On December 14, 2001, Centrum filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Pennsylvania, and the case was terminated on April 1, 2003.

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 ACT OF 1933

Release No. 9167 / December 21, 2010

SECURITIES EXCHANGE ACT OF 1934

Release No. 63585 / December 21, 2010

INVESTMENT ADVISERS ACT OF 1940

Release No. 3125 / December 21, 2010

INVESTMENT COMPANY ACT OF 1940

Release No. 29542 / December 21, 2010

ADMINISTRATIVE PROCEEDING

File No. 3-14169

In the Matter of

AMERICAN PEGASUS LDG, LLC,
AMERICAN PEGASUS
INVESTMENT MANAGEMENT,
INC., BENJAMIN P. CHUI,
CHARLES E. HALL, JR., AND
TRIFFANY MOK

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933, SECTION 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, SECTIONS 203(e), 203(f), AND 203(k)
OF THE INVESTMENT ADVISERS ACT OF
1940, SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940, AND RULE 102(e)
OF THE COMMISSION'S RULES OF
PRACTICE, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND
CEASE-AND-DESIST ORDERS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 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 American Pegasus LDG, LLC ("APLDG"), American Pegasus Investment Management, Inc. ("APIM"), Benjamin P. Chui ("Chui"), Charles

E. Hall, Jr. ("Hall"), and Triffany Mok ("Mok") (collectively "Respondents"), and pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice against Hall.¹

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 Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, Section 9(b) of the Investment Company Act of 1940, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders ("Order"), as set forth below.

III.

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

Summary

The Respondents in this matter—two investment advisory firms, their CEO Benjamin P. Chui, their portfolio manager Triffany Mok, and their general counsel Charles E. Hall, Jr.—failed to disclose conflicts of interest, misused client assets, and engaged in improper self-dealing.

During 2007 through 2009, the two advisory firms, American Pegasus Investment Management, Inc. and its successor American Pegasus LDG, LLC ("APLDG"), managed up to \$150 million in assets held by several offshore hedge funds invested in subprime automobile loans and life settlements. In 2007, a holding company owned by Chui, Hall, and Mok purchased a finance company that was the sole supplier of subprime auto loans to the largest hedge fund (the "Auto Loan Fund" or "the Fund"). As directed by Chui, the holding company used roughly \$18.5 million of the Auto Loan Fund's cash to pay for the purchase.

After the finance company purchase, Chui, Hall, and Mok had a fundamental conflict of interest because they stood to gain by having the Fund continue using their finance company over

¹ Rule 102(e)(1)(iii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

any other suppliers that might better serve the Fund. Yet they failed to disclose this conflict to the Fund's independent directors and investors for nearly two years. In addition, Chui falsely claimed to prospective investors that the Auto Loan Fund used only finance companies that were independent of the advisory firms.

After they acquired the finance company, Chui, Hall, and Mok allowed it to run up large debts to the Auto Loan Fund. Also, Chui caused the Fund to make about \$12 million in undisclosed loans to separate life settlement hedge funds he managed to cover those funds' operating costs.

According to its offering memorandum, the Auto Loan Fund invested primarily in subprime auto loans. By December 2008, however, approximately 40 percent of the Fund's assets consisted of debts and other obligations owed by the various related entities mentioned above—with APLDG charging the Fund fees to manage these same assets. Then, in an early 2009 effort led by Chui, much of this related-party debt was forgiven through a transaction where the finance company bought a distressed auto loan portfolio for \$12 million and immediately sold it to the Auto Loan Fund for over \$38 million, a mark-up of over 300 percent.

Respondents

1. American Pegasus LDG, LLC ("APLDG") is a Delaware limited liability company formed in January 2007 and headquartered in San Francisco, California. Since July 2007, APLDG has been registered with the Commission as an investment adviser.
2. American Pegasus Investment Management, Inc. ("APIM") is a Delaware corporation formed in 1997 and domiciled in San Francisco, California. It was registered with the Commission as an investment adviser from 2005 until July 2009. APLDG replaced APIM as the investment adviser to the Auto Loan Fund in August 2008.
3. Benjamin P. Chui ("Chui"), age 39, is a resident of San Carlos, California. Chui has been the majority owner of APLDG since its inception. He was APLDG's CEO and one of its managing members from its inception until October 2010. He has been the sole owner of APIM and its CEO since its inception.
4. Triffany Mok ("Mok"), age 38, is a resident of Fremont, California. Mok has worked for APIM and APLDG since 2005, first as the Auto Loan Fund's assistant portfolio manager and then as its portfolio manager. She owns 1.6 percent of APLDG.
5. Charles E. Hall, Jr. ("Hall"), age 56, is an attorney licensed in California and a resident of Carlisle, Pennsylvania, where he maintains a law office. Hall was APLDG's chief compliance officer from its inception until February 2009, and one of its managing members from its inception until March 2010. He was the general counsel to APIM from 2005 until April 2010, and APLDG's general counsel from its inception until April 2010. Hall owns 22.5 percent of APLDG.

Background

6. American Pegasus SPC (“the SPC”) is a “segregated portfolio company” organized under the laws of the Cayman Islands and domiciled there. Within the SPC are several segregated portfolios that operate as hedge funds. Starting no later than 2005, APIM and its successor firm APLDG (collectively “the Advisers”) provided investment advisory services to these hedge funds, which at times held up to roughly \$150 million in assets. The bulk of the assets—up to roughly \$100 million—were held in the American Pegasus Auto Loan Fund Segregated Portfolio (“Auto Loan Fund” or “Fund”). The remaining assets were principally held by several “life settlement” funds that invested in life insurance policies, and by one hedge fund, the American Pegasus Auto Loan Fund (Dist) Segregated Portfolio (“Dist Fund”), that invested exclusively in the Auto Loan Fund.

7. According to its offering memorandum, the Auto Loan Fund would seek to generate returns from investing in subprime auto loans. Together, Chui and Mok handled portfolio management for the Fund and determined how to invest its assets during 2005 through 2009.

8. As detailed above, Hall was general counsel to the Advisers, APLDG’s chief compliance officer, and/or a managing member of APLDG at various times starting in 2005.

Chui, Hall, and Mok Failed to Disclose Their Purchase of the Fund’s Key Supplier and the Resultant Conflict of Interest

9. In late June 2007, Synergy Equity LLC (“Equity”), a holding company owned by Chui, bought Synergy Acceptance Corp. (“Acceptance”), a finance company that sold portfolios of subprime auto loans and loan servicing to the Auto Loan Fund. In mid-July 2007, Hall and Mok became joint owners of Equity along with Chui.

10. Although Equity bought Acceptance, Chui used roughly \$18.5 million from the Auto Loan Fund for the purchase. Specifically, Chui arranged for the Fund to prepay loan origination fees to Acceptance, knowing that about \$5 million of that money would go immediately to the seller of Acceptance. For the remainder of the purchase money, Chui had Equity borrow roughly \$13.5 million from the Fund and used that money to pay the seller. The loan terms, which were contained in promissory notes signed by Chui (on behalf of the Fund) and Hall (on behalf of Equity), did not require Equity to pay the Fund any principal or interest for ten years. Mok knew that the Fund’s money was used to pay for Acceptance. After the purchase, Hall became Acceptance’s CEO and he and Chui served on its board of directors.

11. During 2007 through 2009, Acceptance sold subprime auto loan portfolios to the Auto Loan Fund. Sales contracts between Acceptance and the Fund obligated Acceptance to service the portfolios by performing tasks including collecting payments from borrowers, repossessing vehicles from borrowers who failed to pay, and repairing and reselling repossessed vehicles. During the same period, Acceptance was the sole finance company providing auto loans and loan servicing to the Fund, and Acceptance derived virtually all of its income from the Fund.

12. Chui, Hall, and Mok's ownership of Acceptance (through Equity) created a pervasive conflict of interest. As owners of Acceptance, Chui, Mok, and Hall had an incentive to use it over any other finance company that might better serve the Fund. This incentive was particularly acute because Chui and Hall planned to use Acceptance's earnings to pay back Equity's \$13.5 million in loans from the Fund. In addition, Acceptance would benefit by "selling high" to maximize profits in its dealings with the Fund, and the Fund would benefit by "buying low" to maximize its own performance. Thus, Chui and Mok faced competing interests every time they directed the Fund to buy auto loans or services from Acceptance.

13. Respondents did not disclose the purchase of Acceptance or the resultant conflict of interest to the Auto Loan Fund's independent directors or investors for nearly two years. During 2007 through 2009, the directors of the SPC (which includes the Auto Loan Fund) were Chui and two individuals who were independent of the Advisers. Chui was responsible for communicating with the two independent directors on behalf of the Advisers. Neither Chui nor any other Respondent disclosed the purchase of Acceptance to the independent directors until approximately March 2009. Also, investors first learned of the purchase in approximately April 2009, when it was disclosed in the Fund's audited financial statements.

The Fund's Assets Were Misused to Support Related Parties

14. Rather than generating earnings to pay back the \$13.5 million that Equity borrowed from the Auto Loan Fund, Acceptance was unprofitable and used additional money from the Fund to maintain its operations. To help cover its operating costs, Acceptance retained auto loan payments it collected for the Fund and other money it owed the Fund. Also, Chui directed the Fund to prepay \$4.5 million in repossession costs to Acceptance (in addition to the prepaid loan origination fees described above).

15. As a result of this conduct, by December 2008, Acceptance owed the Auto Loan Fund about \$15.7 million in prepaid fees and costs and money Acceptance had retained to pay for its operations, while Equity still owed the Fund the millions it had borrowed. Chui, Hall, and Mok knew or were reckless in not knowing that Acceptance was unprofitable and running up millions of dollars in debts to the Fund during 2007 and 2008. Also, none of the Respondents disclosed to the SPC's two independent directors that a company owned by Chui, Hall, and Mok was incurring this mounting debt to the Fund.

16. Chui also used the Auto Loan Fund's assets for the benefit of the Advisers' other hedge fund clients. Chui served as the portfolio manager for the life settlement funds in the SPC. From April 2007 through May 2009, Chui had the Auto Loan Fund make approximately 60 loans totaling \$12 million to several of the life settlement funds. These interfund loans were unsecured and payable on demand with low interest rates. The life settlement funds used the borrowed money to cover investor redemptions, premiums on the insurance policies in which the funds invested, and sales commissions. Thus, Chui treated the assets of the Auto Loan Fund as available to fund the operations of the life settlement funds.

17. The interfund loans generated additional conflicts of interest. The lender, the Auto Loan Fund, would benefit from high interest rates and prompt payment; the borrowers, the life settlement funds, would benefit from low rates and delayed payment. As the manager of both the lender and the borrowers, Chui thus had a conflict. Mok was aware of the interfund loans.

18. Neither Chui nor Mok kept the SPC's two independent directors apprised of the number, dollar amount, or terms of the interfund loans. The Auto Loan Fund's investors first learned about the loans to the life settlement funds through the April 2009 release of the Fund's audited financial statements.

19. The offering memorandum used to sell shares in the Auto Loan Fund stated that the Fund's "investment objective" was "to earn a steady return by purchasing sub-prime auto loans issued in the United States." The offering memorandum further stated that the Advisers expected to invest the Fund's assets only in subprime auto loans, U.S. Treasury securities, and interest-rate derivatives for hedging. As a result of the conduct above, however, by December 2008, roughly 40 percent of the Auto Loan Fund's assets consisted of debts and other obligations owed to the Fund by Equity, Acceptance, and the life settlement funds. Thus, nearly half of the Fund's assets consisted of debts and obligations owed by entities that were owned and/or controlled by one or more of Chui, Hall, and Mok.

20. The Auto Loan Fund paid the Advisers advisory fees for managing its assets. These fees were based on the value of the Fund's assets—assets that included the debts and obligations owed by Equity, Acceptance, and the life settlement funds. Thus, a substantial portion of the fees the Advisers charged the Fund were for "managing" what were simply debts and obligations that were generated by and benefited related parties, i.e., entities owned and/or controlled by one or more of Chui, Hall, and Mok. This portion of the fees was improper because concentrating nearly half of the Fund's assets in debts and obligations that benefited related parties was contrary to the Fund's investment objective and investment strategy set forth in its offering memorandum. This portion of the fees was also improper because the SPC's independent directors had not been informed of or consented to the related-party debts and obligations or the conflicts of interest they involved. The Advisers also charged the Dist Fund advisory fees, a substantial portion of which were improperly based on the related-party debts and obligations.

21. During 2007 and 2008, Hall earned a salary from Acceptance as its CEO. In addition, Hall borrowed significant sums from Acceptance to cover personal expenses including payments on luxury vehicles, jewelry purchases, and income tax. Hall put his interests ahead of the Fund's interests by borrowing heavily from Acceptance for himself when he knew or recklessly failed to know that Acceptance was unprofitable, using the Fund's money to cover its operating costs, and running up large debts to the Fund.

**Chui, Hall, and Mok Retired Acceptance and Equity's Debts
Through Improper Self-Dealing**

22. In February 2009, Acceptance bought an auto loan portfolio for \$12 million. Acceptance agreed to pay the seller \$2 million in cash at closing and \$10 million over time. As

authorized by Chui and known to Hall, the Auto Loan Fund agreed to act as a guarantor that was obligated to pay the \$10 million if Acceptance did not. As Chui, Hall, and Mok knew, the loan portfolio included some performing loans, but roughly half of it consisted of "deficiency balances," i.e., remaining balances on loans where the borrowers were already in default.

23. On the same day that Acceptance completed its purchase of the portfolio for \$12 million, it sold the portfolio to the Auto Loan Fund for approximately \$38.2 million, i.e., for over three times what Acceptance paid for it.

24. The Fund paid for the portfolio in part by relieving Acceptance and Equity of debts they owed the Fund totaling about \$33.8 million. This debt included the roughly \$15.3 million in principal and interest that Equity owed the Fund for the 2007 purchase of Acceptance. As the remaining payment for the portfolio, the Fund provided Acceptance and Equity with additional consideration worth roughly \$4.4 million. No respondent disclosed the Fund's purchase of the portfolio to the SPC's independent directors.

25. Chui directed and approved all aspects of this transaction. Hall and Mok understood the transaction and participated in it by drafting, reviewing, signing, and/or processing documents used to effect the transaction.

26. In December 2009, Chui and Hall rescinded the Auto Loan Fund's purchase of the deficiency balances, and Acceptance agreed to refund the \$21.5 million it charged the Fund for the balances. Acceptance, which was struggling financially and had minimal assets, had no ability to pay the refund.

Misrepresentations to Investors

27. After Equity acquired Acceptance, Chui told multiple prospective investors in the Auto Loan Fund that the Fund used several finance companies that were all independent of the Advisers. These statements were false because Acceptance, a company Chui owned with Mok and Hall through Equity, was the sole finance company used by the Fund.

28. The Advisers provided prospective investors with the Fund's offering memorandum, which was drafted by Hall and approved by Chui and Mok. After Equity bought Acceptance, the Fund continued to raise new investor funds using the offering memorandum.

29. The offering memorandum stated that the Fund would buy auto loans from "finance companies," but did not disclose that Chui, Mok, and Hall owned the Fund's sole source of auto loans and loan servicing, Acceptance, and had purchased it with the Fund's money. In addition, the memorandum stated that the Advisers would earn fees for managing the Fund's assets, yet omitted that a substantial portion of those assets were not subprime auto loans, but obligations owed to the Fund by entities owned and/or controlled by one or more of Chui, Hall, and Mok. The memorandum did not disclose that the life settlement funds used the Auto Loan Fund's money to cover their operating costs.

30. Attached to the offering memorandum was a copy of Part II of a Form ADV completed by either APIM or APLDG, depending on the time period. It indicated that "from time to time" APIM or APLDG might cause a client to buy securities owned by it or a related person, but did not disclose that the Fund obtained all of its auto loans and loan servicing from a related party (Acceptance). It also disclosed the preceding five years of "business background" for key personnel of the Advisers including Chui, Hall, and Mok, but omitted any mention of their affiliation with Acceptance.

31. After Equity acquired Acceptance, the Advisers filed with the Commission iterations of the Form ADV, signed by Chui or Hall, that included these statements and omissions. Also, APIM provided a version of Part II of the form with these statements and omissions to persons who were already investors in the Auto Loan Fund.

32. After Equity acquired Acceptance, the Dist Fund continued to raise new investor funds based on an offering memorandum and Form ADV Part II with the same omissions as the Auto Loan Fund. Hall drafted this offering memorandum and Chui approved it.

33. The Advisers provided investors and prospective investors with periodic "Performance Sheets," which stated that the Auto Loan Fund "directly sources . . . subprime US auto loans," included charts showing auto loan default rates, and otherwise reinforced the impression that subprime auto loan investments were driving the Fund's performance. From July 2007 through January 2009, the sheets showed an 18 percent increase in the Fund's net asset value per share. During this period, however, investors were not informed through the performance sheets or otherwise that the assets underlying the Fund's performance became increasingly concentrated in obligations owed by Acceptance, Equity, and the life settlement funds, rising to the level of 40 percent of the Fund's overall assets in 2008. Chui and Mok participated in creating the format for the performance sheets, and Mok reviewed the sheets before they went to investors.

Violations

34. As a result of the conduct described above, Respondents willfully violated 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 or sale of securities and in connection with the purchase or sale of securities.

35. As a result of the conduct described above, APLDG, APIM, Chui, and Mok willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit fraudulent conduct by an investment adviser.

36. As a result of the conduct described above, Hall willfully aided and abetted and caused APLDG and APIM's violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

37. As a result of the conduct described above, APLDG, APIM, Chui, and Hall willfully violated Section 207 of the Advisers Act which makes it "unlawful for any person

willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein.”

38. As a result of the conduct above, APLDG and APIM willfully violated, and Chui, Hall, and Mok willfully aided and abetted and caused APLDG and APIM’s violations of, Section 206(3) of the Advisers Act, which prohibits an investment adviser from, “acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction.”

Undertakings

Respondents have undertaken as follows:

39. Within five (5) days of the entry of this Order, APLDG will permanently forgive and cancel a total of \$850,000 in its claims against the Auto Loan Fund and the Dist Fund for accrued but unpaid advisory fees and certain reimbursement. Within fifteen (15) days of the entry of this Order, APLDG shall provide to the Commission’s staff a written accounting of the claims forgiven. The accounting shall be in a form deemed acceptable by the staff and certified under penalty of perjury by signature of APLDG’s Chief Compliance Officer or Chief Operating Officer.

40. Chui shall not serve as a director of American Pegasus SPC or any of its segregated portfolios.

41. Hall shall not serve as a director of American Pegasus SPC or any of its segregated portfolios.

42. Mok shall not serve as a director of American Pegasus SPC or any of its segregated portfolios.

43. Mok shall provide to the Commission, within thirty (30) days after the end of the 12-month suspension period described below, an affidavit that she has complied fully with the sanctions described in Sections IV.A, IV.G, and IV.L below.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Sections 203(e), 203(f), and 203(k) of the Advisers Act, Section 9(b) of the Investment

Company Act, and Rule 102(e)(1)(iii) of the Commission's Rules of Practice it is hereby ORDERED that:

A. Respondents cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 206(3), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

B. APLDG, APIM, Chui, and Hall cease and desist from committing or causing any violations and any future violations of Section 207 of the Advisers Act.

C. Chui be, and hereby is barred from association with any 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 five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

D. Any reapplication for association by Chui 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 Chui, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. Hall be, and hereby is barred from association with any 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.

F. Any reapplication for association by Hall 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 Hall, 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.

G. Mok be, and hereby is suspended from association with any investment adviser, and prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, for a period of twelve (12) months, effective on the second Monday following the entry of this Order.

H. Respondents are censured.

I. APLDG and APIM are jointly and severally liable for, and shall pay, disgorgement in the amount of \$850,000, representing improper advisory fees they received. This payment obligation shall be offset and deemed satisfied by performance of the undertakings in Section III.39 above.

J. Chui shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$175,000 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 Chui 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 Michael S. Dicke, Associate Regional Director, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

K. Hall shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$100,000 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 Hall 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 Michael S. Dicke, Associate Regional Director, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

L. Mok shall, within ten (10) 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 Mok 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 Michael S. Dicke, Associate Regional Director, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

M. Effective immediately, Hall is denied the privilege of appearing or practicing before the Commission as an attorney for three (3) years. Furthermore, after three (3) years from the date of this Order, Hall 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 this Order, that he is not subject to any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession, and that he has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice.

N. APLDG shall comply with the undertakings enumerated in Section III.39 above; Chui shall comply with the undertaking enumerated in Section III.40 above; Hall shall comply with the undertaking enumerated in Section III.41 above; and Mok shall comply with the undertakings enumerated in Sections III.42 and III.43 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 EXCHANGE ACT OF 1934
Release No. 63583 / December 21, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14168

In the Matter of

**EC Power, Inc.,
Electro Energy, Inc.,
EMB Corporation (n/k/a AMT
Group, Inc.),
Encore Computer Corp.,
Enhance Life Sciences, Inc.,
e.Nvizion Communications
Group Ltd., and
Exchange Applications, 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 EC Power, Inc., Electro Energy, Inc., EMB Corporation (n/k/a AMT Group, Inc.), Encore Computer Corp., Enhance Life Sciences, Inc., e.Nvizion Communications Group Ltd., and Exchange Applications, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. EC Power, Inc. (CIK No. 1083954) 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). EC Power 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 \$680,480 for the prior nine months. As of December 9, 2010 the company's stock (symbol "ECPW") was traded on the over-the-counter markets.

2. Electro Energy, Inc. (CIK No. 1175636) is an inactive Florida corporation located in Danbury, Connecticut with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Electro 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 June 30, 2008, which reported a net loss of over \$9 million for the prior six months. On March 26, 2009, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Connecticut, which was still pending as of December 20, 2010. As of December 9, 2010, the company's stock ("EEEE") was quoted on the Pink Sheets.

3. EMB Corporation (n/k/a AMT Group, Inc.) (CIK No. 1017797) is a revoked Nevada corporation located in Fort Salonga, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EMB is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2007, which reported a net loss of \$1,300 for the prior three months. As of December 9, 2010, the company's stock (symbol "AMTN") was traded on the over-the-counter markets.

4. Encore Computer Corp. (CIK No. 764037) is an inactive Delaware corporation located in Eastlake, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Encore Computer is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002. The company discontinued operations in January 1999. In a Schedule 14C, definitive information statement, filed on January 10, 2003, it was reported that a majority of stockholders had approved the dissolution and liquidation of the company.

5. Enhance Life Sciences, Inc. (CIK No. 1080300) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Enhance Life Science 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, 2003, which reported a net loss of over \$1 million for the prior six months.

6. e.Nvizion Communications Group Ltd. (CIK No. 803265) is an administratively dissolved Colorado corporation located in Rochester, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). e.Nvizion is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported a net loss of \$684,396 for the prior three months. As of December 9, 2010, the company's stock (symbol "ENCG") was traded on the over-the-counter markets.

7. Exchange Applications, Inc. (CIK No. 1065857) is an inactive Delaware corporation located in Boston, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Exchange Applications 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 ending September 30, 2002, which reported a net loss of \$36,250 for the prior nine months. On June 9, 2004, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Delaware and was terminated on February 8, 2005. As of December 9, 2010, the company's stock ("EXAP") 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

Will M. Peterson
By **Will M. Peterson**
Assistant Secretary

*Chairman Schapiro
Commissioner Walter
not participating*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 63600 / December 22, 2010

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3222 / December 22, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14171

In the Matter of

JAMES M. SCHNEIDER, 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 James M. Schneider ("Respondent" or "Schneider") 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. Schneider, age 57, is and has been a certified public accountant licensed to practice in the State of Wisconsin. Schneider served as Chief Accounting Officer ("CAO") of Dell Inc. from the time he joined the company in September 1996 until March 2000, when he also became Dell's Chief Financial Officer ("CFO"). In November 2002, Schneider ceased to be CAO, but remained CFO, a position he held until January 1, 2007. Schneider left Dell on February 2, 2007.

2. Dell Inc. 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 July 22, 2010, the Commission filed a complaint against Schneider in the U.S. District Court for the District of Columbia captioned SEC v. Dell Inc. et al. (Civil Action No. 1:10-cv-01245). On October 13, 2010, the court entered an order permanently enjoining Schneider, 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 13a-14, 13b2-1, and 13b2-2 thereunder, and from aiding and abetting violation 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. Schneider was also ordered to pay \$83,096 in disgorgement of ill-gotten gains, \$38,640 in prejudgment interest, and a \$3 million civil money penalty.

4. The Commission's complaint alleged, among other things, that Dell fraudulently committed various disclosure and accounting violations through the conduct of Schneider and others. The Complaint alleged that Schneider made or was involved in making material misrepresentations in earnings calls and material misrepresentations and omissions in Dell's annual reports on Form 10-K for the fiscal years 2003 through 2006 and in the company's quarterly reports on Form 10-Q for the first three quarters of fiscal years 2003 through 2006 and the first quarter of fiscal 2007 relating to the impacts on Dell's operating results from payments from Intel Corp. The material misrepresentations during earnings calls misled investors as to the bases for Dell's success in meeting or exceeding analyst consensus EPS estimates and the reasons

for Dell's sharp drop in operating results in its second quarter of fiscal year 2007. The disclosure violations misrepresented to investors the bases for Dell's increasing profitability and failed to disclose information required by Item 303 of Regulation S-K. The Commission's complaint also alleged, among other things, that Schneider 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 for the fiscal years 2002 through 2004, and in the company's quarterly reports on Form 10-Q for the first three quarters of fiscal years 2002 through 2004 and the first two quarters of fiscal 2005. The Complaint alleged that Schneider directed and engaged in a number of improper accounting practices in contravention of generally accepted accounting principles that materially misstated Dell's financial results and enabled the company to report lower operating expense as a percentage of revenue. These practices included improperly manipulating excess reserve balances and improperly accounting for certain restructuring costs.

IV.

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

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

A. Schneider 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

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 33-9168 / December 22, 2010

Securities Exchange Act of 1934
Release No. 34-63596 / December 22, 2010

**ORDER APPROVING PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
BUDGET AND ANNUAL ACCOUNTING SUPPORT FEE FOR CALENDAR YEAR
2011**

The Sarbanes-Oxley Act of 2002, as amended (the "Sarbanes-Oxley Act"), established the Public Company Accounting Oversight Board ("PCAOB") to oversee the audits of companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB is to accomplish these goals through registration of public accounting firms and standard setting, inspection, and disciplinary programs. The PCAOB is subject to the comprehensive oversight of the Securities and Exchange Commission (the "Commission").

Section 109 of the Sarbanes-Oxley Act provides that the PCAOB shall establish a reasonable annual accounting support fee, as may be necessary or appropriate to establish and maintain the PCAOB. Under Section 109(f) of the Sarbanes-Oxley Act, the aggregate annual accounting support fee shall not exceed the PCAOB's aggregate "recoverable budget expenses," which may include operating, capital and accrued items. The Commission must approve the PCAOB's annual budget and accounting support fee.

Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")¹ amended the Sarbanes-Oxley Act to provide the PCAOB with explicit

¹ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

authority to oversee auditors of broker-dealers registered with the Commission. In addition, the PCAOB must allocate the annual accounting support fee among issuers and among brokers and dealers, beginning in 2011. The 2011 budget approved and submitted by the Board includes an allocation of the annual accounting support fee among issuers and brokers and dealers.

Section 109(b) of the Sarbanes-Oxley Act directs the PCAOB to establish a budget for each fiscal year in accordance with the PCAOB's internal procedures, subject to approval by the Commission. The Commission's Rules of Practice related to its Informal and Other Procedures include a rule that facilitates the Commission's review and approval of PCAOB budgets and the annual accounting support fee.² This budget rule provides, among other things, a timetable for the preparation and submission of the PCAOB budget and for Commission actions related to each budget, a description of the information that should be included in each budget submission, limits on the PCAOB's ability to incur expenses and obligations except as provided in the approved budget, procedures relating to supplemental budget requests, requirements for the PCAOB to furnish on a quarterly basis certain budget-related information, and a list of definitions that apply to the rule and to general discussions of PCAOB budget matters.

In accordance with the budget rule, in March 2010 the PCAOB provided the Commission with a narrative description of its program issues and outlook for the 2011 budget year. In response, the Commission provided the PCAOB with economic assumptions and budgetary guidance for the 2011 budget year. The PCAOB subsequently delivered a preliminary budget and budget justification to the Commission. Staff from the Commission's Offices of the Chief Accountant and Executive Director dedicated a substantial amount of time to the review and analysis of the PCAOB's programs, projects and budget estimates; reviewed

² 17 CFR 202.190. See Release No. 33-8724 (July 18, 2006) [71 FR 41998 (July 24, 2006)].

the PCAOB's estimates of 2010 actual spending; and attended several meetings with management and staff of the PCAOB to further develop an understanding of the PCAOB's budget and operations. During the course of this review, Commission staff relied upon representations and supporting documentation from the PCAOB. Based on this review, the Commission issued a "pass back" letter to the PCAOB. The PCAOB approved its 2011 budget during an open meeting on November 23, 2010 and submitted that budget for Commission approval on November 29, 2010.

After considering the above, the Commission did not identify any proposed disbursements in the 2011 budget adopted by the PCAOB that are not properly recoverable through the annual accounting support fee, and the Commission believes that the aggregate proposed 2011 annual accounting support fees do not exceed the PCAOB's aggregate recoverable budget expenses for 2011. The Commission looks forward to the PCAOB's annual updating of its strategic plan and the opportunity for the Commission to review and provide views to the PCAOB on a draft of the updated plan.

In its role as the oversight body of the PCAOB, the Commission is aware of the various uncertainties the PCAOB faces with respect to budgeting its resources and the potential impact if actual experience deviates from budget assumptions. Further, the Commission believes that the 2011 budget approved and submitted by the Board provides sufficient resources and flexibility for the PCAOB to continue to fulfill its mandate and to respond to changes in the assumptions upon which the budget is based. Should the PCAOB find the need to reallocate resources, the PCAOB should work closely with Commission staff on whether any reprogramming efforts result in the need for a supplemental budget request under the Commission's budget rule. In considering any reallocation that may be necessary in 2011, the

Commission encourages the Board to identify expenditures in its 2011 budget where flexibility exists.

As part of its review of the PCAOB's 2011 budget, the Commission notes that there are certain budget-related matters that should be addressed or more closely monitored during 2011 related to: (1) the PCAOB's inspections program; (2) its information technology programs; and (3) the impact of implementing legislative and other actions on the PCAOB. Accordingly, the Commission directs the PCAOB during the 2011 budget cycle to:

- (1) Continue to include in its quarterly reports to the Commission information about the PCAOB's inspections program. Such information will include (a) statistics relative to the numbers and types of firms budgeted and expected to be inspected in 2011, including by location and by year the inspections that are required to be conducted in accordance with the Sarbanes-Oxley Act and PCAOB rules, (b) information about the timing of the issuance of inspections reports for domestic and non-U.S. inspections, and (c) updates on the PCAOB's efforts to establish cooperative arrangements with respective non-U.S. authorities for inspections required in those countries.
- (2) Continue to include detailed information about the state of the PCAOB's information technology in its quarterly reports to the Commission, including planned, estimated, and actual costs for information technology projects. Such information should also include project plans, life cycle costs and progress, and provide an indication of the level and nature of involvement of consultants.
- (3) Consult with the Commission about the PCAOB's plans for implementing changes in response to legislative actions, advisory committees, or consultant reports.

The Commission has determined that the PCAOB's 2011 budget and annual accounting support fee are consistent with Section 109 of the Act. Accordingly,

IT IS ORDERED, pursuant to Section 109 of the Act, that the PCAOB budget and annual accounting support fee for calendar year 2011 are approved.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

*Chairman Schapiro
not participating*

SECURITIES AND EXCHANGE COMMISSION

Release No. IA-3126 / December 22, 2010

Order Approving Investment Adviser Registration Depository Filing Fees

Section 204(b) of the Investment Advisers Act of 1940 ("Advisers Act") authorizes the Commission to require investment advisers to file applications and other documents through an entity designated by the Commission, and to pay reasonable costs associated with such filings.¹ Commission staff, representatives of the North American Securities Administrators Association, Inc. ("NASAA"),² and representatives of the Financial Industry Regulatory Authority ("FINRA"), the IARD system operator, periodically hold discussions on IARD system finances.

FINRA wrote to Commission staff in November recommending revised annual and initial IARD filing fees to commence on January 1, 2011.³ The recommended fee levels would increase the fee for advisers with assets under management of \$100 million or higher, but would not change the fee levels for advisers with assets under management under \$100 million.⁴ The recommended annual filing fees due beginning January 1, 2011 are \$40 for advisers with assets under management under \$25 million; \$150 for advisers

¹ 15 U.S.C. 80b-4(b).

² The IARD system is used by both advisers registering or registered with the SEC and advisers registered or registering with one or more state securities authorities. NASAA represents the state securities administrators in setting IARD filing fees for state-registered advisers.

³ FINRA letter dated November 12, 2010 available at <http://www.sec.gov/rules/other/2010/finraletter111210-iardfees.pdf>.

⁴ The revised fee level for advisers in the largest category would newly include advisers that report assets under management of exactly \$100 million (not just over \$100 million). We are making this revision to track the new mid-sized adviser category for advisers reporting assets under management of \$25 million up to, but not including, \$100 million. See section 410 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, 124 Stat. 1376 (2010)).

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advisers with assets under management under \$25 million; \$150 for advisers with assets under management from \$25 million to \$100 million; and \$225 for advisers with assets under management of \$100 million or higher.

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. 63608 / December 23, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-14102

In the Matter of

BARRY SCHWARTZ,

Respondent.

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

I.

On October 28, 2010, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Barry Schwartz ("Schwartz" or "Respondent").

II.

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

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III.

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

1. Between 1993 and 1995, Schwartz was a registered representative with Barrett Day Securities, Inc. ("Barrett Day"), a broker-dealer registered with the Commission. Schwartz, 64 years old, is currently incarcerated at United States Penitentiary-Canaan.
2. Schwartz participated in an offering of Tera West Ventures, Inc. ("Tera West") stock, which is a penny stock.
3. On December 10, 2003, Schwartz pled guilty to conspiracy to commit securities fraud in violation of Title 18 United States Code, Section 371, and conspiracy to commit money laundering in violation of Title 18, United States Code, Section 1956, before the United States District Court for the Eastern District of New York, in United States v. Barry Schwartz, et al., Crim. Information No. 03-CR-290. On May 15, 2009, a judgment in the criminal case was entered against Schwartz. He was sentenced to a prison term of 18 months followed by three years of supervised release. Schwartz also forfeited a total of \$1,276,552.
4. The counts of the criminal indictment to which Schwartz pled guilty alleged, inter alia, that Schwartz, while associated with Barrett Day, used nominees to conceal his ownership of National Health and Safety ("National Health") and Tera West, whose stocks were traded on the OTC Bulletin Board. The indictment alleged that Schwartz used his controlling interest in National Health and Tera West to arbitrarily set their stock prices and deceived the investing public by making it appear that the sales price was set by a market of multiple, independent shareholders selling their shares of National Health and Tera West.

IV.

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

Accordingly, it is hereby ORDERED that:

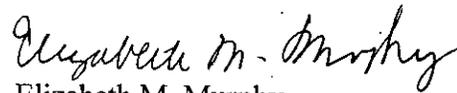
- A. Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Schwartz be, and hereby is barred from association with any broker or dealer;

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.

B. Respondent be, and hereby is, barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

By the Commission.


Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63606; File No. PCAOB 2010-01)

December 23, 2010

Public Company Accounting Oversight Board; Order Approving Proposed Rules on Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards

I. Introduction

On September 15, 2010, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") a notice (the "Notice") of proposed rules (File No. PCAOB 2010-01) on Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards. Those eight auditing standards (hereinafter referred to as "Risk Assessment Standards"), which will supersede six of the Board's interim auditing standards, are:

- Auditing Standard ("AS") No. 8, Audit Risk;
- AS No. 9, Audit Planning;
- AS No. 10, Supervision of the Audit Engagement;
- AS No. 11, Consideration of Materiality in Planning and Performing an Audit;
- AS No. 12, Identifying and Assessing Risks of Material Misstatement;
- AS No. 13, The Auditor's Responses to the Risks of Material Misstatement;
- AS No. 14, Evaluating Audit Results; and
- AS No. 15, Audit Evidence.

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Notice of the proposed rules was published in the Federal Register on September 27, 2010.¹ The Commission received two comment letters relating to the proposed rules. For the reasons discussed below, the Commission is granting approval of the proposed rules. As specified by the Board, the rules are effective for audits of fiscal years beginning on or after December 15, 2010.

II. Description

The Board adopted eight auditing standards and related amendments that are designed to benefit investors by establishing requirements that enhance the effectiveness of the auditor's assessment of and response to the risks of material misstatement in an audit. Assessing and responding to risks underlies the entire audit process. The risk assessment standards that the PCAOB is replacing were part of the Board's interim standards and were in large part written twenty to thirty years ago. In adopting the new Risk Assessment Standards, the Board intended to build upon and improve the risk framework that was already established by the interim standards, rather than replacing that framework altogether.

Changes that the Board made to the interim standards reflect: improvements that the PCAOB has observed in the audit methodologies of many registered firms; recommendations from academia; recommendations from the Board's Standing Advisory Group ("SAG") and other groups; the adoption of AS No. 5, An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements; improvements made to similar risk assessment standards by other standard setters (e.g., the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants); and observations from the Board's oversight activities.

¹ See Release No. 34-62919 (September 15, 2010) [75 FR 59332 (September 27, 2010)]. The notice included a 21-day comment period. The comment period closed on October 18, 2010.

Key changes made to the standards include an increased emphasis on fraud risks, an increased emphasis on disclosures, inclusion of multi-location audit requirements, an alignment of the standards with AS No. 5, and inclusion of a concept of materiality more specifically grounded to that used in the federal securities laws.

III. Discussion

The Commission received two comment letters: one from Deloitte & Touche, LLP (“Deloitte”) and one from the Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce (“CMCC”). Deloitte supported approval of the standards, while expressing certain concerns largely of a more general nature regarding the PCAOB’s approach to standard-setting. The CMCC believed that the Risk Assessment Standards should not be approved, but rather sent back to the PCAOB in order for the PCAOB to address certain concerns, most of which also related to the PCAOB’s overall approach to standard-setting as opposed to the particular standards at issue.

Integration of Fraud Risk Standard into the Risk Assessment Standards

One of the significant changes to the Risk Assessment Standards was the incorporation of aspects of AU sec. 316, Consideration of Fraud in a Financial Statement Audit, into the Risk Assessment Standards. In explaining why the PCAOB incorporated portions of the fraud standard into the Risk Assessment Standards, it stated that:

incorporating these requirements makes clear that the auditor’s responsibilities for assessing and responding to fraud risks are an integral part of the audit process rather than a separate, parallel process. It also benefits investors by prompting auditors to make a more thoughtful and thorough assessment of fraud risks and to develop appropriate audit responses.²

² PCAOB Release No. 2010-004, August 5, 2010, p. 3.

The CCMC did not agree with the level of integration. The CCMC made a similar comment during the PCAOB's due process stage, which the Board addressed in its adopting release. This comment largely relates to a disagreement as to the manner in which the standards are constructed, as compared to the performance required of auditors. The Commission believes that the PCAOB has given due consideration to the comments received about this matter.

Effective Date

The effective date of the standards will be for audits of fiscal years beginning on or after December 15, 2010. The CMCC expressed concern about the effective date, stating that the effective date "would not allow adequate time for audit firms to revise their audit methodologies and train their audit staffs around the world for audits in 2011." In response to similar concerns raised in its comment letter process, including from the CCMC, the PCAOB, stated in its release that the underlying concepts of risk-based auditing have not changed, and therefore, while there are many incremental requirements in the updated standards, these standards should not require wholesale changes to audit methodologies.³ Any delay in the effective date of these standards would likely delay the implementation for most issuers for at least one year (e.g., the standards would not be applicable generally until calendar year 2012 audits related to audit reports to be issued in 2013).

After considering the nature of the changes in the Risk Assessment Standards, the timing of Commission approval, and the fact that the standards will not be applicable to audits for which audit reports will be issued in 2011 (i.e., the first audit reports issued for which audits would be required to be conducted using the new standards would not be issued until 2012) we believe the PCAOB's approach for implementation is not unreasonable.

³ PCAOB Release No. 2010-004, August 5, 2010, p. 8.

PCAOB Standard-Setting Process

Both commenters noted various concerns about the PCAOB's standard-setting process. The concerns identified included divergence from other standard-setters, what the commenters viewed as a "prescriptive" nature of the standards, the lack of a codification of PCAOB standards, the usefulness of the appendix that compares the PCAOB proposed standard to the similar standards of other standard-setters, and the use of certain terms in the standards. These comments all relate more to the PCAOB's overall approach to standard-setting than particular concerns with respect to the individual Risk Assessment Standards.

All of these comments are similar to those received by the PCAOB during its standard-setting process, which the Board addressed. For example with respect to divergence from other standard-setters, the Board noted the following:

In previous releases on its proposed risk assessment standards, the Board has stated that it has sought to eliminate unnecessary differences with the risk assessment standards and those of other standards-setters. However, because the Board's standards must be consistent with the Board's statutory mandate, differences will continue to exist between the Board's standards and the standards of the IAASB and ASB e.g., when the Board decides to retain an existing requirement in PCAOB standards that is not included in IAASB or ASB standards. Also, certain differences are often necessary for the Board's standards to be consistent with relevant provisions of the federal securities laws or other existing standards or rules of the Board.⁴

The Board also noted that it "continually endeavors to improve its processes" and explained other initiatives it uses in both gaining input on its standard-setting activities (e.g., through its SAG and by releasing multiple exposure documents) and providing additional transparency of its standards-setting process (e.g., through posting its standards-setting agenda and enhanced discussions in its releases on the Board's conclusions). The Commission notes and encourages

⁴ See PCAOB Release No. 2010-004, August 5, 2010, pp. A10-91 - A10-92 (internal footnotes omitted).

the Board's efforts to consider standards issued by the IAASB and the ASB, and appreciates the reasons why it is reasonable to expect that the Board's standards may appropriately differ from such standards. The Commission and its staff will continue to provide oversight of the Board and its staff's ongoing endeavor to improve its processes.

Regarding the "prescriptive" nature of the standards, we recognize that there should be an appropriate balance in auditing standards between providing necessary minimum requirements and allowing auditors to apply judgment in determining the nature and extent of audit procedures given the particular circumstances of an individual engagement. PCAOB standards recognize that the auditor uses judgment in planning and performing audit procedures and evaluating the evidence obtained from those procedures. We recognize, however, that overly broad standards without an appropriate balance of necessary requirements could lead to a level of discretion in the nature and extent of audit procedures that may limit the effectiveness of audits. The Commission believes the PCAOB's approach in the Risk Assessment Standards is not unreasonable and encourages the PCAOB to monitor implementation and evaluate the input received during the development of future standards to continue to strive to achieve an optimal balance.

Regarding a codification of the auditing standards, the Commission notes that the Board has recently added this project to its strategic plan and amended its performance measure on standard-setting activities to reflect this new initiative.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed PCAOB Rules on Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards (File No. PCAOB-2010-01) are consistent with the

requirements of the Sarbanes-Oxley Act of 2002, as amended (the "Act") and the securities laws and are necessary or appropriate in the public interest or for the protection of investors.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Act and Section 19(b)(2) of the Securities Exchange Act of 1934, that the proposed PCAOB Rules on Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards (File No. PCAOB-2010-01) be and hereby are approved.

By the Commission.


Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

Release No. IA-3129; File No. S7-10-00

RIN 3235-AI17

Amendments to Form ADV; Extension of Compliance Date

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; extension of compliance date.

SUMMARY: The Securities and Exchange Commission is extending the compliance date for Part 2B of Form ADV, the brochure supplement, and for certain rule provisions that relate to the delivery of brochure supplements. The Commission is extending the compliance date generally for four months to provide certain investment advisers additional time to design, test and implement systems and controls to satisfy their obligations to prepare and deliver brochure supplements.

DATES: The effective date for amendments to Part 2 of Form ADV and related rules under the Advisers Act remains October 12, 2010. The compliance date for Form ADV, Part 2B and the provisions of rule 204-3 concerning the delivery of brochure supplements is extended generally for four months as described in the Supplementary Information section.

FOR FURTHER INFORMATION CONTACT: Vivien Liu, Senior Counsel, or Daniel Kahl, Branch Chief, 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: On July 28, 2010, the Commission adopted amendments to Part 2 of Form ADV [17 CFR 279.1], and related rules under the Investment Advisers Act of 1940 [15 USC 80b] (“Advisers Act”),¹ to require registered investment advisers to provide clients with a brochure and brochure supplements written in plain English (“Adopting Release”).² The brochure contains information about the advisory firm, whereas the brochure supplement contains information about the advisory personnel on whom clients rely for investment advice.

When we adopted amendments to Form ADV last July, we established two separate compliance dates for delivering brochure supplements. New investment adviser registrants, *i.e.*, those that apply for registration on or after January 1, 2011, would begin providing brochure supplements to clients upon registering. Existing investment adviser registrants would provide brochure supplements to new and prospective clients upon filing their annual updating amendment to Form ADV for fiscal year ends beginning on December 31, 2010, and to existing clients within 60 days of filing the annual updating amendment. Most registered advisers have fiscal years ending on December 31 and must, as a result, file an annual updating amendment by March 31, 2011.³ Absent an extension of the compliance date, these advisers would be required to deliver their first brochure supplements to new and prospective clients no later than March 31, 2011 and to existing clients no later than May 31, 2011.

¹ See *e.g.*, rule 204-3 [17 CFR 275.204-3], which requires registered advisers to deliver brochures and brochure supplements.

² *Amendments to Form ADV*, Investment Advisers Act Rel. No. 3060 (July, 28, 2010) [75 FR 49234 (Aug. 12, 2010)].

³ Based on Investment Adviser Registration Depository data as of December 1, 2010, 92% of SEC-registered investment advisers report a December fiscal year end.

We have received correspondence from the Securities Industry and Financial Markets Association ("SIFMA"), requesting that we delay the compliance date for at least an additional four months, until July 31, 2011, solely with respect to requirements regarding delivery of the brochure supplement.⁴ SIFMA asserts that preparing and disseminating brochures with respect to thousands of supervised person to tens of thousands of clients presents its members with substantial logistical challenges in meeting the compliance date. It asserts that its members need additional time to design, test and implement systems and controls that will assure that each client receives an accurate brochure supplement with respect to the supervised person who provides advice to that client.

Based on the concerns expressed in the correspondence, and in light of similar concerns that have been expressed by other investment advisers to our staff, we are persuaded that a limited extension of the compliance date for the delivery of brochure supplements for existing registered advisers is appropriate.⁵ We have based this decision on the information SIFMA has provided and our experience in overseeing the industry. In addition, to provide consistent treatment for newly registering advisers, we are also persuaded that the limited extension of the compliance date for the delivery of brochure supplements is appropriate for these advisers as well. We are not extending the compliance date for the filing and delivery of the brochure required by Part 2A of Form ADV and related rules under the Advisers Act, which is required for newly registering

⁴ Memorandum from Morgan Lewis on behalf of certain SIFMA member firms dated Dec. 16, 2010 available at <http://www.sec.gov/rules/proposed/s71000.shtml>.

⁵ The North American Securities Administrators Association has recommended that the state securities authorities provide the same extension for state-registered investment advisers. However, state-registered advisers should contact the states where they are registered to confirm compliance dates.

investment advisers beginning on January 1, 2011, and for existing registered advisers when they file their annual updating amendments for fiscal years ending on and after December 31, 2010.

Accordingly, the Commission believes it is appropriate to modify and extend the compliance date for brochure supplements for the following investment advisers:⁶

Existing Registered Investment Advisers. All investment advisers registered with the Commission as of December 31, 2010, and having a fiscal year ending on December 31, 2010 through April 30, 2011, have until July 31, 2011, to begin delivering brochure supplements to *new and prospective clients*. These advisers have until September 30, 2011 to deliver brochure supplements to *existing clients*. The compliance dates for delivering brochure supplements for existing registered investment advisers with fiscal years ending after April 30, 2011 remain unchanged.

Newly-registered Investment Advisers. All newly registered investment advisers filing their applications for registration from January 1, 2011 through April 30, 2011, have until May 1, 2011 to begin delivering brochure supplements to *new and prospective clients*. These advisers have until July 1, 2011 to deliver brochure supplements to *existing clients*. The compliance dates for delivering brochure supplements for newly-registered investment advisers filing applications for registration after April 30, 2011 remain unchanged.

The Commission finds that, for good cause and the reasons cited above, including the brief length of the extension we are granting, notice and solicitation of comment regarding the extension of the compliance date for Part 2B of Form ADV and the

⁶ Advisers may choose to deliver brochure supplements earlier than the dates outlined in this release.

provisions of rule 204-3 that relate to the delivery of brochure supplements are impracticable, unnecessary, or contrary to the public interest.⁷ In this regard, the Commission also notes that investment advisers need to be informed as soon as possible of the extension and its length in order to plan and adjust their implementation process accordingly.

By the Commission.



Elizabeth M. Murphy
Secretary

Date: December 28, 2010

⁷ See Section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) (“APA”) (an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are “impracticable, 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. The change to the compliance date is effective upon publication in the Federal Register. This date is less than 30 days after publication in the Federal Register, in accordance with the APA, which allows effectiveness in less than 30 days after publication for “a substantive rule which grants or recognizes an exemption or relieves a restriction.” See 5 U.S.C. 553(d)(1).

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-3128; File No. S7-23-07

RIN 3235-AJ96

Temporary Rule Regarding Principal Trades with Certain Advisory Clients

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is amending rule 206(3)-3T under the Investment Advisers Act of 1940, a temporary rule that establishes an alternative means for investment advisers who are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Investment Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients. The amendment extends the date on which rule 206(3)-3T will sunset from December 31, 2010 to December 31, 2012.

DATES: The amendments in this document are effective December 30, 2010 and the expiration date for 17 CFR 275.206(3)-3T is extended to December 31, 2012.

FOR FURTHER INFORMATION CONTACT: Brian M. Johnson, Attorney-Adviser, Devin F. Sullivan, Senior Counsel, Matthew N. Goldin, 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 20549-5041.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is adopting an amendment to temporary rule 206(3)-3T [17 CFR 275.206(3)-3T] under the

Investment Advisers Act of 1940 [15 U.S.C. 80b] that extends the date on which the rule will sunset from December 31, 2010 to December 31, 2012.

I. BACKGROUND

On September 24, 2007, we adopted, on an interim final basis, rule 206(3)-3T, a temporary rule under the Investment Advisers Act of 1940 (the “Advisers Act”) that provides an alternative means for investment advisers who are also registered as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients.¹ In December 2009, we extended the rule’s sunset period by one year to December 31, 2010.²

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).³ Under section 913 of the Dodd-Frank Act, we are required to conduct a study, and provide a report to Congress, concerning the obligations of broker-dealers and investment advisers, including the standards of care applicable to those intermediaries and their associated

¹ Rule 206(3)-3T [17 CFR 275.206(3)-3T]. All references to rule 206(3)-3T and the various sections thereof in this release are to 17 CFR 275.206(3)-3T and its corresponding sections. *See also Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 (Sep. 24, 2007) [72 FR 55022 (Sep. 28, 2007)] (“2007 Principal Trade Rule Release”).

² *See Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965 (Dec. 23, 2009) [74 FR 69009 (Dec. 30, 2009)] (“2009 Extension Release”) and *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965A (Dec. 31, 2009) [75 FR 742 (Jan. 6, 2010)] (making a technical correction to the 2009 Extension Release).

³ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

persons.⁴ We intend to deliver the report concerning this study, as required by the Dodd-Frank Act, no later than January 21, 2011.⁵

Section 913 of the Dodd-Frank Act also authorizes us to promulgate rules concerning, among other things, the legal or regulatory standards of care for broker-dealers, investment advisers, and persons associated with these intermediaries for providing personalized investment advice about securities to retail customers. In enacting any rules pursuant to this authority, we are required to consider the findings, conclusions, and recommendations of the mandated study. The study and our consideration of the need for further rulemaking pursuant to this authority are part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers in connection with the Dodd-Frank Act.⁶

In light of these legislative developments, we proposed on December 1, 2010 to extend the date on which rule 206(3)-3T will sunset for a limited amount of time, from December 31, 2010 to December 31, 2012.⁷ We received 10 comment letters addressing

⁴ See generally section 913 of the Dodd-Frank Act and *Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, Investment Advisers Act Release No. 3058 (July 27, 2010) [75 FR 44996 (July 30, 2010)].

⁵ See section 913(d)(1) of the Dodd-Frank Act (requiring us to submit the study to Congress no later than six months after the date of enactment of the Dodd-Frank Act).

⁶ The study mandated by section 913 of the Dodd-Frank Act is one of several studies and other actions relevant to the regulation of broker-dealers and investment advisers mandated by that Act. See, e.g., section 914 of the Dodd-Frank Act (requiring the Commission to review and analyze the need for enhanced examination and enforcement resources for investment advisers); section 919 of the Dodd-Frank Act (authorizing the Commission to issue rules designating documents or information that shall be provided by a broker or dealer to a retail investor before the purchase of an investment product or service by the retail investor).

⁷ See *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3118 (Dec. 1, 2010), [75 FR 75650 (Dec. 6, 2010)] ("Proposing Release").

our proposal prior to the expiration of the comment period.⁸ Six of these commenters generally supported extending rule 206(3)-3T,⁹ and two commenters opposed an extension.¹⁰ Two other commenters did not address the extension directly.¹¹ The comments we received on our proposal are discussed below. After considering each of the comments, we are extending the rule's sunset period by two years to December 31, 2012, as proposed.

II. DISCUSSION

We are amending rule 206(3)-3T only to extend the rule's expiration date by two years. Absent further action by the Commission, the rule will expire on December 31, 2012. We are adopting this extension because, as we discussed in the Proposing Release, we believe that firms' compliance with the substantive provisions of rule 206(3)-3T provides sufficient protection to advisory clients to warrant the rule's continued operation for the additional two years while we conduct the study mandated by section 913 of the Dodd-Frank Act and consider more broadly the regulatory requirements applicable to

⁸ See Comment Letter of the Consumer Federation of America (Dec. 20, 2010) ("CFA Letter"); Comment Letter of Bank of America Corporation (Dec. 20, 2010) ("Bank of America Letter"); Comment Letter of Fiduciary360 (Dec. 20, 2010) ("Fiduciary360 Letter"); Comment Letter of Tamar Frankel, Professor of Law, Boston University School of Law (Dec. 14, 2010) ("Frankel Letter"); Comment Letter of the National Association of Personal Financial Advisors (Dec. 20, 2010) ("NAPFA Letter"); Comment Letter of Pickard and Djinis LLP (Dec. 10, 2010) ("Pickard and Djinis Letter"); Comment Letter of Public Investors Arbitration Bar Association (Dec. 20, 2010) ("PIABA Letter"); Comment Letter of Ron A. Rhoades, JD, CFP (Dec. 20, 2010) ("Rhoades Letter"); Comment Letter of the Securities Industry and Financial Markets Association (Dec. 20, 2010) ("SIFMA Letter"); Comment Letter of Winslow, Evans & Crocker (Dec. 8, 2009) ("Winslow, Evans & Crocker Letter"). The comment letters are available at <http://www.sec.gov/comments/s7-23-07/s72307.shtml>.

⁹ See Bank of America Letter; CFA Letter; PIABA Letter; Pickard and Djinis Letter; SIFMA Letter; Winslow, Evans & Crocker Letter. We note that PIABA supported a one-year extension.

¹⁰ See Fiduciary360 Letter; NAPFA Letter.

¹¹ See Frankel Letter; Rhoades Letter.

broker-dealers and investment advisers.¹² As part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers, we intend to carefully consider principal trading by advisers, including whether rule 206(3)-3T should be substantively modified, supplanted, or permitted to expire.

If we permit rule 206(3)-3T to expire on December 31, 2010, after that date investment advisers also registered as broker-dealers who currently rely on rule 206(3)-3T would be required to comply with section 206(3)'s transaction-by-transaction written disclosure and consent requirements without the benefit of the alternative means of complying with these requirements currently provided by rule 206(3)-3T. This could limit the access of non-discretionary advisory clients of advisory firms that are also registered as broker-dealers to certain securities. In addition, certain of these firms have informed us that, if rule 206(3)-3T were to expire on December 31, 2010, it would be disruptive to their clients, and the firms would be required to make substantial changes to their disclosure documents, client agreements, procedures, and systems.

We expect to revisit the relief provided in rule 206(3)-3T soon after the completion of our study in January 2011. Although we anticipate that will occur prior to the amended expiration date for the temporary rule, we want to ensure that we have sufficient time to engage in any potential rulemaking or other process that may emerge from either the study or any broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers prior to the rule's expiration.

¹² See Proposing Release, Section II.

As discussed above, six commenters generally supported our proposal to amend rule 206(3)-3T to extend it,¹³ and two commenters opposed it.¹⁴ Commenters who supported the extension cited the disruption to investors that would occur if the rule expired at this time, asserting that investors would be forced to change their accounts and would lose access to a wider range of securities.¹⁵ Commenters who supported the extension of the rule also asserted that allowing the rule to sunset would prove disruptive to advisory firms that are registered as broker dealers: they explained that expiration of the rule would act as an operational barrier to their ability to engage in principal trades with their customers.¹⁶ These and other commenters further explained that, if the rule were allowed to expire, firms relying on the rule would be required to make considerable changes to their disclosure documents, client agreements, procedures, and technical systems at substantial expense.¹⁷ These commenters agreed that extending the rule while the Commission conducted its review of the obligations of broker-dealers and investment advisers, as mandated by the Dodd-Frank Act, would be the least disruptive option.

Conversely, two commenters questioned whether the rule benefits clients and asserted that the Commission should not further extend the rule in light of what they view as risks posed by the compliance issues that the staff identified.¹⁸ One commenter, while opposing the extension, encouraged the Commission to take additional measures to

¹³ See Bank of America Letter; CFA Letter; PIABA Letter; Pickard and Djinis Letter; SIFMA Letter; Winslow, Evans & Crocker Letter.

¹⁴ See Fiduciary360 Letter; NAPFA Letter.

¹⁵ See Bank of America Letter; CFA Letter; SIFMA Letter.

¹⁶ See Bank of America Letter; SIFMA Letter.

¹⁷ See Bank of America Letter; SIFMA Letter; Winslow, Evans & Crocker Letter.

¹⁸ See Fiduciary360 Letter; NAPFA Letter. We also note that one commenter who supported the extension, CFA, also expressed concern about these compliance issues. See CFA Letter.

protect clients from the conflicts of interest raised by principal trading if we chose to extend the rule.¹⁹ Another commenter challenged the proposition that firms and investors would face disruptions if the rule sunsets, asserting that few firms and investors rely on the rule.²⁰

On balance, and after careful consideration of these comments, we conclude that the benefits from extending this rule outweigh the potential costs of an extension. First, we believe that permitting the rule to sunset just before we commence a comprehensive review of the obligations of broker-dealers and investment advisers could produce substantial disruption for investors with accounts serviced by firms relying on the rule. These investors might lose access to securities available through principal transactions and be forced to convert their accounts in the interim, only to face the possibility of future change — and the costs and uncertainty such additional change may entail.²¹ This disruption will be avoided if we maintain the *status quo* while we engage in our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.²² We continue to believe that the rule benefits investors because it provides

¹⁹ See NAPFA Letter. We also note that CFA, while supporting the extension, stated that the Commission should address “weaknesses identified in the current approach and [back] that rule with tough enforcement focused on the larger issue of the appropriateness of recommendations.” CFA Letter.

²⁰ See Fiduciary360 Letter.

²¹ As discussed in the 2007 Principal Trading Release and again in the 2009 Extension Release, firms have explained that they may refrain from engaging in principal trading with their advisory clients in the absence of the rule given the practical difficulties of complying with Section 206(3), and thus may not offer principal trading through advisory accounts. See 2007 Principal Trading Release, Section I.B; 2009 Release, Section I.

²² See CFA Letter (“Although CFA has been critical of the temporary rule and has in the past urged the Commission to act expeditiously to replace it, we believe that, at this point, revision of the rule is best achieved in conjunction with the Commission’s broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.”).

investors with access to a wider range of securities and protects investors who hold billions of dollars in advisory accounts.

In reaching this conclusion, we have paid particular attention to our staff's observations about firms' compliance with the rule. We emphasize that we share the commenters' concerns about the compliance issues that the staff identified, the critical aspects of which we summarized in the Proposing Release.²³ Having carefully considered the staff's observations, we conclude that the requirements of rule 206(3)-3T, coupled with regulatory oversight informed by those observations, will adequately protect advisory clients during the extension. Throughout the period of the extension, the staff will examine firms with higher risk characteristics, including firms that engage in principal transactions in reliance on rule 206(3)-3T,²⁴ and continue to take appropriate action to help ensure that firms are complying with the rule's conditions, including referring firms to the Division of Enforcement for possible enforcement action if warranted. One commenter asserted that the burdens placed on firms by rule 206(3)-3T are too stringent.²⁵ As this commenter noted, the staff did not identify instances of "dumping," a harm that section 206(3) is designed to redress, and we believe that the conditions and limitations in the rule serve as appropriate safeguards during the pendency of the extension.

²³ Although some of the commenters suggested that the discussion of the staff's observations in the Proposing Release was not robust enough, we believe the summary contained in the release outlined the critical aspects of the issues observed by the staff with respect to compliance with the rule. See NAPFA Letter; Fiduciary360 Letter; CFA Letter.

²⁴ One commenter suggested that the Commission's Office of Compliance Inspections and Examinations should conduct additional examinations to determine if firms are complying with rule 206(3)-3T, among other requirements. See NAPFA Letter.

²⁵ See Pickard and Djinis Letter.

We note that one commenter asserted that even if principal trading relief may have been appropriate when we originally adopted rule 206(3)-3T in 2007, it no longer is.²⁶ In particular, the commenter contended that the valuation of certain securities — such as municipal bonds — has become much more difficult, such that “a much greater amount of due diligence is required of the investment adviser who engages in advising clients on purchases of individual municipal bonds.” But extension of the rule does not have any bearing on an adviser’s due diligence obligations. The standard of care to which advisers are subject and the duties they owe clients are in no way diminished by their reliance on rule 206(3)-3T.²⁷

Second, we further conclude that the extension of the rule’s sunset date is warranted to avoid the disruption to firms relying on the rule that will occur if the rule expires. The letters submitted by three commenters demonstrated that some firms in fact do rely on the rule, and that those firms will be faced with uncertainty and disruption of operations should the rule expire just as the Commission is about to begin a comprehensive review process that may ultimately produce a different regulatory standard.²⁸ One commenter that represents securities firms described that large and small firms have relied upon the rule, and provided data showing that a substantial number of accounts and volume of trades would be affected by a change in the rule.²⁹

²⁶ See NAPFA Letter.

²⁷ See rule 206(3)-3T(b) (“This section shall not be construed as relieving in any way an investment adviser from acting in the best interests of an advisory client, including fulfilling the duty with respect to the best price and execution for the particular transaction for the advisory client; nor shall it relieve such person or persons from any obligation that may be imposed by section 206(1) or (2) of the Advisers Act or by other applicable provisions of the federal securities laws.”).

²⁸ See Bank of America Letter; SIFMA Letter; Winslow, Evans & Crocker Letter.

²⁹ See SIFMA Letter.

We received four comment letters specifically addressing the duration of our proposed extension of rule 206(3)-3T.³⁰ Three expressed support for extending the rule for an additional two years, but argued that the rule should be made permanent.³¹ One of these commenters cited uncertainty and its attendant costs as a reason to make the rule permanent.³² Other commenters supported a shorter extension of the rule. For example, one commenter supported a one-year extension.³³ This commenter stated that a one-year extension of the rule strikes the proper balance between the concerns of investor protection and the burden of potential revised regulations applying to investment advisers and broker-dealers.³⁴ Two commenters generally opposed the extension and supported allowing the rule to expire: one commenter stated alternatively that the Commission should adopt a one-year extension with the imposition of other measures to ensure firms' compliance with the rule and with their fiduciary obligations generally, and the other indicated that it would support an extension of six months if the Commission provided "further explanation and supporting evidence."³⁵

As we noted in the Proposing Release, we believe that the rule should be extended only for a limited amount of time.³⁶ That period of time, however, must be long enough

³⁰ See Bank of America Letter; Fiduciary360 Letter; Winslow, Evans & Crocker Letter; PIABA Letter.

³¹ See Bank of America Letter; Winslow, Evans & Crocker Letter; Pickard and Djinis Letter.

³² See Winslow, Evans & Crocker Letter.

³³ See PIABA Letter.

³⁴ See *id.*

³⁵ See NAPFA Letter; Fiduciary360 Letter.

³⁶ See Proposing Release, Section II. The statements in the Proposing Release should not be read as limiting the scope of the alternatives we will consider in conducting the study mandated by section 913 of the Dodd-Frank Act and considering more broadly the regulatory requirements applicable to broker-dealers and investment advisers.

to permit the Commission to engage in any rulemaking prompted by our study under section 913 of the Dodd-Frank Act and our broader review of regulatory requirements applicable to investment advisers and broker-dealers. Having considered the comments regarding the duration of the extension, and taking into account the importance of the issues that this process will address, the Commission believes on balance that a two-year extension is necessary to give the Commission adequate time to complete any such rulemaking. Because that process cannot begin until the completion of the study required by the Dodd-Frank Act, adopting a six-month or one-year extension, as certain commenters recommended, most likely would not provide sufficient time for such rulemaking, and thus could result in greater uncertainty (along with its attendant costs) for investors and firms that rely on the rule. We believe that certainty in this area is important, and we will complete any relevant rulemaking as soon as is feasible consistent with administrative procedure.

A number of commenters also raised issues that were beyond the scope of our proposal to extend rule 206(3)-3T, including the broader legal and policy questions related to the meaning, scope, and application of a fiduciary standard and the appropriate considerations related to principal trading.³⁷ These comments pertain to our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers, and we will consider these comments in conducting this broader review.

III. CERTAIN ADMINISTRATIVE LAW MATTERS

The amendment to rule 206(3)-3T is effective on December 30, 2010. The Administrative Procedure Act generally requires that an agency publish a final rule in the

³⁷ See CFA Letter; Fiduciary360 Letter; Frankel Letter; NAPFA Letter; Pickard and Djinis Letter; Rhoades Letter; SIFMA Letter.

Federal Register not less than 30 days before its effective date.³⁸ However, this requirement does not apply if the rule is a substantive rule which grants or recognizes an exemption or relieves a restriction, or if the rule is interpretive.³⁹ Rule 206(3)-3T is a rule that recognizes an exemption and relieves a restriction and in part has interpretive aspects.

IV. PAPERWORK REDUCTION ACT

Rule 206(3)-3T contains “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995.⁴⁰ The Office of Management and Budget (“OMB”) approved the burden estimates presented in the 2007 Principal Trade Rule Release,⁴¹ first on an emergency basis and subsequently on a regular basis. OMB approved the collection of information with an expiration date of March 31, 2011. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for the collection of information is: “Temporary rule for principal trades with certain advisory clients, rule 206(3)-3T” and the OMB control number for the collection of information is 3235-0630. The 2007 Principal Trade Rule Release and the Proposing Release solicited comments on our PRA estimates, but we did not receive comment on them.⁴²

The amendment to the rule we are adopting today — to extend rule 206(3)-3T for two years — does not affect the burden estimates contained in the 2007 Principal Trade

³⁸ 5 U.S.C. 553(d).

³⁹ *Id.*

⁴⁰ 44 U.S.C. 3501 *et seq.*

⁴¹ See 2007 Principal Trade Rule Release, Section V.B&C.

⁴² See 2009 Extension Release, Section IV; Proposing Release, Section IV.

Rule Release. Therefore, as was the case when we extended rule 206(3)-3T in December 2009, we are not revising our Paperwork Reduction Act burden and cost estimates submitted to OMB as a result of this amendment. We will submit burden and cost estimates as part of our routine renewal of OMB's approval of the rule's collection of information.

V. COST-BENEFIT ANALYSIS

Other than extending rule 206(3)-3T's sunset period for two years, we are not otherwise modifying the rule from the form in which we initially adopted it on an interim final basis in September 2007 or as final in December 2009. We discussed the benefits provided by rule 206(3)-3T in both the 2007 Principal Trade Rule Release and the 2009 Extension Release.

In summary, as explained in the 2007 Principal Trade Rule Release, the 2009 Extension Release, and the Proposing Release,⁴³ we believe the principal benefit of rule 206(3)-3T is that it maintains investor choice and protects the interests of investors who formerly held an estimated \$300 billion in fee-based brokerage accounts. A resulting second benefit of the rule is that non-discretionary advisory clients of advisory firms that are also registered as broker-dealers have easier access to a wider range of securities which, in turn, should continue to lead to increased liquidity in the markets for these securities and promote capital formation in these areas. A third benefit of the rule is that it provides the protections of the sales practice rules of the Securities Exchange Act of 1934 ("Exchange Act")⁴⁴ and the relevant self-regulatory organizations because an

⁴³ See 2007 Principal Trade Rule Release, Section VI.C; 2009 Extension Release, Section V; Proposing Release, Section V.

⁴⁴ 15 U.S.C. 78 *et seq.*

adviser relying on the rule must also be a registered broker-dealer. Another benefit of rule 206(3)-3T is that it provides a lower cost alternative for an adviser to engage in principal transactions.

One commenter disputed a number of the benefits of rule 206(3)-3T we have described above. The commenter did not provide any specific data, analysis, or other information in support of its comment.⁴⁵ No commenter provided any substantive or specific evidence to contradict the Commission's previous conclusion that the rule benefits investors, and the Commission continues to believe that the rule provides those benefits.⁴⁶

In addition to the general benefits described above, there also are benefits to extending the rule for an additional two years. By extending the rule for two years, non-discretionary advisory clients who have had access to certain securities because of their advisers' reliance on the rule to trade on a principal basis will continue to have access to those securities without disruption. If we chose not to extend the rule in its current form, firms currently relying on the rule would be required to restructure their operations and client relationships on or before the rule's current expiration date — potentially only to have to do so again shortly thereafter (first when the rule expires or is modified, and again if we adopt a new approach after the study mandated by the Dodd-Frank Act,

⁴⁵ See NAPFA Letter (questioning the benefits of the rule in: (1) providing protections of the sales practice rules of the Exchange Act and the relevant self-regulatory organizations; (2) allowing non-discretionary advisory clients of advisory firms that are also registered as broker-dealers to have easier access to a wider range of securities which, in turn, should continue to lead to increased liquidity in the markets for these securities and promote capital formation in these areas; and (3) maintaining investor choice).

⁴⁶ See 2007 Principal Trade Rule Release, Section VI.C; 2009 Extension Release, Section V; Proposing Release, Section V.

discussed above, is complete). Firms relying on the rule will continue to be able to offer clients and prospective clients access to certain securities on a principal basis as well and will not need during this two-year period to incur the cost of adjusting to a new set of rules or abandoning the systems established to comply with the current rule. In other words, extension will avoid disruption to clients and firms during the period while we complete the study mandated by section 913 of the Dodd-Frank Act and our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

We also discussed the costs associated with rule 206(3)-3T in the 2007 Principal Trade Rule Release, the 2009 Extension Release, and the Proposing Release.⁴⁷ In the 2007 Principal Trade Rule Release, we presented estimates of the costs of each of the rule's disclosure elements, including: prospective disclosure and consent; transaction-by-transaction disclosure and consent; transaction-by-transaction confirmations; and the annual report of principal transactions. We also provided estimates for the following related costs of compliance with rule 206(3)-3T: (i) the initial distribution of prospective disclosure and collection of consents; (ii) systems programming costs to ensure that trade confirmations contain all of the information required by the rule; and (iii) systems programming costs to aggregate already-collected information to generate compliant principal transactions reports. We did not receive comments directly addressing with supporting data the cost-benefit analysis we presented in the 2007 Principal Trade Rule

⁴⁷ See 2007 Principal Trade Rule Release, Section VI.D; 2009 Extension Release, Section V; Proposing Release, Section V.

Release.⁴⁸ We do not believe that a two-year extension of rule 206(3)-3T would materially affect those costs.⁴⁹

We recognize that, as a result of our amendment, firms relying on the rule will incur the costs associated with complying with the rule for two additional years. We also recognize that a temporary rule, by nature, creates uncertainty, which in turn, may generate costs and inefficiency.⁵⁰ However, we believe that a temporary extension of the rule is the most appropriate action that we can take at this time while we conduct the study mandated by section 913 of the Dodd-Frank Act and consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers.⁵¹

VI. PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 202(c) of the Advisers Act mandates that the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of

⁴⁸ In the 2007 Principal Trade Rule Release, we estimated the total overall costs, including estimated costs for all eligible advisers and eligible accounts, relating to compliance with rule 206(3)-3T to be \$37,205,569. *See* 2007 Principal Trade Rule Release, Section VI.D.

⁴⁹ *See* Proposing Release, Section V.

⁵⁰ *See* Winslow, Evans & Crocker Letter (“We do, however, feel that extending the temporary rule is in the best interest of investors but think that doing so on a temporary basis is short sighted and leads to certain inefficiencies, particularly to smaller firms... We believe the Commission should adopt the rule on a permanent basis thus eliminating uncertainty with respect to compliance in this area.”). *See also* Bank of America Letter (urging the Commission to consider a permanent rule that would allow firms to continue acting in a principal capacity in transactions with certain of their clients).

⁵¹ *See* CFA Letter (“If, as we hope, more extensive revisions to the principal trading requirements are just around the corner, it would be unduly disruptive to abandon the existing system now absent evidence of significant harm to investors.”).

investors, whether the action will promote efficiency, competition, and capital formation.⁵²

We explained in the 2007 Principal Trade Rule Release, the 2009 Extension Release, and the Proposing Release, the manner in which rule 206(3)-3T, in general, would promote these aims.⁵³ We continue to believe that this analysis generally applies today.

As noted in the 2009 Extension Release and Proposing Release, we received comments on the 2007 Principal Trade Rule Release from commenters who opposed the limitation of the temporary rule to investment advisers that are also registered as broker-dealers, as well as to accounts that are subject to both the Advisers Act and Exchange Act as providing a competitive advantage to investment advisers that are also registered broker-dealers.⁵⁴ Based on our experience with the rule to date, just as we noted in the 2009 Extension Release and Proposing Release, we have no reason to believe that broker-dealers (or affiliated but separate investment advisers and broker-dealers) are put at a competitive disadvantage to advisers that are themselves also registered as broker-dealers;⁵⁵ however we intend to continue to evaluate these effects in connection with our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

⁵² 15 U.S.C. 80b-2(c).

⁵³ See 2007 Principal Trade Rule Release, Section VII; 2009 Extension Release, Section VI; Proposing Release, Section VI.

⁵⁴ See 2009 Extension Release, Section VI; Proposing Release, Section VI; Comment Letter of the Financial Planning Association (Nov. 30, 2007).

⁵⁵ See 2009 Extension Release, Section VI; Proposing Release, Section VI.

We received one comment letter arguing that rule 206(3)-3T would impede capital formation because it would lead to “more numerous and more severe violations...of the trust placed by individual investors in their trusted investment adviser.”⁵⁶ While we share the view that numerous and severe violations of trust could theoretically impede capital formation, we have not seen any evidence that rule 206(3)-3T has caused this result. We also reiterate that, in addition to conducting a broader review, we will continue to consider any potential violations of the rule and take appropriate action as necessary.

VII. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Final Regulatory Flexibility Analysis (“FRFA”) regarding the amendment to rule 206(3)-3T in accordance with 5 U.S.C. 604. We prepared and included an Initial Regulatory Flexibility Analysis (“IRFA”) in the Proposing Release.⁵⁷

A. Need for the Rule Amendment

We are adopting an amendment to rule 206(3)-3T to extend the rule for two years in its current form because we believe that it would be premature to require firms relying on the rule to restructure their operations and client relationships before we complete our study and our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers. The objective of the amendment to rule 206(3)-3T, as discussed above, is to permit firms currently relying on rule 206(3)-3T to limit the need to modify their operations and relationships on multiple occasions, both before and potentially after we complete our study and any related rulemaking.

⁵⁶ See NAPFA Letter.

⁵⁷ See Proposing Release, Section VII.

We are amending rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 15 U.S.C. 80b-11(a)].

B. Significant Issues Raised by Public Comments

We received one comment letter related to our IRFA.⁵⁸ The commenter stated that extending the rule temporarily, rather than permanently, would create uncertainty, thereby causing certain inefficiencies, particularly with regard to smaller firms.⁵⁹ We recognize that a temporary rule, by nature, creates uncertainty, which in turn may generate costs and inefficiency, especially for smaller firms. However, as discussed above, we believe that a temporary extension of the rule is the most appropriate approach at this time while we conduct the study mandated by section 913 of the Dodd-Frank Act and consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers.⁶⁰

C. Small Entities Subject to the Rule

Rule 206(3)-3T is an alternative method of complying with Advisers Act section 206(3) and is available to all investment advisers that: (i) are registered as broker-dealers under the Exchange Act; and (ii) effect trades with clients directly or indirectly through a broker-dealer controlling, controlled by or under common control with the investment adviser, including small entities. Under Advisers Act rule 0-7, for purposes of 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

⁵⁸ See Winslow, Evans & Crocker Letter.

⁵⁹ See *id.*

⁶⁰ See CFA Letter ("If, as we hope, more extensive revisions to the principal trading requirements are just around the corner, it would be unduly disruptive to abandon the existing system now absent evidence of significant harm to investors.").

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.⁶¹

As noted in the Proposing Release, we estimate that as of November 1, 2010, 680 SEC-registered investment advisers were small entities.⁶² As discussed in the 2007 Principal Trade Rule Release, we opted not to make the relief provided by rule 206(3)-3T available to all investment advisers, and instead have restricted it to investment advisers that also are registered as broker-dealers under the Exchange Act.⁶³ We therefore estimate for purposes of this FRFA that 38 of these small entities (those that are both investment advisers and broker-dealers) could rely on rule 206(3)-3T.⁶⁴ We did not receive any comments on these estimates.

D. Reporting, Recordkeeping, and other Compliance Requirements

The provisions of rule 206(3)-3T impose certain reporting or recordkeeping requirements, and our amendment will extend the imposition of these requirements for an additional two years. The two-year extension will not alter these requirements.

Rule 206(3)-3T is designed to provide an alternative means of compliance with the requirements of section 206(3) of the Advisers Act. Investment advisers taking advantage of the rule with respect to non-discretionary advisory accounts are required to

⁶¹ See 17 CFR 275.0-7.

⁶² IARD data as of November 1, 2010.

⁶³ See 2007 Principal Trade Rule Release, Section VIII.B.

⁶⁴ IARD data as of November 1, 2010.

make certain disclosures to clients on a prospective, transaction-by-transaction and annual basis.

Specifically, rule 206(3)-3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Advisers Act by, among other things: (i) making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client confirmation statements for each principal trade that disclose the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. Advisers are already required to communicate the content of many of the disclosures pursuant to their fiduciary obligations to clients. Other disclosures are already required by rules applicable to broker-dealers.

Our amendment will only extend the rule for two years in its current form. Advisers currently relying on the rule already should be making the disclosures described above.

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.⁶⁵ Alternatives in this category would include: (i) establishing different compliance or reporting standards or timetables that take into account the resources

⁶⁵ See 5 U.S.C. 603(c).

available to small entities; (ii) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

We believe that special compliance or reporting requirements or timetables for small entities, or an exemption from coverage for small entities, may create the risk that the investors who are advised by and effect securities transactions through such small entities would not receive adequate disclosure. Moreover, different disclosure requirements could create investor confusion if it creates the impression that small investment advisers have different conflicts of interest with their advisory clients in connection with principal trading than larger investment advisers. We believe, therefore, that it is important for the disclosure protections required by the rule to be provided to advisory clients by all advisers, not just those that are not considered small entities. Further consolidation or simplification of the rule for investment advisers that are small entities would be inconsistent with the Commission's goals of fostering investor protection.

We have endeavored through rule 206(3)-3T to minimize the regulatory burden on all investment advisers eligible to rely on the rule, including small entities, while meeting our regulatory objectives. It was our goal to ensure that eligible small entities may benefit from the Commission's approach to the new rule to the same degree as other eligible advisers. The condition that advisers seeking to rely on the rule must also be registered as broker-dealers and that each account with respect to which an adviser seeks to rely on the rule must be a brokerage account subject to the Exchange Act, and the rules

thereunder, and the rules of the self-regulatory organization(s) of which it is a member, reflect what we believe is an important element of our balancing between easing regulatory burdens (by affording advisers an alternative means of compliance with section 206(3) of the Act) and meeting our investor protection objectives.⁶⁶ Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

VIII. STATUTORY AUTHORITY

The Commission is amending rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act.

LIST OF SUBJECTS IN 17 CFR PART 275

Investment advisers, Reporting and recordkeeping requirements.

TEXT OF RULE AMENDMENT

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is 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.

* * * * *

⁶⁶ See 2007 Principal Trade Rule Release, Section II.B.7 (noting commenters that objected to this condition as disadvantaging small broker-dealers (or affiliated but separate investment advisers and broker-dealers)).

§275.206(3)-3T [Amended]

2. In § 275.206(3)-3T, amend paragraph (d) by removing the words "December 31, 2010" and adding in their place "December 31, 2012."

By the Commission.



Elizabeth M. Murphy
Secretary

Dated: December 28, 2010